PitchBook

PE Firm Flagship Funds—Public Versus Private

Comparing fund tactics and performance for select private and public PE firms

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Key takeaways

- The four largest US-based public PE firms have been seeking steeper step-ups for their flagship buyout funds than their privately held peers, appearing to show more aggressive fundraising tactics after going public.
- While nearly all PE firms delayed fundraising efforts following the financial crisis, these public PE firms were less hesitant than their privately held peers to resume normal activity levels. The public GPs we selected for our sample set pushed back fundraises by less than a year in the period following the crisis compared to the private GPs in our sample, which delayed fundraises by nearly two years.
- The cohort of public PE firms outperforms their private peers when using IRR and shows borderline outperformance when using PME, while TVPI growth is marginally superior for the private firms. The pressures of being a public company with outside investors do not seem to affect fund performance negatively; relative performance is consistent before and after these firms listed publicly.

Methodology note: *Due to SEC regulations, we are unable to publish fund performance data for certain GPs. We instead pooled cash flows for each cohort and drew comparisons from this.*

Public cohort		Private cohort
Firm name	**IPO date**	**Firm name**
Apollo Global Management	March 29, 2011	Advent International
Blackstone	June 22, 2007	Bain Capital
The Carlyle Group	May 3, 2012	TPG Capital
KKR	July 15, 2010*	Warburg Pincus

**This is the date listed on NYSE. It had been listed on the Euronext Amsterdam since October 1, 2009.*

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Introduction

Public shareholders generally have difficulty valuing the complex, variable cash flows that public PE firms earn, preferring the repetitive nature of management fees. Public PE firm managers claim their firms are perpetually undervalued as a result. Additionally, public companies are often incentivized to "maximize short-term returns at the expense of long-term growth," according to BlackRock CEO, Larry Fink.[1] We wondered if PE firms were pressured to boost profits in the near term and emphasize management fees after going public. To help determine this, we decided to examine the flagship funds and performance of Apollo Global Management (NYSE: APO), Blackstone (NYSE: BX), The Carlyle Group (NASDAQ: CG), and KKR (NYSE: KKR), compared to a cohort of similar, privately held peers.

Absolute performance for PE funds has trended downward for over a decade, making performance fees (carried interest) more difficult to earn. As such, GPs are incentivized to garner inordinate sums of capital, thereby growing the fee base. Management fees, unlike carry, are recurring and predictable, which public investors value more highly. It can be difficult to disentangle all the factors at play, however. While share price is not typically the primary factor in GP decision makers' pay—which is instead primarily comprised of salary and bonuses from carry and management fees—share price does seem to be gaining importance for the publics. Blackstone and Apollo's recent transitions into the C-Corp structure are an example of this. To establish a baseline, we compared these four public PE firms against four private PE firms with similar flagship fund sizes: Advent International, Bain Capital, TPG Capital, and Warburg Pincus.[2]

Fund sizes

The first metric we reviewed was the average flagship fund size for the public and private cohorts in five timeframes. From 1997–2000, the public GPs—which were private at the time—raised funds 56.4% larger than the private GPs did, though this gap dropped to just 18.3% in the time leading up to the financial crisis, 2006-2008. This is when the four public GPs began listing, with Blackstone going public in 2007. By 2012, Apollo, KKR, and Carlyle had gone public as well. This is also when the gap in fund size began to widen again, swelling to a 46.9% gap in 2011-2014 and then further expanding to a 63.3% spread in the most recent

1: "Larry Fink's 2019 Letter to CEOs: Purpose & Profit," BlackRock, 2019
2: TPG has received an outside investment (GP stakes), but these investors are perceived to think longer term than public market investors and better understand the variable cash flows.

