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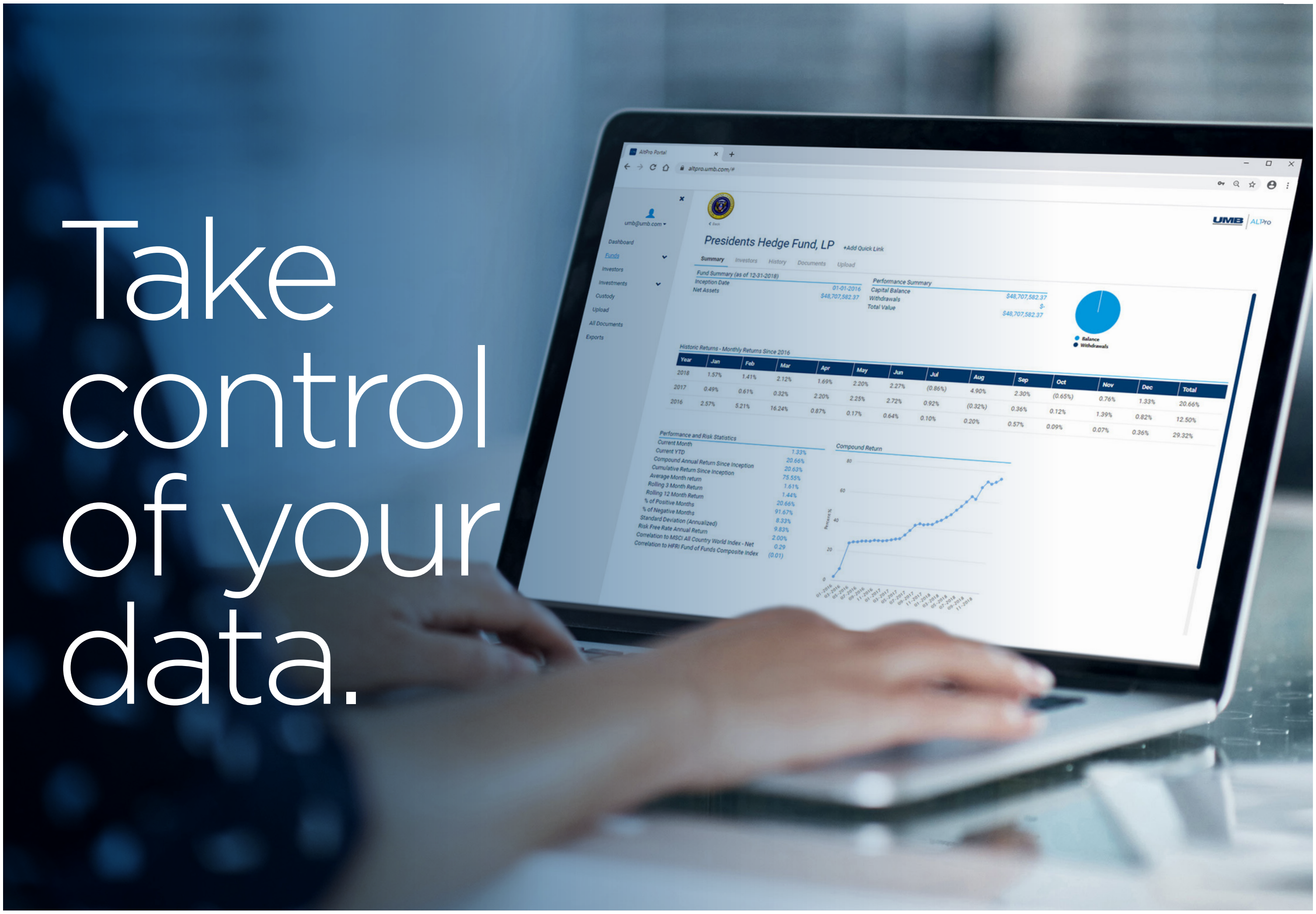
UMB

# US PE Breakdown

Q3 2020

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## Credits & contact


**PitchBook Data, Inc.**

**John Gabbert** Founder, CEO
**Adley Bowden** Vice President, Market Development & Analysis

**Research**

**Wylie Fernyhough** Senior Analyst, PE
wylie.fernyhough@pitchbook.com

**Data**

**Andrew Akers, CFA** Senior Data Analyst

**Design**

**Julia Midkiff** Junior Graphic Designer


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# Introduction

**US PE deal activity continues to lag in the wake of COVID-19's impact on the economy.** Technology-focused deals have kept relatively steady, though, as valuations have remained stable through the pandemic, even rising in some cases. The current trend of weaker deal activity across other sectors appears poised to change in the coming quarters, with more announced deals likely leading to a pick-up in future dealmaking. Furthermore, updated Department of Justice (DOJ) guidelines and a potential change to the tax code could further underpin PE deal activity into the future. Credit markets have already rebounded and kept liquidity flowing to fund new buyouts and dividend recaps. In fact, there are now cases of new financing packages containing even weaker covenants than in the pre-COVID-19 period.

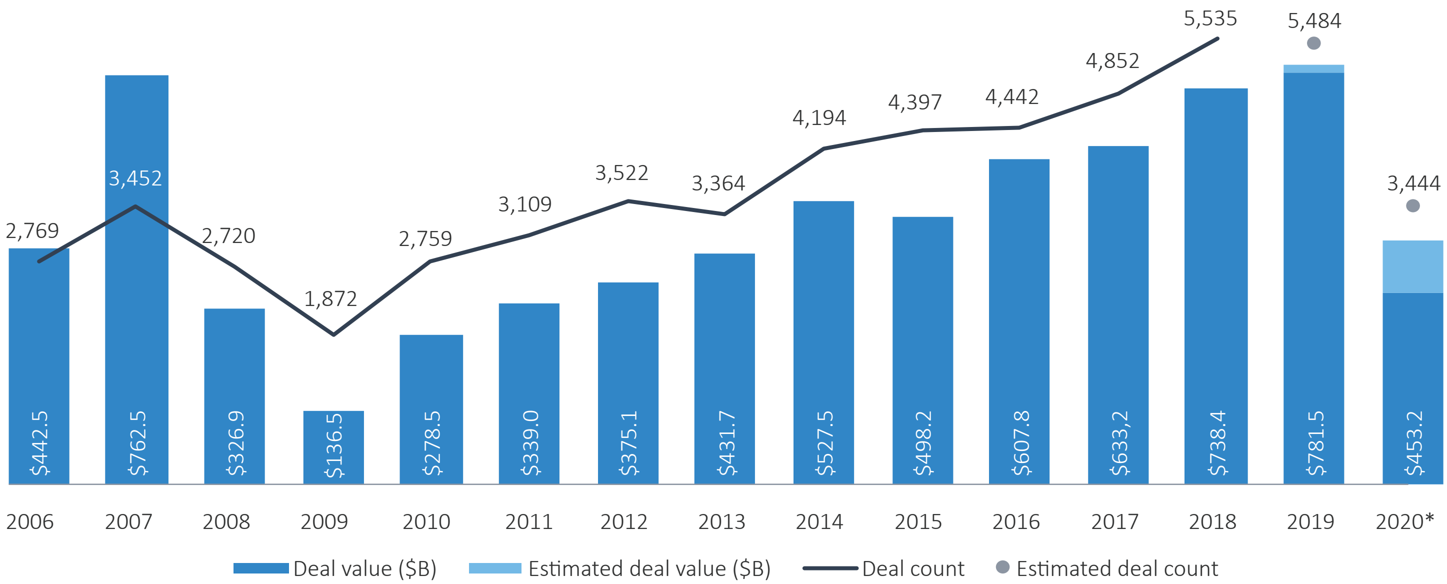
**Exit count has also diminished compared to last year's tally, but several multibillion-dollar exits via IPOs have helped buttress exit value amid a roaring public equity market recovery.** As part of the unbridled enthusiasm witnessed in public markets, we have seen SPACs raise capital in a manner never before seen. Through Q3, they have already set their record for most capital raised, and already PE firms are participating in the trend. Several GPs have agreed to sell portfolio companies to SPACs, and other GPs have signed up to become SPAC sponsors.

