PitchBook

PE Mega-Fund Strategy Overview: Part 1

An overview of fundraising and fund families for $5 billion+ vehicles

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Note: The geography of this note is limited to North America and Europe.

Key takeaways

- Mega-funds ($5 billion+) are a growing force within PE fundraising, reaping an ever-growing portion of capital raised. This handful of funds accounted for 45.3% of capital raised in North America between 2016 and 2018 and 42.2% in Europe over the same timeframe. There are currently at least 19 open or upcoming mega-funds seeking north of $185 billion, potentially propelling 2019 to record-setting figures.

- While many of the household name firms have multiple strategies with mega-funds, the types of GPs raising these funds are changing, as is the nature of the underlying fund strategies. More niche vehicles—GP stakes and technology funds, for example—are growing into the mega-fund category, and many of the generalist buyout funds are coming from less diversified GPs, offering just a couple of distinct strategies rather than the multitude offered by household names.

- The stratospheric rise in mega-fund sizes may be finding a ceiling. There seems to be a soft cap around the $20 billion to $25 billion mark as Blackstone is seeking $20 billion for its upcoming fund, just $1.1 billion more than its previous fund. To grow capital further, the largest GPs may further expand strategy offerings and seek larger step-ups in secondary and tertiary offerings.

- Managers are achieving mega-fund status more quickly as successful managers are aggressively stepping up fund sizes, forcing LPs to consider allocating to the rising star managers of today to secure allocations with the mega-fund managers of tomorrow.

Published on March 11, 2019

Overview

Fund sizes have been on the rise for years, with the average PE fund surpassing $1 billion for the first time. During this growth in fund size, the most sizable funds—or mega-funds ($5 billion+) as they are known—have cemented their status as the most influential group of funds in the industry due to the sum of capital they control. These funds can deploy billion-dollar-plus equity checks and account for a mounting portion of capital raised. The unbated growth in mega-funds is yet to curtail, driven by the desire of the largest GPs to garner significant assets and to meet swelling LP target allocations.

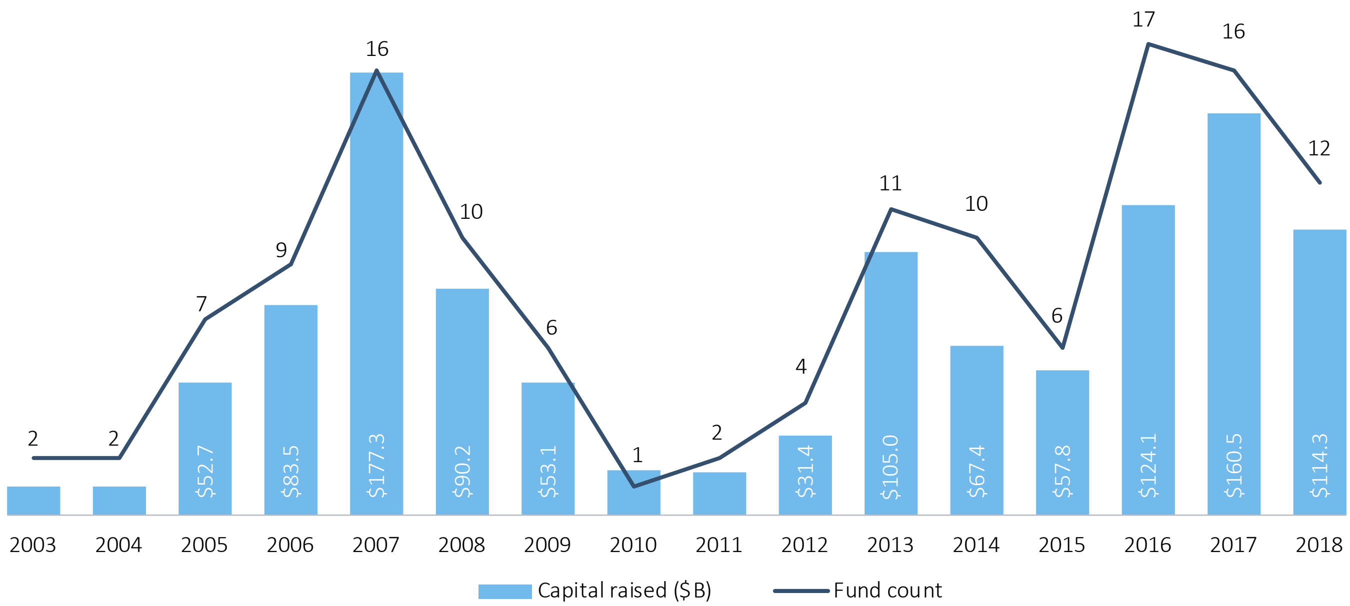
Just who are these managers? While Blackstone is the most prolific mega-fund manager, there are over a dozen more GPs that have closed on multiple mega-funds. However, with thousands of active GPs and trillions of dollars in AUM, this is still rarified air. A select list of these managers is available in the appendix.

PE mega-funds ($B) by close year and size

Source: PitchBook

Conventional investing wisdom has led many to believe size eventually hinders performance. In public markets, size can impede active managers' ability to quickly capitalize on dislocations in market pricing and deploy large sums of capital, negatively affecting returns. In PE, however, the largest GPs are now touting size as an asset, arguing that it opens up opportunities for deals with less competition as middle-market strategies become more crowded. On its 2018 4Q earnings call, Blackstone's Jon Gray indicated that "scale continues to be [Blackstone's] competitive advantage." The size of mega-funds can be advantageous for many large LPs as well. They find these funds convenient for meeting private market allocation targets while keeping the count of GP relationships (and subsequent due diligence costs) limited. Additionally, many of these managers offer an array of strategies, acting as a one-stop shop for LPs looking to invest in multiple private market strategies.

PE mega-fund fundraising activity



Source: PitchBook

Activity in the space shows that LPs are buying into this line of thinking. 12 mega-funds closed in 2018 (of the 263 total PE funds closed) raising $114.3 billion (of the $269.0 billion raised by all PE firms). Although 2018's numbers may seem impressive, it is a marked slowdown from 2017—which saw mega-funds raise the most capital ($160.5 billion) since the financial crisis ($177.3 billion). Even though no year has surpassed the sum of capital raised by mega-funds in 2007, the industry is not turning away from these funds. In fact, much of the difference is due to the inherent lumpiness of fundraising data, especially among the $5 billion+ funds space. When looking at a rolling three-year period, 2016-2018 accounted for $398.9 billion, surpassing the $351.0 billion raised by mega-funds from 2006-2008. Consequently, with at least 19 open mega-funds seeking to raise over $185 billion, future fundraising figures will likely be robust.