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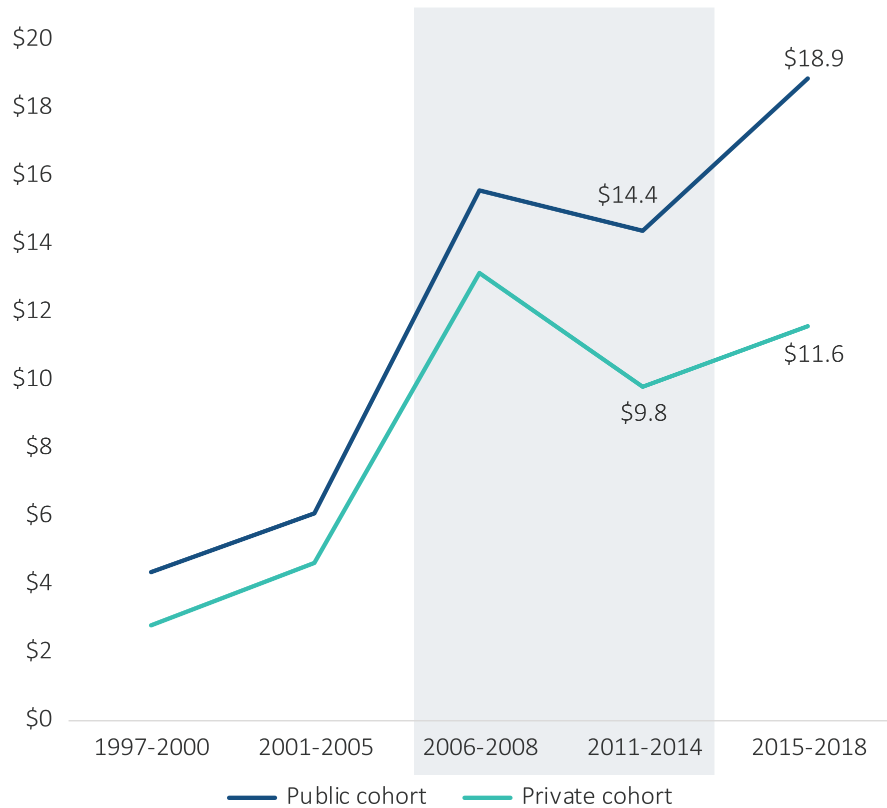
timeframe. This data shows that the public cohort has been more assertive in pursuing steep step-ups between funds after going public, which could lead to higher management fees and potentially higher carry.

The average flagship fund size for the public cohort now eclipses the figures they achieved pre-crisis, whereas the private cohort raised smaller funds on average, two periods in a row. Apollo and Carlyle from the public group have raised larger funds since 2006-2008 compared with just Advent from the private group. Three of the four privately held PE firms are currently fundraising for the next flagship fund or have recently held a final close. We will watch to see if this group's average finally surpasses its pre-crisis high.[3]

Average flagship fund sizes ($B)



Source: PitchBook | Flagship buyout funds of select firms
Note: Shaded area represents period in which public GPs listed.

3: None of the eight GPs raised a flagship fund in 2009 or 2010.

Fund timing

The duration of a fund's life can play heavily into the total fee revenue a GP earns. Longer fund lives tend to lead to additional years of charging management fees and give investments the opportunity to compound, potentially earning a higher cash-on-cash return. On the other hand, truncated fund lives can help produce higher IRRs if the fund realizes large markups early in the fund life, even if the fund is unable to continue the same pace of value creation. Another method by which GPs could augment earnings would be to call down capital more quickly and try to earn carry sooner. Not only did we find that the public cohort had been returning capital at a faster pace as of late, but drawdown rates for the public cohort had been slowing across the board more recently. They dramatically slowed capital calls in the 2011-2014 timeframe, running counter to our expectations.

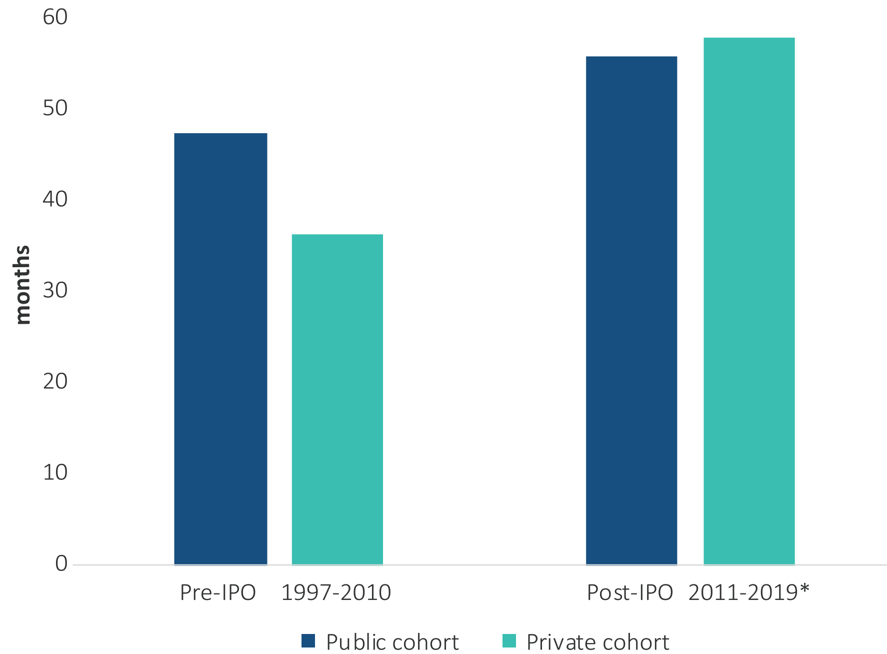
In part, this could be due to the hefty step-ups public GPs sought after the crisis, making it more difficult to deploy meaningful portions of the total fund size. Whatever the case, we do not find that these public PE firms are being overly hawkish compared to their drawdown rates before publicly listing or compared with their privately held counterparts, nor do we find that these firms draw out fund lives to continue collecting management fees.