**Fundraising activity also appears modest YTD, but current signs point to a feverish finish to the year.** A pair of record-setting tech funds could close on nearly $40 billion in Q4, with many additional $1 billion-plus funds also seeking to hold a final close in 2020. The current climate, where LPs are forced to conduct due diligence via teleconference, continues to favor the established managers. This is reflected in the data, as the median fund size is up YoY. However, LPs are figuring out ways to better vet newer small managers, meaning these GPs may find more success in 2021, even if the lockdown persists.


**Wylie Fernyhough**
Senior Analyst, PE

# Overview

## PE deal activity




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

US PE deal activity continued to lag due to COVID-19-related frictions, though it is beginning to rebound. Through Q3, 2020 US PE deal activity registered 3,444 deals worth a combined $453.2 billion—declines of 16.2% and 20.6% compared to this time last year. Registering the lowest deal value since 2015, Q2 2020 seems to be the nadir in deal activity because Q3 numbers were higher and likely signal the beginning of the recovery. Announced deal activity is also up, suggesting that we may be in for a healthy end to 2020 and robust start to 2021. In a similar vein, Bain & Co.'s global head of PE, Hugh MacArthur, notes that after the initial pandemic reaction forced PE firms to pivot to distressed and PIPE deals, most firms have resumed traditional buyout activity.[1] MacArthur believes that the US should see a vigorous deal market for PE firms from September onward, barring any pandemic-related twists.

A couple of additional tailwinds may buoy PE deal activity over the shorter and longer term as well. Depending on US presidential election outcomes, some business owners may seek to sell and capitalize on lower capital gains taxes.[2] We have seen this before. In the waning months of 2010 and 2012, dealmakers closed on a flurry of deals as families and PE firms sold their businesses in an attempt to maximize after-tax proceeds before tax rates jumped. This may push some PE-backed companies into an exit process, which would present buyout firms opportunities, but family-owned companies in particular may be fertile hunting ground for deals.

In September, the DOJ updated its merger remedies guidelines for the first time in nearly a decade, which may lift deal opportunities for mega-managers long term. These guidelines explicitly call out PE firms as viable—and in some cases, preferred—buyers of divested assets in mega-mergers. Axios summarized the reasoning, given PE firms' "financial resources, strategic flexibility, and access to industry expertise."[3] Divestitures are also expected to play a larger role in remedying antitrust concerns, with the DOJ preferring that "merging companies divest their way out of antitrust concerns than promise to be on their best behavior (i.e., conduct remedy)," as Axios put it.[4]

Divestitures have already played a part in deal activity YTD, with many conglomerates selling noncore assets to raise cash, and the DOJ guideline update is likely to further boost the number of divestitures. One recent example, prompted by a business restructuring and not anti-trust concerns, was Clayton, Dubilier & Rice's (CD&R) purchase of HD Supply's Construction & Industrial business for $2.9 billion. The deal

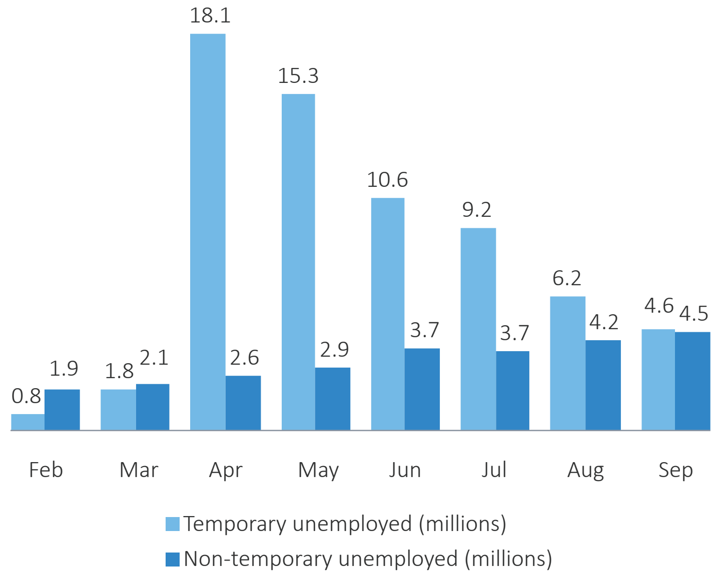
1: "Bain & Co.'s Hugh MacArthur Says Private Equity Must Adapt to Thrive in Post-Covid World," WSJ Pro, Preeti Singh, August 5, 2020
2: The assumption by many is that Joe Biden would raise capital gains taxes, which may cause a flurry of deal opportunities. "The Prospect of Higher Taxes Could Spur Rush of Year-End PE Deals," Brian Richards, CFO Publishing, August 11, 2020
3: "DOJ Updates Merger Remedies Guidelines for First Time in Nearly a Decade," Axios, Dan Primack, September 4, 2020
4: Ibid.

features a unique  structure, whereby HD Supply's business ("White Cap") will combine with Construction Supply Group ("CSG"), a distributor of concrete and masonry accessories backed by the Sterling Group, but CD&R funds will hold a 65% share of the combined entity. We believe more carveouts will continue as buyout firms sit on a quickly expanding mountain of dry powder and as companies in hard-hit sectors—such as retail, leisure, and hospitality—continue to struggle and look for new sources of capital.

An overall healthy credit market, fueled by Federal Reserve liquidity injections, has seen prices recover and is also poised to prop up future PE deal activity. A prolonged low interest rate environment has kept investors yield-starved and willing to commit to private debt funds and buy collateralized loan obligations. In fact, the rebound in pricing has been so swift that the average new-issue yields on high-yield bonds hit their lowest figures since S&P began keeping records in 2006.[5] Similarly, Ball Corp issued $1 billion of 10-year bonds with a 2.875% coupon, the lowest on record for a high-yield bond with a maturity beyond five years, according to Bloomberg. Overall, high-yield issuance since May has set a record. As one PE executive told Axios, "The banks obviously know there's a pandemic, but you wouldn't know it when you talk to them about financing a new deal."[6]

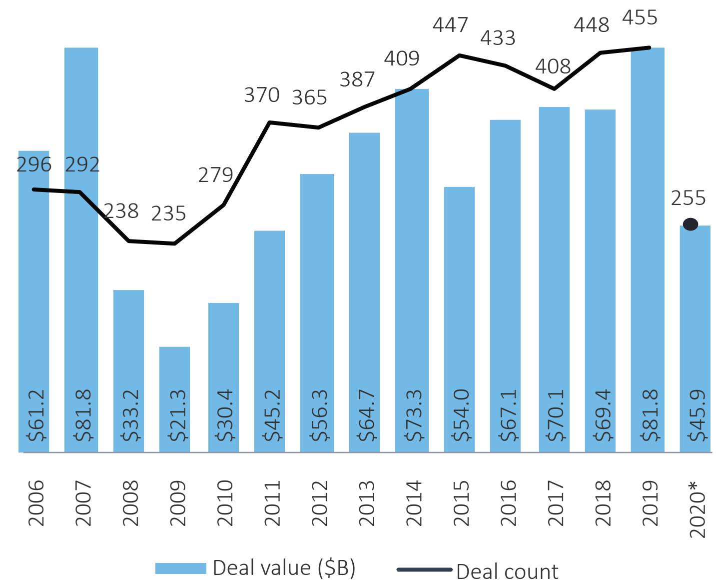
But as PE firms have pivoted from their reliance on high-yield bonds to finance leveraged buyouts (LBOs) and now mostly use leverage loans, high-yield bond issuance has been weaker. Since fewer LBOs have closed in recent months, the leveraged loan segment of the market has been desperate for new issuance. The dearth of new leveraged loan issuance, combined with a rebounding credit market, has sparked some PE firms into action. GPs have stepped up their dividend recap activity. According to S&P Global Market Intelligence data, nearly 24% of the capital raised in the US loan market funded dividends through the first half of September, compared to less than 4% on average over the past two years. While the activity is reportedly confined to the higher-quality borrowers, it still speaks to a recovery in parts of the market while other segments are reeling. Some recent loan issuances contain a portability clause, which allows the financing to be transferred to a new buyer and could mean that lenders will not be repaid when a company is sold.[7] While this provision often makes the company more attractive to a prospective buyer, it achieves this by stripping away rights from the lender. Whereas many recessions see lenders assert power and implement additional covenants and protections into new issuances, we may be witnessing a shift from the norm with this new covenant-loosening language.