Select open and upcoming PE mega-funds

Investor name	Fund name	Target size ($B)	Country
Blackstone	Blackstone Capital Partners VIII	$20.0	USA
Vista Equity Partners	Vista Equity Partners Fund VII	$16.0	USA
Advent International	Advent Global Private Equity IX	$15.0	USA
TPG Capital	TPG Partners VIII	$14.0	USA
Warburg Pincus	Warburg Pincus Global Growth	$13.5	USA
Apax Partners	Apax X	$10.0	UK
BlackRock	Long Term Private Capital	$10.0	USA
Leonard Green & Partners	Green Equity Investors VIII	$10.0	USA
Cinven	Seventh Cinven Fund	$9.3	UK
BDT Capital Partners	BDT Capital Partners Fund II	$9.0	USA
Platinum Equity	Platinum Equity Capital Partners V	$8.0**	USA
The Carlyle Group	Carlyle Europe Partners V	$8.0	USA
HPS Investment Partners	HPS Mezzanine Partners IV	$8.0	USA
Dyal Capital Partners	Dyal Capital Partners IV	$7.0	USA
Permira	Permira VII	$5.8	Germany
Partners Group	Partners Group Direct Equity 2019	$5.8	Switzerland
KKR	KKR European Fund V	$5.8	USA
JAB Holdings	JAB Consumer Fund	$5.8	Luxembourg
Bain Capital	Bain Capital Europe Fund V	$5.1	UK

Source: PitchBook
*As of February 8, 2019
**Seeking $6.5B-$8.0B

The state of the mega-fund environment is healthy, though there is a bifurcation of managers. Some of the managers raising mega-funds—such as Blackstone, Bain, and KKR, among others—tend to skew toward being diversified generalists; however, a new crop of less diversified GPs—such as tech-focused PE firms or managers with just one or two buyout strategies—are raising mega-funds.

Silver Lake Management closed on a $15.0 billion fund in 2017; in January 2019, Thoma Bravo closed on its $12.6 billion fund, and Vista Equity Partners is fundraising for a $16.0 billion vehicle. All three of these tech-focused shops—each of which have raised at least two mega-funds—are making waves with $10 billion+ funds. These GPs are remaining focused while slowly expanding into complementary offerings. In a recent example, Thoma Bravo raised a second fund in its Discover fund family, which targets middle-market deals. Similarly, Vista Equity Partners created its Endeavor fund family, which pursues investments too small for the flagship fund after closing on its first mega-fund. This is likely the beginning of the trend, and we expect to see more tech-focused funds raise capital in the coming years considering technology produced the second-highest returns of any sector between 2009 and 2015.[1] Additionally, the capital-light business model often has high rates of recurring revenue and organic growth, attractive traits to GPs.

Another specialty area has been GP stakes, where prolific GP Dyal is fundraising for the strategy's second mega-fund. (Dyal closed the first GP stakes mega-fund in 2016.) While we believe there will always be a demand for the generalist mega-buyout funds, we think more niche strategies will be vaulted into mega-fund status as LPs look to commit capital to strategies that have differentiated risk/return profiles and growth drivers.

What do we mean by fund families?

A fund family is a series of funds offered by a GP with the same strategy in the same geography. For example, Ardian has a flagship secondaries strategy, all the funds of which fall into a single fund family—Ardian Secondary Fund V, Fund VI, Fund VII, etc. Now Ardian is looking to raise a mature secondaries fund. Since this fund has a separate objective than its generalist secondaries fund, it will constitute a new fund family. These fund families also account for naming changes. Ardian was spun out of AXA, and the older buyout funds are monikered "AXA LBO Fund." The newer LBO funds carry on the lineage, even though the family name shifted to "Ardian LBO Fund." We use these fund families to calculate step-ups and performance persistence, among other metrics, by comparing apples to apples.

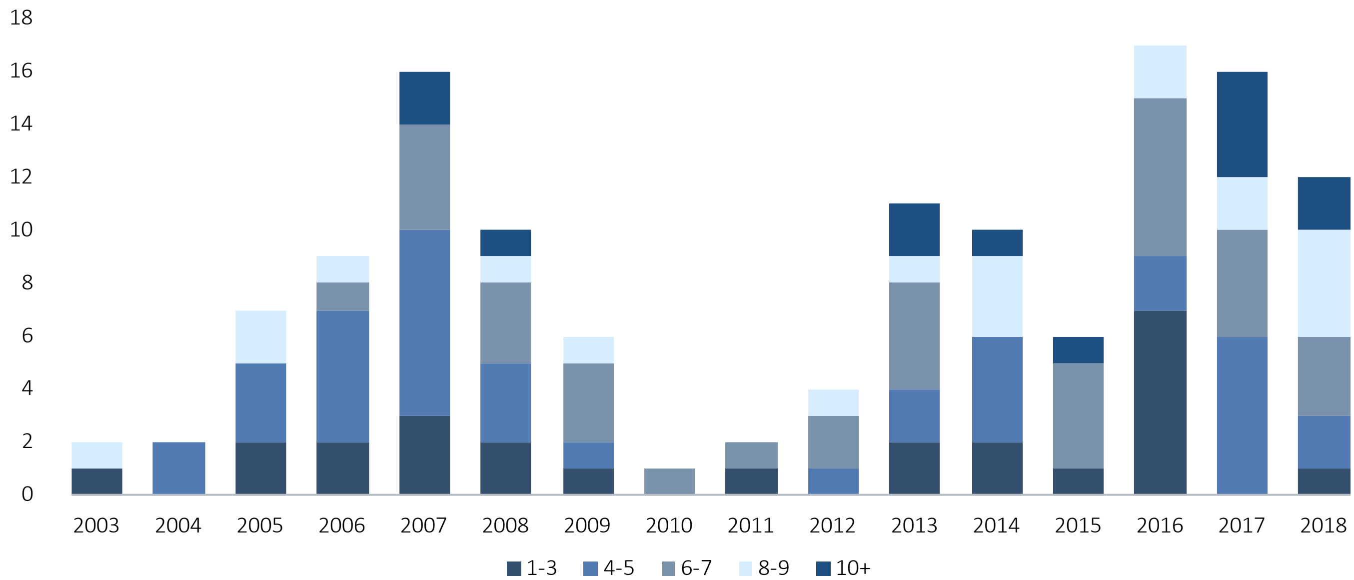
A look at fund families

Both new and established managers have been elevating fund families to mega-fund status more quickly. The Blackstones and KKRs of the world, with dozens of fund families already, only continue to grow and offer more, spanning multiple strategies including buyout, long-term, growth, and more. When a large, diversified manager such as The Carlyle Group raises capital for a new strategy, the premiere fund can be above the billion-dollar mark and, in just two or three funds, the strategy may crest the $5 billion mark. We believe this will allow fund families of established GPs to meet the mega-fund threshold more quickly. A twist on an old phrase sums up the thinking: "Nobody ever got fired for allocating to Blackstone."

Regardless of the GP's path to mega-fund status, closing a vehicle of that size is a strong signal that the firm is perceived favorably by investors. As such, once a GP climbs to mega-fund status, we observe a proliferation in its number of fund families—PE and other—between a GP's first, second, and third-plus mega-fund raised as managers look to capitalize on the market's confidence. GPs, on average, add one new fund family between their first and third mega-funds.

