PitchBook

Private Fund Strategies Report

2018 Annual

Contents

Note: Download the accompanying Excel pack for all underlying data and additional charts not included in this report.

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Introduction

Strategy	Capital raised ($B)	YoY change	Fund count	YoY change
Private capital	$567.7	-6.4%	820	-18.1%
Private equity	$246.5	-21.8%	258	-25.6%
Venture capital	$65.9	52.0%	322	-3.9%
Real assets	$140.5	39.4%	112	-27.7%
Debt	$69.6	-28.3%	63	-32.3%
Fund-of-funds	$16.4	19.7%	36	-20.0%
Secondaries	$28.8	-21.6%	29	11.5%

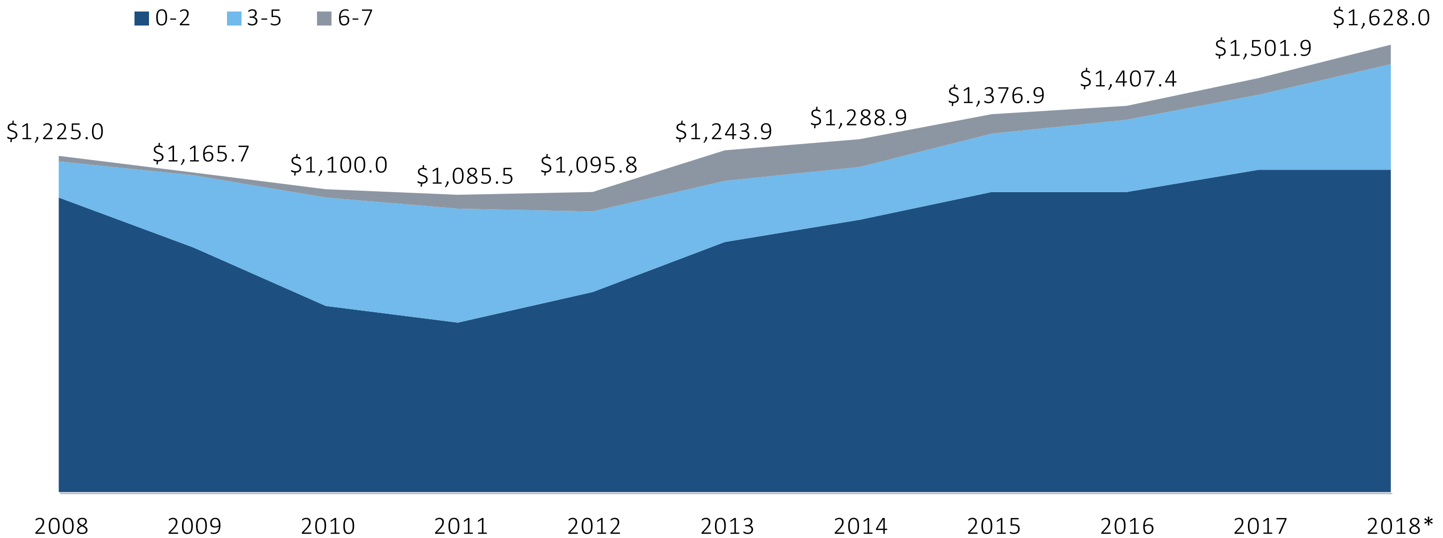
Private market fundraising in North America and Europe fell slightly in 2018 on a capital basis from the decade-high amount set in 2017, but the $567.7 billion raised during the year is still high by historical standards. The fund count plummeted to 820—the lowest total since 2004—as the average fund size has continued its meteoric rise, more than doubling since 2010 to $717.7 million. The much-discussed bifurcation of the fundraising market can be witnessed across strategies, as capital is increasingly concentrated in a handful of premier firms. With the exception of VC, first-time funds are seeing a decline as LPs seek to place large, strategic commitments with GPs that have a track record of success.

Wylie Fernyhough
Analyst, PE

Even with the pullback in fundraising, dry powder held in private market funds in North America and Europe rose to an all-time high of $1.6 trillion as of 2018. Keep in mind that this figure does not include capital available for co-investment or that has been earmarked for direct investment from sovereign wealth funds, family offices and other entities that invest outside of a fund structure. Total AUM continues to rise as well, with private market funds holding a combined $3.2 trillion in unrealized investments. This level of capital in private markets may have seemed unimaginable just a decade ago, but the space continues to proliferate and now encompasses a broader range of strategies and asset types.

In 2018, PE fundraising activity receded after 2017 posted the highest capital raised figures in a decade. The downturn was mainly driven by a dearth of mega-funds (defined as $5 billion+ for PE, real assets, debt, and secondaries and as $500 million+ for VC and FoF) closing as GPs are waiting longer to return to market with successor funds. However, average fund size still rose—approaching $1 billion—and dry powder eclipsed $800

North American and European private capital overhang ($B) by age of fund (years)



Source: PitchBook
*As of June 30, 2018

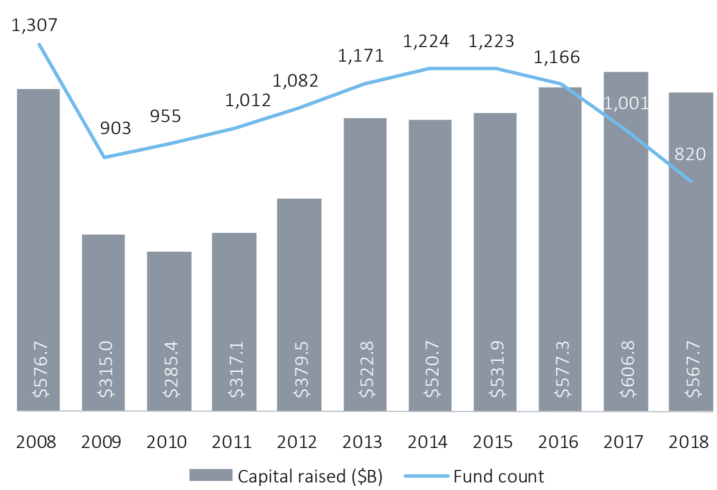
billion for the first time. Looking forward, a slew of mega-funds is set to close in 2019 and many LPs are seeking to lift their target allocations to private markets, leading us to believe that 2018 was a temporary slowdown in fundraising and not the beginning of a cyclical decline.

VC fundraising continues to post strong results, raising the most capital since the dot-com boom. 2018 was the year of the mega-fund as VC firms closed on 27 mega-funds in an attempt to compete with SoftBank's $100 billion Vision Fund (and its impending successor). Additionally, the size for early and late stage rounds keeps rising, necessitating larger equity checks, and subsequently, funds. In a showing of robust LP demand, first-time funds are also seeing a rise in activity.

Fewer real assets funds closed in 2018, yet total capital raised grew as the average fund size exploded upward. LPs were bullish on the asset class as governments forego infrastructure spending—creating potential private market investment opportunities—and real estate remains a cornerstone of alternative investment portfolios. LPs also invested heavily in private debt funds, though falling shy of 2017's record year. Debt and direct lending vehicles continue growing market share due to banking regulations favoring non-bank lenders. Moreover, GPs closed on the highest amount of distressed debt capital in four years, perhaps preparing to act opportunistically in case of an economic downturn.

Fundraising for secondaries slowed, counter to the general upward trend for the strategy seen over the last decade. On the other hand, fundraising for FoFs rose, posting the first YoY increase in capital raised since 2014. These strategies—often compared for their diversification benefits—have been trending in opposite directions for a while, with secondaries on the rise and FoFs declining. GPs are in the market seeking to raise record-setting numbers for secondaries funds, while FoF GPs are undergoing consolidation and other managers are exiting the space. In fact, many FoFs managers are looking to evolve by gravitating to the secondaries space while LPs are growing in sophistication and comfort regarding secondaries transactions. We expect the longer-term trends to continue and secondaries to further grow while just a few FoF managers will remain.

North American and European private capital fundraising activity

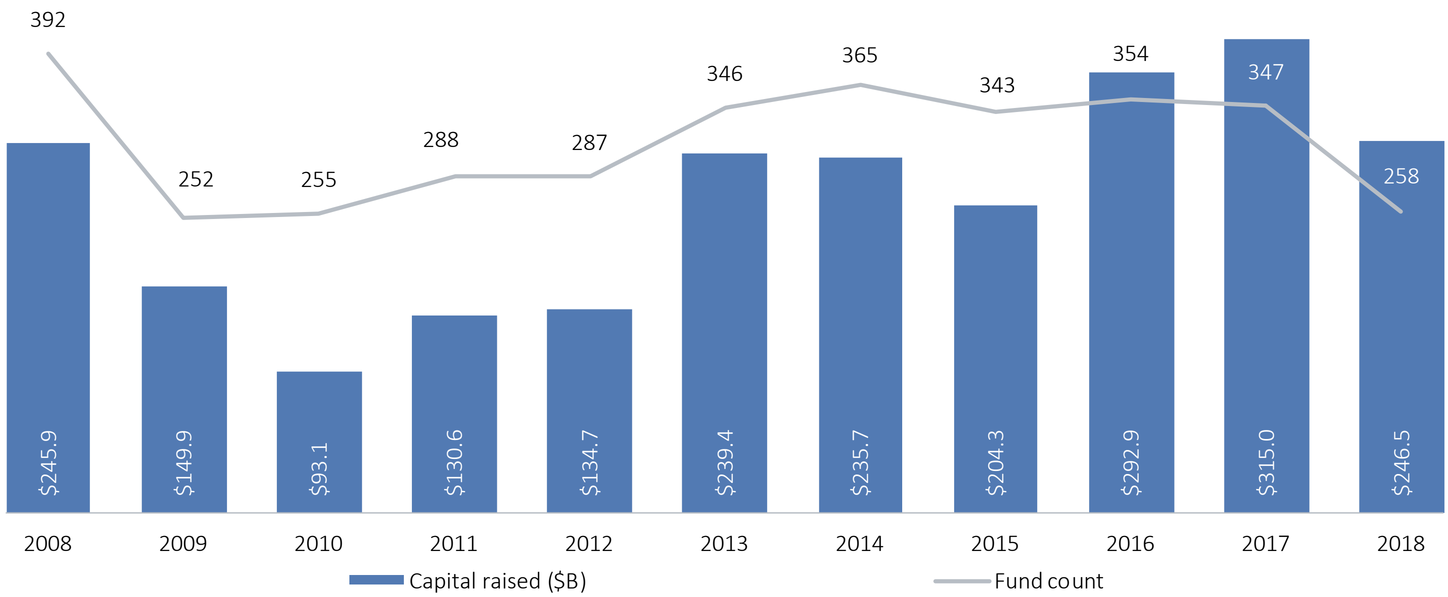


Source: PitchBook

PitchBook

Private equity

North American and European PE fundraising activity



Source: PitchBook

PE fundraising in North America and Europe dipped in 2018 with GPs closing on $246.5 billion across 258 funds—YoY declines of 21.8% and 25.6%, respectively. The slowdown comes after the industry's total capital raised eclipsed $300 billion in 2017; last year marked the second time in which total fund value surpassed this figure, with 2007 being the first. A few factors drove activity lower, including a weak showing from mega-funds ($5 billion+). Separating funds at the $5 billion threshold shows a dichotomy in YoY changes. For the sub-$5 billion category, the YoY decline in total capital raised was 8.0% with $154.7 billion spread across 246 funds. The YoY decline in capital raised for mega-funds was 37.5%, with 10 funds totaling $91.8 billion.

We see the 2018 downtrend as a blip in an otherwise healthy fundraising environment. Heading into 2019, several PE mega-funds are currently raising capital, and even more are expected to begin shortly. Fundraising for smaller GPs shows promise as well. Our 2018 Annual Institutional Investor Survey details anticipated investor changes in the coming years, with 43.4% of surveyed LPs expecting to lift the number of manager relationships and just 15.1% foreseeing a reduced figure. While it is true that many of the largest LPs are consolidating GP relationships with bulge bracket firms, many smaller, less experienced LPs are doing the opposite as they build a diversified private market portfolio. Additionally, LPs continue to shift their target allocations away from other strategies toward private markets. Our survey delineates how respondents are expecting to make the largest increases—both on a relative and absolute basis—to their target allocation for private market strategies, with the average allocation expected to grow from 30.9% to 32.5% over the next two years.

Some of this growth in private markets allocation is targeting co-investments, of which several public pensions have been looking to do more. Additionally, some pushed forward with plans to eventually undertake direct PE deals outside of a traditional fund structure. CalPERS has garnered much of the attention for weighing changes that would transform the pension to more closely reflect the Canadian model. Some of the larger Canadian pension plans—such as CPPIB and CDPQ—have rewritten the LP rule book and often act as GPs in deals. With public pensions looking to reduce fees paid and increase performance, we expect to see a rise in co-investments. We may even see several larger LPs allocate capital away from traditional PE firms as they act as their own GPs.