## Unemployment in 2020 by type




**Source**: US Bureau of Labor Statistics | **Geography**: US
*As of September 30, 2020

## PE-backed carveout and divestiture activity




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

Through the alphabet soup of letter-shaped recovery projections that have graced headlines, we believe the K-shaped recovery best captures the bifurcated and uneven recovery of the US economy. This type of recovery sees high-earning individuals and large companies approaching a full economic recovery while lower earners and small businesses continue to see their economic prospects

5: "Earnings at Leveraged Loan Issuers Plunge 23%, Exceeding Great Recession Decline," S&P Global Market Intelligence, John Atkins, September 2, 2020
6: "It's the Corporate Debt Market's Turn to Ignore the Real Economy," Axios, Dan Primack, July 17, 2020

dim. For example, we are seeing simultaneous spikes in residential mortgage delinquencies and mortgage applications to purchase a new home, the latter of which are up 33% compared to this time last year. This point is also exemplified by the YTD performance of the Russell 2000, which comprises small cap companies, compared to the performance of the S&P 500, which is weighted toward the mega-caps. The S&P 500 has handedly outpaced the Russell 2000 by just over 15 percentage points. As Ares co-head of PE Matt Cwiertnia said on the company's earnings call, "Small and medium businesses or the middle market are really struggling more than you would be led to believe if you just follow the S&P 500 or the NASDAQ." We believe this means that valuations will remain pressured for small and medium-sized buyouts even while tech valuations continue to skyrocket.

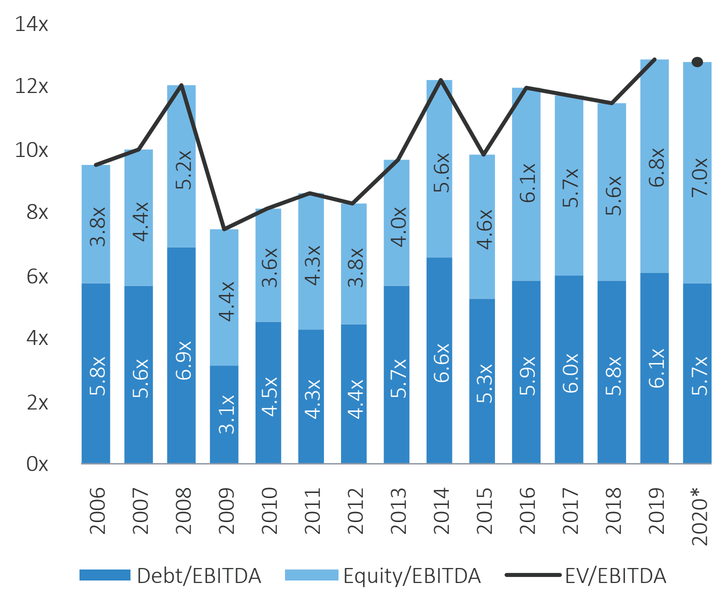
Coming into the fourth quarter, two of the largest pending buyouts involve companies with aspects of technology-enabled personalized medicine—Blackstone's $4.7 billion deal for Ancestry.com and KKR's $3.0 billion deal for 1-800 Contacts. PE investments into healthcare-related businesses have accounted for a higher share of overall PE deal activity over the past decade and often produce returns above the median. While we expect the healthcare investment trend to continue, the torrid pace of PE firms investing in technology-enabled or software businesses will likely also sustain. According to Orlando Bravo, founder and managing partner of Thoma Bravo, the software companies his firm owns reported stable revenue figures throughout the worst of the pandemic shutdown even as some other industries witnessed revenue drop to zero. As Bravo put it, "People have proven that they can conduct business without going to an office, but they can't do it without software."[7] The differentiated revenue drivers prove that tech-focused PE funds can play a diversifying role within an LP's broader PE allocation.

Tech-focused PE fundraising appears to be accelerating from an already elevated growth rate. As we detail in the fundraising section of this report, over $50 billion has been closed on or allocated to tech-focused, US-based PE funds in 2020. As more companies are leveraging technology to improve profitability and drive growth, more generalist investors are becoming acquainted with investing in companies with some technology aspects. Because of this, we expect technology-focused—specifically, software—buyout and growth equity deals to further proliferate. The plethora of software deals has also elevated overall PE deal multiples, which now sit near all-time highs, higher since dealmakers often pay up for quickly growing businesses. For additional context, most deals that appear in our multiples dataset were likely negotiated in 2019. As software becomes a greater focus within PE, we expect more generalists to enter the fray and for multiples to remain aloft.

## Select public index performance (rebased to 100 on January 1, 2020)


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

## Median buyout multiples

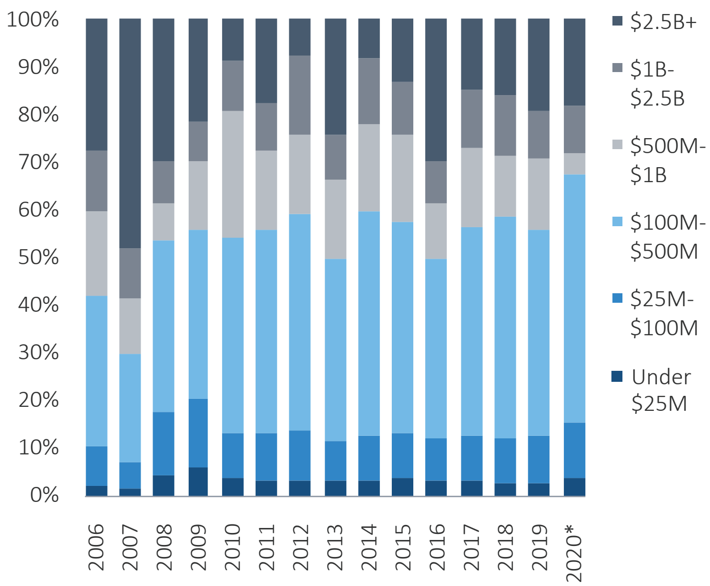



**Source**: PitchBook | **Geography**: US
*As of September 30, 2020

7: Orlando Bravo Rides Software Deals to Heights of Private-Equity Industry," Wall Street Journal, Miriam Gottfried, September 22, 2020

# Deals by size and sector

## PE deals ($) by size




Source: PitchBook | Geography: US
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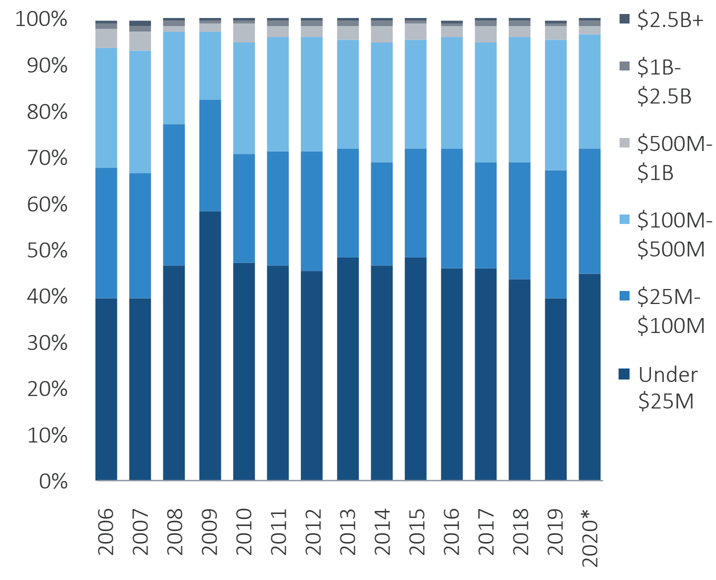
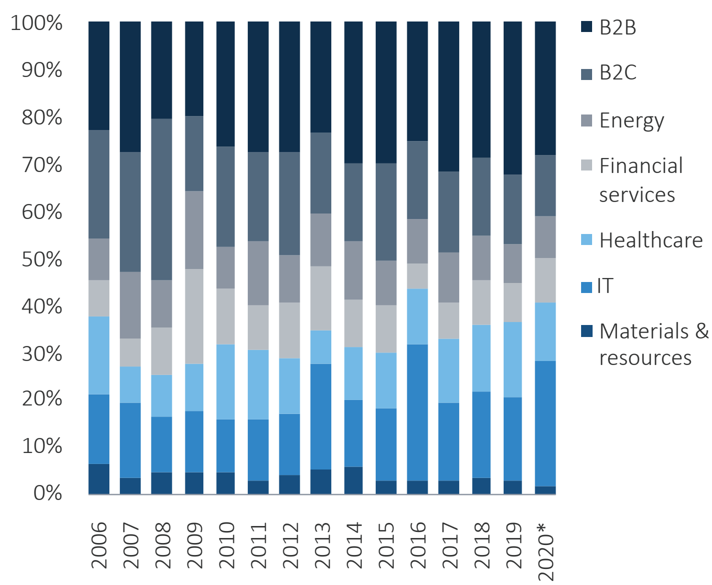
## PE deals (#) by size