1: "Global Private Equity Report 2019," Bain & Company, 2019

PE mega-funds (#) by order in fund family



Source: PitchBook

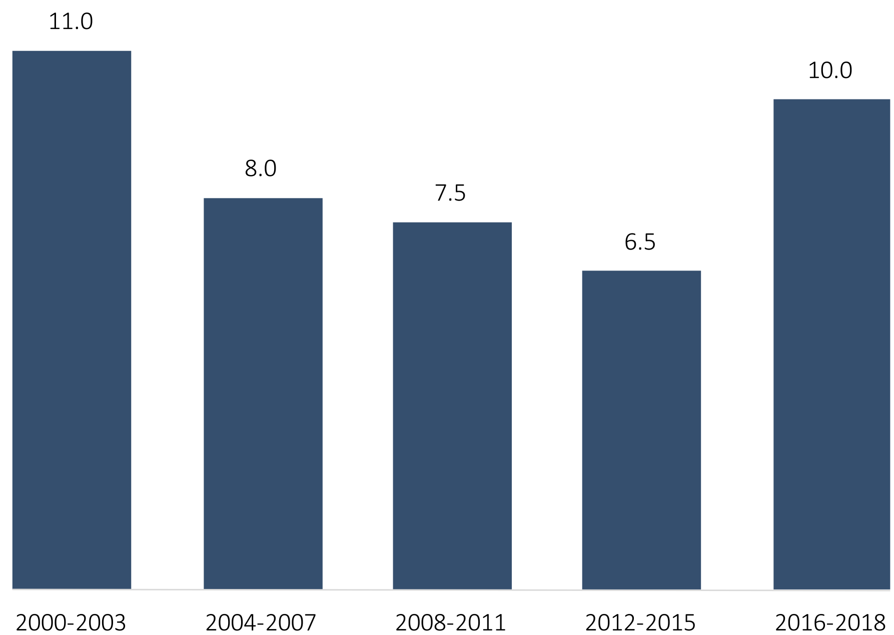
First-time mega-funds

Older GPs often took upward of 10 fundraises before achieving mega-fund status. Newer GPs, though, are achieving mega-fund status more swiftly, except within the most recent year bucket—which is inflated due to several established managers with dozens of closed funds raising an initial mega-fund. This is unlikely to signal a break in trend, and we expect GPs to achieve mega-fund status around their sixth fund, or sooner, going forward.

Newer managers are also raising larger first-time funds. A recent example of this is a new fund started by Alexander Navab—the former head of KKR's Americas PE business—rumored to be seeking $4 billion in its inaugural fund. This would make the leap to mega-fund status by just the second fund an easy task if performance is adequate. Furthermore, a competitive fundraising environment is allowing GPs to aggressively target steep step-ups between funds.

Even with a resurgence of first-time mega-funds, recent years have seen existing mega-fund families account for most of the fundraising activity. Between 2016 and 2018, existing mega-fund families accounted for 60.0% of mega-funds closed and 71.7% of mega-fund capital raised. For example, Blackstone's Capital Partners fund family has raised four mega-funds dating back to 2003 and will begin fundraising for its fifth mega-fund in the fund

Median PE funds (#) closed before GP's first mega-fund



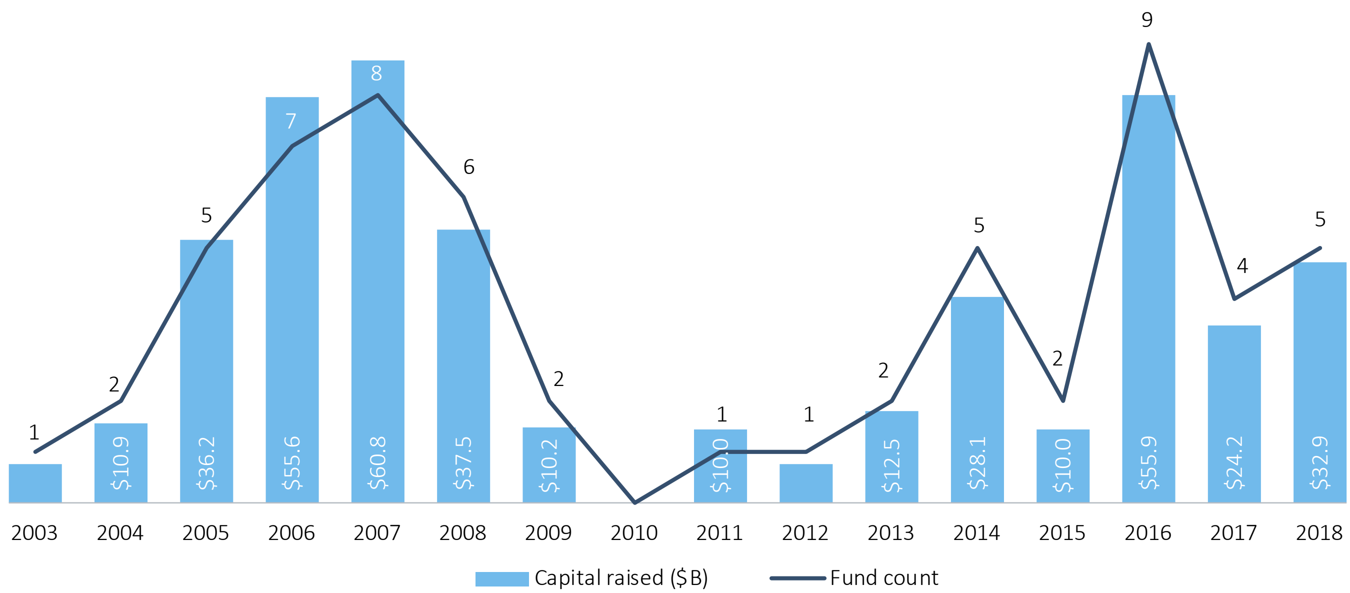
Source: PitchBook

family in 2019. While there are some fund families raising initial mega-funds, it will likely take even more time for the industry to eclipse the level of activity seen in the pre-crisis years.

The past three years (2016-2018) have seen the most first-time mega-fund fundraising since the crisis. GPs have raised $113.0 billion across 18 mega-funds that were the first in their fund family. 16 of those vehicles represented the GP's first fund family to achieve mega-fund status. One of those premier mega-fund families came from Insight Venture Partners; its $6.3 billion growth fund, Insight Venture Partners X, closed in 2018. This landmark closing marked the first time a growth equity fund closed above $5 billion.

Many of the largest, PE-focused GPs—especially tech-focused firms—regularly invest in late-stage VC rounds and growth rounds. We expect more of this activity going forward and for these firms to split out these investments into growth funds, separate from their buyout offerings, as a means to expand strategy offerings. It is highly likely a growth fund from KKR, Vista Equity Partners, or Silverlake would eclipse the mega-fund mark. Additionally, Blackstone is getting into the growth equity investing business, seeking to build out the strategy in 2019 before bringing a fund to the public—

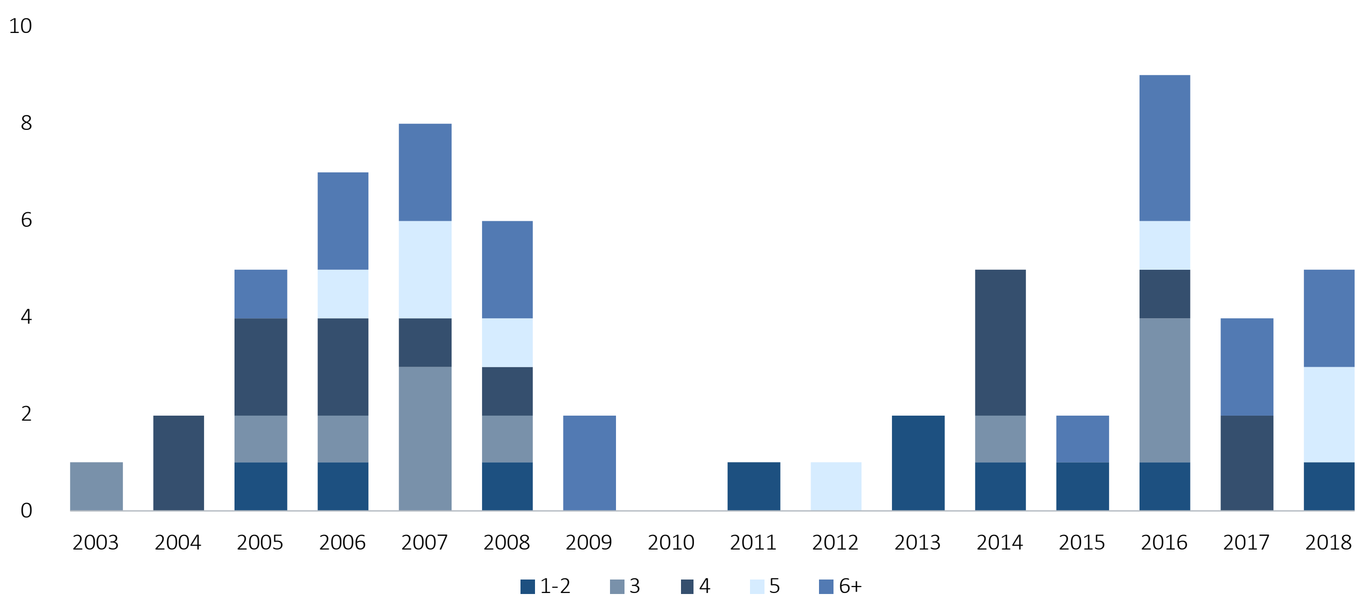
Fundraising activity for first PE mega-funds in fund family



