PitchBook

2020 Private Equity Outlook: H1 Follow-Up

Assessing our predictions amidst the pandemic

PitchBook is a Morningstar company. Comprehensive, accurate, and hard-to-find data for professionals doing business in the private markets.

Credits & contact

Analysts

DYLAN COX LEAD ANALYST, PE
dylan.cox@pitchbook.com

WYLIE FERNYHOUGH Senior Analyst, PE
wylie.fernyhough@pitchbook.com

STEPHEN-GEORGE DAVIS Analyst, PE
stephengeorge.davis@pitchbook.com

ZANE CARMEAN Senior Data Analyst

Design

JULIA MIDKIFF Junior Graphic Designer

Contact PitchBook

pitchbook.com

RESEARCH

reports@pitchbook.com

2020 predictions updates:

Published on August 10, 2020

DYLAN COX LEAD ANALYST, PE
dylan.cox@pitchbook.com

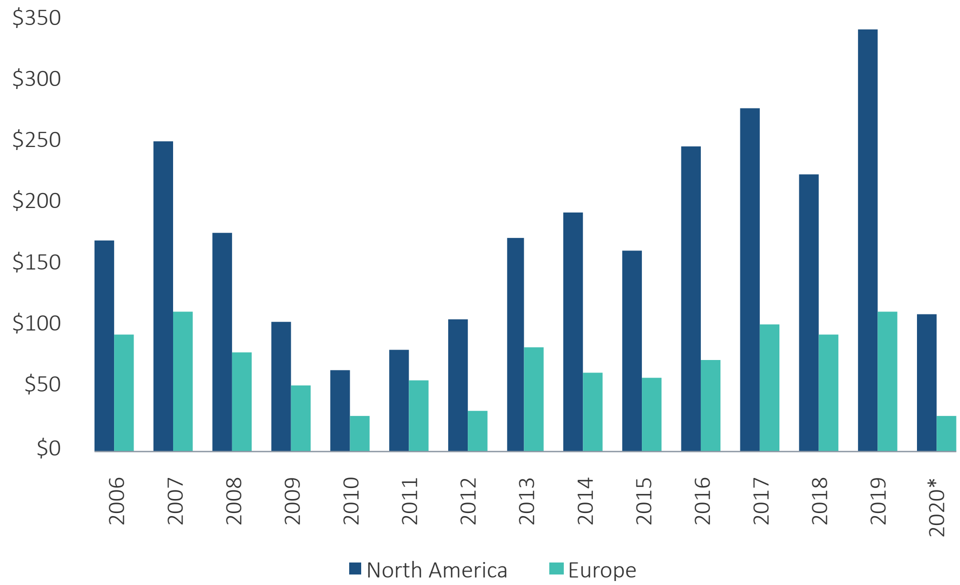
Prediction: PE fundraising will fall below 2019 totals.

> ***Score:*** Pass
>
> ***Rationale:*** Most of the large PE firms—including Blackstone, Vista, and Leonard Green—raised record-setting sums in 2019 and will be in the capital deployment phase next year. While 2020 PE fundraising is sure to be strong when compared to almost any other year, there are currently few funds in the market targeting more than $10 billion.
>
> ***Caveat:*** Continually healthy distributions to LPs means it will be necessary to redistribute dollars to new funds in order to maintain current allocations. In this environment, GPs can raise capital quickly, so we could see a few mega-funds ($5.0 billion+) announced and closed by the end of 2020. In fact, three major European PE firms are set to raise flagship mega-funds in 2020.

H1 2020 update: PE fundraising has cooled through the first half of 2020, although not for the reasons we originally anticipated. The COVID-19 pandemic forced IR teams to operate entirely remotely, which has benefitted established managers with long-standing LP relationships. Some of the publicly traded GPs reported record fundraising months in Q2, during the depths of the economic shutdown. Conversely, some would-be first-time managers have delayed hitting the road until the dust settles, causing there to be fewer vehicles in the market.