Family offices, which can adapt to a changing environment more quickly than pensions, are considering in-house, direct-deal capabilities as well. Lastly, hedge funds are seeking to cash in on the demand for additional private market exposure by offering PE funds. According to EY global alternative fund surveys, 28% of hedge fund respondents offer or are planning to offer PE vehicles in the next two years. Well-known activist investors Elliott Management and Icahn Capital already have in-house buyout firms.[1]

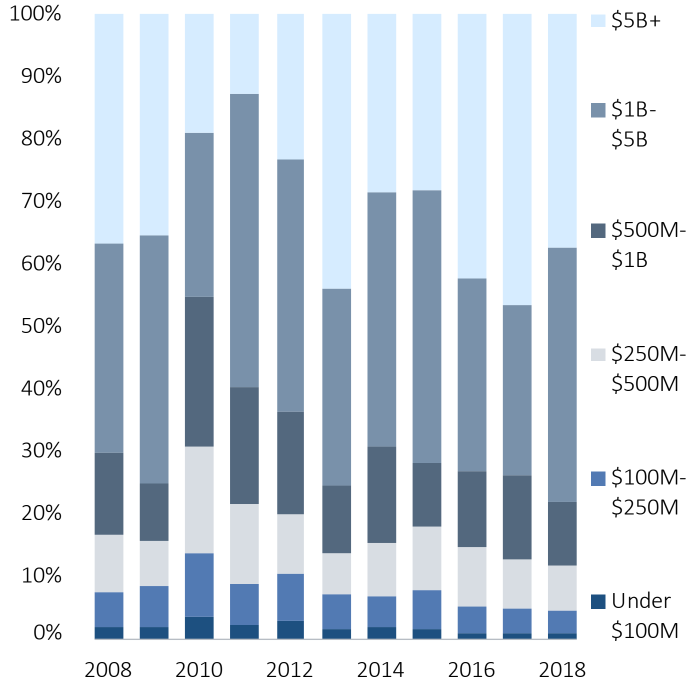
Although PE mega-fund closings were rarer and accounted for a lower percentage of total PE capital raised than in the year prior, the proportion of capital for funds above $1 billion was the highest on record. Fundraising for funds between $1 billion and $5 billion jumped substantially as managers ascended to the upper echelons of PE and as the largest GPs returned to the middle market with smaller funds. Activity across the $1 billion-$5 billion fund space was unrelenting with 48 funds closing in 2018, accounting for 18.8% of all PE funds closed—up from 12.5% in 2017.

In 2018, the average PE fund size rose to an all-time high of $963.0 million from $934.8 million in 2017. YoY growth has been slower for median fund size than average fund size due to fewer but larger mega-funds, skewing the average higher while the median plateaued. Within PE fundraising, buyouts—which represent the bulk of total capital raised—saw average fund size crest $1.1 billion in 2018. Buyout funds such as The Carlyle Group's seventh flagship fund, the largest to close in 2018 at $18.5 billion, drove the average higher. With Thoma Bravo closing on its $12.6 billion flagship buyout fund in January 2019, and with five other firms fundraising or preparing to fundraise for vehicles above $10 billion, activity for the largest funds appears set to continue, and possibly accelerate.

After the dramatic slowdown in 2010, PE funds have generally been closing more quickly. In 2018, the median time to close PE funds was just 12.5 months, the shortest timespan since the global financial crisis (GFC). A multitude of factors is likely driving the decline, including a seemingly insatiable LP demand for PE allocation and the shakeout of active managers that were struggling to fundraise. Additionally, there are fewer first-time funds—which typically take longer to close than vehicles raised by more established managers—coming to market. First-time managers raised $8.7 billion across 32 funds during the year.

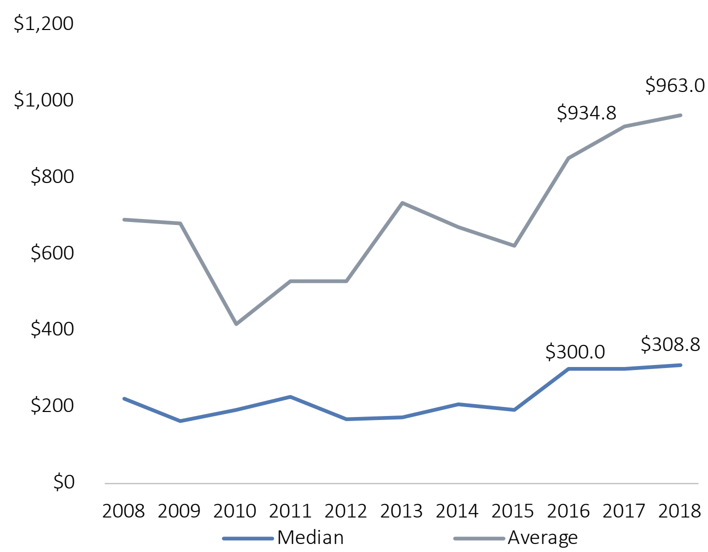
Dry powder—which is often used as a figure to portray PE as entering bubble territory—rose to an all-time high of $803.0 billion as of 2018. The total overhang climbed even as GPs put decade-high sums of capital to work while the industry experienced a slower fundraising environment. However, just as

North American and European PE fundraising ($) by size



Source: PitchBook

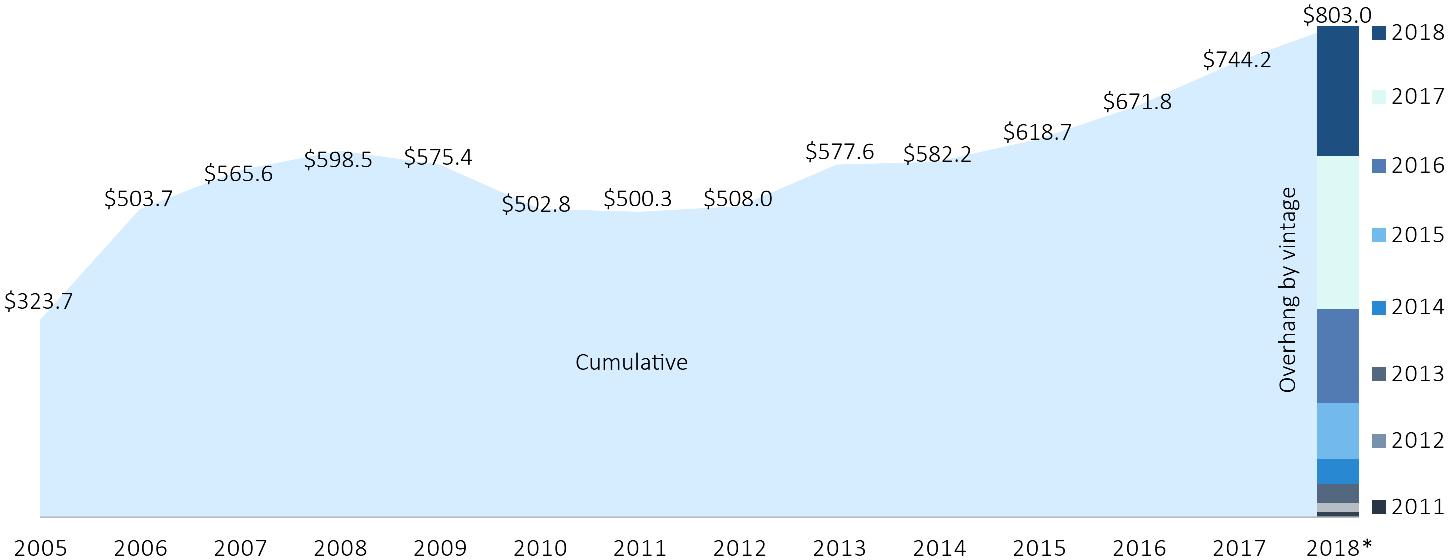
Median and average North American and European PE fund sizes ($M)



Source: PitchBook

1: "2018 Global Alternative Fund Survey," Ernst & Young, 2018

North American and European PE capital overhang ($B)



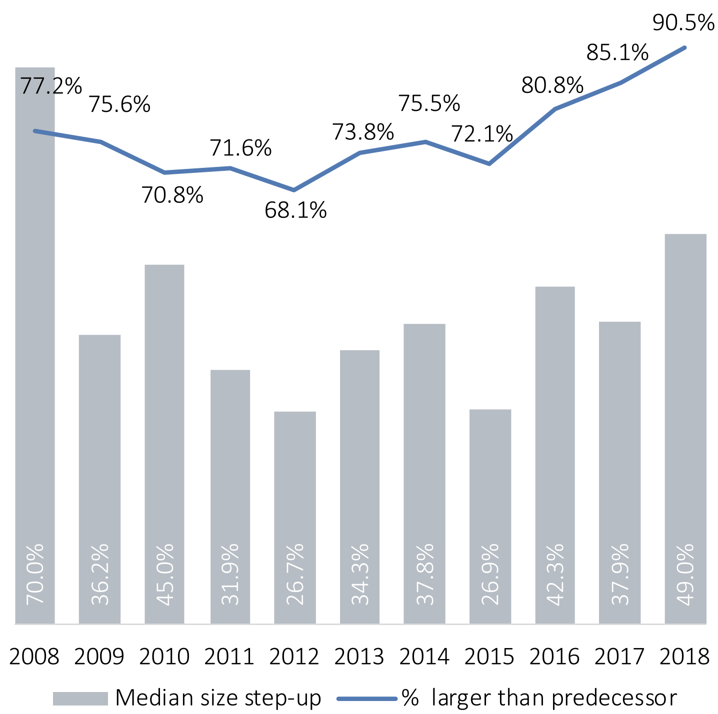
Source: PitchBook
*As of June 30, 2018

capital has been building up thanks to concerted fundraising efforts, ardent dealmaking activity has seen GPs put this capital to work. As a result, the years of dry powder on hand dropped from 3.7 to 3.6, meaning PE may have the capacity to fundraise more aggressively in the coming years if firms continue investing capital at a similar rate.

While most successor funds are larger than their predecessor across fundraising cycles, 2018's step-up figure (49.0%) was the highest figure since 2008, a time when then-unprecedented capital availability led to myriad ill-advised buyouts. Furthermore, 90.5% of funds raised in 2018 were larger than the predecessor fund. Although successor funds have been more sizable, the step-up size has lessened since the pre-crisis heyday. The median size step-up for funds was 49.0% in 2018; while this is a far cry from the 98.2% median size step-up seen in 2006, average fund sizes are larger now, making comparisons more difficult.

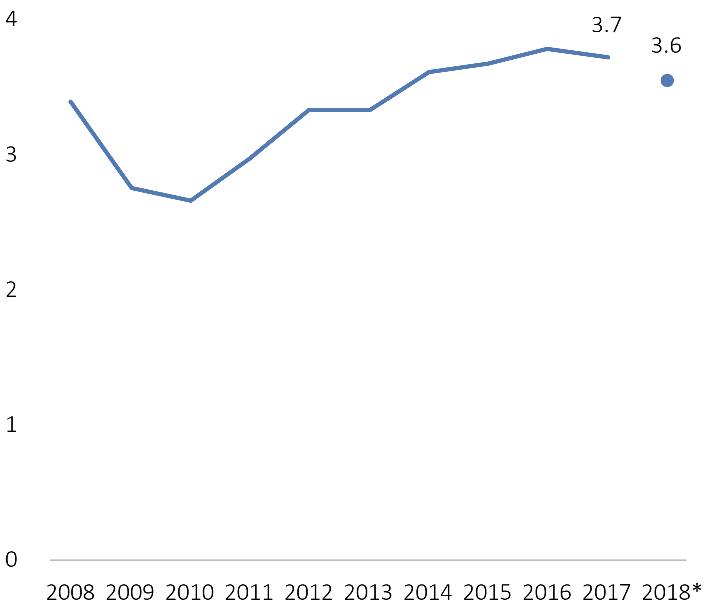
2018 enjoyed the highest step-ups in a decade and greatest proportion of successor funds closing larger than their predecessor, though PE firms waited longer to return to market with funds. The average time between funds climbed to 4.4 years, marking the first increase since 2014. In this GP-friendly fundraising environment, it is surprising that firms are waiting longer to hit the fundraising trail. In 2018, GPs had called down 82.9% of capital in a fund before closing a new one, a decline from the 87.4% in 2017 and the lowest figure in over a decade. In recent years, PE firms have been calling down capital at a slower rate, making new funds harder to sell to LPs.

Change in North American and European PE fund sizes



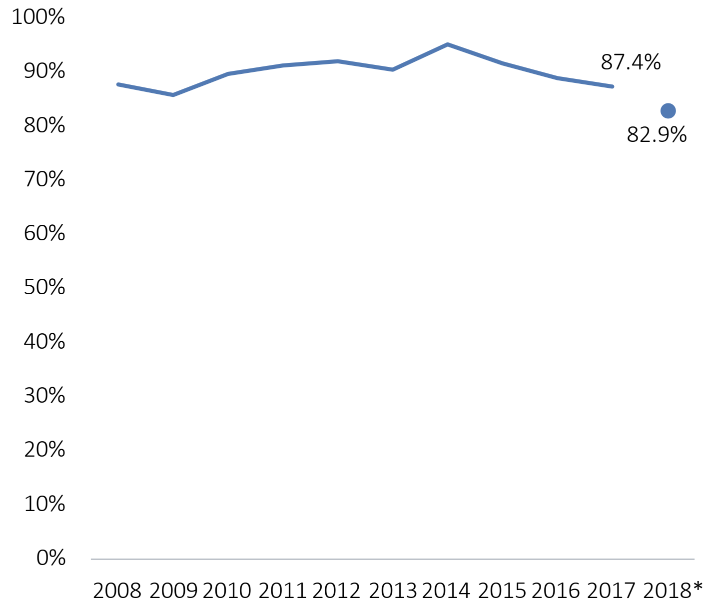
Source: PitchBook

North American and European PE dry powder on hand (years)