Source: PitchBook

which will probably seek north of $5 billion. On the 4Q 2018 earnings call, Blackstone chairman and co-founder Steve Schwarzman highlighted the unit saying, “A few weeks ago, we proudly announced the launch of our dedicated Growth Equity platform, which will provide capital to companies during the phase between venture funding and traditional buyouts.”[2]

Order in PE fund family of fund family’s first mega-fund (#)



Source: PitchBook

2: “BlackStone Fourth Quarter and Full Year 2018 Earnings Investor Call,” BlackStone, January 31, 2019

Looking forward to the mega-fund families of tomorrow, there are seven fund families we believe could raise a first-time mega-fund for their next fundraise. Most managers primed to raise their first mega-fund, such as Veritas Capital and Madison Dearborn Partners, only have one fund family. Of those GPs with fund families we believe could raise a premiere mega-fund, only CVC Capital Partners already has a mega-fund fund family. CVC now offers a strategic opportunities fund in addition to its flagship buyout fund family. As these more nascent managers raise larger funds, we believe they will branch out and begin offering complementary strategies to grow the management business, diversify income streams, and retain top talent.

Potential upcoming first PE mega-funds in fund family

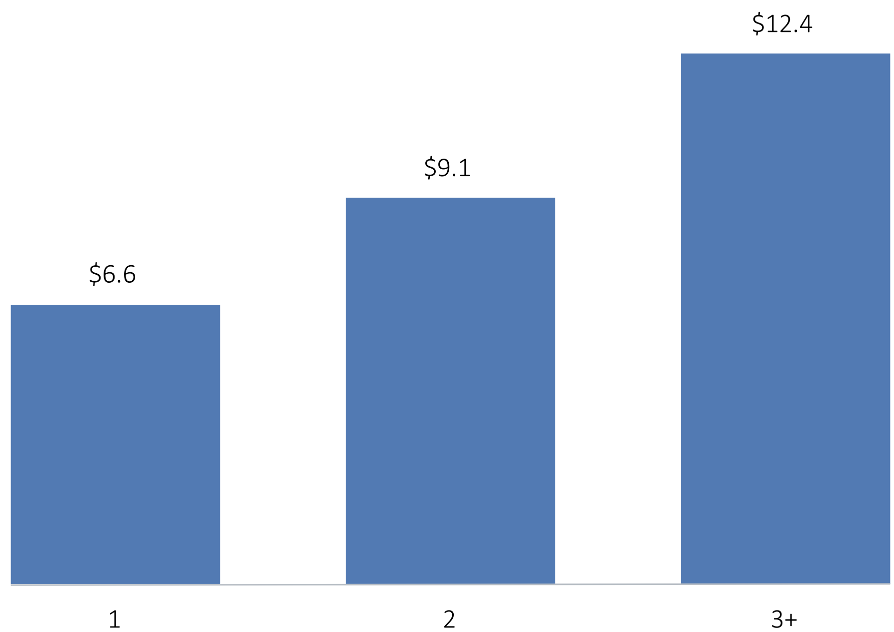
Investor name	Fund family	Previous fund size ($B)	Previous fund vintage	Country
Madison Dearborn Partners	MDP Capital Partners	$4.4	2015	USA
Bridgepoint Advisers	Bridgepoint Advisers Europe	$4.3	2015	UK
CVC Capital Partners	Strategic opportunities	$4.4	2016	UK
Francisco Partners	Francisco Partners	$4.0	2017	USA
Veritas Capital	Veritas Capital Fund	$3.6	2017	USA
Equistone Partners Europe	Equistone Partners Europe Fund	$3.5	2017	UK
Clearlake Capital Group	Clearlake Capital Partners	$3.6	2018	USA

Source: PitchBook

How big is too big?

The question of whether mega-funds have grown too large to efficiently deploy capital and achieve competitive returns seemed to be unanswerable until recently. For many years, it appeared no buyout fund was "too big," and we have seen clear step-ups in average fund size between fund families' first ($6.6 billion), second ($9.1 billion), and third-plus ($12.4 billion) mega-funds. However, after Apollo closed on its 2017 vintage buyout fund at $24.7 billion, many in the industry saw this as a sort of ceiling on buyout fund size. Blackstone—the firm that has raised the most mega-fund capital—is raising a $20 billion buyout fund, just $1.1 billion (5.8%) larger than its $18.9 billion predecessor fund in 2016. The 2016 fund originally sought $17.5 billion, closing oversubscribed. Additionally, Blackstone closed on a $17.5 billion buyout fund in 2011 and a $21.7 billion buyout fund in 2006. This miniscule step-up amount may signal that Blackstone believes $20 billion to be the soft ceiling for buyout funds, at least for the time being. Real estate may have a similar ceiling. In fact, Blackstone is nearing a close on a $20 billion real estate fund—the largest ever. Infrastructure, though, may have a higher ceiling due to the gargantuan deal sizes and equity checks needed in energy infrastructure, airports, toll roads, and more. Blackstone is currently seeking $40 billion for an infrastructure fund, though the fundraising challenges for this vehicle have been quite public.