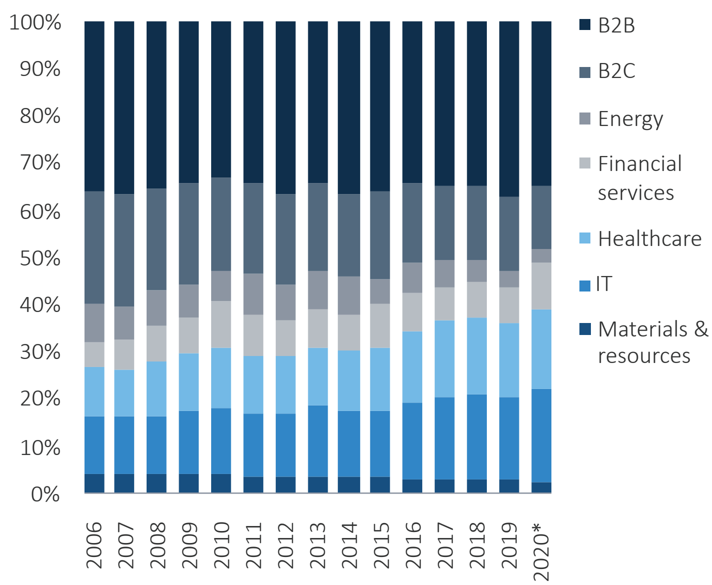

Source: PitchBook | Geography: US
*As of September 30, 2020

## PE deals ($) by sector




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

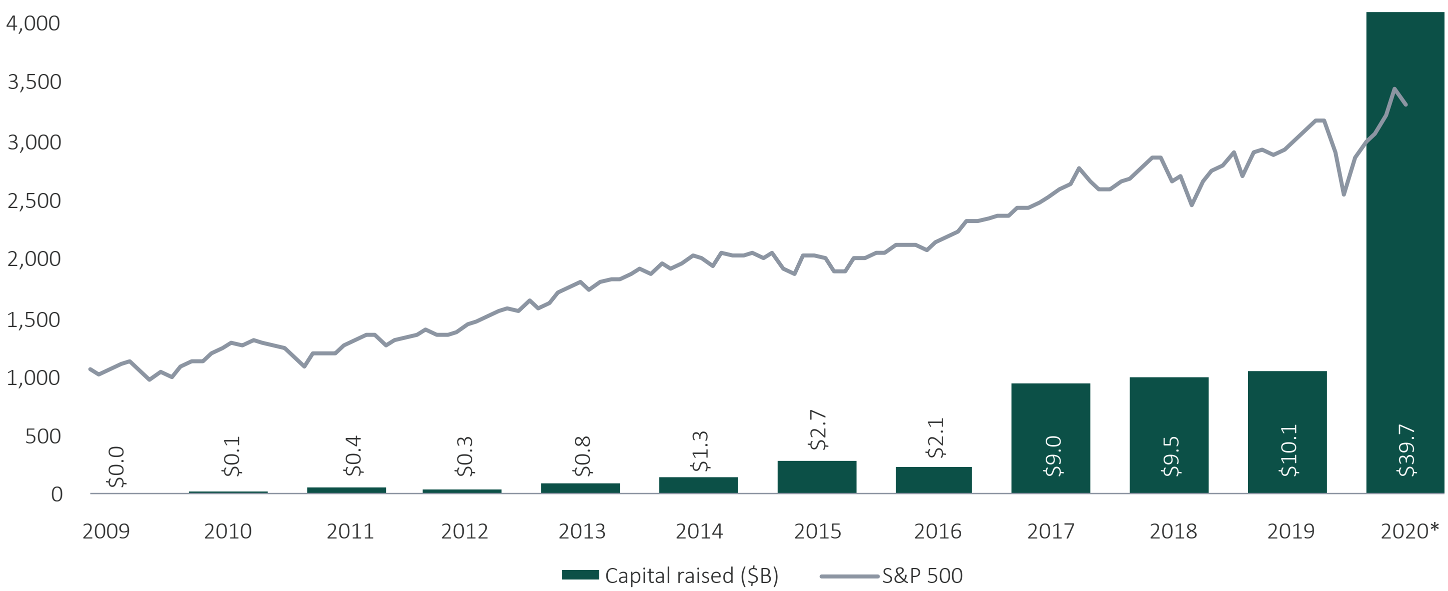
## PE deals (#) by sector




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

# Spotlight: The 2020 SPAC frenzy

## SPAC proceeds and public market performance




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

*Note: This spotlight was abridged from an analyst note on SPACs. For a more detailed analysis of the subject, which also covers institutional investors, SPAC targets, and sector spotlights, please read our report on the 2020 SPAC frenzy.*

*Introduction*

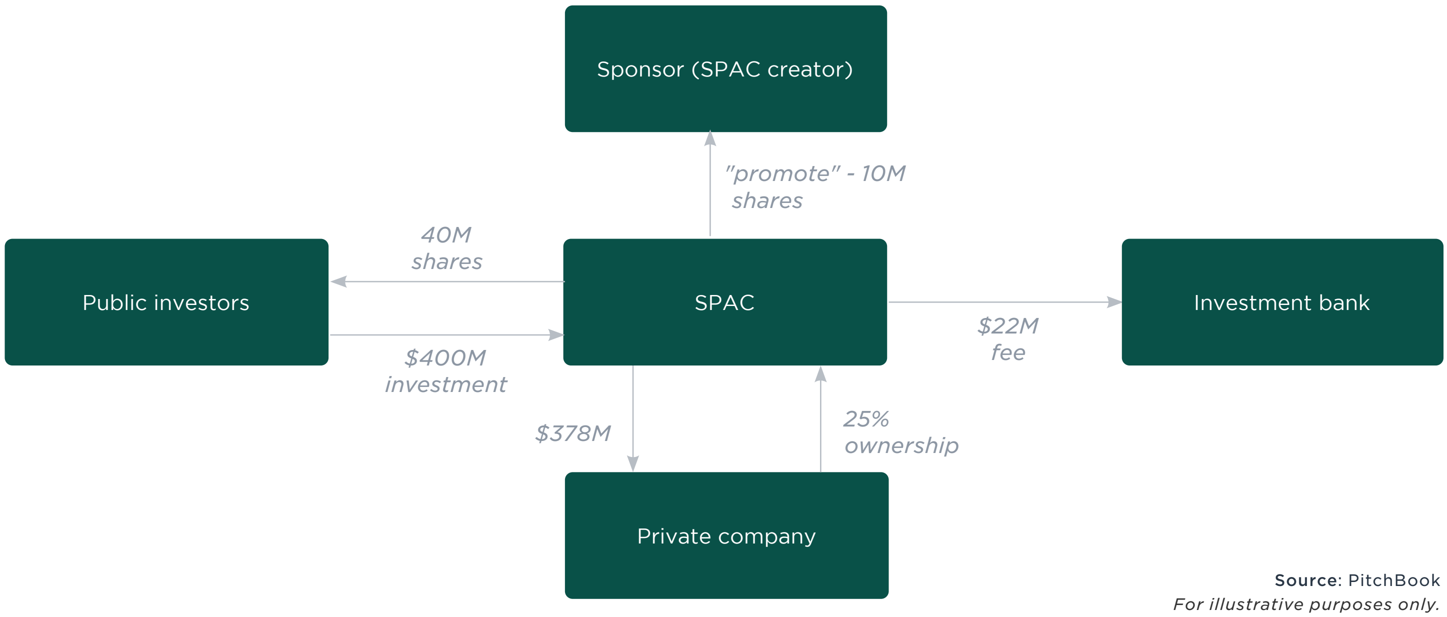
If there is one corner of the financial markets that has benefited from the pandemic, it is special purpose acquisition companies (SPACs). This atypical pathway to the public markets was once a niche strategy for small investment firms. These early embracers saw SPACs as a way to extract fees from adding structure to a reverse merger. The strategy has now become the hottest financial topic of 2020 after a massive uptick in the volume of these blank-check vehicles and as the stature of the investment professionals involved legitimized the space. The surge in IPO activity from SPACs has been covered by research providers ad nauseam, with PitchBook producing a few reports on the topic as well.

