PitchBook

Global PE & VC Fund Performance Report

Data through 2Q 2017

PitchBook

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Key takeaways from the analysts

- On a one-year horizon, private equity funds reported a 19.1% IRR compared to just 3.1% for debt funds—the best- and worst-performing private capital strategies over this period, respectively. PE returns have been boosted by the bull market in equities, while debt markets have continued to be tilted in borrowers' favor, which has led to relatively low rates and borrower-friendly terms for new lending.
- Capital is moving both to and from LPs at a record pace. Globally, net cashflows to LPs of PE funds totaled $60.6 billion through 1H 2017, on pace for a 35% increase over 2016 and the seventh consecutive year of positive cashflows.
- Capital is being called down by VC funds at a much greater level than nearly any other year in our sample, with LP contributions from 1H 2017 surpassing the full-year totals from 2009, 2010 and 2014.

19.1%
1-year horizon IRR for in PE funds

$60.6B
total net cashflows to PE LPs in 1H 2017

$34.5B
total called down by VC funds in the first six months of 2017

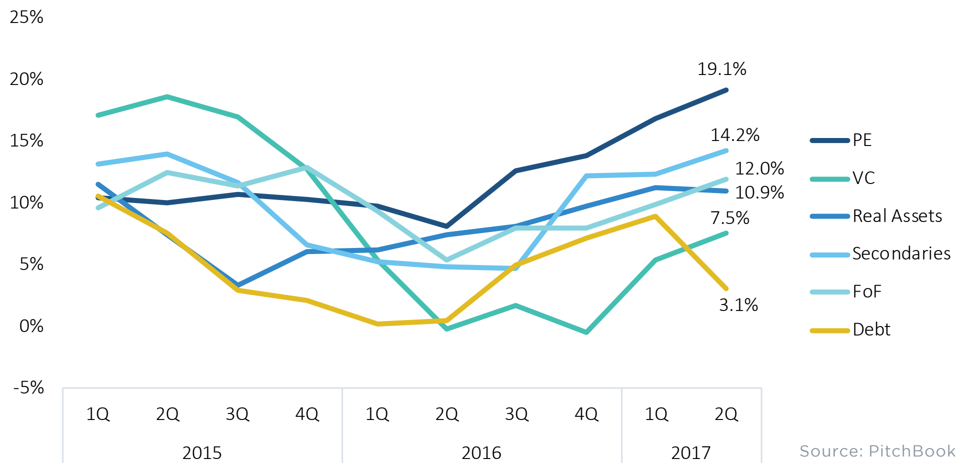
IRR by Fund Type

On a one-year horizon, PE funds reported a 19.1% IRR compared to just 3.1% for debt funds—the best- and worst-performing private capital strategies over this period, respectively. The one-year return for PE has been strong for some time but has trended upward over the last four quarters. Debt funds, on the other hand, saw some improvement through 2016, but that reversed in early 2017. PE returns have been boosted by the bull market in equities, enabling managers to exit at attractive valuations and realize paper gains by marking up existing investments. At the same time, markets have continued to be tilted in borrowers' favor, which has led to relatively low rates and borrower-friendly terms for new lending. The market is also beginning to show signs of aging, with the leverage loan default rate rising over the course of 2017. Despite the late-cycle characteristics shown in many parts of the economy, private debt managers continue to raise funds at unprecedented levels, largely driven by the demand for non-bank lending created by post-financial-crisis regulation.