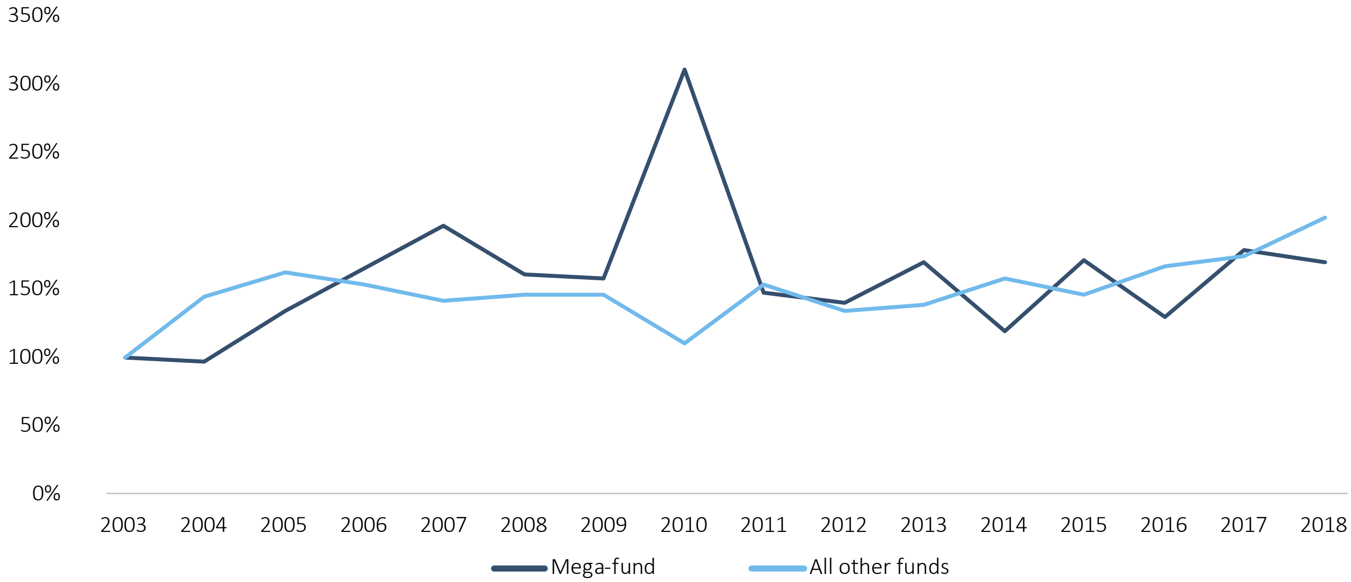
Average mega-fund size ($B) by order in fund family



Source: PitchBook

Fund sizes have been rising at approximately the same rate for smaller funds and mega-funds over the past 15 years, with mega-funds growing at a 3.6% CAGR during that timeframe and non-mega-funds growing at 4.5% during the same time. There is a high degree of volatility in the data since so few mega-funds close. Looking at the data just one year ago would lead one to believe the average mega-fund size was growing faster. Overall, the trend has been growth for both segments of the market. It will be more difficult, however, for the average mega-fund size to keep up with the smaller funds because of the potential $20 billion soft cap on fund sizes and because more than half of all open or upcoming mega-funds are seeking less than $10 billion.

Average PE fund size growth



Source: PitchBook

Advantages and disadvantages for LPs and GPs

Performance

Allocating to mega-funds holds certain advantages and disadvantages of which LPs and GPs ought to be aware. On the disadvantage side, there is less ability for mega-funds to significantly outperform smaller funds and public markets. PitchBook research on the topic shows that the distribution of performance for the largest fund group is leptokurtic, meaning fewer funds showed significant levels of outperformance or underperformance. Furthermore, smaller deals—which tend to transact at lower multiples and carry higher potential for appreciation—are less able to move the performance needle for such a large fund, forcing its managers to go after larger deals, often at higher multiples. GPs may also have to more accurately mark investments to market. The larger investments in mega-funds likely mirror a cohort of public companies—due to similar company sizes and the high proportion of public holdings in many mega-funds—and volatility in public marks may show up more quickly than smaller funds holding assets that are more difficult to mark to market. One counterpoint to this argument is that smaller funds are less apt to mark to market than mega-funds, which artificially decreases volatility in the underlying investments, failing to mirror reality.

Skin in the game

Another disadvantage may arise from the amount of "skin in the game" GPs raising mega-funds are able to put up. A GP must invest at least 1% into a fund to attain LP status, though most GPs choose to invest more. For GPs of smaller funds, a 3% commitment—approximately average for GPs in PE—is reasonable. For a $20 billion fund, however, that 3% commitment becomes $600 million, an amount nearly impossible to fund by anyone but the founders. This issue paired with the LPs' desire to align performance incentives with GPs (LPs wanting GPs to invest significant sums of capital alongside them) has driven many GPs to sell stakes in the management company (GP stakes) to investors to fund GP allocations.

Deal pricing

Mega-funds do have several advantages, though, including the ability to close on multi-billion-dollar buyouts that have fewer competitive bids due to sheer size. There is an increased likelihood for rational pricing amid lower levels of competition. This is seen in lower return dispersion, making performance forecasting easier for large pensions and endowments.

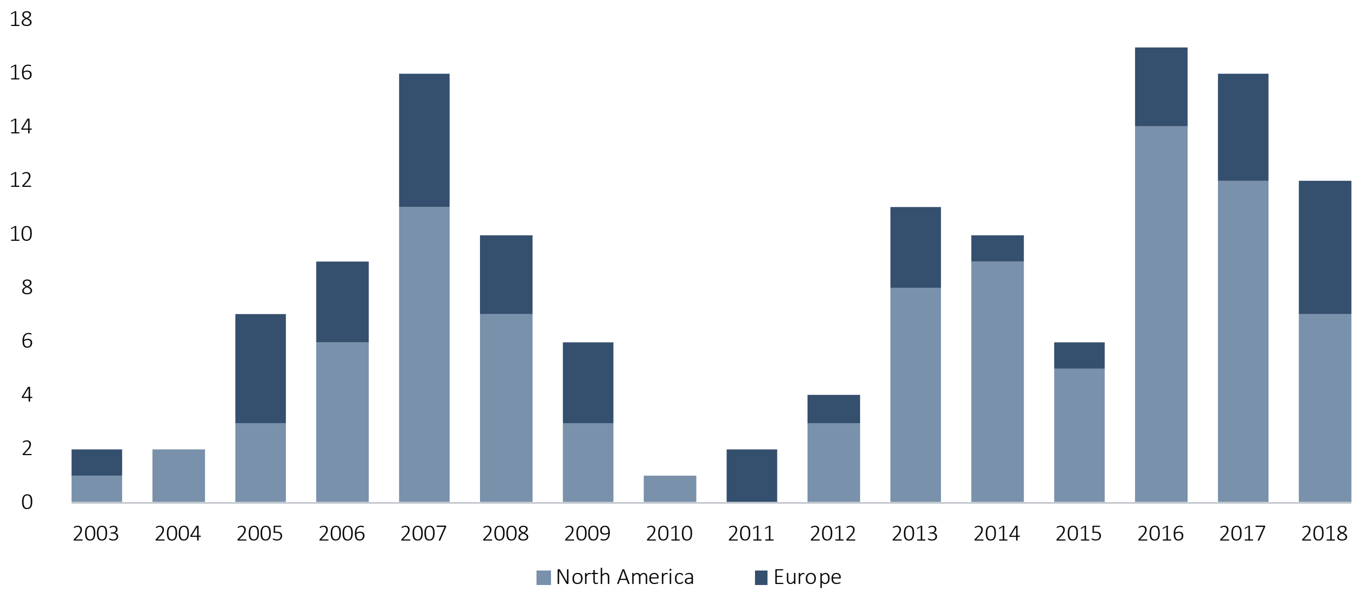
Fees and ease

Fees can be another advantage. Mega-funds often charge a 1.5% management fee, opposed to the 2% that most smaller funds charge, because a 1.5% fee is more than enough to "keep the lights on" and cover basic legal, staffing, and other expenses. This also gives LPs writing massive checks the ability to negotiate fees more aggressively. However, GPs with mega-funds have firepower to push back on these negotiations. With name brands and proven track records, these funds are usually a hot commodity. For most mega-funds, more LPs are vying for an allocation than the fund can handle, which means if one LP backs out, others will be more than willing to write a check. Another advantage for LPs is the institutionalization of mega-fund managers. Typically, by the time managers raise a mega-fund, they have raised several previous funds and likely can work with LPs more easily, equipped with reporting and investor relations teams with experience serving LPs.