The pandemic has had a similar effect on either side of the Atlantic. Fundraising for North American funds totaled just $115.3 billion through H1, well behind the pace of last year's high-water mark of $322.2 billion. Similarly, European fundraising has faltered, totaling just €24.0 ($28.3) billion in H1, but a few large funds could help make up ground in the back half of the year. In early July, London-based CVC Capital Partners closed on a €21.3 ($24.0) billion buyout fund, which is the largest European PE fund of all time. This fund and others from established managers, such as BC Partners and EQT, will propel official fundraising figures, continuing Europe's relative rise in the fund management ecosystem.

PE fundraising ($B) by region



Source: PitchBook | **Geography:** North America and Europe
*As of June 30, 2020

DYLAN COX LEAD ANALYST, PE
dylan.cox@pitchbook.com

Prediction: We will see another acquisition of a major alternative asset manager.

> ***Score:*** Fail
>
> ***Rationale:*** On the heels of Brookfield's $4.7 billion acquisition of credit-focused Oaktree and SoftBank's $3.3 billion purchase of long-time private equity and private debt manager Fortress, other asset managers are gearing up to become full-service alternative asset platforms. Blackrock could buy credit-focused Ares or Centerbridge Partners. EQT—with a small lending operation and fresh IPO proceeds—could expand its US and credit presence by acquiring Antares or a similar middle-market-focused shop.
>
> ***Caveat:*** The growth in GP stakes investing provides enough liquidity to existing owners that they aren't motivated to give up control. The largest platforms—including Blackstone, Brookfield, and Blackrock—already have substantial market share, so most remaining managers could start to market themselves as smaller specialists.

H1 2020 update: There have been no acquisitions of major asset managers thus far in 2020. In fact, quite the opposite has occurred; EQT sold its credit business ($4 billion AUM) to rival Bridgepoint, while TPG chose to part ways with affiliate Sixth Street Partners after a ten-year partnership. The GP stakes market has continued its expansion, offering growth capital and some liquidity to founders without them having to sell the entire firm. Although a major consolidation is still possible in H2, it appears the major players are content to wait out the pandemic before making any big splashes.

WYLIE FERNYHOUGH Senior Analyst, PE
wylie.fernyhough@pitchbook.com

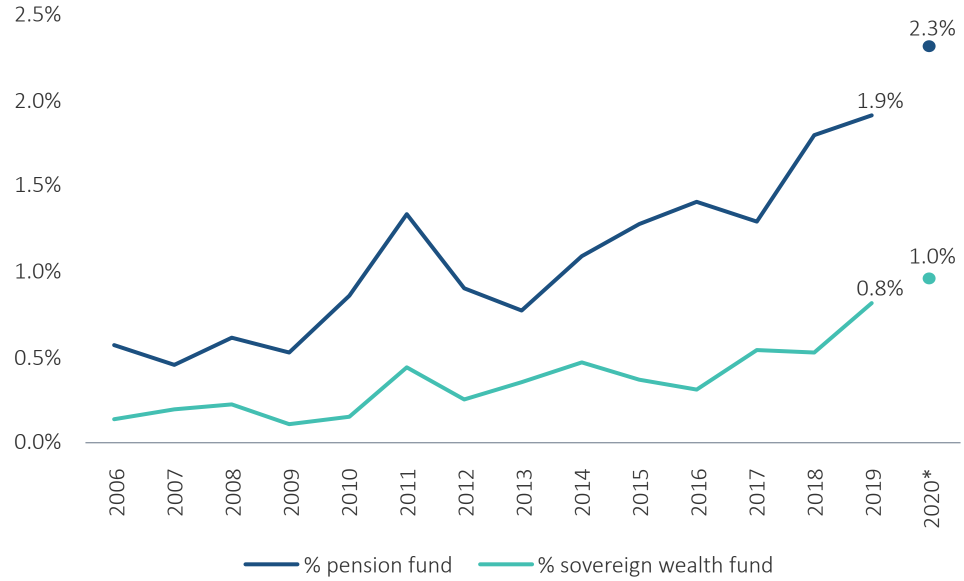
Prediction: Sovereign wealth funds and pension plans will become more sophisticated investors, increasing control over investments.