In conjunction with faster drawdown rates, returning to the fundraising trail more swiftly is another way in which PE firms could boost earnings. We found that the public cohort raised funds at a more consistent pace on average pre- and post-IPO, and while both groups waited longer to raise flagship funds after the financial crisis, the private cohort continues to show hesitancy while the public cohort appears to be resuming pace. The private GPs in our sample have taken nearly two years longer on average to raise successor funds than they did before the crisis while the public GPs have delayed efforts by less than a year on average. This is our clearest finding of public GPs taking more aggressive fundraising action after their IPOs.[4]

While nearly all PE firms delayed fundraising efforts following the financial crisis, these public PE firms were less hesitant than their privately held peers to resume normal activity levels. The public GPs we selected for our sample set pushed back fundraises by less than a year in the period following the crisis.

4: To minimize any overlap between fundraising between Blackstone's listing in 2007 and Carlyle's in 2012, we used January 1, 2011 as the cutoff date for the private firms. Any funds raised before this were compared to the "pre-IPO" timeframe, and all funds closed after were compared to the "post-IPO" timeframe.

Average time (months) between flagship funds



Source: PitchBook | Flagship buyout funds of select firms
*As of September 30, 2018

Performance

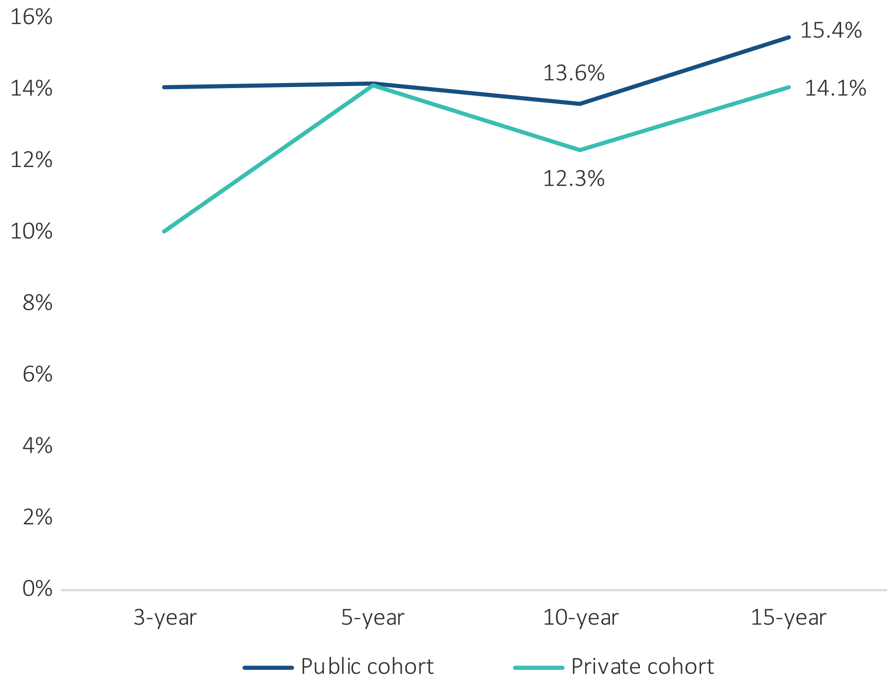
The pressures of answering to public shareholders can lead to short-term actions and inefficiencies, as many public CEOs have bemoaned. We expected the focus on management fees, strategy expansion, and short-term profits to lead to worse long-term performance for the flagship buyout funds of the public PE firms compared to the private PE firms, but this is not the case. To determine performance, we looked at pooled IRR, TVPIs, and PMEs over the past 15 years.[5,6] These metrics each tell a slightly different story and give a more holistic performance picture.