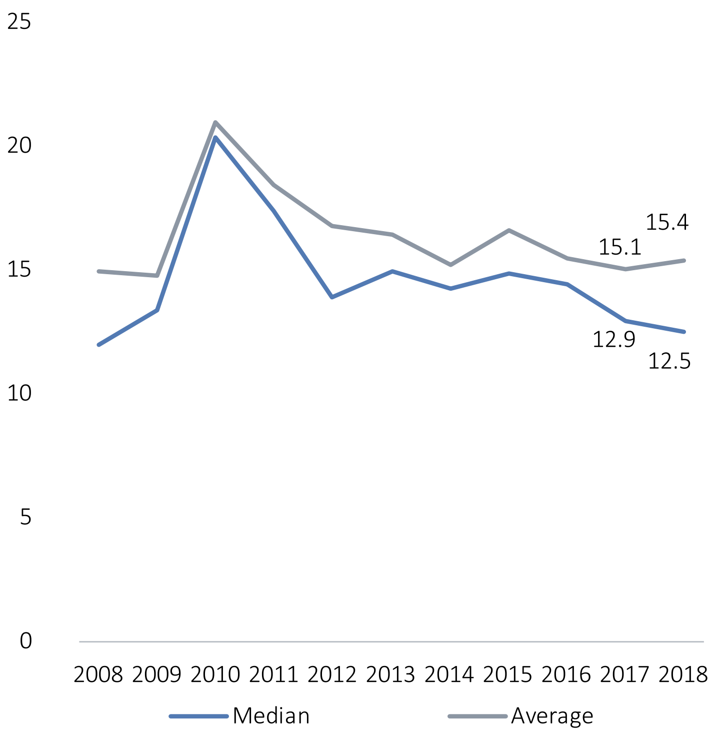
Source: PitchBook
As of June 30, 2018

Median proportion of PE capital called down at subsequent fundraise



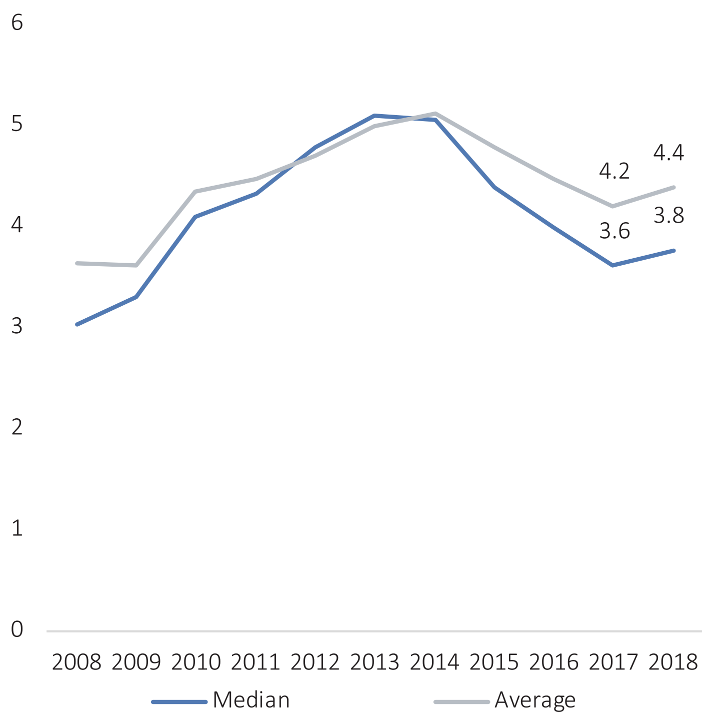
Source: PitchBook
As of June 30, 2018

Median and average time to close (months) North American and European PE funds



Source: PitchBook

Median and average time (years) between North American and European PE funds



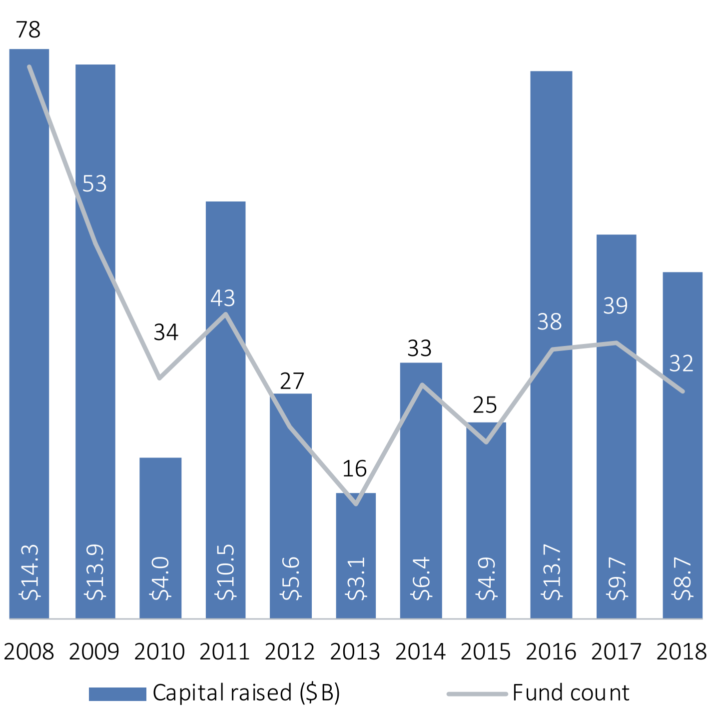
Source: PitchBook

Largest North American and European PE funds to close in 2018

Investor name	Fund name	Type	Size ($M)	HQ	Close date
The Carlyle Group	Carlyle Partners VII	Buyout	$18,500	Washington	July 30
Hellman & Friedman	Hellman & Friedman Capital Partners IX	Buyout	$16,000	San Francisco	October 30
EQT	EQT VIII	Buyout	$13,287*	Stockholm	February 23
BC Partners	BC European Capital X	Buyout	$8,524*	London	January 17
American Securities	American Securities Partners VIII	Buyout	$7,000	New York	February 27
Insight Venture Partners	Insight Venture Partners X	Growth	$6,300	New York	July 19
PAI Partners	PAI Europe VII	Buyout	$6,287*	Paris	March 30
Triton	Triton Fund V	Buyout	$5,825*	Frankfurt	December 1
Nordic Capital	Nordic Capital Fund IX	Buyout	$5,090*	Stockholm	May 21
Roark Capital Group	Roark Capital Partners V	Buyout	$5,000	Atlanta	October 24

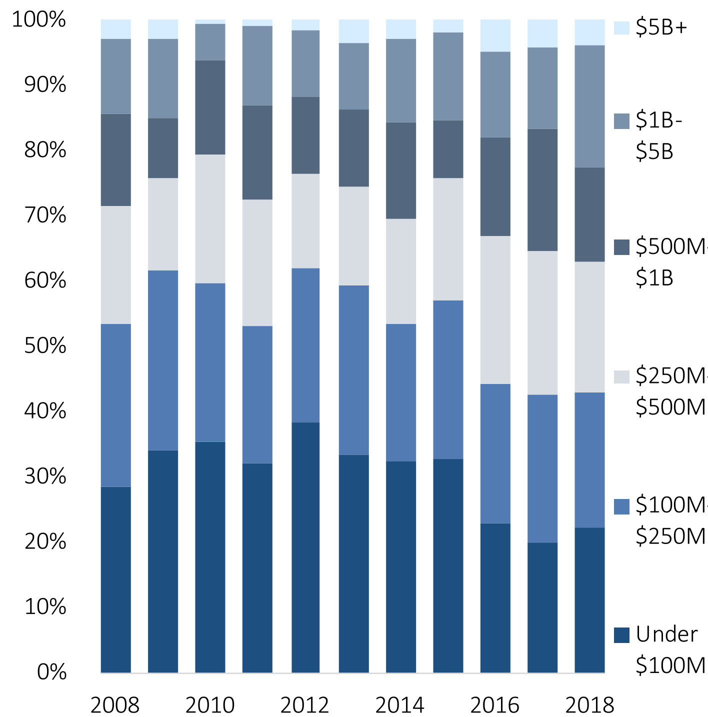
Source: PitchBook
*Denominated in €

North American and European first-time PE fundraising activity ($B)



Source: PitchBook

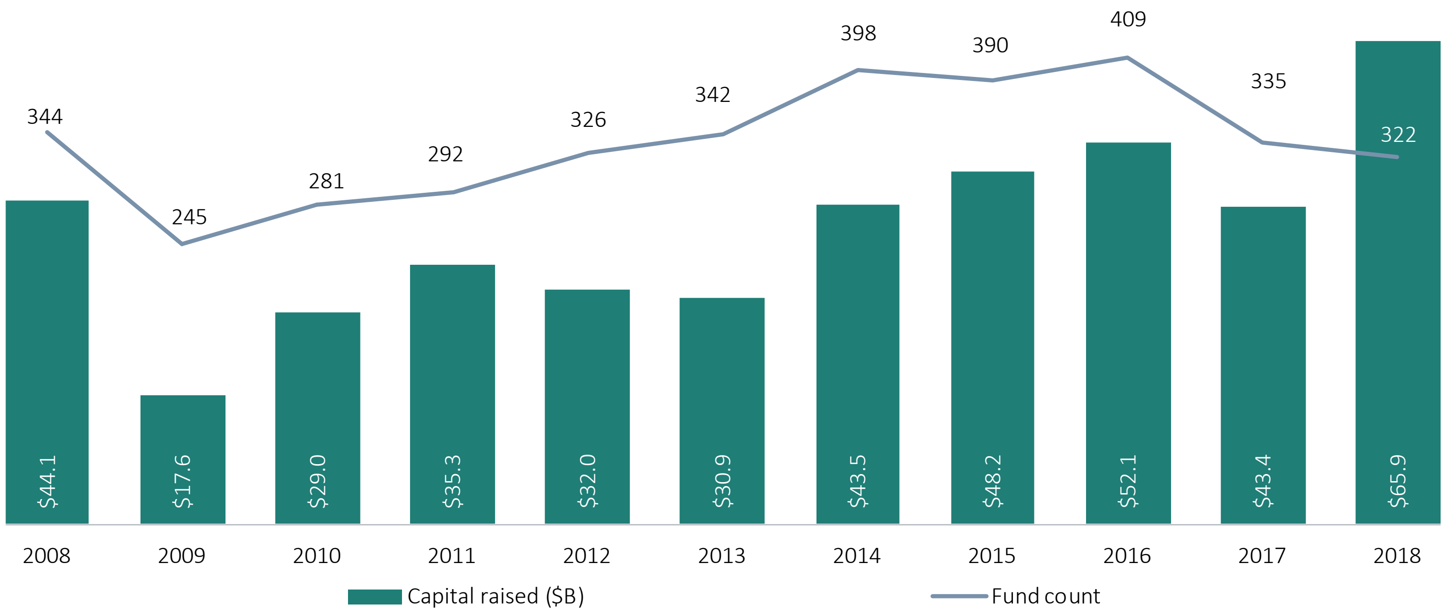
North American and European PE fundraising (#) by size



Source: PitchBook

Venture capital

North American and European VC fundraising activity



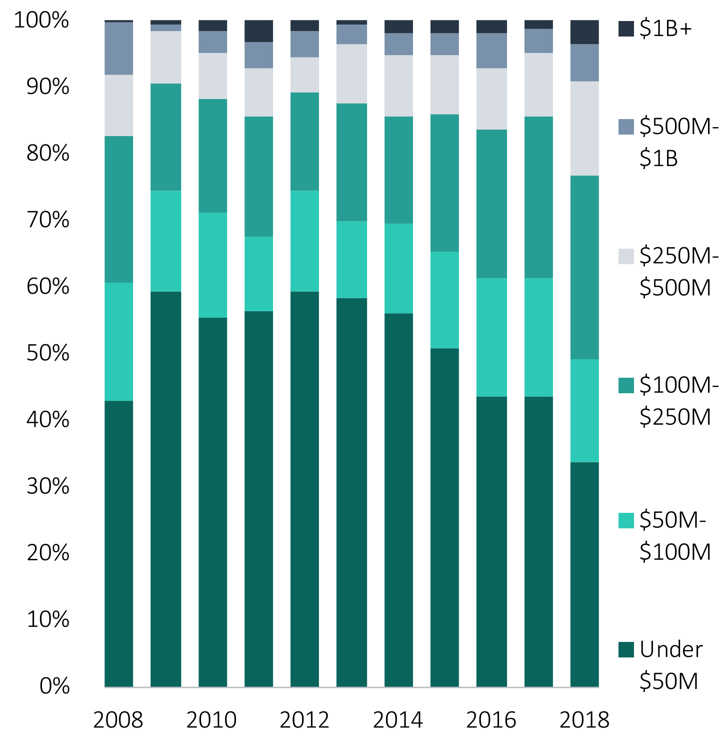
Source: PitchBook

After diminishing in 2017, VC fundraising in North America and Europe in 2018 resumed the long-term trend of rising aggregate capital raised, which soared 52.0% YoY to $65.9 billion. This marks the fifth consecutive year VC fundraising surpassed $40 billion. It is also the greatest aggregate fundraising total on record since the peak of the dot-com bubble in 2000 and the first time in nearly two decades that it has exceeded $60 billion. Conversely, fund count fell for the second year in a row, dropping to 322, representing a 3.9% decline YoY.

As can be surmised, fund sizes continue to grow despite a decline in count, with 2018 truly being the year of the VC mega-fund ($500 million+). Perhaps in an effort to adequately compete with SoftBank Group's Vision Fund I and Vision Fund II, 27 VC mega-funds closed in 2018 (all but three based in Silicon Valley, New York, or Boston), headlined by Sequoia Capital's $8 billion Global Growth Fund III which intends to funnel hefty checks into growth-stage technology firms.

The rise of mega-funds marks a shift in venture investment strategy toward "industry plays," where a single company has the potential to dominate the market. In this strategy, instead of concentrating on finding companies with a competitive advantage in their space, the focus is first on identifying either young or antiquated industries ready for disruption. Investors then choose a company within

North American and European VC fundraising (#) by size



Source: PitchBook

these industries to infuse with such massive quantities of capital that the firm comes to dominate the market and transform the industry.