> ***Score:*** Pass
>
> ***Rationale:*** Many sovereign wealth funds (SWFs) and pension plans have become comfortable with their allocations to private markets and want to take the next step toward becoming sophisticated actors. These entities strive to maximize returns while minimizing fees, and many of them believe direct investments and co-investments are the best way to achieve this. Some high-profile actors, such as the Canada Pension and Investment Board and Singapore's GIC, are already active in the direct space, perhaps encouraging others to join in.
>
> ***Caveat:*** Some poorly performing direct investments, such as Saudi Arabia's Public Investment Fund's (PIF) investment into Uber, may cause SWFs to act with increased caution and forego direct investments and co-investments for fund commitments. Additionally, the California Public Employees' Retirement System (CalPERS) and other large US public pensions may not be able to get around the optics of paying dealmakers a market wage, which tends to be multiple times what their average pensioners make. This has stifled or negated any movement toward building out an in-house team and doing deals. Additionally, CalPERS has recently announced it is making a direct-deal team less of a priority.

H1 2020 update: Through the first half of 2020, SWFs and pensions have boosted their direct participation in US PE deal activity. Increasingly, these massive institutions are lifting PE allocations and using direct dealmaking as they become more sophisticated actors. One area in which SWFs and pensions put capital to work in recent months has been private investment in public entities (PIPEs). As the COVID-19 pandemic and ensuing economic carnage caused public share prices to plunge in Q1, public companies issued shares at the fastest rate ever, leading to many dealmaking opportunities. For example, after declaring bankruptcy, utility company PG&E (NYSE: PCG) issued $3.25 billion in shares in a private transaction to several institutional investors, including GIC. Similarly, Carnival (NYSE: CCL) received a $370.0 million capital injection from Saudi Arabia's PIF as the cruise operator has struggled financially because cruises have been effectively shut down.

Large US pension plans have committed to doubling down on private market investments and taking more control over the portfolio in the process. CalPERS plans to lever up its portfolio and put more capital to work in private debt and PE. The pension plan expects to make more contributions to co-investments and emerging managers, likely because it can exert more control. Other pension plans have done this to great effect, including The State of Wisconsin Investment Board and Texas Teacher Retirement System (TRS). Texas TRS has also boosted control over its portfolio this year as it pursues more direct dealmaking. The pension plan has already hit its 50% direct real estate investment target, contributing $3.0 billion to non-fund real estate investments in the last year. Going forward, we expect bellwether SWFs and pension plans to continue innovating and asserting more control over their portfolios and for smaller SWFs and pensions to follow in their footsteps.

Pension and SWF involvement in US PE deals (#)



Source: PitchBook | **Geography:** US
*As of June 30, 2020

WYLIE FERNYHOUGH Senior Analyst, PE
wylie.fernyhough@pitchbook.com

Prediction: The big four public GPs will expand their strategy offerings at twice the rate of comparable GPs.[1]

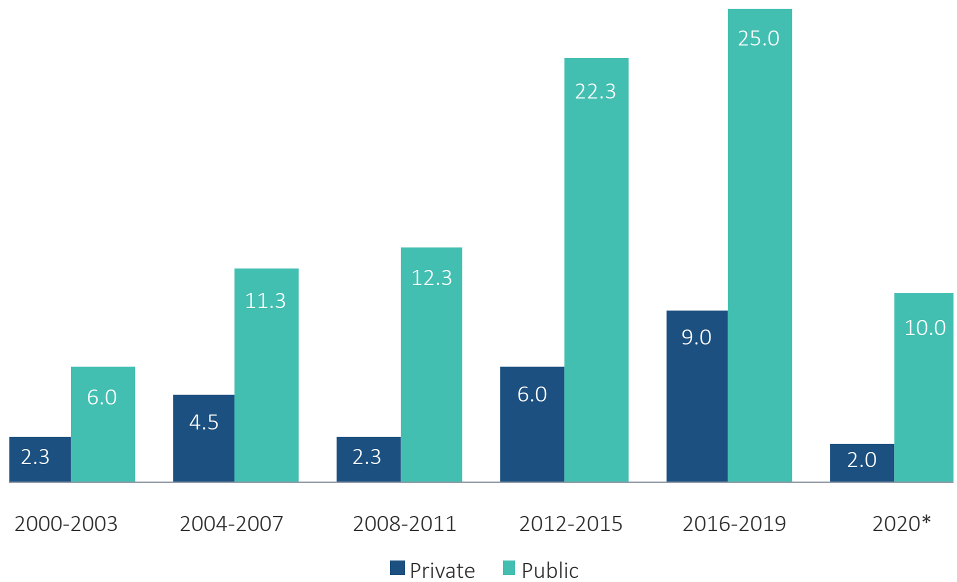
> ***Score:*** Pass
>
> ***Rationale:*** The large public GPs have taken steps, including converting from public partnerships to C-Corporations, to boost the value of their shares. Expanding into new strategies not only helps these GPs grow AUM at a quicker pace, it also allows for a more diverse revenue stream that can weather all economic environments, potentially lifting share prices further.
>
> ***Caveat:*** Other GPs will see the success of these massive public GPs as they promote new offerings and will likely match or outpace their rate of strategy expansion. The comparable private GPs are also starting from a lower base, so new offerings are likely closer to their core offerings. Additionally, LPs could begin to push back and, rather than invest in the new offerings from one-stop-shops, invest in the industry specialists instead, thwarting the public GPs' efforts.