Despite extensive coverage by the industry, many misconceptions are still widely reported, and details that add nuance to the debate are commonly omitted from discussion. This analyst note aims to highlight some of these missing pieces for people in the investment community who are looking to change the way private companies become public companies and might be considering SPACs as an option.

*Why SPACs? And why now?*

This time last year, direct listings were the newest and shiniest toy for VCs when they were evaluating potential public market exits for their portfolio companies. Then came the pandemic, which plagued markets with economic uncertainty, especially public markets. The sustained volatility and the distinct price declines earlier in 2020 made IPOs and direct listings impractical options for the majority of private companies, which is where SPACs have found an opportunity. Unlike SPACs, direct listings do not allow private companies to raise any new capital during their transition to the public markets, which presents a problem for many startups given the elongated economic ambiguity driven by the pandemic. This is poised to change given NYSE's recent approval of adding primary shares into the opening auction, which would level the playing field of each public market pathway. Furthermore, direct listings and IPOs involve selling shares via an auction process, which can be messy in a volatile market.

## Hypothetical SPAC funding




**Source:** PitchBook
*For illustrative purposes only.*

Since a SPAC is essentially just a large box of money, the listing of a SPAC necessitates a much lower level of diligence than a similarly sized IPO of an operating entity since there are no financial statements to scrutinize. For a sponsor, one could say, raising a SPAC is more akin to raising a closed-end fund, allowing for a shorter and more comfortable timeline during the fundraise. The simplified process of raising a SPAC IPO has allowed these listings to go forward since SPACs usually trade near the NAV, and the reverse merger represents the true test for SPACs when a new operating company actually becomes public and investors then evaluate and trade shares accordingly.

*Sponsors*

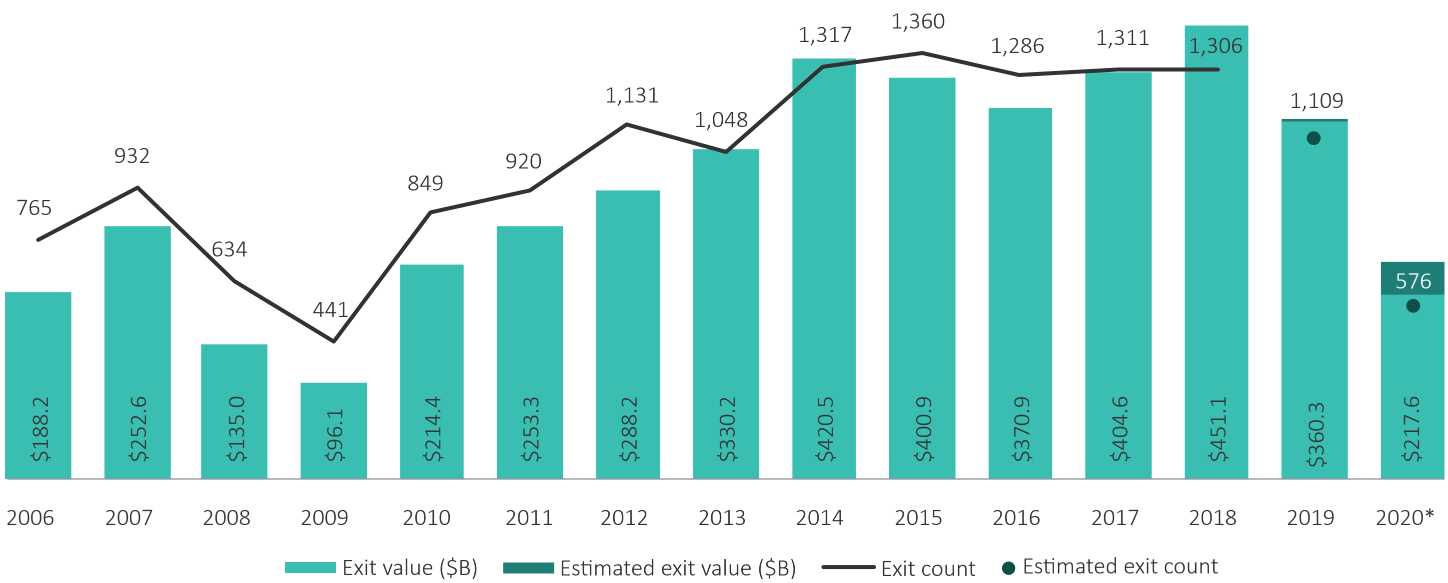
We start with the creators of the SPAC: the sponsors. For these players, incentives tend to be clear, since the sponsor acquires a special class of shares that equates to 20% of the shares in the SPAC for a nominal cash consideration, known as the "promote." These sponsors also reap other benefits in leading the SPAC, such as the option to organize a PIPE deal concurrently with the acquisition and the chance to offer some input on the strategy of the acquired business, often times through a position on the board. This strategic decision-making aspect is why former operators and executives often lead SPACs, using their expertise to identify attractive targets and help guide them to success. Sponsors do receive a lot of economic interest in the business for essentially finding the deal; that said, there are signs, such as the reduction or elimination of the promote or warrant allocations, that the SPAC structure is becoming less of a fee grab on subpar deals and instead more of a company-friendly vehicle with potential to create value. A shift in the makeup of SPAC sponsors toward institutional and reputable market participants has also begun to further legitimize the future of SPACs.

Since traditional IPOs of operating companies have been relatively scarce, SPACs have seen a huge boost in demand so far in 2020. Typical IPO investors have rushed to participate in these deferred listings in the hopes of backing the next great growth story. The high demand has allowed many SPACs to upsize the amount raised in their IPOs; both serial SPAC sponsors and new entrants alike have taken it as an opportunity to raise capital while the strategy remains in good favor. From the sponsor's point of view, raising a SPAC is just another fundraise with a slightly different LP base.

Sponsors are also potentially assuming that the market dynamics driven by the pandemic will create a host of targets at attractive valuations, suggesting the explosion may have stemmed from opportunism rather than deeper analysis around particular investment theses. This frenzy in new SPAC listings could hinder performance for these vehicles as competition heightens, which could inflate some valuations. It will be a couple years before we can tell whether or not this was a truly sound strategy for the sponsors, but for now it seems better to accumulate assets while the iron's hot.

# Exits

## PE exit activity




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

US PE exit activity is on pace to hit a 10-year low in terms of count and an eight-year low in terms of value. Through Q3 2020, US PE firms exited 576 portfolio companies for a combined $217.6 billion—YoY declines of 29.3% and 23.6%, respectively. The theme of GPs holding on to portfolio companies until valuations recover has continued for another quarter, though there are signs of change on the horizon. One of the major changes that could propel exit activity through the end of 2020 and into 2021 is that many buyout firms are now showing positive marks on portfolio valuations YTD. With PE firms feeling better about portfolio company valuations, we may see them more willing to sell in the coming quarters. Additionally, a change to tax policy driven by the US presidential election results (i.e., if a Biden Administration raises taxes on carried interest and top marginal earners) could spur GPs with massive gains in certain portfolio companies to sell ahead of schedule.[8] These theoretical changes to the tax code are predicated on a close election and may not be instituted immediately, potentially giving PE firms a year or more to exit if put into place.