On an IRR basis, we see consistent outperformance by the public PE firms' flagship funds compared to non-public PE flagship funds.

On an IRR basis, we see consistent outperformance by the public PE firms' flagship funds compared to the private PE flagship funds. The public cohort's funds outperformed in all timeframes, with the highest levels coming over the longest and shortest horizons. To note, the performance during the three- and five-year horizons took place after all of the public GPs had publicly listed.[7] The outsized step-ups in fund sizes do not seem to have had a negative effect on performance for these public GPs. Neither does being a public company, with the outperformance spanning pre- and post-IPOs.

5: Horizon IRRs are the compound rates of return an investor would have earned if invested over the trailing XX number of years. The cash flows from the public and private GPs are pooled into one investment. Then performance is calculated from those cash flows.
6: This is an imperfect metric given that investments made toward the beginning of this timeframe were made before any PE firm went public.
7: Horizon IRR figures include cash flow data from pre-IPO funds, but shorter horizons will be more heavily weighted toward the post-IPO funds.

Pooled horizon IRRs (1997-2014 vintage)



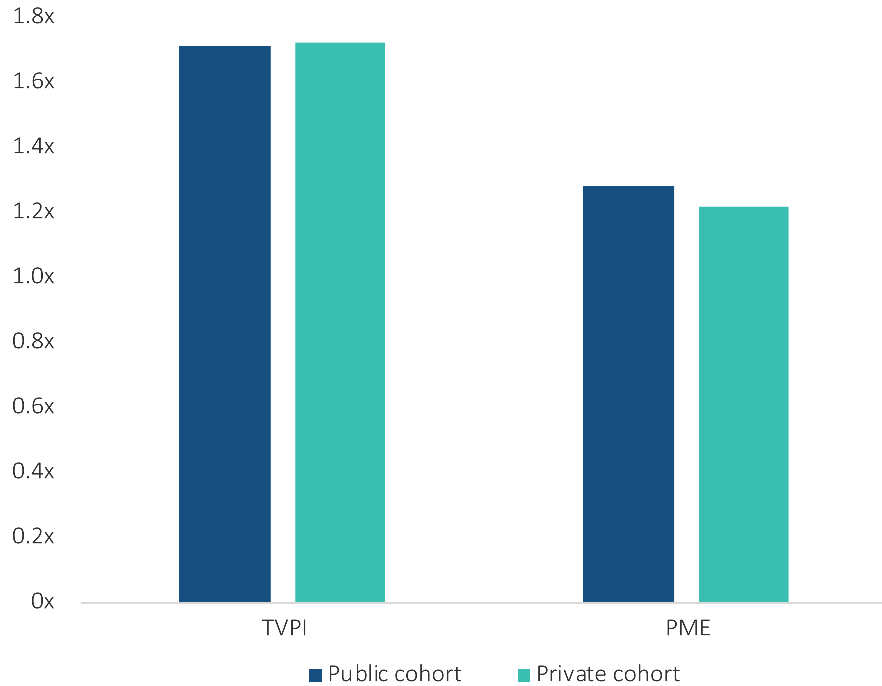
Source: PitchBook | Flagship buyout funds of select firms

Looking to cash multiples and PMEs, we find a murkier picture. The public cohort marginally underperformed on a cash multiple basis but posted higher PMEs.[8] While the difference in TVPIs is minimal, the PMEs show a clearer level of outperformance by the public GPs. One point that stood out was Apollo's differential when ranking IRRs and cash multiples. Out of the four public GPs, Apollo recorded the highest IRRs over the past 15 years, but they also recorded the lowest TVPI gains. Their strategy of quickly returning capital to investors proves to be efficient at producing lofty IRRs but leaves something to be desired on a cash multiple basis, highlighting the importance of using multiple metrics when evaluating performance.

Regarding performance for every public GP in our sample more broadly, it appears the demand to boost profits has not had a negative impact on performance compared with the private PE firms. Though absolute returns have been falling over the past two decades, all the GPs have seen similar downward pressure on performance over time. We should note there is some selection bias in the data because we are looking at some of the largest GPs, which were presumably able to grow AUM by consistently delivering healthy returns. Overall, it seems these public PE firms excel at performance measured by time value of money, posting higher IRRs and PMEs, but the private GPs produce higher TVPIs on average, which is likely a result of longer fund lives.