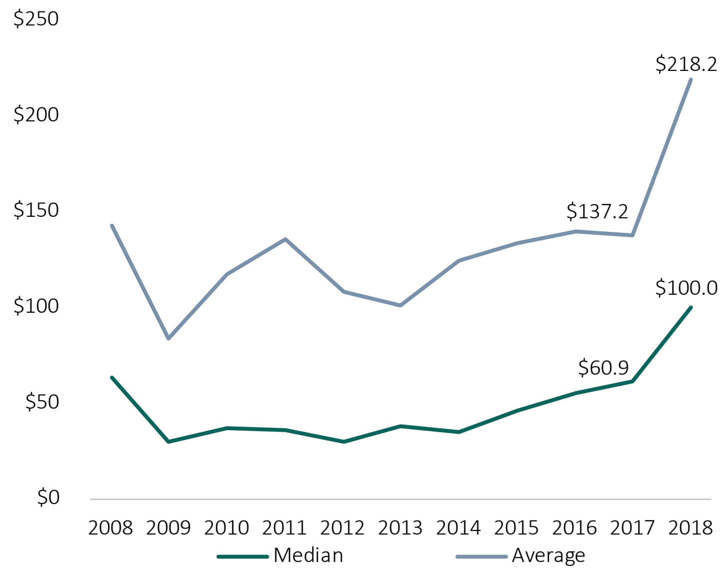
Investments by these mega-funds essentially allow portfolio companies to scale and gain market share while operating in the red for extended periods. For example, SoftBank has invested over $7 billion in Uber, helping the firm to transform the ridesharing industry. SoftBank appears to be fully committed to the construction industry as well, leading an $865.0 million investment in Katerra last January (with a rumored $700 million of additional investment on the way) and participating in massive deals with real estate firms Opendoor ($725.0 million total in 2018) and Compass ($950 million total since 2016). (PitchBook classifies SoftBank as a growth fund.) We expect the rise of mega-funds will help more venture funds compete with investors such as SoftBank and will lead to more industry plays in the near future.

The proliferation of mega-funds coincides with an industry-wide shift toward larger VC funds in general. Funds sized $100 million and above have seen total fund count increase 66.3% over the last five years. Conversely, micro-funds (funds under $50 million) have seen a sharp decline since 2013, dropping 43.0% over the past five years. This shift may be due to venture funds trending toward investing in older startups at the later stages or to smaller funds being outmatched in an environment of larger deal sizes and rising valuations.

Another factor is that the median age of startups at each stage of venture investment has slowly crept up over the past decade, with firms at the angel & seed stage increasing 20.7% YoY. This increased age coincides with a surge in firm traction and maturity at fundraise. With maturity comes higher valuations, and investors have paid the price by writing larger checks or accepting lower equity stakes. The median pre-money valuation of firms at the angel & seed stage is up 16.7% YoY, and the median D+ round valuation is up 45.4% YoY. Higher valuations, coupled with growing competition among VC investors, has led to bigger round sizes. We have observed this with the 22.9% YoY rise of median deal size for early-stage ventures. Each of these factors plays a role in driving GPs to raise progressively larger funds.

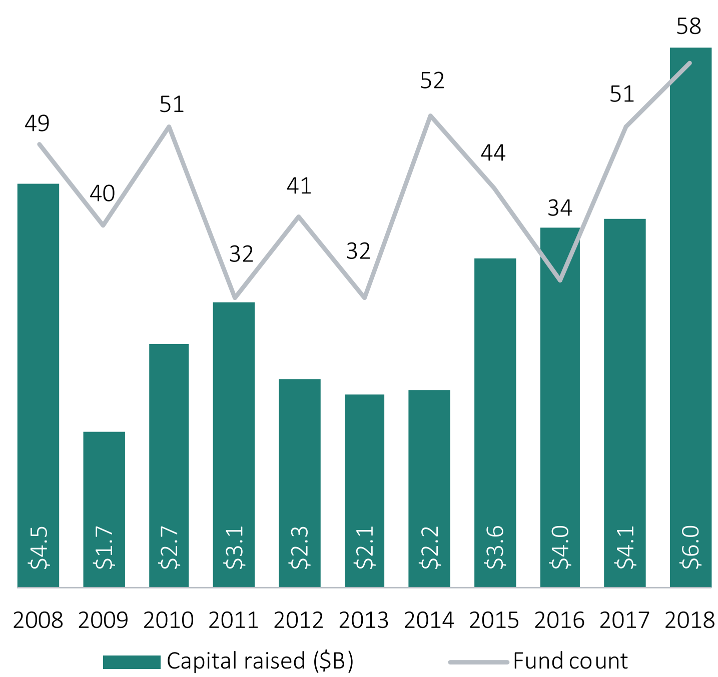
One barometer of investor enthusiasm for VC is first-time fund activity. First-time fund count ascended precipitously in 2018, reaching a decade high. This may come as a surprise given the drop in micro-funds. Indeed, first-time funds tend to be smaller because, by definition,

Median and average North American and European VC fund sizes ($M)



Source: PitchBook

North American and European first-time VC fundraising activity



Source: PitchBook

Largest North American and European VC funds closed in 2018

Investor name	Fund name	Type	Size ($M)	HQ	Close date
Sequoia Capital	Sequoia Capital Global Growth Fund III	VC	$8,000	Menlo Park	September 6
Tiger Global Management	Tiger Global Private Investment Partners XI	VC	$3,750	New York	October 15
Bessemer Venture Partners	Bessemer Venture Partners X	VC	$1,850	Boston	October 25
Norwest Venture Partners	Norwest Venture Partners XIV	VC	$1,500	Palo Alto	February 14
General Catalyst	General Catalyst Group IX	VC	$1,375	Cambridge	March 26
GGV Capital	GGV Capital VII	VC	$1,360	Menlo Park	October 16
Newview Capital	NewView Capital Fund I	VC	$1,350	Burlingame	December 3
Lightspeed Venture Partners	Lightspeed Venture Partners Select III	VC	$1,050	Menlo Park	July 7
Index Ventures (UK)	Index Ventures Growth V	VC	$1,000	San Francisco	July 9
Thrive Capital	Thrive Capital Partners VI	VC	$1,000	New York	October 23

Source: PitchBook

they have no track record of success which can make convincing LPs to invest difficult. This conventional wisdom has broken down, however; we have observed a swelling quantity of first-time funds over $50 million, with the greatest uptick in the $100 million-$250 million range, climbing 30.8% YoY. Aggregate capital raised for first-time funds reached $6.0 billion in 2018, a 46.5% increase YoY and the greatest amount raised since the end of the dot-com bubble in 2001.

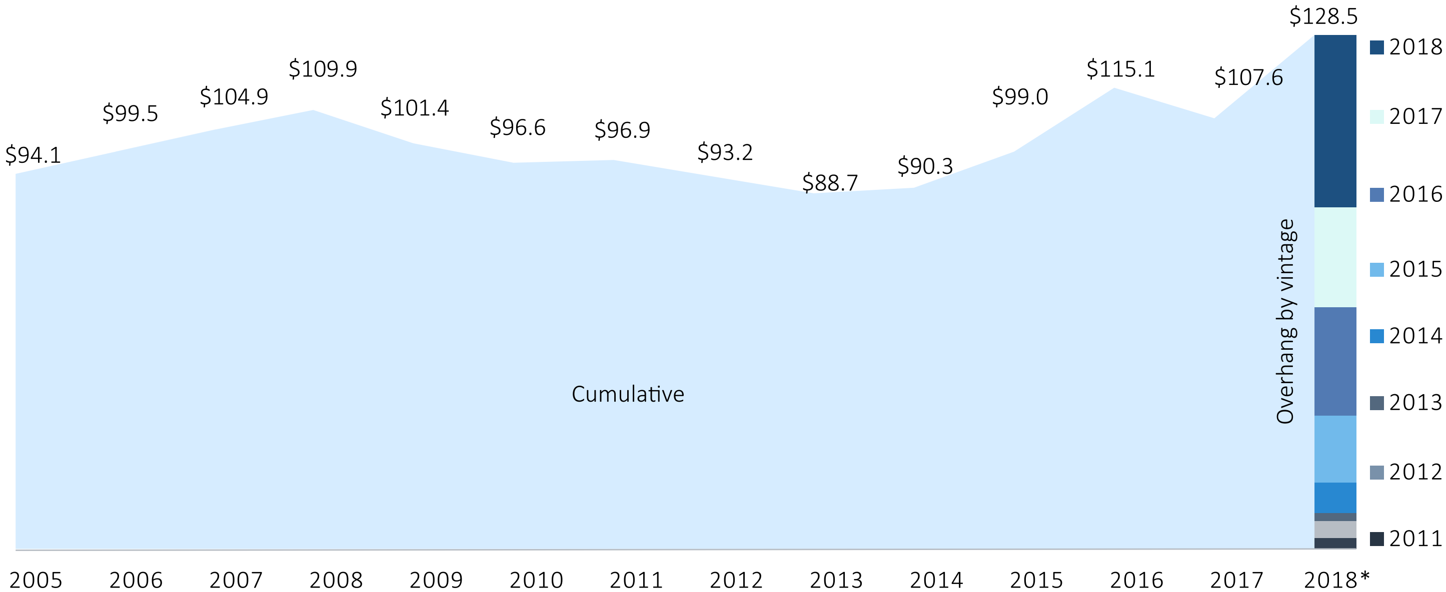
A strong showing in first-time fund count and capital raised indicates investor confidence in the VC strategy, which has exhibited robust performance in recent years. PitchBook's latest Global PE & VC Fund Performance Report revealed that one-year rolling IRR for VC funds over $250 million reached 13.8% in 2018. Another reason LPs are growing more confident in these "newcomers" is that they more often have established credentials either from other VC firms or from launching a successful startup of their own. As indicated in a previous analyst note, venture firms with investment teams that have both prior VC experience and entrepreneurial experience have the highest (66%) likelihood of raising a follow-on fund. This suggests that a combination of operational and investment experience bolsters the probability of success for first-time managers, which are perceived as riskier than more established GPs. A thriving VC industry over the past decade has created a remarkably high number of spin-out funds, which, led by partners with favorable histories of investment, has contributed to the recent success in raising first-time funds.

In PitchBook's 2018 Annual Institutional Investors Survey, 75.0% of LPs reported committing to first-time funds, and 46.2% reported committing as anchor investors. Notwithstanding macroeconomic impacts, we expect to see a continued boost in first-time funds as LP interest in VC only continues to grow. On the supply side, the wave of first-time funds is indicative of growth and maturity in the industry as VCs at existing funds leave to start their own, as angel investors move to institutionalize, and as tech entrepreneurs try their hand at investing.

VC dry powder levels in North America and Europe skyrocketed to a decade high of $128.5 billion in 2018, a 19.4% increase YoY. Mega-funds alone made up over 60% of the overhang from the 2018 vintage, and tremendous fundraising over the past several years has also contributed to the cumulative dry powder, with $52.3 billion remaining in 2016 and 2017 vintages. It is worth noting that these figures exclude some of the largest VC investors, including sovereign wealth funds (e.g. Caisse des Depots Group), corporate VCs, and investors that do not have traditional VC fund structures (e.g. SoftBank). The sums captured by the included funds are impressive given the strength of venture deal activity over the past five years. According to our latest Venture Monitor, cumulative US VC deal value has surpassed $70 billion for the past five years, for example, soaring to $131.4 billion in 2018. Accelerating levels of deployed capital likely necessitate deeper pockets to accommodate larger investments and follow-on rounds.

Venture capital

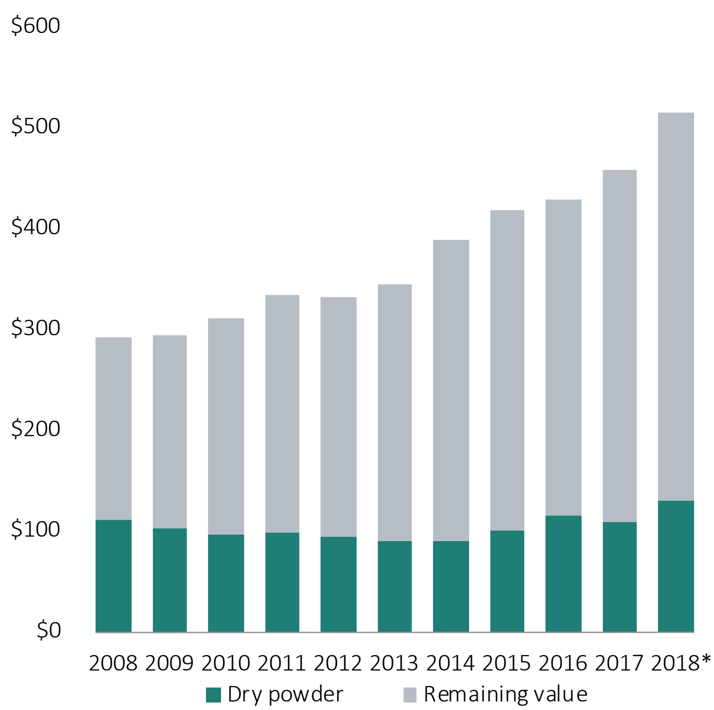
North American and European VC overhang ($B)



Source: PitchBook
*As of June 30, 2018

AUM for the asset class continues to swell, rising 12.3% YoY to reach $514.9 billion in 2018, due to sustained fundraising and substantial markups on existing portfolio companies. Although total AUM continues to climb, dry powder has historically held relatively flat, causing the ratio of dry powder to total AUM to decline from 37.8% in 2008 to 25.0% in 2018. The recent rise in dry powder showcases heightened competition in the strategy as well as the upward pressure on valuations as investors are on the hook to put said capital to work. The sustained markup of portfolio companies will continue to elevate aggregate remaining value, maintaining the suppressed ratio of dry powder to total AUM. Cumulative dry powder from the 2011-2013 vintages sits at $9.3 billion, or 7.2% of total dry powder. These funds are past or nearing the end of the traditional investment period. Although this capital may be utilized in follow-on rounds, it may prove difficult to invest given the run-up on valuations. We have observed leading VCs respond by raising funds dedicated to follow-on investments.