A roaring stock market has also helped elevate exit figures, with many PE firms choosing to exit multibillion-dollar portfolio companies via IPOs. Early July saw a consortium of backers publicly list Dun & Bradstreet less than 18 months after closing on a buyout that delisted the data and analytics company. Initial demand led to an upsized listing that saw the firm raise $1.7 billion and valued the equity at $9.1 billion, a healthy step up from the $6.9 billion take-private value. Several massive growth-equity-backed healthcare companies listed publicly in 2020, including Oak Street Health and Royalty Pharma. These gigantic IPOs, wherein Oak Street was initially valued at just over $5 billion while Royalty Pharma was initially valued just under $10 billion, may help lift growth equity fundraising as capital is recycled into the strategy and as these exits prove out certain investment theses. Overall, public markets accounted for the bulk of multibillion-dollar PE-backed exits. Eight out of the 11 largest PE-backed exits in 2020 have gone through an IPO, which already puts 2020's PE-backed IPO value above any year since 2014.

The recent explosion of SPAC listings may also propel the number of PE-backed companies that exit to public markets—either through an IPO or a reverse merger with a SPAC. The sheer volume of SPAC launches is unprecedented, with 2020 values already topping any other year on record. The structure of many SPACs, whereby founder shares equal to 20% of the SPAC's value post acquisition (known as the "promote") are purchased for a nominal sum[9] by the SPAC sponsor, may incentivize

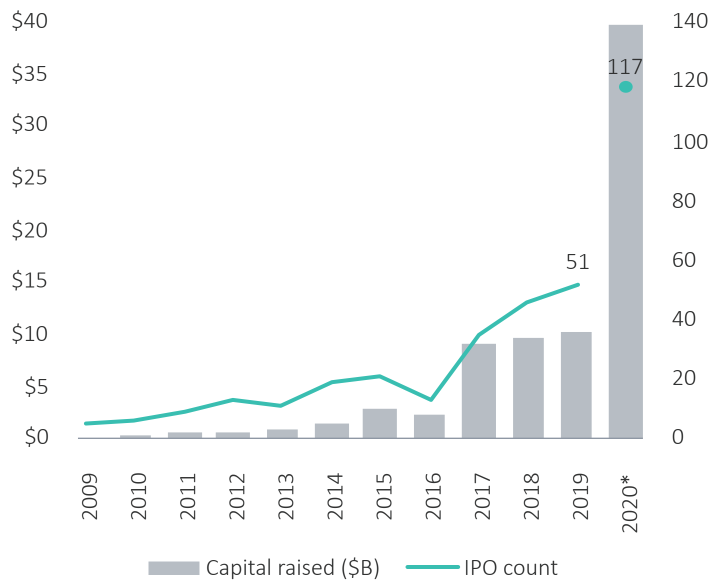
8: President Trump has also discussed changing the taxation of carried interest, but there has been no legislation brought forward to tax carried interest as income rather than capital gains at the time of this writing.

SPACs to finalize a deal above all else.[10] Since these shell companies often have a predefined life expectancy, the SPAC may also prioritize completing a deal above all else if the deadline is quickly approaching. With over 150 SPACs listing since the beginning of 2019, PE firms have a new target for portfolio company exits, especially since some with looser governance may be less valuation oriented. This set up can often lead to a win for SPAC sponsors and the party selling the company, but not for shareholders. To that point, the data shows that SPACs have dramatically underperformed other IPOs. Since 2015, nonSPAC IPOs have returned 37.2% on average while the 89 SPACs to complete a deal have returned -18.8% on average as of July 24, 2020.[11] However, many newer SPACs appear to be heading down a more shareholder-friendly path. A push to alter the promote structure[12] and increased sponsorship by institutional and reputable market participants may keep SPACs more disciplined on valuations and could help with share price performance going forward.

PE firms are already participating on both sides, sponsoring SPACs and selling portfolio companies to them as well. GCM Grosvenor, a Chicago-based hedge fund backed by Hellman & Friedman (H&F), recently agreed to a reverse merger with a Cantor Fitzgerald-affiliated SPAC. H&F plans to exit through the deal, thus ending the buyout firm's 13-year holding of GCM. Another PE-involved SPAC transaction, whereby Advantage Solutions agreed to go public via a reverse merger with Conyers Park II Acquisition Corp, has PE firms on both sides of the deal. Centerview Capital sponsored the SPAC while existing Advantage Solutions shareholders, including CVC Capital Partners, Bain Capital, and Leonard Green, will roll over their whole stakes and inject another $200 million into the company.

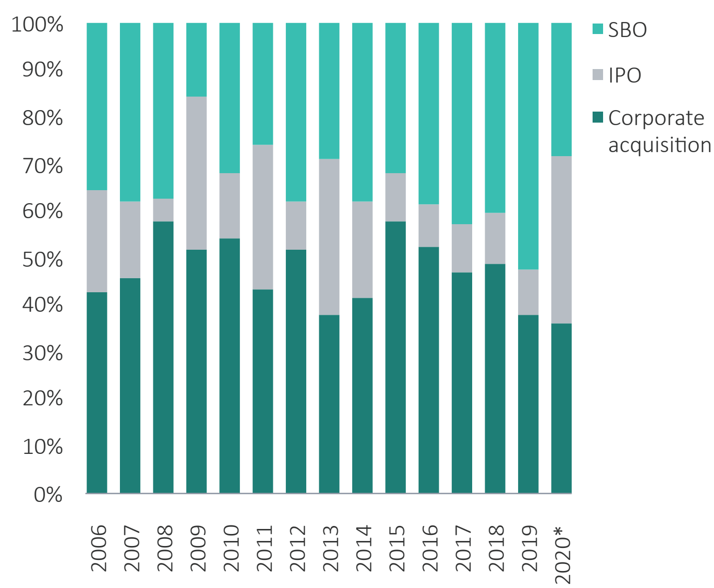
While PE firms selling assets to a SPAC appears to be a win for GPs and LPs because it creates more competition for portfolio companies, especially in the case where the buyer is less valuation oriented, having PE-sponsored SPACs on the buy side has the potential to create conflicts of interest for LPs. According to Buyout Insider, some LPs are already voicing concerns about the conflicts present in cases where a PE-sponsored SPAC and that same PE firm's buyout fund are competing for the same deal, particularly if the SPAC offers a higher payment through founder shares to the GP. This potential conflict could occur more frequently as more PE firms enter the space, including TPG, Gores, and H.I.G. Going forward, we may see some PE firms begin using

## SPAC IPO activity




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

## PE exits ($) by type




**Source**: PitchBook | **Geography**: US
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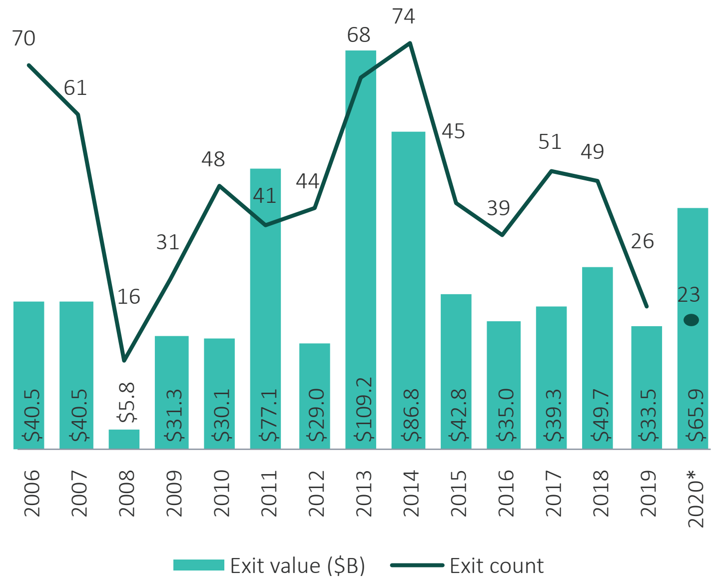
9: Founder shares are typically purchased for $25,000 and can be worth tens or hundreds of millions of dollars depending on the SPAC size.
10: "Special Purpose Acquisition Companies: An Introduction," Ramey Layne and Brenda Lenahan, Harvard Law School Forum on Corporate Governance, July 6, 2018
11: "Welcome to the Great 2020 SPAC Boom," Institutional Investor, Michelle Celarier, 9/21/2020
12: For example, Pershing Square Tontine Holdings Ltd. does not take any founder shares up front, the firm is only taking a 6.21% promote after the SPAC investors have already received a 20% return

SPACs as an alternative fundraising option, just as some credit firms use business development companies. We will be watching to see how these potential alignment issues play out, whether SPACs sponsored by PE firms deliver better share price performance, and how these PE firms square the traditional buyout financing and governance structure with SPAC acquisitions and less flexibility afforded to them by public markets.[13]

High-profile IPOs and reverse mergers with SPACs have garnered inordinate attention through 2020, but sales to other sponsors or corporates drove the bulk of exit count and value. One of the largest of the year, which is announced but yet to close, comes from Microsoft's $7.5 billion acquisition of ZeniMax Media. ZeniMax, better known for its subsidiary video game studio, Bethesda Softworks, has been backed by Providence Equity Partners since the firm invested $300 million for a 25% stake back in 2007. Producing a more than six times return on investment, Providence's growth equity transaction exit is one of the largest we have seen in recent years. As fundraising and deal activity for growth equity heat up, we expect to see more high-profile growth equity investments show up in our exits data.