While returns vary widely over short horizons, the performance of private capital funds converges over longer timeframes. As of 2Q 2017, funds-of-funds, debt funds, VC funds and PE funds all posted 10-year horizon IRRs between 7.4% and 9.6%, with PE at the top of that range. However, not all strategies posted single-digit returns; secondaries funds boasted an IRR of 15.3% over the period. Notably, secondaries also posted the highest

Performance has been trending positively for most strategies

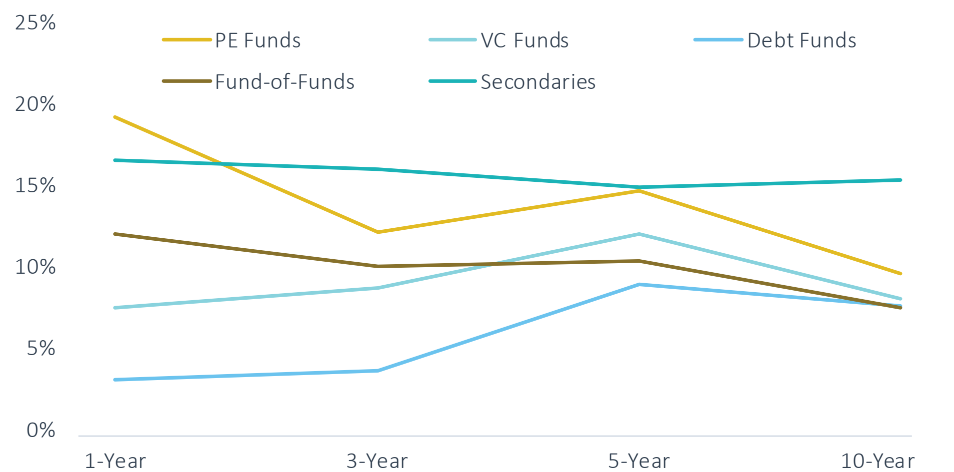
Rolling one-year horizon IRRs by fund type



Source: PitchBook
*As of 6/30/2017

Secondaries funds outperform over long horizons

Horizon IRR by fund type



Source: PitchBook
*As of 6/30/2017

returns of any private-markets strategy on both five- and three-year bases. This strategy has experienced growing interest in recent years as a means for institutional LPs to quickly gain allocation to private markets while diversifying amongst vintages. Secondaries are also an effective means of mitigating the J-curve, as the investments typically involve mature fund stakes.

PE Fund Performance

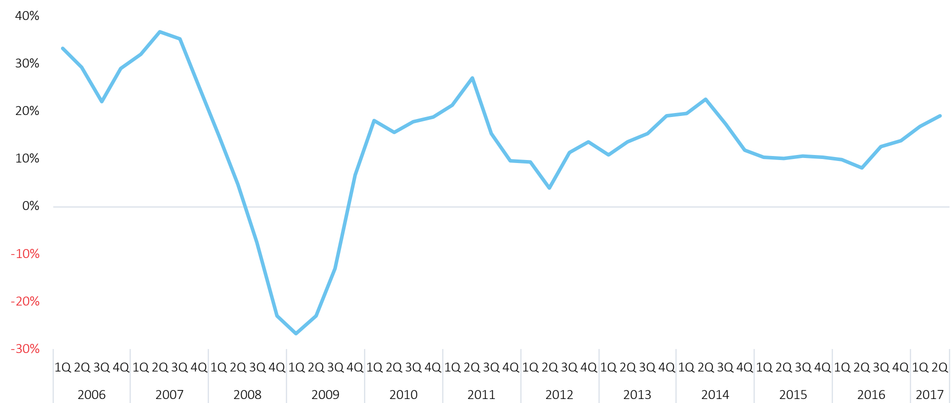
Despite slowing distributions, IRRs on the rise

Rolling one-year horizon IRRs have now increased for four consecutive quarters, driven by mark-to-market portfolio company NAVs in an appreciating public equity market, as well as valuation markups at the time of exit. The rolling one-year horizon IRR as of the end of 2Q 2017 reached 19.1%—its highest in three years. Though there have been dips in performance growth rates—notably in mid-2012 and 2016—one-year horizon IRRs have remained in positive territory since the financial crisis.

Having benefited from depressed entry multiples immediately following the financial crisis, PE funds that made their first investments in 2009 continue to return capital at a faster pace than other vintages. As of the end of 2Q 2017, 2009 vintages reached an average DPI of 1.06x, slightly above the 1.04x returned by 2008 vintages, which benefit from one additional year of operations.