North American and European VC AUM ($B)

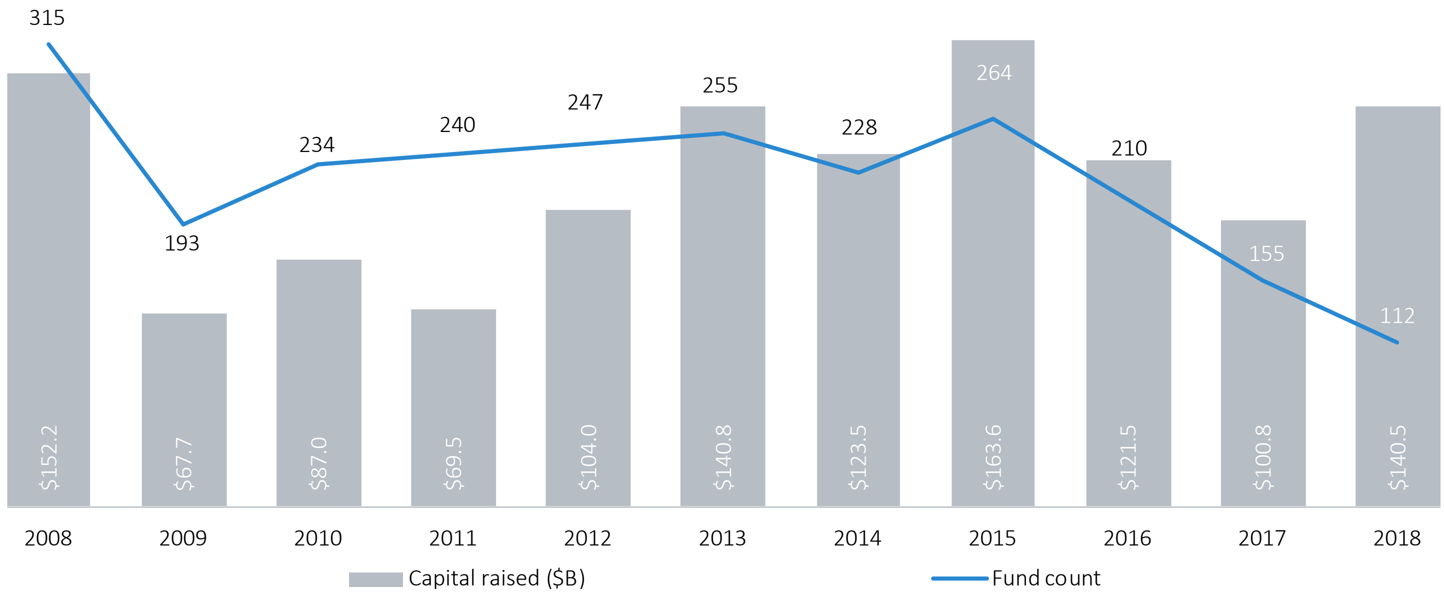


Source: PitchBook
*As of June 30, 2018

PitchBook

Real assets

North American and European real assets fundraising activity

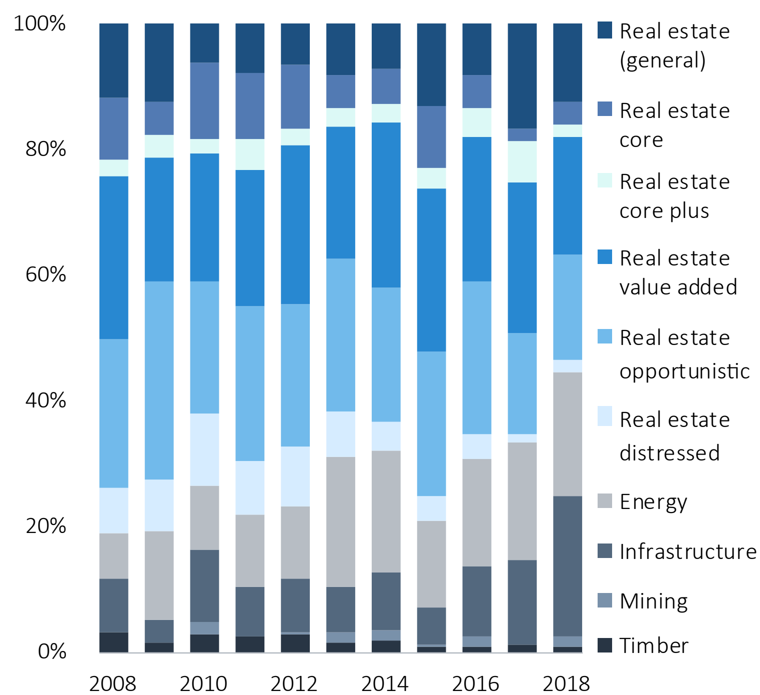


Source: PitchBook

In 2018, fundraising for real assets funds in North America and Europe grew total capital commitments, but the number of vehicles raised shrank considerably. GPs closed on $140.5 billion, representing a 39.4% increase over the previous year's figure and the third highest total in the last decade. The strong fundraising figures reverse the downward trend of recent years, which had resulted in a decline in dry powder. With ample fundraising in 2018, however, capital available for deployment has rebounded to $328.9 billion—the second highest total on record. At the same time, just 112 funds held a final close in 2018, a 27.7% decrease from the prior year and the lowest number in at least 10 years.

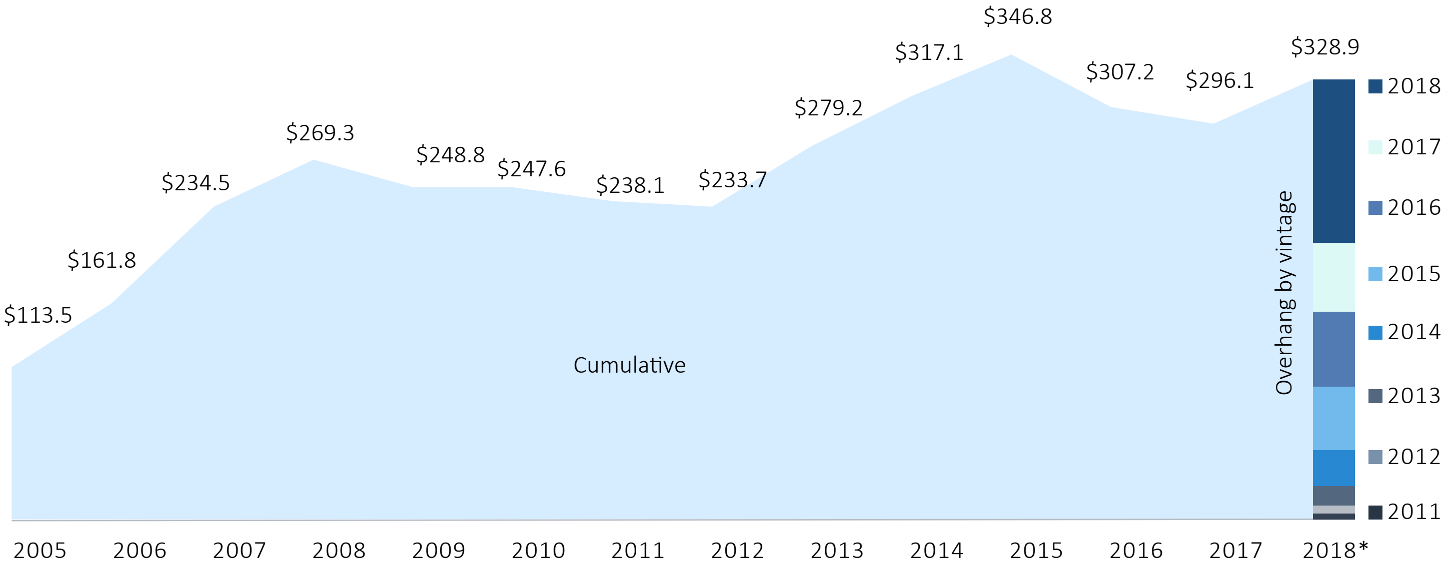
Due to strong demand from LPs and fewer first-time funds in the market, real assets fund sizes have grown much larger, mirroring trends in other private capital asset classes. The median fund size within this category increased by 80.4% in 2018 to $557.7 billion, and 87.1% of funds were larger than their predecessor—the highest figure we've ever tracked. In years past, the real assets category was dominated by real estate funds, which accounted for about four out of every five vehicles prior to the GFC. However, that proportion has been falling and slipped to just 55.4% in 2018, with energy and infrastructure accounting for the second and third largest fund categories by type.

North American and European real assets fundraising (#) by type



Source: PitchBook

North American and European real assets capital overhang ($B)

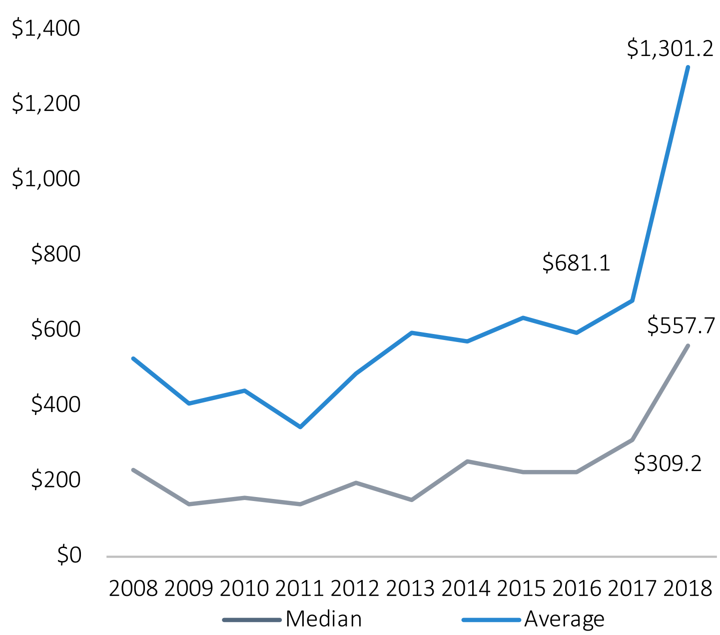


Source: PitchBook
*As of June 30, 2018

Infrastructure was the standout strategy within real assets, raising $61.0 billion during the year—the highest annual figure we have documented. KKR, Stonepeak Infrastructure Partners, I Squared Capital, and Macquarie Asset Management all raised funds of at least $5 billion. These vehicles will pursue targets in the midstream and downstream oil & gas, telecom networking, power generation, and transportation industries, among others. Another fund still in the market is Blackstone's planned $40 billion infrastructure vehicle, which garnered an unprecedented $20 billion commitment from PIF, the Saudi sovereign wealth fund. Given the size of the commitment, Blackstone will charge PIF a management fee of just 65-75 bps and carry fee of just 10%, per a report from Bloomberg, which is roughly half the average management fee for all real assets funds in PitchBook's dataset.[2]

One area to watch closely in 2019 will be oil & gas funds (which tend to invest exclusively in this field, including in exploration & production projects, as opposed to the broader mandate of infrastructure funds). Energy-focused GPs (most of which operate in oil & gas) closed on 22 funds totaling $18.4 billion in commitments in 2018, a decrease from the prior year. However, the sell-off in crude oil that began in September could prompt opportunistic managers to raise funds with the hope of capitalizing on underpriced assets. 2015, the year after the most recent crude price crash of this magnitude, saw fund managers raise a record $44.0 billion in energy funds.

Median and average North American and European real assets fund sizes ($M)

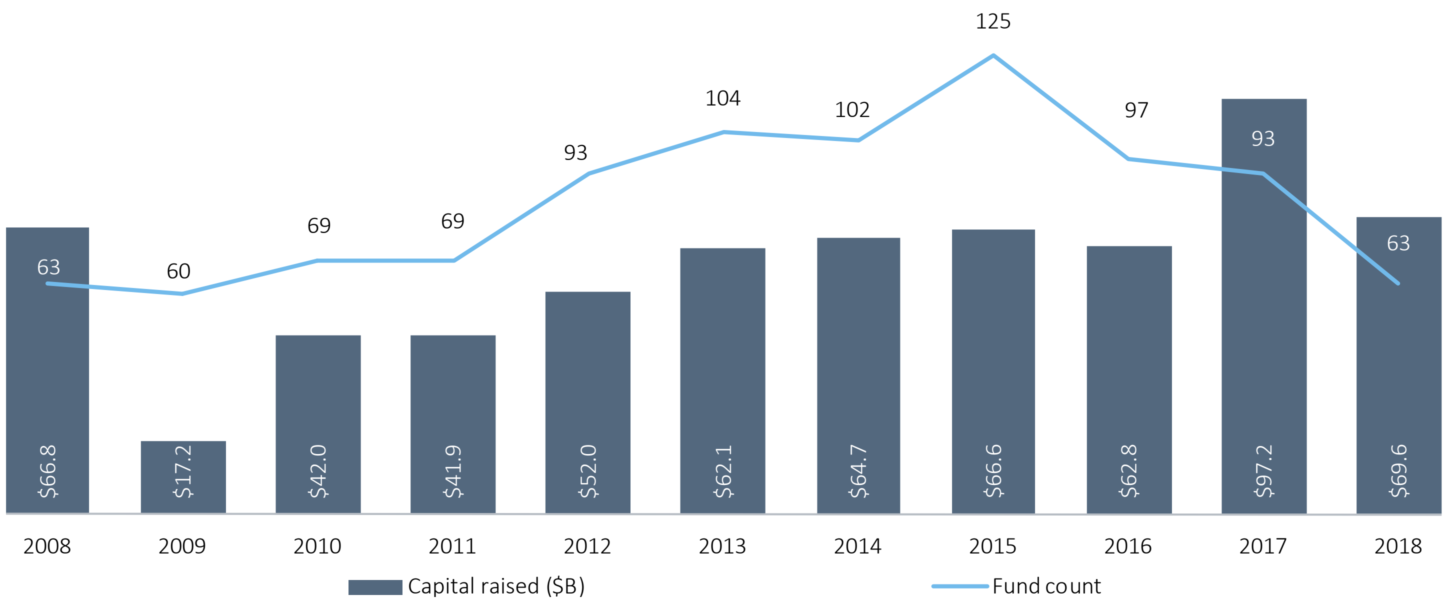


Source: PitchBook

2: "How Blackstone Landed $20 Billion From Saudis for New Fund," Bloomberg, Gillian Tan, October 21, 2018