H1 2020 update: The large public GPs have been more opportunistic with new fund launches since the COVID-19 crisis struck. We also saw the public GPs foraying into new spaces in the past year or two, such as Blackstone's launch of its first growth equity fund or Apollo's Navigator Aviation fund. To approximate the strategy expansion, we are looking at funds that these GPs have launched since 2019 and/or closed in 2020. We see here that not only have the public GPs been launching more strategies recently, but in 2020 that trend has accelerated. KKR closed on $4.0 billion for its Dislocation Opportunities Fund, and Apollo is launching a new $12.0 billion credit operation focused on making loans of about $1 billion. Additionally, Blackstone's GSO launched a CLO opportunities fund to take advantage of distressed pricing in the leveraged loan market.

The privately held GPs have launched some new strategies in the past two years, including Bain's and TPG's initial public equity investment funds. Advent also recently closed on its initial Global Technology fund, but in general, the private cohort has not been as aggressive as the public GPs. However, coming out of the pandemic environment, we expect the investment landscape to remain in flux, leaving openings for opportunistic GPs. The public and private cohorts will have plenty of chances to expand their current offerings to LPs.

1: The big four public GPs include Blackstone, Apollo Global Management, KKR, and The Carlyle Group. The private cohort includes Bain Capital, TPG Capital, Warburg Pincus, and Advent International.

Average number of funds raised per manager**



Source: PitchBook | **Geography:** US
*As of June 30, 2020
***Calculated as total funds raised by the public or private cohort divided by the number of firms in that cohort*

WYLIE FERNYHOUGH Senior Analyst, PE
wylie.fernyhough@pitchbook.com

Prediction: GPs will increasingly hold some of their top-performing assets longer.