Regional breakout

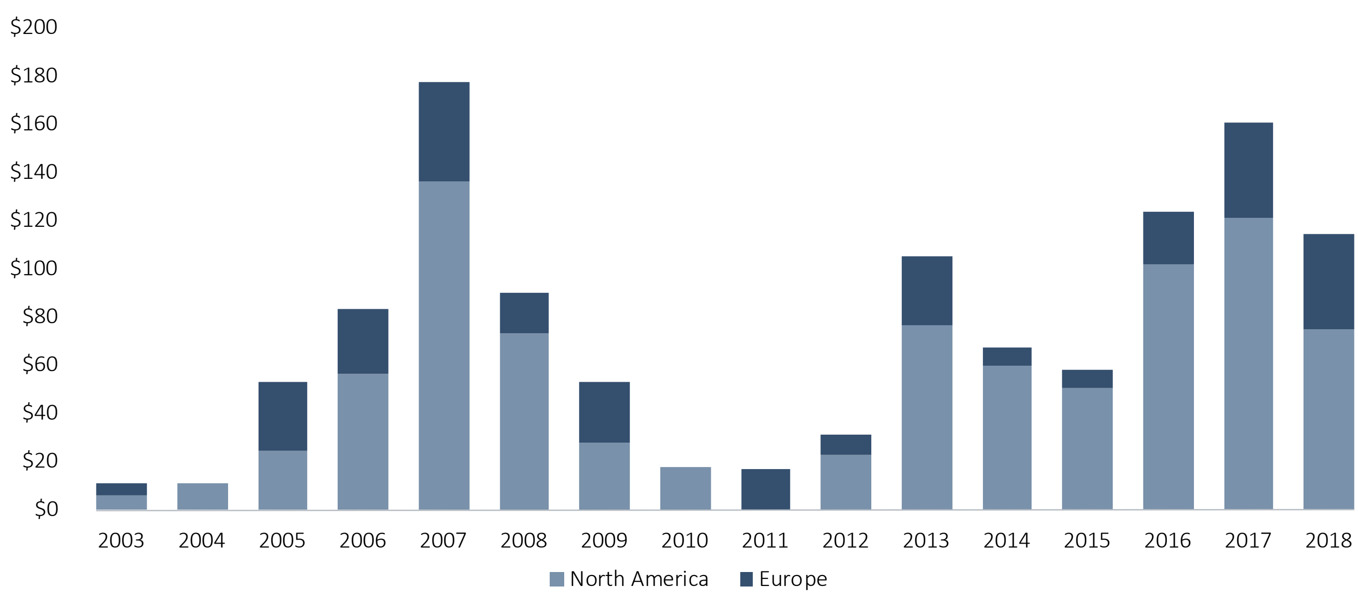
Just as the types of GPs raising mega-funds are shifting, the regional makeup of these funds is as well. For many years, US GPs were raising the largest funds while European GPs could only muster funds a fraction of the size. Now Europe-headquartered GPs are flexing their fundraising muscles and proving there is sufficient demand for mega-funds on the continent as well. This

PE mega-funds (#) by region



Source: PitchBook

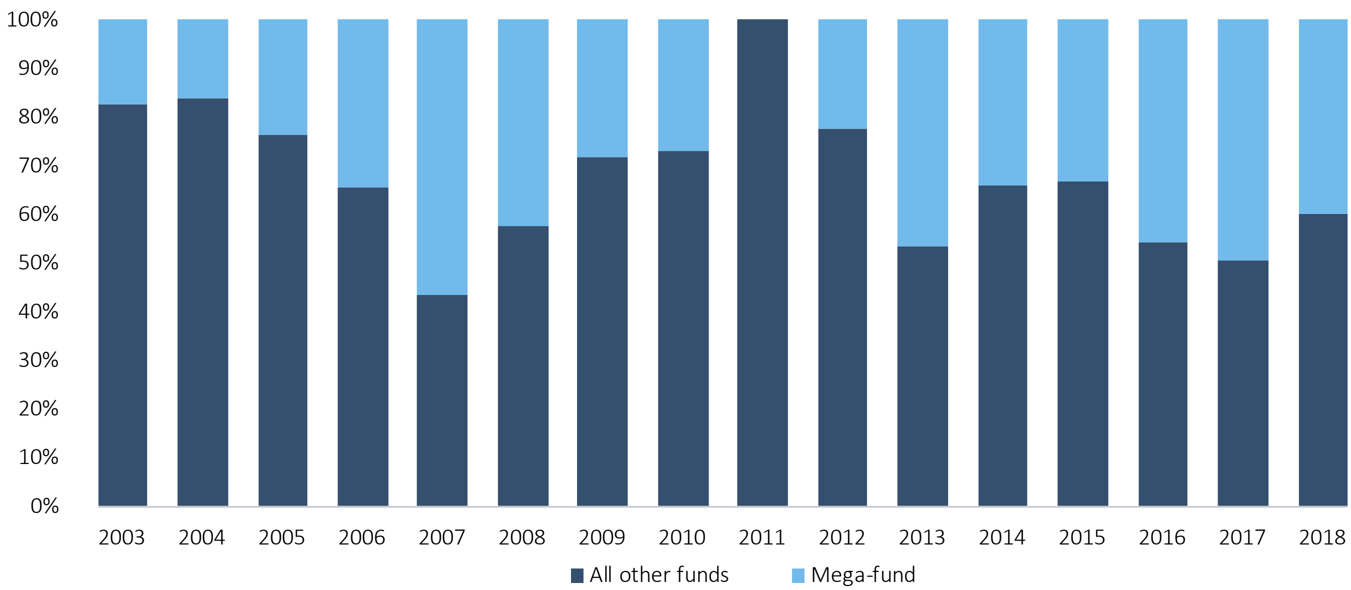
PE mega-funds ($B) by region



Source: PitchBook

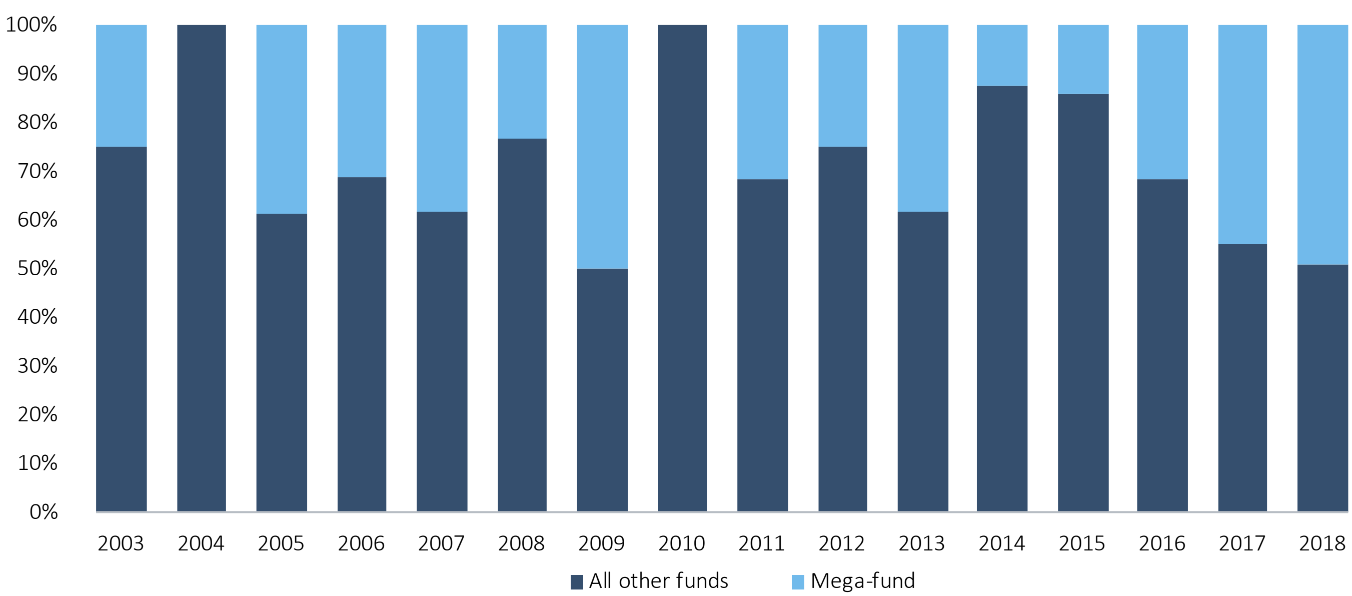
trend was especially apparent in 2018 when European mega-funds made up the highest proportion of European capital raised since 2009 while North American mega-funds made up a lower proportion than in 2016 and 2017. We believe the decline for North American fundraising is a blip in an otherwise steady trend. However, the European figures are likely indicative of future results, though 2018's high bar will make for a tough comparison.