Debt

North American and European debt fundraising activity

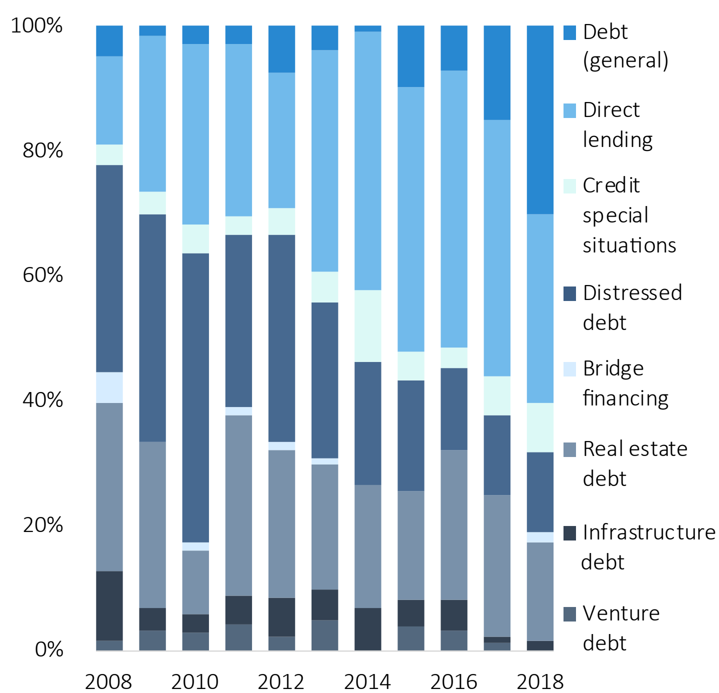


Source: PitchBook

After raising a record $97.2 billion in 2017, private debt managers fell back through the stratosphere and closed on just $69.6 billion last year—a 28.3% decrease, but still the second-highest annual figure on record. Managers also raised far fewer funds, with just 63 vehicles holding a final close during the year, the lowest count since 2009. Despite relatively lofty fund sizes, managers tended to reach a final close quite quickly. The median fund size reached $673.0 million, while the median time to close dropped to just under 14 months. Dry powder climbed to an unprecedented $208.9 billion as of 2018, and there are a few massive funds that could hold final closes in 2019, including a targeted $5.0 billion by Fortress Investment Group, now a subsidiary of SoftBank Group.

The YoY slowdown in commitments came primarily from a pullback in the direct lending strategy, which saw about 50% decreases in terms of both count and value. The decrease in value, however, was more of a reversion to the mean, as the $27.5 billion raised in 2018 approximated annual totals from 2014 to 2016. Growing interest in the strategy, alongside the proliferation of covenant-lite loans and other borrower-friendly terms, has spurred criticisms of an overheated leveraged loan market from the likes of Janet Yellen and the IMF, among others.[3]

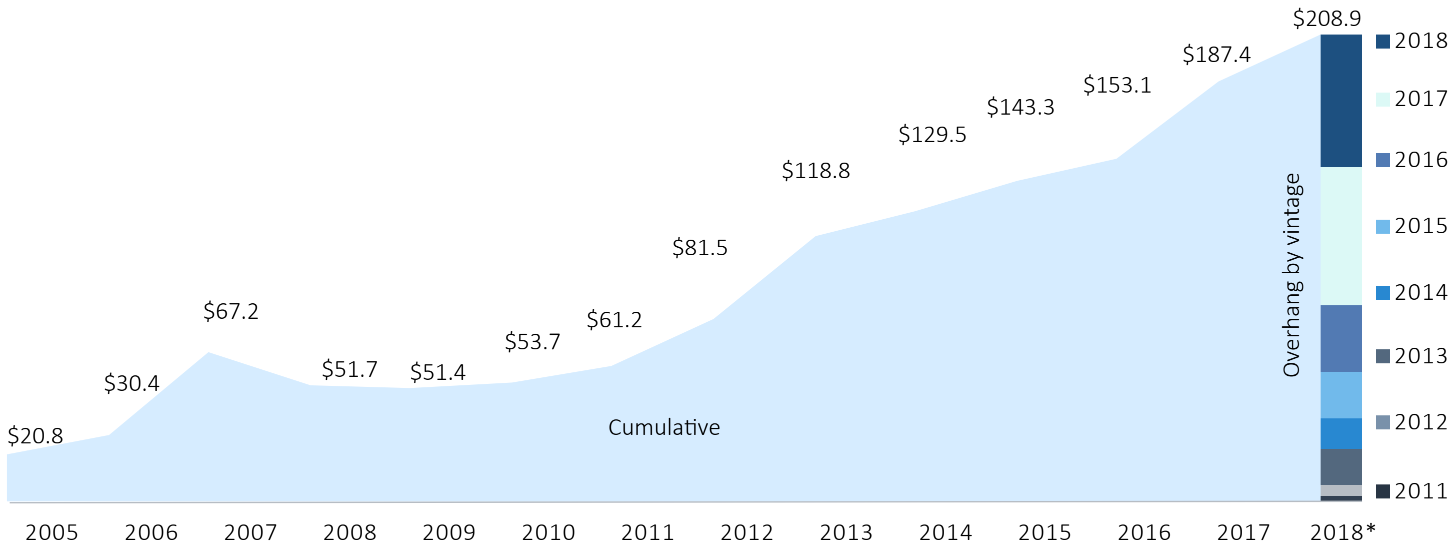
North American and European debt fundraising (#) by type



Source: PitchBook

3: "The $1.3 trillion loan market that's spooking everyone right now," Quartz, Eshe Nelson, November 16, 2018

North American and European debt overhang ($B)

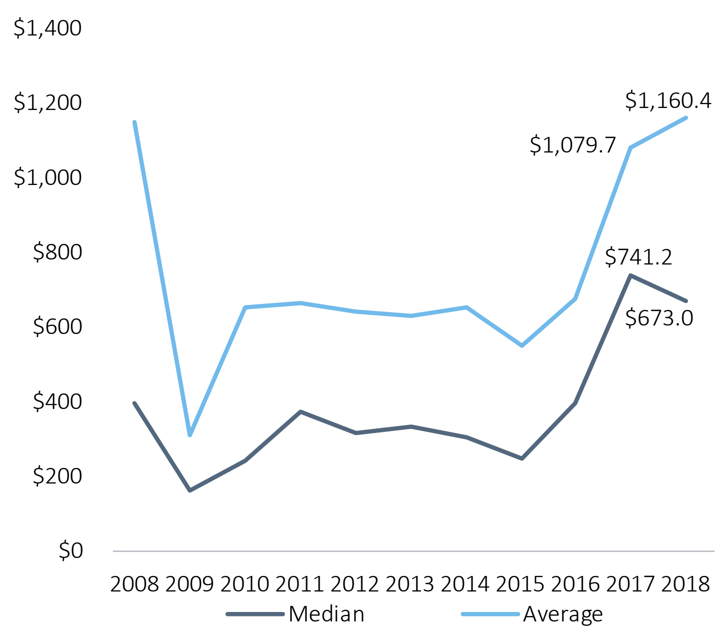


Source: PitchBook
*As of June 30, 2018

Indeed, the leveraged loan market experienced its largest sell-off in years in 4Q 2018 but started to bounce back in January of this year. Leveraged buyouts, often financed by direct lending funds, have also started using more leverage; the median debt/EBITDA multiple for US buyouts clocked in at 6.2x during both 2017 and 2018, for example. Regardless, we expect the market of non-bank lenders to continue developing for as long as central banks keep interest rates at historically low levels and appetite for higher-yielding debt products remains intact.

Not all private debt strategies experienced pullbacks in fundraising during 2018. Distressed debt and credit special situations managers raised $22.8 billion in 2018—the highest figure in four years and another indication that investors may be positioning for a market downturn. Although managers insist that they can invest successfully throughout credit cycles, the distressed strategy has obvious tie-ins with an expected deterioration in loan pricing (which occurred in 4Q 2018) as well as anticipation of a broader macroeconomic slowdown (which many expect in the next couple of years). In fact, distressed managers raised more than any other year on record immediately around the GFC in 2008.

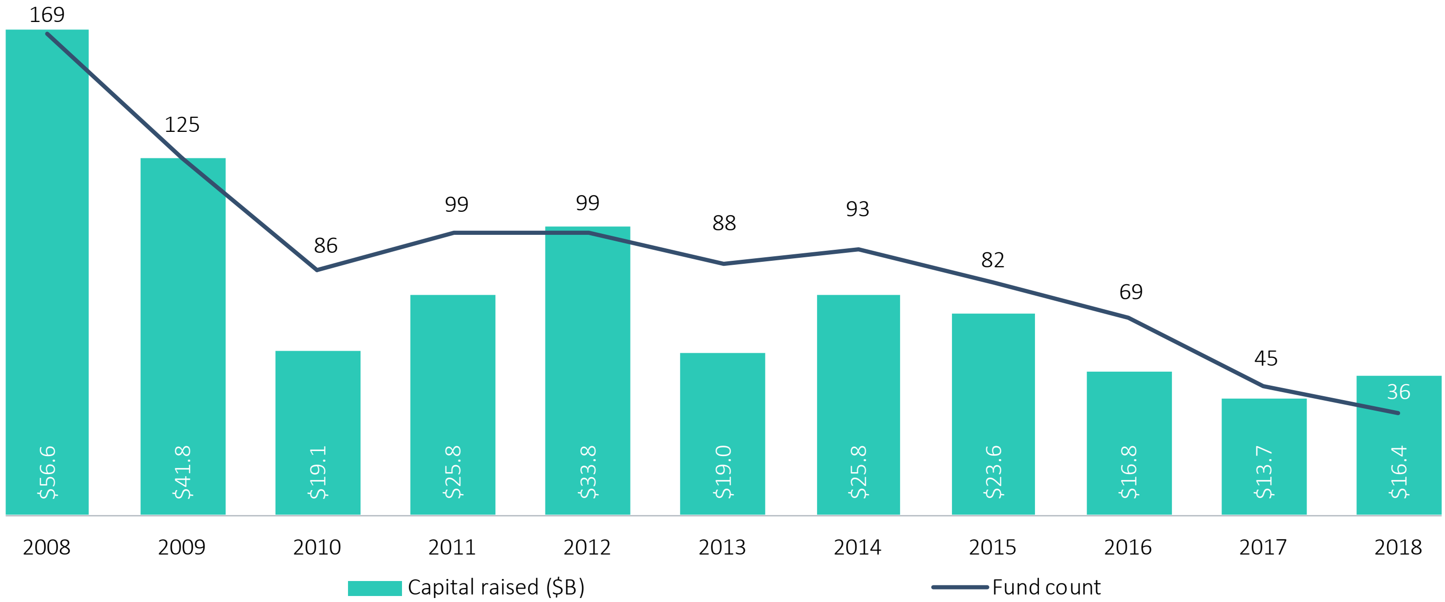
Median and average North American and European debt fund sizes ($M)



Source: PitchBook

Fund-of-funds

North American and European FoF fundraising activity

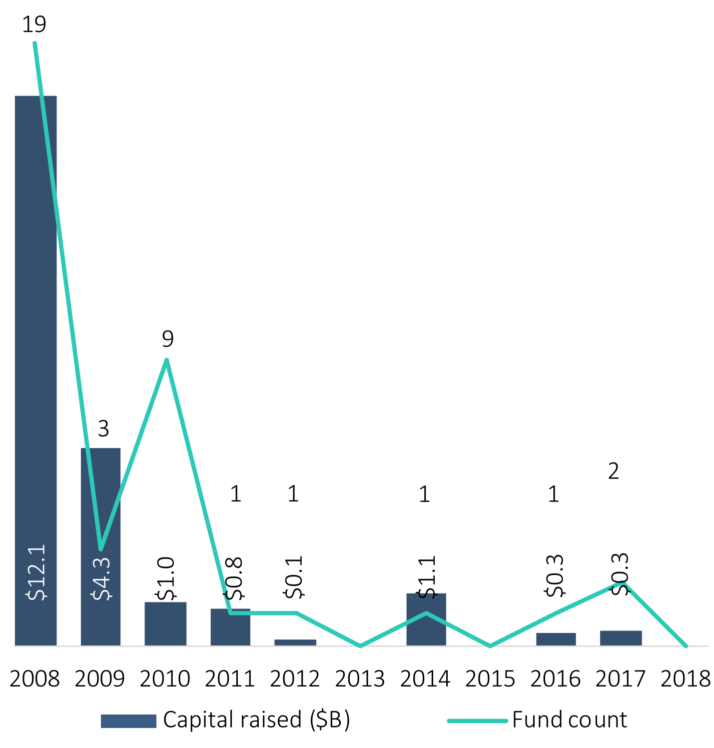


Source: PitchBook

The slow death of FoFs continues to be reflected in meek 2018 results; 36 funds raised a total of $16.4 billion. The decline in fundraising since 2007's peak has been substantial, with fund count and value each down around 75%. For years, the pitch for FoFs had been the diversification effects, access to GPs, and a near one-stop shop for investing across private markets. In recent years, however, secondaries funds have proven to be a preferred option for LPs seeking diversification, particularly for more sophisticated investors. Many LPs are bypassing FoFs and directly investing in GP funds in an attempt to cut fees and increase performance. Additionally, while FoFs have a "higher performance floor" with a higher bottom quartile than buyouts, they have consistently underperformed buyout funds. However, some FoF managers will live on in a different capacity as many are now raising secondaries funds.

Industry stalwarts have driven nearly all FoF fundraising while newcomers are nowhere to be seen. No first-time managers closed on an FoF fund in 2018—the third time since 2013. It is challenging enough for GPs in the space to convince LPs—who are always negotiating for lower fees—to invest in FoFs due to the added fee layer. Furthermore, much of the strategy's appeal is the access to GPs, a task inherently more difficult for a newcomer.