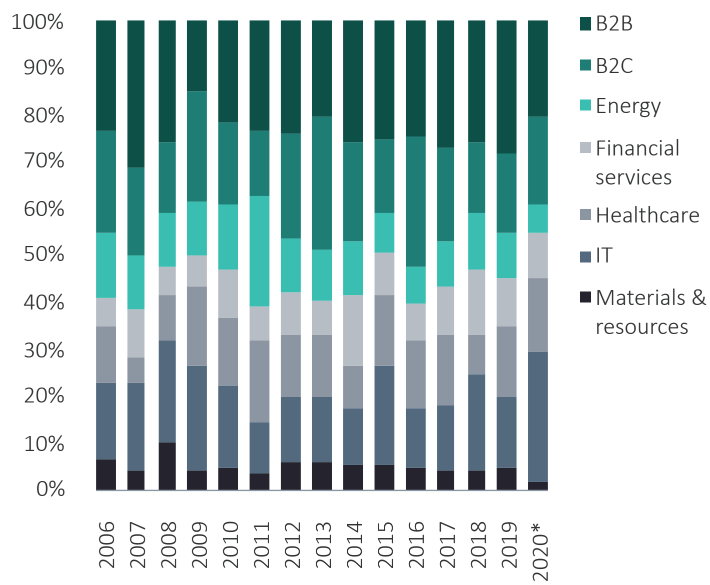
Topping other high-profile liquidity events, the largest exit of the year so far was a corporate acquisition, in which Thoma Bravo sold Ellie Mae to Intercontinental Exchange for $11.0 billion. This massive sale came just 18 months after Thoma Bravo took the mortgage processing software firm private for $3.75 billion. Thoma Bravo quadrupled the value of the company by bringing older contracts up to the current pricing and implementing engineering efficiencies. The deal also gave more credence to the ability of software-focused PE firms to create massive returns in short order and demand top-tier valuations even in a pandemic. Another announced software deal, where KKR-backed Epicor Software will be sold to CD&R for $4.7 billion, illustrates that non-software specialists are becoming more active in the space. Additionally, TPG is seeking to sell its US cable company—a combination of Wave Broadband, RCN, and Grande Communications—for $8 billion or more, according to Reuters. This could lead to a healthy return for TPG, which acquired the combined assets for just under $5.0 billion through 2016 and 2017 and has likely seen demand spike as more US citizens work from home than ever before. More broadly, internet-enabled and -enabling businesses have long been a focus on the deals side, but now these businesses are showing up on the exits side as well, with tech's proportion of exit value on pace for the highest figures in over a decade.

## PE-backed IPO activity




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

## PE exits ($) by sector




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

13: Buyouts are typically mostly debt financed while SPAC acquisitions are mostly equity financed. Further, there is less disclosure and reporting requirements for PE-backed businesses compared to public market ownership.

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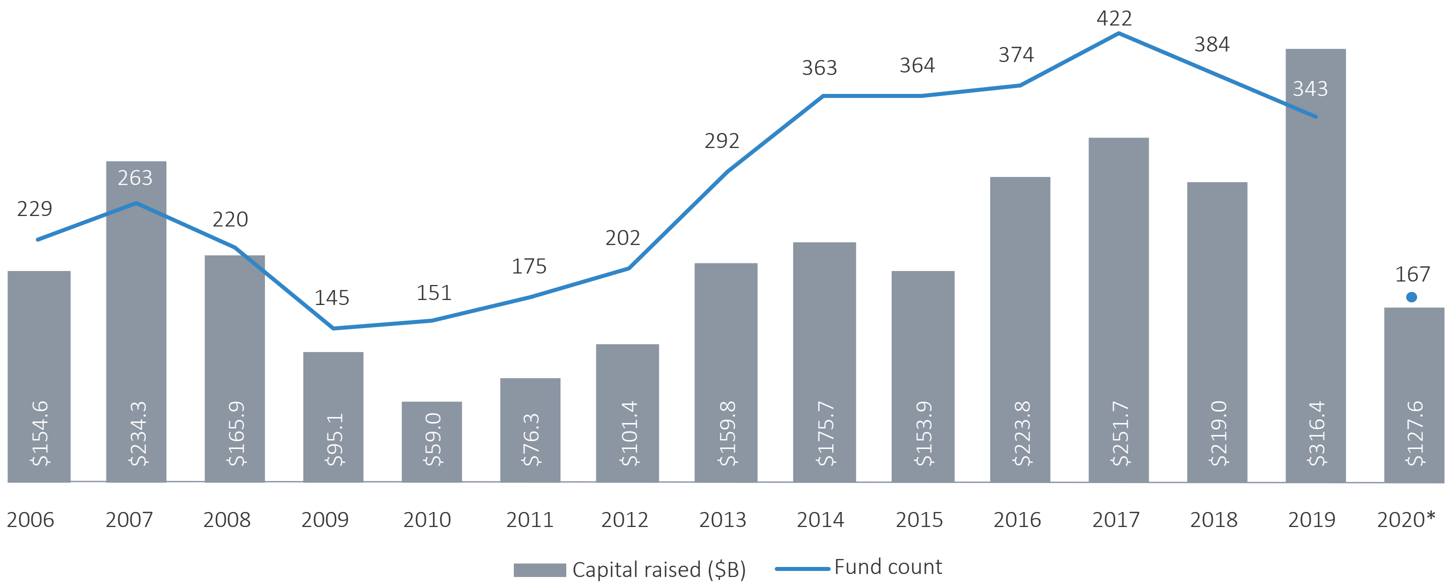
# Fundraising

## PE fundraising activity




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

Fundraising totals through Q3 2020 have been meager relative to recent years, with just 167 funds closing on $127.6 billion—27.4% and 42.7% reductions YoY, respectively. While these headline numbers may seem to indicate that COVID-19 is having a detrimental impact on US PE fundraising, there is more to the story. First, US PE funds are coming off the all-time record set for commitments, and we had been predicting a downturn in capital raised even before we knew about the coronavirus. This is because over a dozen mega-funds closed in 2019, and the list of open mega-funds heading into 2020 was low. So far, though, we have been surprised by the vigor in which mega-funds have come to market through 2020, despite the pandemic.

We have seen numerous massive funds launch, and signs now point to an active finish to the year for mega-fund closes. For example, CD&R has already collected $12 billion of the $13 billion target for its latest fund offering, and New Mountain's sixth flagship offering has collected $6 billion of its $8 billion target. Moreover, Thoma Bravo has already collected nearly $21 billion across three buyout offerings, and Silver Lake's latest flagship has surpassed $18 billion in commitments with a reported goal of $20 billion. These four GPs alone closing their current offerings at or above the reported targets would tack on at least $62 billion to 2020's fundraising total, placing this year near the figures achieved in 2016-2018. The largest publicly traded GPs are also finding success during this pandemic. On KKR's Q2 2020 earnings call, CFO Robert Lewin stated that the firm is finding this to be a good environment in which to raise capital.