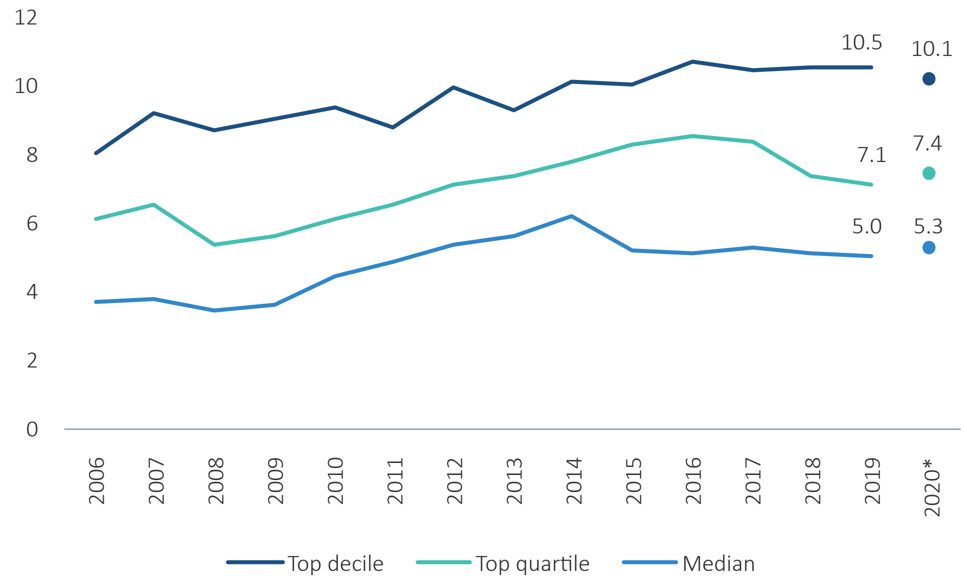
> ***Score:*** Undetermined
>
> ***Rationale:*** With many PE holding times stretching past a decade, fund lives often bump up to the end of the allotted lifespan, and managers frequently seek extensions. Additionally, in an extended bull market, many portfolio companies have hit their financial targets—which would typically trigger a sale—but still hold promise. Almost everywhere we look, GPs are trying to hold their winners for longer and are coming up with innovative methods to do so. The GP-led secondaries market, perhaps the largest beneficiary of extended holding times, has seen explosive growth over the past decade and is the fastest growing sector in the secondaries space. We believe 2020 will be the most innovative year yet with more GPs than ever seeking to hold part of their top assets longer and pursuing new funds dedicated to holding extended stakes in companies.
>
> ***Caveat:*** LPs could demand liquidity sooner and be unwilling to wait for these extended liquidity options. Investors in funds that seek extensions or GP-led secondaries rollovers could choose to vote against these choices and demand GPs stick to their predetermined investment timeframe.

H1 2020 update: Median holding periods have ticked up as has the top quartile, although the top decile is down slightly. We expect these numbers will continue to rise in the coming quarters as PE firms hold onto their winners and other portfolio companies fight to stay afloat. With so much uncertainty about the economy, PE firms are choosing to forego nearly all exits. Our data shows exit activity falling dramatically year over year, and we expect the drop to last through at least the end of the year. The current COVID-19-induced economic crisis has caused this prediction to come true, although signs indicate it may have come true regardless of the crisis as GP-led secondaries transactions continue to take more share of the secondaries market.

GPs have been creative in finding ways to finance portfolio companies. Appetite by GPs to raise annex funds or to pursue preferred equity financing for older funds has skyrocketed, according to industry sources. These financing options grant GPs the financial firepower to support struggling portfolio companies and opportunistically pounce on add-ons well after the fund’s investment period is up. Annex funds are often raised by LPs, whereas preferred equity financings usually come from specialist firms such as Whitehorse Liquidity Solutions or 17Capital.

While the current economic waves have caused GPs to hold nearly all of their portfolio companies, GPs may end up selling their winners first once we arrive in calmer waters. Many GPs will be looking to raise new funds after this crisis is over. Showing LPs some successful exits can go a long way toward securing fresh capital. Furthermore, selling winners often provides GPs with carry that managers can roll into their GP commitment for upcoming funds.

US PE holding times (years)