Conversely, 2013 vintage funds, now four years from inception, have returned just 0.26x paid-in capital, which is not surprising given these funds began investing during the recent run-up in valuation. No other vintage since 2007 has reported such a low DPI figure after four years.

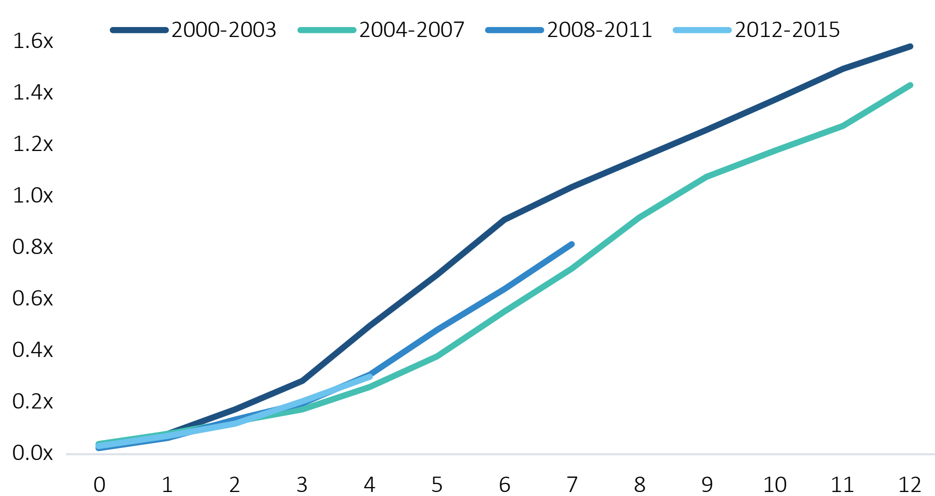
PE one-year rolling horizon IRR



Source: PitchBook
*As of 6/30/2017

Distributions have been slowing for recent vintages

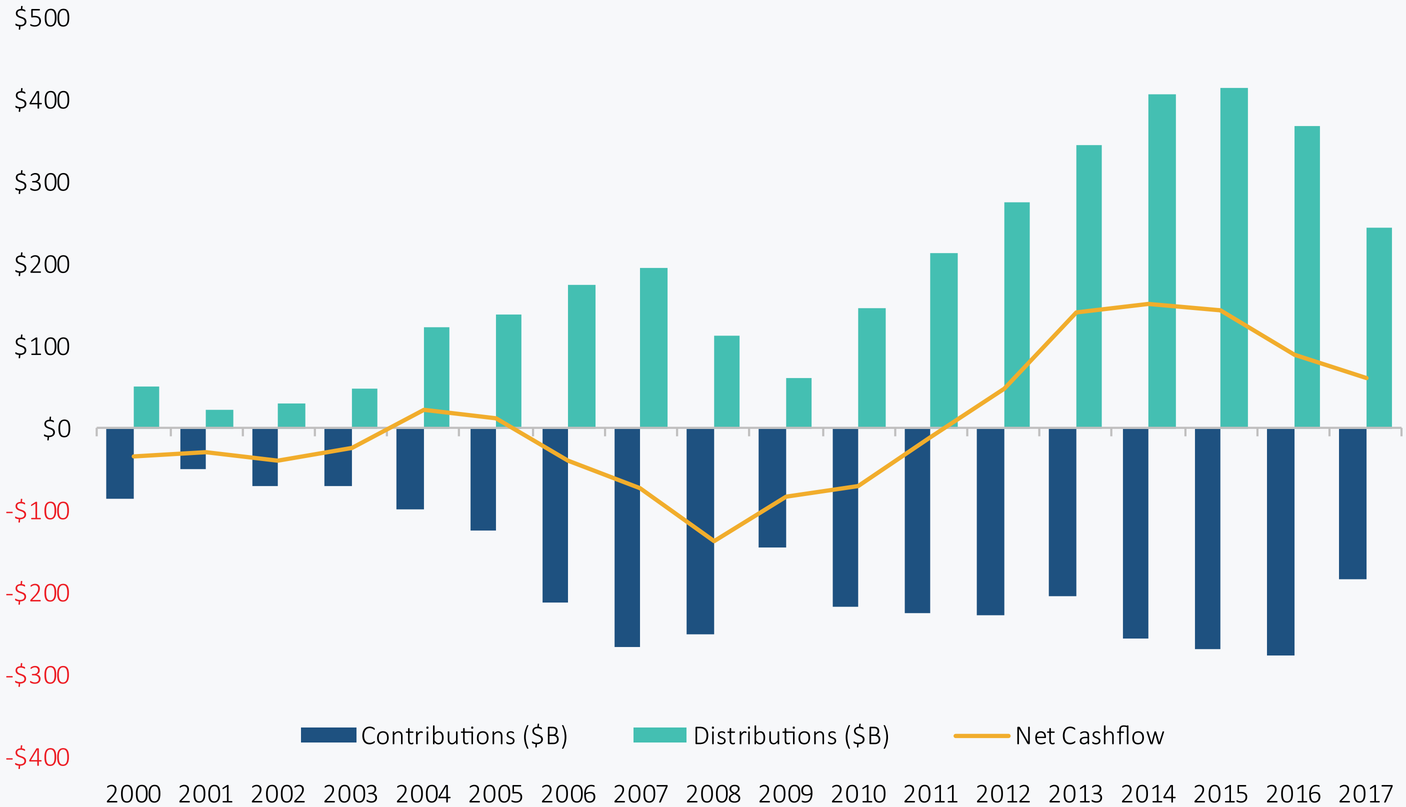
PE DPI multiples over time by vintage bucket