PE mega-funds ($) as proportion of overall North American fundraising



Source: PitchBook

PE mega-funds ($) as proportion of overall European fundraising



Source: PitchBook

Fund-of-funds lifeline?

While we have looked at differences between mega-funds and smaller funds as well as changes throughout time, it is worth detailing the LPs investing in mega-funds. LPs allocating to mega-funds tend to be the largest and most sophisticated. These LPs have a rich history of private market allocation and maintain relationships with multiple GPs.

On the other hand, the elite GPs are often highly sought after, which can result in the largest funds being the most oversubscribed. Typically, LPs lacking a history with a GP raising a mega-fund cannot simply write a check, even if they have the capital. The ability to grant access to oversubscribed mega-funds is one of the main selling points for FoFs and may be their saving grace. FoF managers maintain relationships with the largest, most prominent GPs over many years, often making FoFs the only access point for many LPs to these $5 billion+ vehicles. This is welcome news in an industry in which capital raised is down by 75% compared to just over a decade ago.

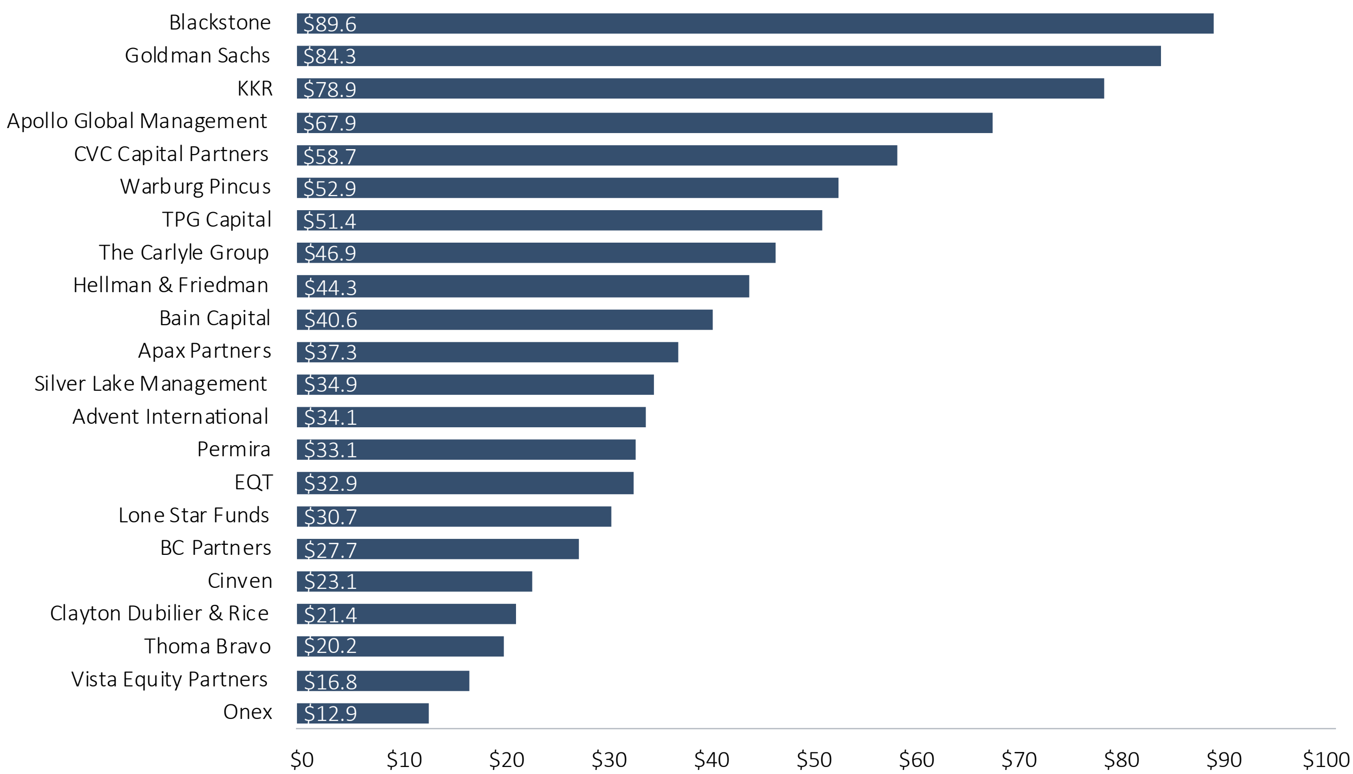
For LPs seeking to allocate large checks to mega-funds in the future, the best bet may be to commit to the rising stars of today in expectation of future mega-fund raises or to capitulate and invest via an FoF. Many LPs are likely to reap rewards by allocating to emerging managers, though it carries elevated risk. Successful relationships with GPs can often last decades across many funds in a family. It is important for LPs to plan for future allocations—as well as current needs—or run the risk of being unable to directly contribute to the mega-funds of the future.

Further considerations

In coming follow-on notes covering mega-funds, we will explore mega-fund terms and fees, cash flow metrics, performance, and more as we dive deeper into what makes these funds unique and cover everything LPs need to know when allocating capital. Additionally, the scope of this note—limited to North America and Europe—will likely expand to Asia in a future iteration. Firms such as KKR and Carlyle are pushing into Asia with multiple closed mega-funds to date, and a new crop of GPs in Asia capable of raising mega-funds is emerging.