Source: PitchBook | **Geography:** US
*As of June 30, 2020

STEPHEN-GEORGE DAVIS Analyst, PE
stephengeorge.davis@pitchbook.com

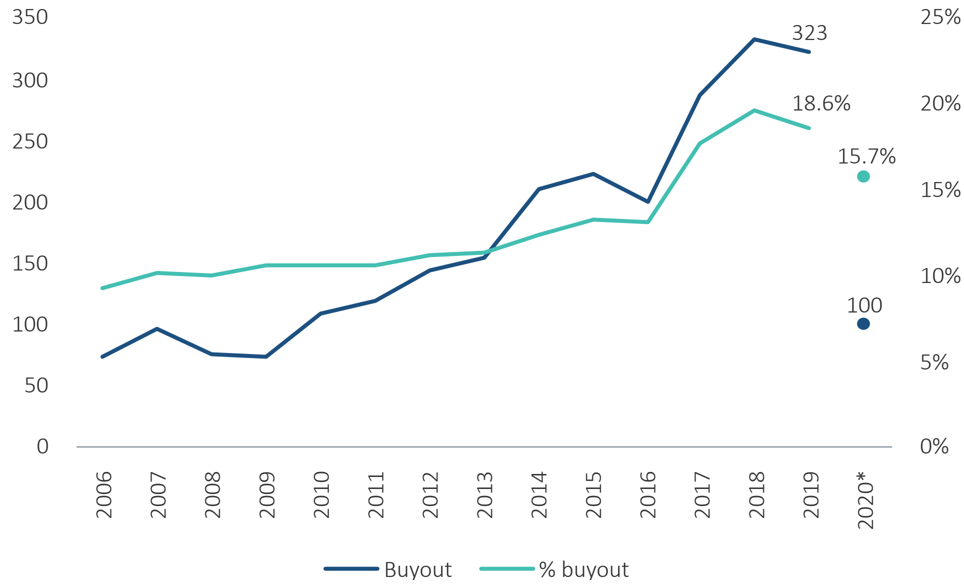
Prediction: VC-to-PE buyouts will continue to proliferate.

> ***Score:*** Fail
>
> ***Rationale:*** VC-to-PE buyouts are growing in prominence, with an ever-expanding group of GPs specializing in software buyouts. Between 2000 and 2018, the number of North American and European VC-to-PE buyouts has grown at a CAGR of 17.9%, compared to 9.4% growth for all buyouts. VC-backed companies are also more mature and abundant, increasing the number of viable candidates for PE firms to target. Tech companies continue to drive performance in both the public and private equity markets, pointing to heightened investment in the space.
>
> ***Caveat:*** Notable failures in the tech space from VC-backed companies (WeWork, for example) have made headlines recently as some of these quickly growing, high-cash-burn companies have unsuccessfully tried to tap the public markets for liquidity. PE firms may begin to focus on cash flows and profitability metrics, potentially dissuading GPs from investing in these types of VC-backed companies. We believe these high-profile failures may also deter investment in nascent tech companies and push PE firms to target more established (that is, no longer VC-backed) tech companies, which we see as the biggest threat to VC-to-PE buyouts.

H1 2020 update: While the reverberations from the global pandemic have led to a 16.9% year-over-year decline in the percentage of VC-backed companies exited to PE firms, the proportion of buyouts that are VC exits has held steady year over year. This is indicative of continued proliferation of VC-to-PE buyout deal making. For context, in both 2015 and 2016, 13.2% of all VC-backed exits were to PE firms; however, in 2016 the proportion of buyouts that were VC exits fell by 12.8% year over year. Moreover, a rising equity market led to an increase in VC-backed IPOs in Q2 2020, suppressing VC-to-PE buyout counts, and with another two quarters to go in the year we expect more VC-to-PE deals to close. However, it should be noted that in the first half of 2020, we saw 39 SPAC IPOs, which have collectively raised over $12 billion, nearly eclipsing 2019 figures. These blank check companies offer VC-backed firms an exit option that can be seen as a hybrid between an IPO and a buyout. SPACs may compete with PE shops for deals, taking away some of the VC-backed deal flow from private equity sponsors.