Source: PitchBook
*As of 6/30/2017

PE net cashflows remain positive for the seventh straight year

PE fund cashflows



Source: PitchBook
*As of 6/30/2017

While distributions are lagging, RVPI values remain high due to the mounting inventory of PE-backed companies being marked to an inflated public equity market. We do not expect this dynamic to change in the next few quarters (keeping in mind that returns data are lagged by two quarters) due to the continually lackluster exit market recorded in 2H 2017 and early 2018. However, there has been an uptick in dividend recaps, which PE funds are likely to explore as a means of accelerating distributions in a slow exit market.

Capital is moving both to and from LPs at a record pace. Globally, net cashflows to LPs of PE funds totaled $60.6 billion through 1H 2017, on pace for a 35% increase over the $89.9 billion recorded during the entirety of 2016, and marking the seventh consecutive year of positive cashflows. Distributions totaled $243.0 billion in 1H 2017, while contributions clocked in at $182.5 billion—each of which will best any other year if that pace holds through the back half of 2017. The sheer volume of capital changing hands between LPs and GPs is indicative of the growing heft of the PE industry in recent years, including both developed and emerging markets. Strong deal flow figures, as well as dry powder from earlier vintages, should continue to bolster drawdowns in the coming quarters, while the stronger distribution figures, despite tepid exit activity, provide evidence of a growing reliance on dividend recaps and other means of tapping existing investments.

VC Fund Performance

Returns trending up, but still trail long-term average

The one-year horizon IRR for VC inched up to 7.5% in 2Q 2017, which is the second consecutive quarterly increase after dipping into negative territory during 2016. The one-year horizon IRR data point is an interesting gauge of the short-term performance of VC as an asset class; however, in isolation, it doesn't tell the full story. Due to the volatility of this statistic, context is crucial to understanding. As the chart shows, there have been some distinct cycles over the past 10 years, mainly oscillating around 10% (notwithstanding the extreme negative move during the financial crisis). Therefore, despite the improvement in recent quarters, one-year horizon IRRs are lagging the long-term average of 10.4%. Due to the strong exit value recorded in 2017, we expect to see this metric continue to trend upward toward the long-term average as we receive the rest of the 2017 data.