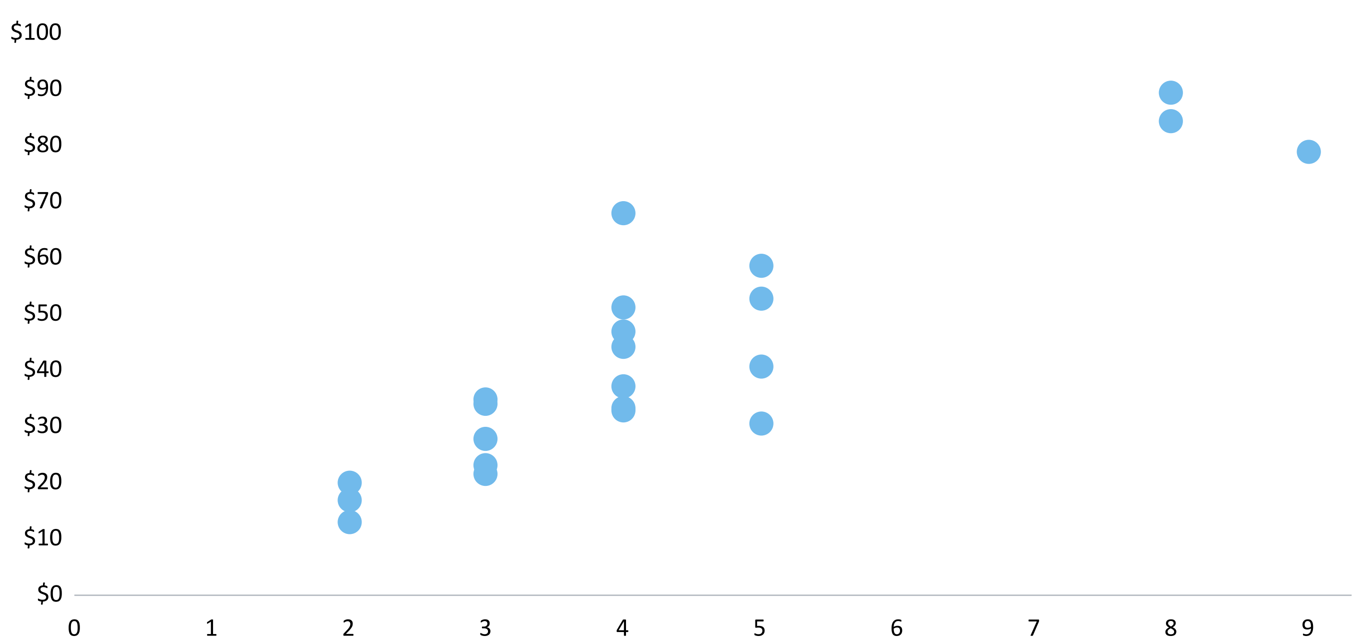
Appendix

PE aggregate capital raised in mega-funds ($B) by GP



Source: PitchBook
*As of February 8, 2019

PE mega-funds (#) and capital raised ($B) by GP



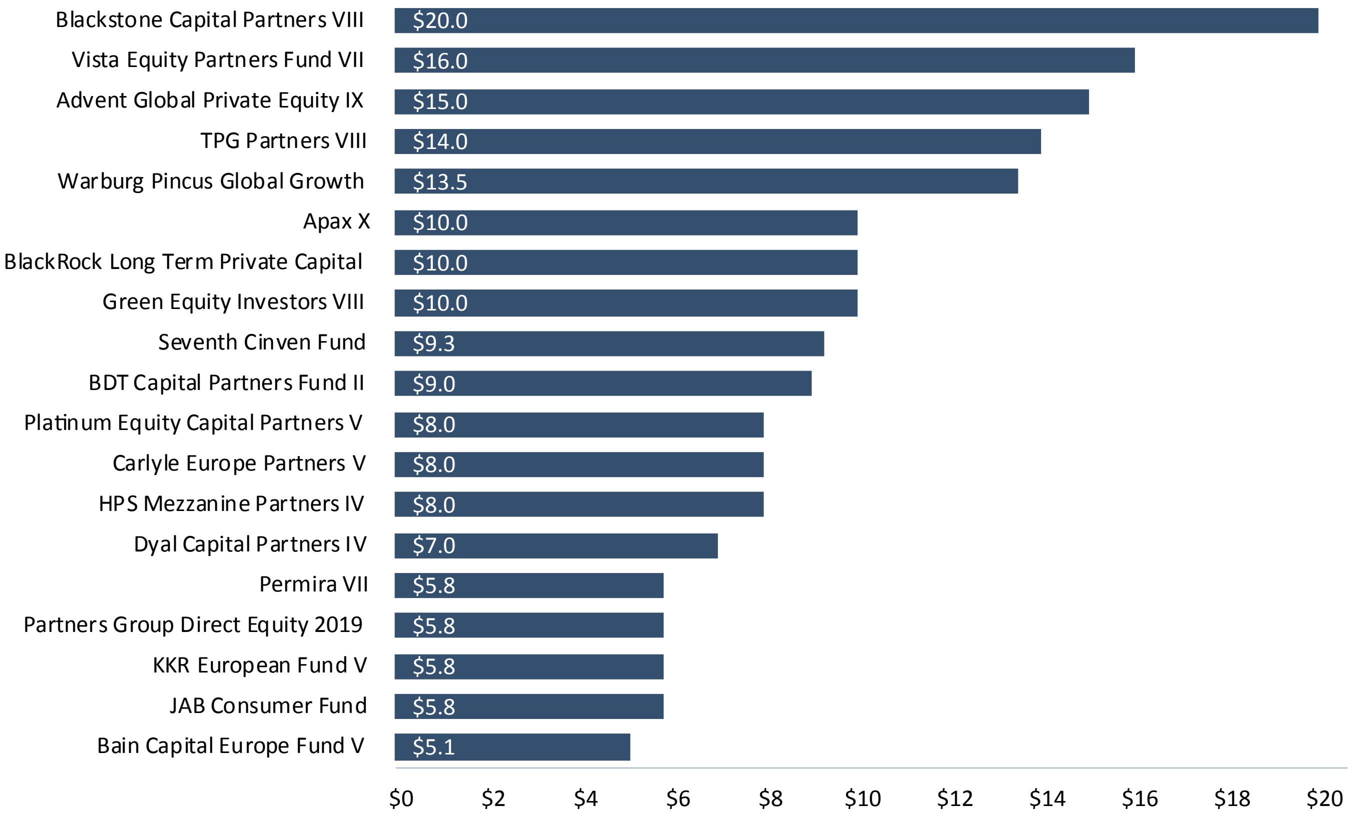
Source: PitchBook
*As of February 8, 2019

Select GPs with multiple PE mega-fund closes

Investor name	Closed mega-funds	Capital raised ($B)	Open or upcoming mega-funds	Country	Mega-fund families
Blackstone	8	$89.6	1	USA	3
Goldman Sachs	8	$84.3	0	USA	2
KKR	9	$78.9	1	USA	2
Apollo Global Management	4	$67.9	0	USA	1
CVC Capital Partners	5	$58.7	0	UK	1
Warburg Pincus	5	$52.9	1	USA	1
TPG Capital	4	$51.4	1	USA	1
The Carlyle Group	4	$46.9	1	USA	2
Hellman & Friedman	4	$44.3	0	USA	1
Bain Capital	5	$40.6	1	USA	2
Apax Partners	4	$37.3	1	UK	1
Silver Lake Management	3	$34.9	0	USA	1
Advent International	3	$34.1	1	USA	1
Permira	4	$33.1	1	Germany	1
EQT	4	$32.9	0	Sweden	1
Lone Star Funds	5	$30.7	0	USA	1
BC Partners	3	$27.7	0	UK	1
Cinven	3	$23.1	1	UK	1
Clayton Dubilier & Rice	3	$21.4	0	USA	1
Thoma Bravo	2	$20.2	0	USA	1
Vista Equity Partners	2	$16.8	1	USA	1
Onex	2	$12.9	0	Canada	1

Source: PitchBook
*As of February 8, 2019

Select open and upcoming PE mega-funds ($B)



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