North American and European first-time FoF fundraising activity



Source: PitchBook

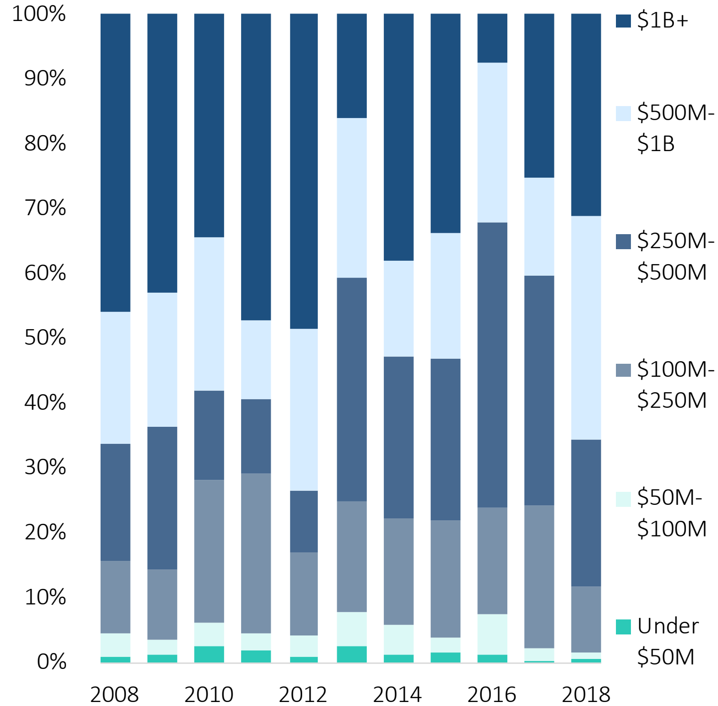
FoF managers will need to scale to combat fee pressure being exerted by LPs or delve into niche areas to justify the extra layer of fees and differentiate themselves from other managers. We see this happening as lesser managers are shaken out, which has caused fund sizes to explode. In 2018, the average fund size rose 46.3% to $455.4 million, and 11 mega-funds ($500 million+) closed. A wave of consolidation and groupthink has seen the industry move in lockstep to produce a more standardized fund type with a seemingly melodic rhythm for fundraising. As such, the pendulum is beginning to swing the other way with more customized solutions becoming a trend. How this will affect fundraising is yet to be seen.

One way in which we have seen specialization and ingenuity is by transforming the typical fund structure raised every few years into an offering that raises smaller, annual funds. This strategy is gaining in popularity among the players who remain in the FoF space, such as The Investment Fund for Foundations (TIFF) and Hamilton Lane. These annual funds, though, have been growing. For example, Adams Street Partners closed on its $824 million 2018 Global Fund in the year, a 27.9% step up from its $644 million 2017 Global Fund.

After experiencing an outsized rise in 2017, time to close for FoF receded to normal levels in 2018, where the average fund took 17.3 months to close. Recent years (2014-2017) have experienced volatility in the time it takes to close as fewer funds are coming to market and LPs gain comfort and sophistication, causing them to rethink FoF allocations entirely. The time to close is longer for FoFs than other PE strategies, perhaps because GPs are struggling to convince LPs to invest.

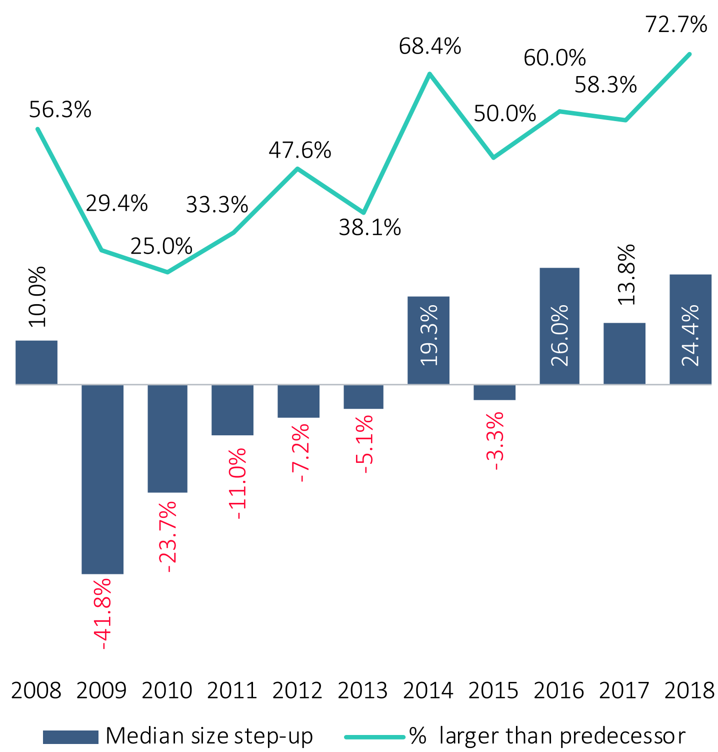
There is some good news, though; the proportion of funds that are larger than their predecessor has nearly trebled to 72.7% in 2018 since the mere 25.0% seen in 2010. Despite the general slowdown in FoF fundraising, some managers are having success. This likely precludes the future in which FoFs live on but with only a few winners. Recent years have seen median step-ups in positive territory; 2009-2013 marked a five-year span in which the median "step-up" was negative. The time between funds has come down in recent years, likely due to managers rolling out the annual fund structure. In 2018, the average FoF had 2.6 years between funds, down from 4.4 years in 2015. The median step up of 24.4%—lower than any other strategy—is likely due to the more truncated annual fundraising cycle many managers now use.

North American and European FoF fundraising ($) by size



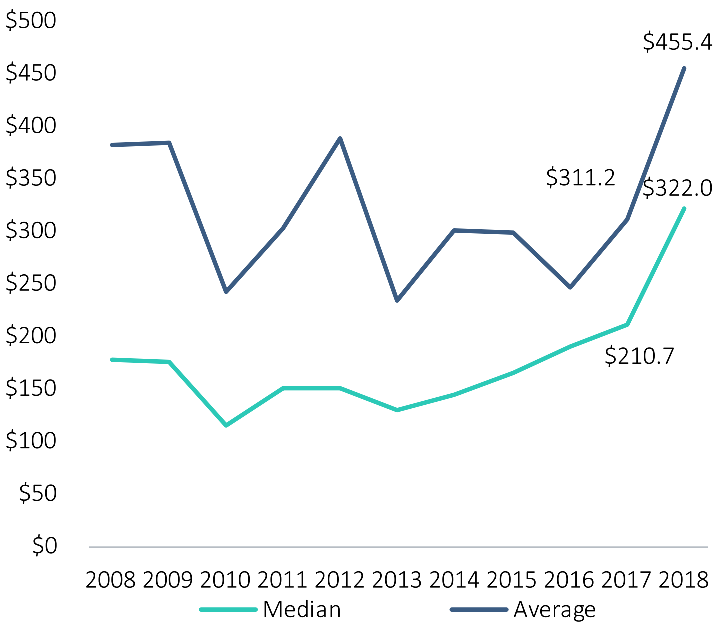
Source: PitchBook

Change in North American and European FoF sizes



Source: PitchBook

Median and average North American and European FoF sizes ($M)

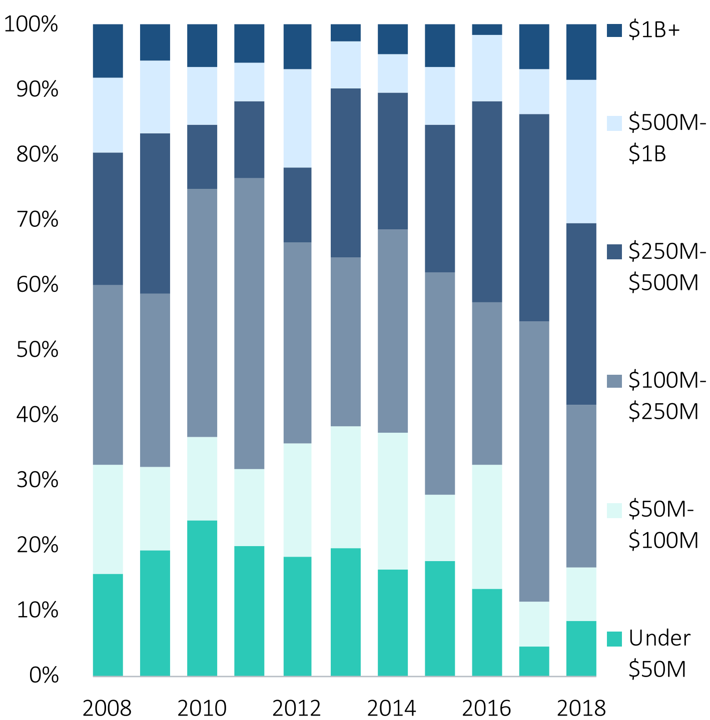


Source: PitchBook

Median and average time (months) to close North American and European FoFs

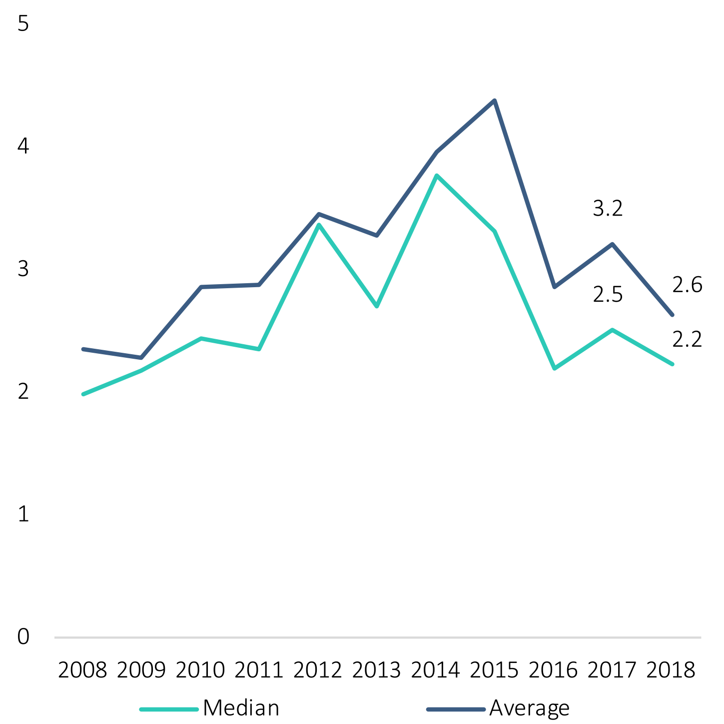
Source: PitchBook

North American and European FoF fundraising (#) by size



Source: PitchBook

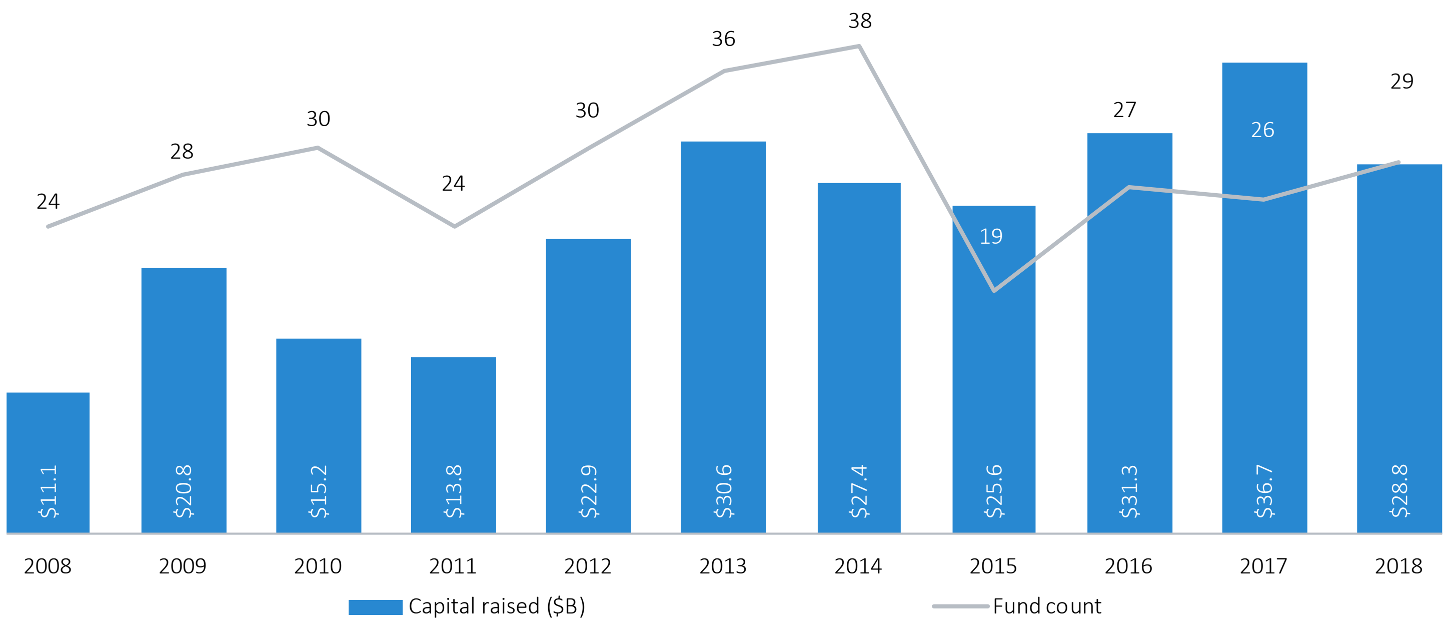
Median and average time (years) between North American and European FoF funds



Source: PitchBook

Secondaries

North American and European secondaries fundraising activity

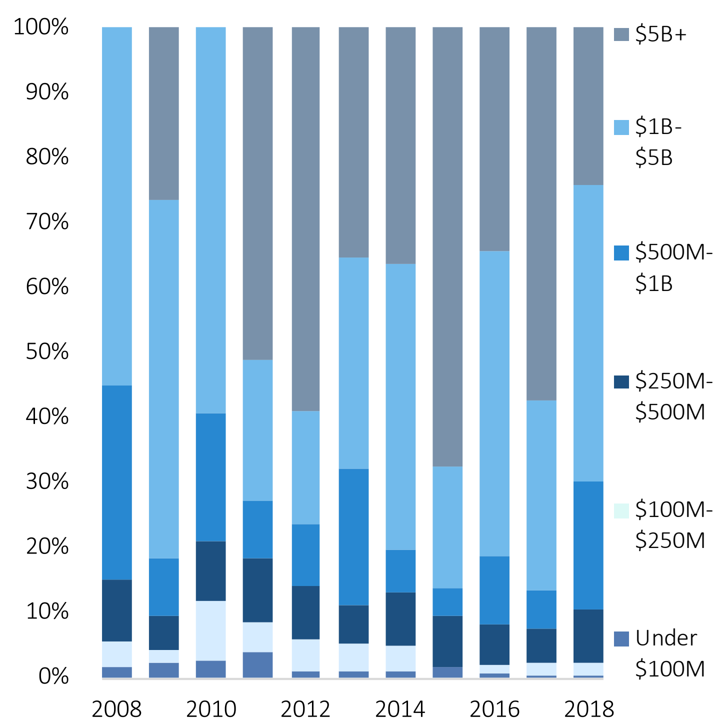


Source: PitchBook

Fundraising for secondaries vehicles remained healthy with $28.8 billion raised across 29 funds. Although this is a dip from the record levels of 2017, LPs continue to report strong demand for the strategy, and several of the largest-ever secondaries funds are currently raising capital. To note, the five largest open secondaries funds are seeking to raise a combined $48.0 billion (Ardian and Lexington targeting $12.0 billion, Coller Capital targeting $9.0 billion, Strategic Partners Fund Solutions targeting $8.0 billion, and Goldman Sachs AIMS targeting $7.0 billion). Those five alone closing in 2019 would propel the year to the highest value raised on record.