VC cash multiples continue to be a similar story of improving performance for the asset class. Median DPIs have generally stayed flat from last quarter despite historically healthy exit activity during the first half of 2017. One exception is the 2010 vintage, which saw its median DPI increase by 0.11x over last quarter and is returning capital at a much faster pace than all other 2005-2013 funds.

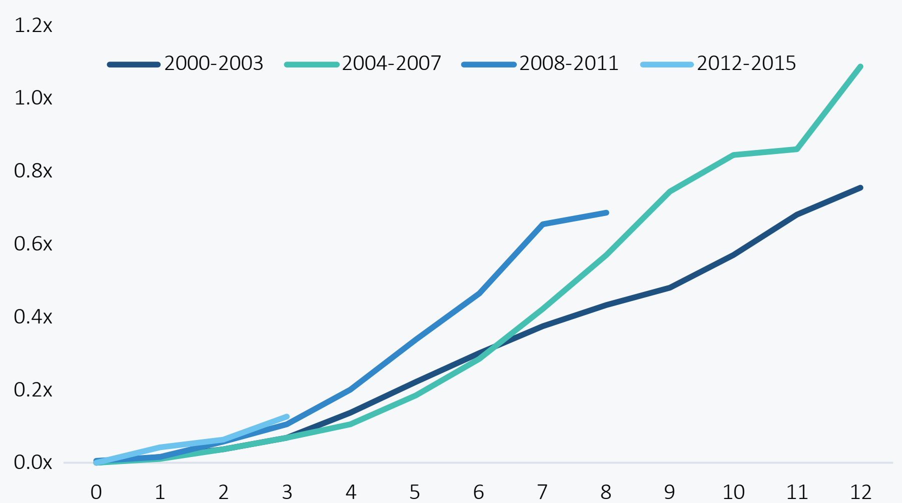
One-year horizon IRR continues to uptrend