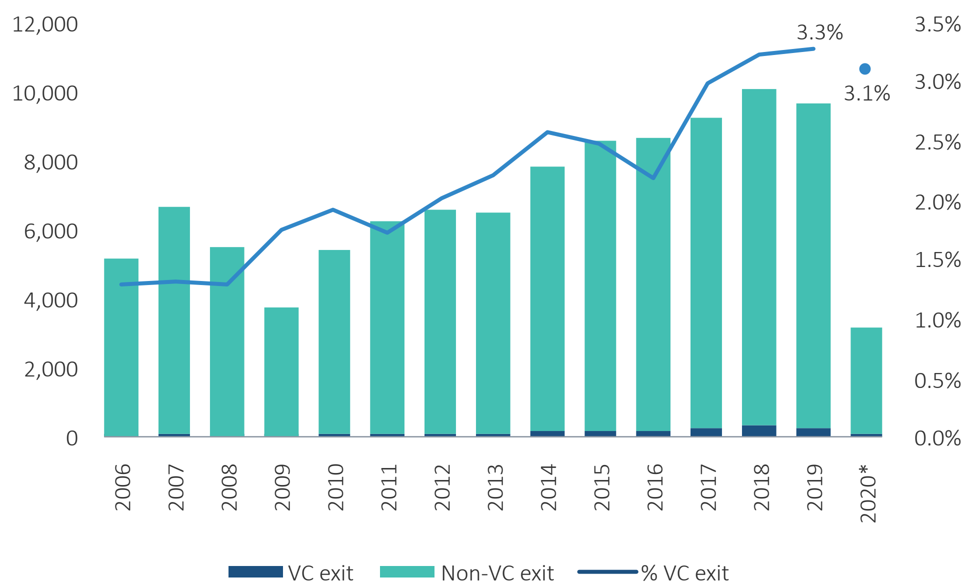
PE firms are fond of investing in VC-backed companies because the companies are often high-growth tech (software/SaaS) firms, which are easy to add on and integrate with portfolio companies. PE firms also appreciate VC-backed companies, as the backing of another financial sponsor can act as a stopgap due-diligence barometer. Although the current pandemic has curbed dealmaking for the time being, and VCs are hesitant to let go of coveted assets at potential subdued prices, it is clear that PE firms are still interested in these types of companies and will continue to pursue them down the line.

Buyouts as a percentage of VC exits (#)



Source: PitchBook | **Geography:** North America and Europe
*As of June 30, 2020

Proportion of buyouts that are VC exits (#)



Source: PitchBook | **Geography:** North America and Europe
*As of June 30, 2020

STEPHEN-GEORGE DAVIS Analyst, PE
stephengeorge.davis@pitchbook.com

Prediction: There will be continued expansion in growth equity deals.

> ***Score:*** Undetermined
>
> ***Rationale:*** Growth equity deals will continue to proliferate as a swelling number of firms expand beyond late-stage VC financing and need one or two more capital infusions before posting positive cash flows. In many cases, staying private may translate to taking a growth round rather than hitting the public markets. On the supply side, many large GPs are attempting to expand into new offerings and see growth equity as a strategy that fits into their existing framework. GPs and LPs also like the attractive fundamentals at the growth stage and appreciate the lack of control premiums for said investments.
>
> ***Caveat:*** Similar to VC-to-PE buyouts, growth equity often favors the tech sector, where high-profile failures may lead to skittish investor sentiment. Many growth equity targets have likely seen inflation in valuations akin to what we've witnessed in late-stage VC in recent years.

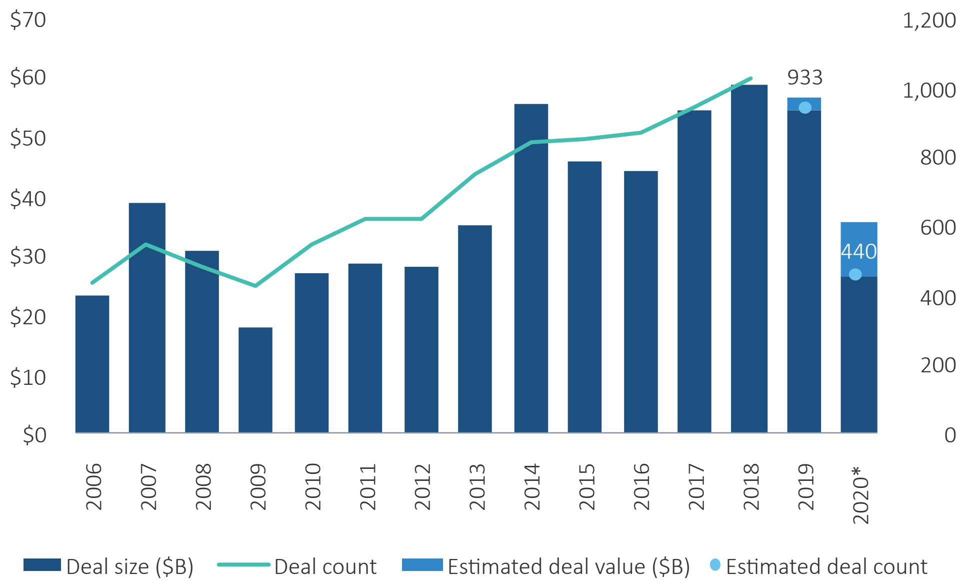
H1 2020 update: Growth equity deals have become increasingly popular with GPs of late and have led to a flood of funds actively targeting these types of investments. The global pandemic has only accelerated the rise of this private market strategy. As COVID-19 has taken the world—and the US in particular—by storm, growth equity has become increasingly integral for many GPs for a number of reasons. Furthermore, the current pandemic-induced economic environment makes it difficult for GPs to execute buyouts. Without insight into when the virus will subside or when earnings will stabilize, buyers and sellers will disagree on valuations. As such, growth equity investments are one way GPs can put some of their dry powder to work in companies with viable growth prospects. While majority deals are not getting done, a company in need of capital may prefer a growth equity infusion that enables them to sell the majority down the road at a higher valuation. Additionally, partnering with PE firms, which tend to be more operationally intensive than VC firms, may help companies weather the storm.