Overall fundraising ought to further strengthen in 2019 and the years to come. With LPs growing more comfortable with using secondaries to manage their alternative assets portfolios and with GPs proactively leading secondaries transactions to hold assets longer and better align incentives with LPs, secondaries transactions are becoming a norm in PE investing. Some of this can be seen in the pricing of secondaries, as price to NAV has steadily marched upward for the past decade to the point that several funds trade at a premium NAV. Though pricing may remain in lofty territory compared to years past, many in the industry, including PitchBook, are calling for record transaction volume in the secondaries market in 2019.

North American and European secondaries fundraising ($) by size



Source: PitchBook

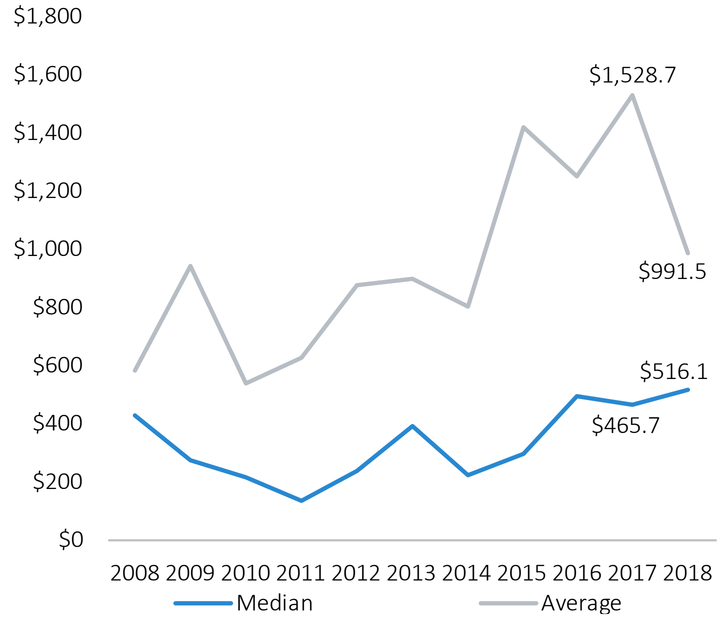
The lack of mega-funds ($5 billion+) closing in 2018 caused a dramatic fall in average fund size. However, 2019 is likely to set the record if the largest open funds close throughout the year. After setting a record for average fund size in 2017 and posting three consecutive years above $1 billion, the average fund size dropped 35.1% to $991.5 million in 2018. The median fund size, however, rose 10.8% to $516.1 million. While the size of funds has generally been growing in the secondaries market, time to close has been lengthening. The jump over the past two years has been substantial, nearly doubling from an average of 12.6 months in 2016 to 21.6 months in 2018. It may be that these larger vehicles are taking longer to close, with many in the industry seeking high step-ups.

With a decline in overall fundraising and a fervent dealmaking environment, dry powder fell as of 2018, bucking the trend seen across nearly all private capital strategies. The 2.1% decline, though marginal, is the first fall since 2009 for secondaries. With 2019 fundraising looking to shatter records, dry powder ought to tick back up in year ahead.

In 2018, secondaries fundraising saw a median step-up in size of 61.2% for successor funds. This step-up outpaced all other private market strategies except private debt. On top of that, 91.7% of successor funds were larger than their predecessor. This exemplifies the furious demand LPs have for the strategy and comes after a perfect 100% of successor funds surpassing predecessor funds in 2017. These numbers were last seen during the financial crisis when GPs were seeking to capitalize on huge amounts of forced selling, though the market looks discernibly different today.

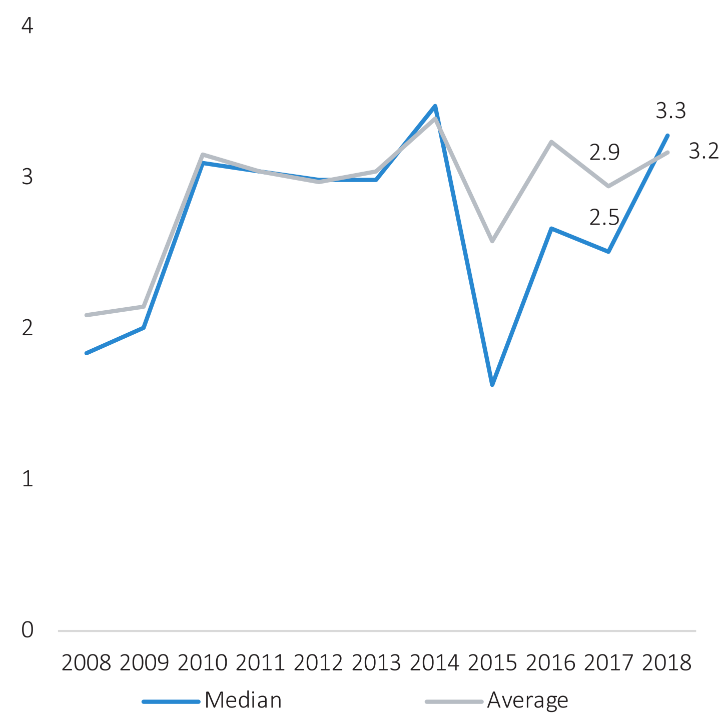
For funds closed in 2018, secondaries firms exhibited a median of 3.3 years between closing funds. After returning to market more quickly between 2015 and 2017, firms were once again taking between 3.0 and 3.5 years to return to market. A deep desire by LPs to gain access to the space and record-setting deal activity have propelled GPs to return to the fundraising trail ahead of schedule. As a flood of vehicles try to raise capital concurrently, we will have to watch to see if the time between funds jumps further.

Median and average North American and European secondaries fund sizes ($M)



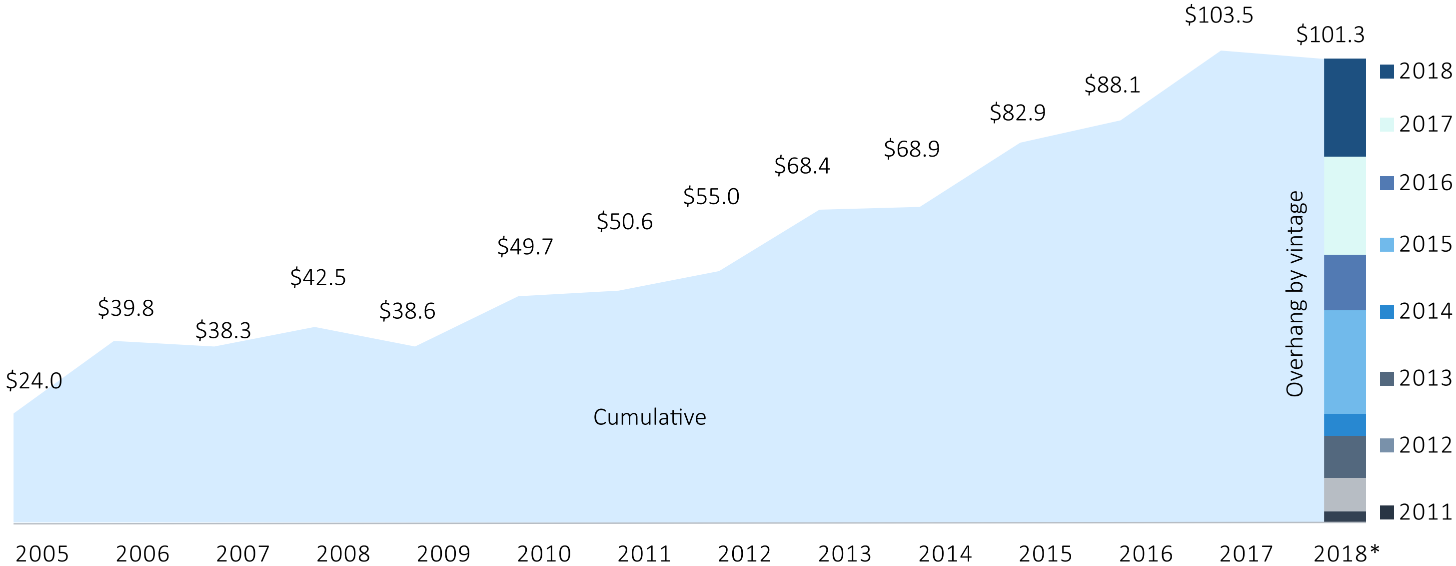
Source: PitchBook

Median and average time (years) between North American and European secondaries funds



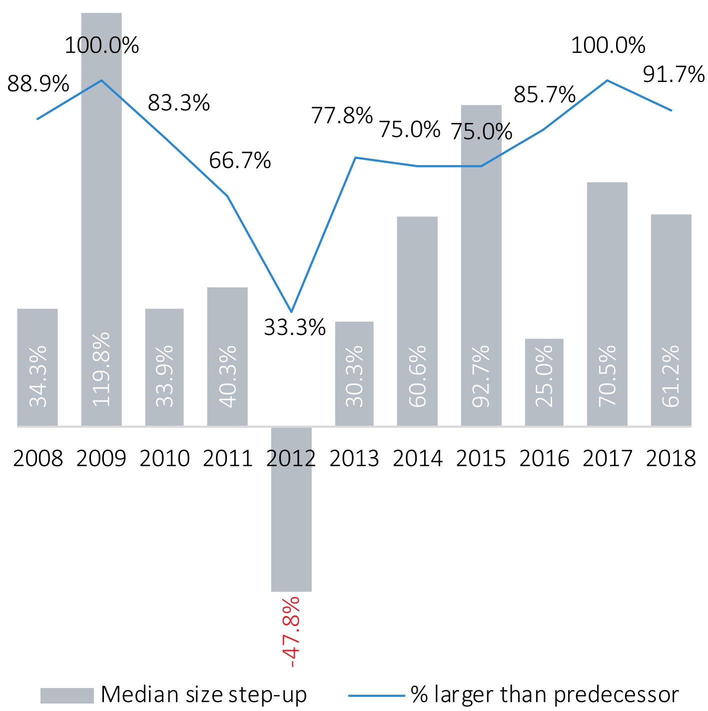
Source: PitchBook

North American and European secondaries capital overhang ($B)



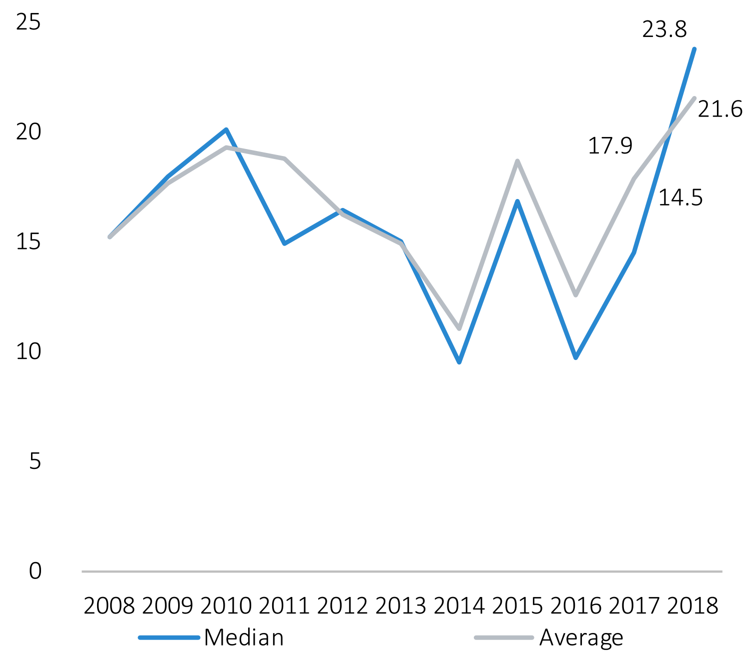
Source: PitchBook
*As of June 30, 2018

Change in North American and European secondaries fund sizes



Source: PitchBook

Median and average time (months) to close North American and European secondaries funds



Source: PitchBook

Don't see the data you need?

Download the accompanying Excel pack for all underlying data and additional charts not included in this report.