VC one-year rolling horizon IRR

Source: PitchBook
*As of 6/30/2017

Recent vintages working to sustain pace of distributions

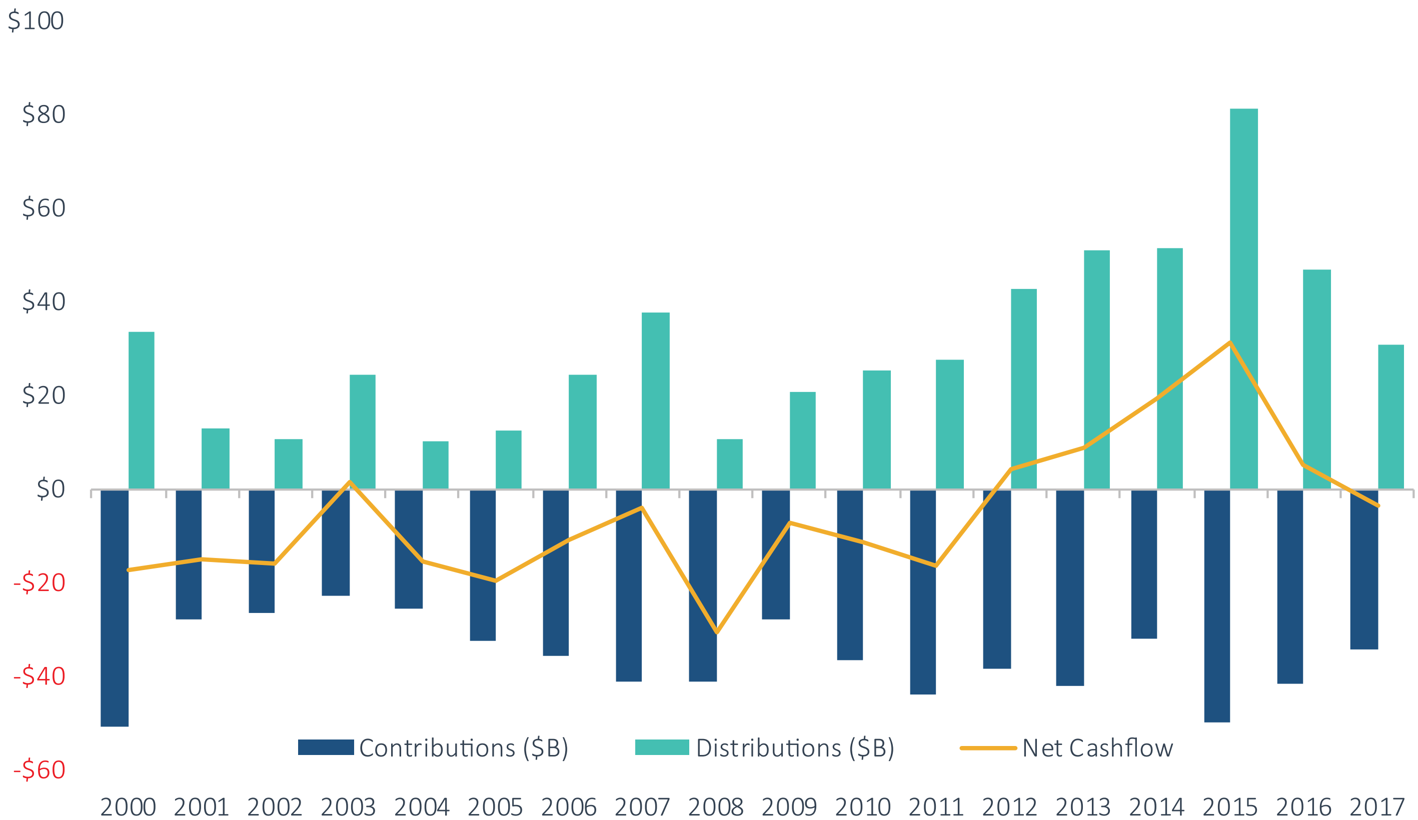
VC DPI multiples over time by vintage bucket



Source: PitchBook
*As of 6/30/2017

VC net cashflow continues to decline as investment outstrips exits

VC fund cashflows



Source: PitchBook
*As of 6/30/2017

2010 vintage funds have also recorded the highest median TVPI since 2002, as investing at depressed valuations in the aftermath of the great recession was beneficial to those funds. The fact that the median DPI for most vintages in the sample is still relatively far from 1.0x emphasizes the importance of VC manager selection, as top-quartile and top-decile funds vastly outperform. If returning less than 1.0x to LPs becomes a trend with top-quartile managers, reinvestment into VC could be deterred. While the effect may take years to materialize because of long fund lives and timing of new commitments, it may limit the pool of LP capital that willingly chooses to invest in venture.

The ultimate success—or failure—of more recent vintages will depend heavily on whether they can convert large portions of RVPI into distributions. All 2009-2013 vintage funds have more than 0.9x median RVPI, and paper gains have become increasingly common with the drastic rise in VC asset valuations over the last 10 years. From an exit perspective, acquisition counts did cool off from the historic highs in 2014 and 2015, but the exit market has shown resiliency and is still providing liquidity for large deals.

Global VC net cashflows through the first half of 2017 dipped into negative territory—at -$3.7 billion—for the first time since 2011. This was a very small decline from where 2016's annual tally finished, which makes sense with the similarity between the exit activity between the two years.

However, capital is being called down at a much greater level than nearly any other year. LPs contributed $34.5 billion through the first six months of 2017, which is close to almost all of the full-year contributions in the sample and even exceeds 2009 and 2014. This volume of contributions has driven down net cashflows and, if the pace is sustained, will cause the full year's figure to move further into negative territory. We expect this scenario to unfold due to the robust dealmaking environment and more subdued exit activity that transpired through the second half of 2017.