Recently, we have seen some notable GPs execute growth equity deals. In June, for instance, Thoma Bravo and Madison Dearborn Partners invested $500.0 million in the Chicago-based enterprise software firm Syntellis Performance Solutions. Also, Vista Equity Partners and KKR both acquired 2.32% of Indian Telecom firm Jio in May, joining a host of other prominent investors and institutions acquiring minority stakes in the firm. Lately, we have seen funds raised by both established players as well as new entrants in the growth equity space. For example, perennial growth equity firms Insight Partners and Spectrum Equity Investors both raised growth funds in 2020, and the former received a sizeable $200.0 million commitment from the Washington State Investment Board. Notable firms such as Blackstone and TPG[2] also currently have open growth funds, an indication that the strategy

2: TPG also closed its growth fund TSSP Capital Solutions in October of 2019, although this was done in conjunction with Sixth Street Partners.

is becoming more mainstream. Given the increasing prominence of the strategy, it is no surprise that 2020 growth equity deal value appears set to surpass 2019 figures while buyouts are falling well behind.

US PE growth deal activity ($B) by year



Source: PitchBook | **Geography:** US
*As of June 30, 2020

2020 predictions scorecard

Below we summarize our predictions for 2020 and how they fared thus far.

PE fundraising will fall below 2019 totals.	Pass	Fundraising has dampened, but not for the reasons we originally anticipated. The remote fundraising environment favors established managers over newcomers.
We will see another acquisition of a major alternative asset manager.	Fail	Although a major consolidation is still possible in H2, it appears the major players are content to wait out the pandemic before making any big splashes.
Sovereign wealth funds and pension plans will become more sophisticated investors, increasing control over investments.	Pass	SWFs and pensions are both asserting more control over their portfolios and participating in more direct deal activity. While SWFs looked to deploy capital and invested heavily in direct private transactions as well as PIPEs, some of the largest US pensions also looked to bring more investing in house and deploy capital into direct deals.
The big four public GPs will expand their strategy offerings at twice the rate of comparable GPs.	Pass	The public GPs have launched new strategies much more quickly than comparable privately-held PE firms have. Many of the new funds launched by the public PE firms are opportunistic, targeting COVID-19-related areas of the economy.
GPs will increasingly hold some of their top-performing assets longer.	Undetermined	GPs have ended up holding nearly all assets longer in 2020 as realization activity has diminished. With wide pricing spreads between buyers and sellers and continued economic uncertainty, holding times across the board are likely to rise in 2020 and beyond.
VC-to-PE buyouts will continue to proliferate.	Fail	Buyouts in general slowed through H1, while SPACS and a roaring public equity market gave other options to VCs searching for liquidity. Buyouts fell to just 15.7% of VC-backed exits in 1H, compared to 18.6% for the entirety of 2019.
There will be continued expansion in growth equity deals.	Undetermined	The COVID-19 pandemic creates the need for growth equity financing in many sectors but also impedes dealmaking more generally.