8: This PME is using capital weighted cash flows and the S&P 500 as a base index.

Pooled performance statistics (1997-2014 vintage)

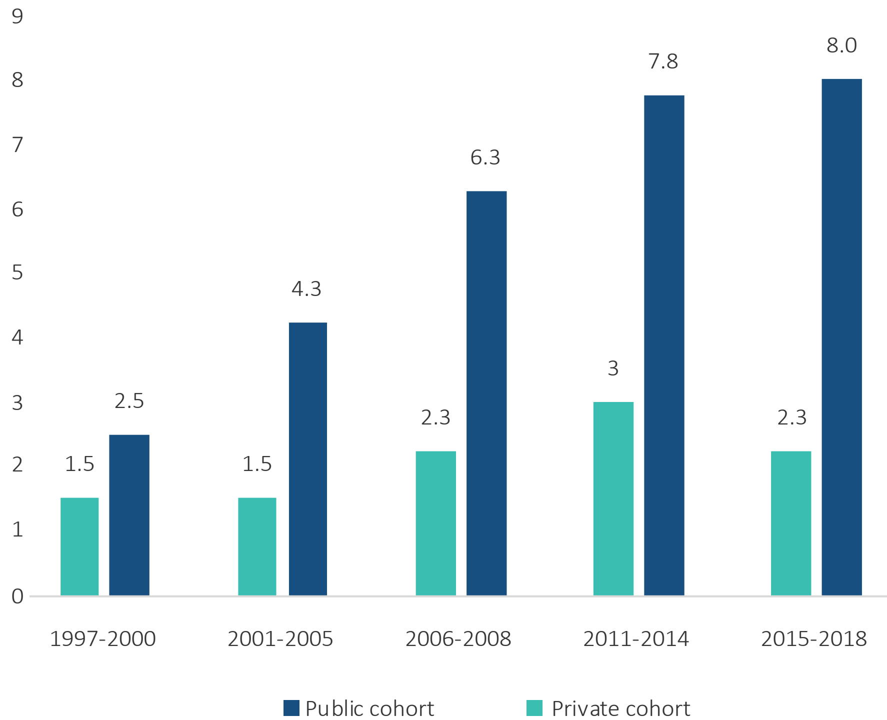


Source: PitchBook | Flagship buyout funds of select firms

Strategy expansion

Beyond flagship funds, the public cohort has showed a propensity for strategy expansion, spanning credit, real estate, infrastructure, and more. From 1997-2000, these public GPs closed an average of 2.5 unique strategy offerings while the private cohort closed an average of 1.5 offerings. These two cohorts took very different approaches over the next two decades with GPs in the public cohort closing an average of 8.0 distinct strategies from 2015-2018 and the GPs in the private cohort closing just 2.3, on average. While the public cohort began expanding its offerings prior to listing publicly, the gap in total new fundraises has persisted thereafter. Total funds closed across all strategies followed a similar track, with the public GPs now closing over three times the total number of funds in 2015-2018 while the private GPs were mostly flat. The growth in strategy offerings and fund closings shows the public cohort's desire to diversify the business and grow AUM and accompanying management fees, while the private cohort has stayed leaner and more focused.

Average number of unique fund strategies closed per GP



Source: PitchBook | Flagship buyout funds of select firms

Looking ahead

Fundraising efforts appear to be in full swing once again, with Advent, Blackstone, TPG Capital, and Warburg Pincus currently fundraising for follow-on flagship funds. Advent continues to separate itself from the other privately held GPs as the firm looks to close on a record-setting $16.0 billion fund while TPG Capital and Warburg Pincus are targeting funds that are still below their pre-crisis fund sizes.[9] Of the publicly traded firms, Blackstone continues to lead the pack with reports of its fund targeting a $25.0 billion hard cap, which would make it the largest buyout fund ever. Going forward, we will watch the performance for these more recently raised funds to see if the substantial step-ups sought by public PE firms have any impact on performance and whether the privately held GPs can keep pace.

9: TPG Capital is currently seeking $12.0 billion-$14.0 billion for its Partners VIII fund, smaller than its 2006 vintage TPG Partners V fund which closed on $15.3 billion and its 2008 vintage TPG Partners VI fund which closed on $19.8 billion. Warburg Pincus is currently seeking $14.0 billion for its Global Growth fund, smaller than the 2007 vintage Warburg Pincus Private Equity X fund which closed on $15.0 billion.