Spotlight: Going with the Flows

Across vintages, debt funds have consistently been the strategy that returned investor capital most quickly, although the absolute level of returns trails the top-performing private market strategies. Secondaries funds also stand out for the rapidity with which they make investors whole, with the average fund achieving a DPI of 1.0x at the eight-year mark.

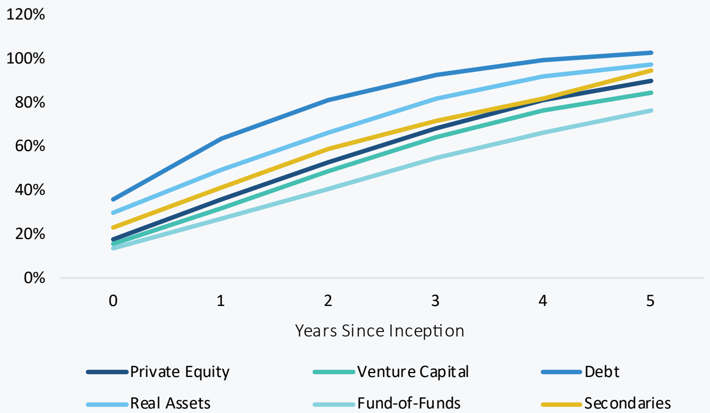
Certain characteristics of these investment strategies facilitate this speedier capital conversion cycle. For debt funds, the yield associated with many investments serves as an accelerant for distributions. In the case of secondaries funds, the investment strategy is predicated on acquiring existing stakes in PE funds, effectively truncating what is typically a prolonged investment period. Another key reason why debt and secondaries funds return capital more quickly is that these strategies often have more flexibility with how they deploy capital, allowing them to streamline investments and call down more than 90% of the fund before the end of their fourth year.

Unsurprisingly, investors have gravitated to debt and secondaries strategies in recent years. As this has happened, competition has naturally increased, engendering skepticism that the strategies can maintain their historical return profile. Indeed, available data from the 2012–2015 vintages shows that distribution rates have slowed for debt funds, perhaps as a symptom of the low-yield environment. At the same time, rising prices in the secondaries market seem to be deterring capital deployment, as contribution rates are more sluggish for newer funds.

On the other end of the spectrum are funds-of-funds (FoFs), which are persistently the slowest strategy to deploy capital. This is to be expected, considering that the strategy involves investing in other closed-end funds, which must subsequently source and execute deals. But slow drawdowns are concerning for LPs, who must find a way to generate a return on that uncalled capital while waiting for it to be deployed, which generally means settling for low-yielding Treasuries. LPs may be more understanding if FoFs compensated when returning capital, but this is simply not the case. Not only do FoFs return capital slower than other strategies, but they also generate lower absolute returns. As a result, many investors have soured on FoFs in recent years, with annual fundraising figures falling to the lowest point in more than a decade.

Debt funds call down capital faster

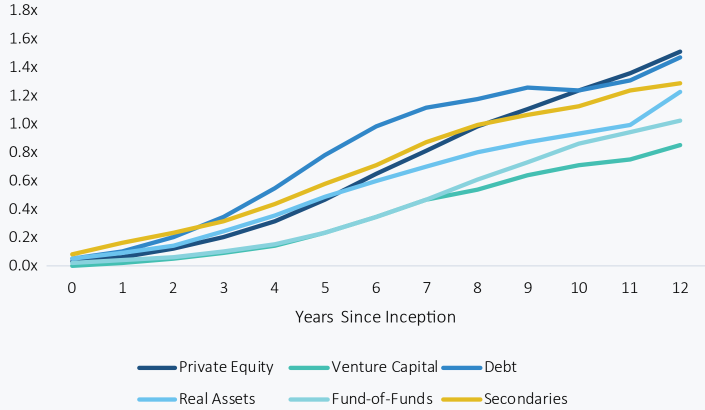
Called down % over time



Source: PitchBook
*As of 6/30/2017
Note: These datasets include data for 2000-2015 vintages.

While both debt and secondaries funds distribute capital more quickly

DPI over time



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