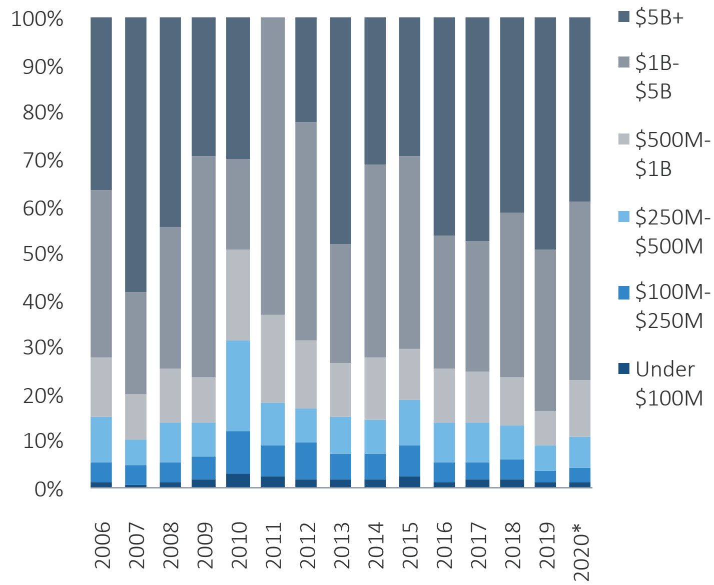
M&A of insurance assets has also helped some of the largest GPs grow AUM in recent quarters, though this will not show up in our fundraising figures. The big five public GPs have been actively acquiring insurance assets in 2020 because this permanent capital allows them to focus more on investing rather than fundraising. Apollo's AUM jumped nearly $100 billion in Q2 largely due to insurance transactions executed by Athora and Athene, for which it manages assets. Athora acquired VIVAT, while Athene closed a deal with Jackson National. KKR announced a major insurance acquisition as well of Global Atlantic, which is poised to boost the firm's AUM by over $70 billion.

Carlyle took a similar approach to Apollo and KKR in directly buying insurance assets. The firm plans to manage Fortitude Re's runoff insurance business and benefit from an influx of managed capital. Ares was active as well, purchasing Pavonia Life Insurance through its insurance and annuity-focused subsidiary, Aspida Financial, though the close date has been pushed back. Despite the postponement, Ares co-founder and CEO, Michael Arougheti, summed up the current state of the market saying, "We're as bullish as we've ever been about the insurance opportunity."

Blackstone hired Global Atlantic CIO, Gilles Dellaert, in January, seemingly setting up an expansion of the firm's insurance solutions business in the coming years. However, Blackstone appears to be focused on raising capital through its closed-end funds. In Q3, the firm held a final close on the inaugural Blackstone Life Sciences Fund at $4.6 billion. While the fund is the first under the Blackstone banner, the team managed several funds at Clarus Ventures—which Blackstone purchased in 2018—though they were much smaller. The fund has been busy inking high-profile deals, and judging from the pace of deployment, the strategy may quickly return for a follow-on fund. The firm is also nearing a final close for its sophomore GP stakes fund, Strategic Capital Holdings II. SEC documents reveal that the firm has raised $3.5 billion of its $4.0 billion target, which matches the target size of competing fund Petershill IV. Blackstone is also in the process of raising its inaugural growth equity fund. SEC documents filed on July 23 report that the fund has raised approximately $900 million of its $3 billion-$4 billion target. Uniquely, the bulk of the capital is reported to have been sourced from wealth management channels as opposed to the institutional LPs from which Blackstone typically sources.

Blackstone's growth equity fund targeting individuals is just the latest in a concerted effort by private capital managers to collect more capital from high-net-worth individuals and retail accounts. Following the Department of Labor's letter clarifying that 401(k) managers could not be sued for including PE in diversified funds (such as target date funds) in June, the SEC voted to expand the definition of accredited investors in August. This could lead to a broader acceptance of private capital funds within people's investment accounts. The move could also lead to a lift in participation from smaller investors, which may be a boon for the funds-of-funds industry, which has generally been battered as many large LPs have chosen to do direct fund investments rather than invest through an intermediary. Newly accredited investors will likely be forced to invest through an intermediary to gain access to top-performing GPs because these highly sought-after GPs are not interested in collecting thousands of sub-million-dollar commitments. It is our understanding that some of the largest asset managers are trying to figure out how to incorporate PE into target date funds, so an increase in fundraising from previously accredited investors may occur quickly. An influx of retail capital may also lead to a demand for transparency and a revision of performance measurement. Critics from academics to Warren Buffett have spoken out against the use of IRR, a metric that is not directly comparable to mutual fund or ETF returns, does not account for cash drag, and assumes that capital is reinvested at the same rate of return.

## PE funds ($) by size

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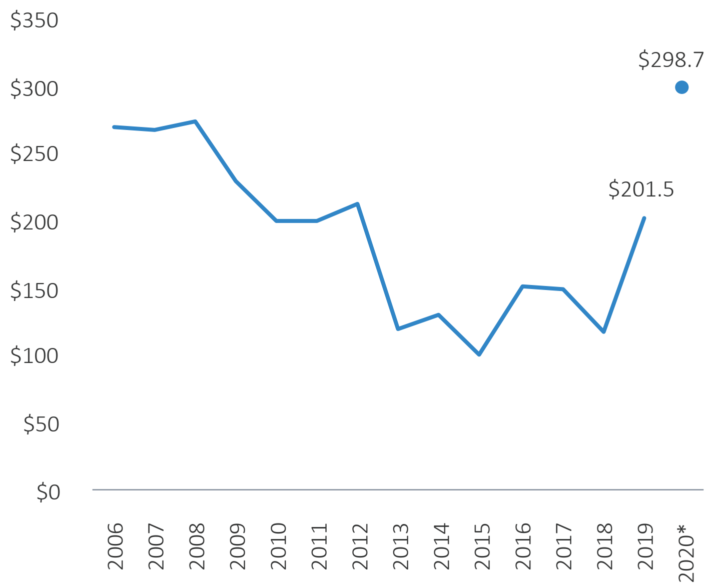
## Median buyout fund size ($M)

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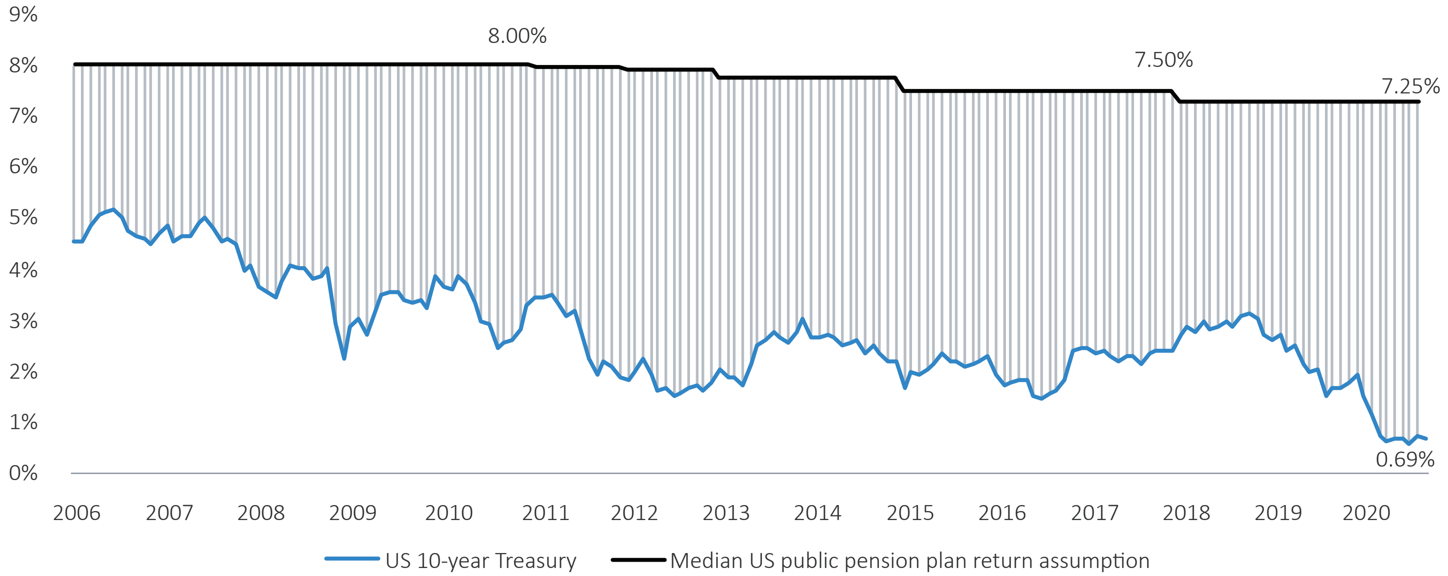
## Pension return assumptions compared to the 10-year Treasury

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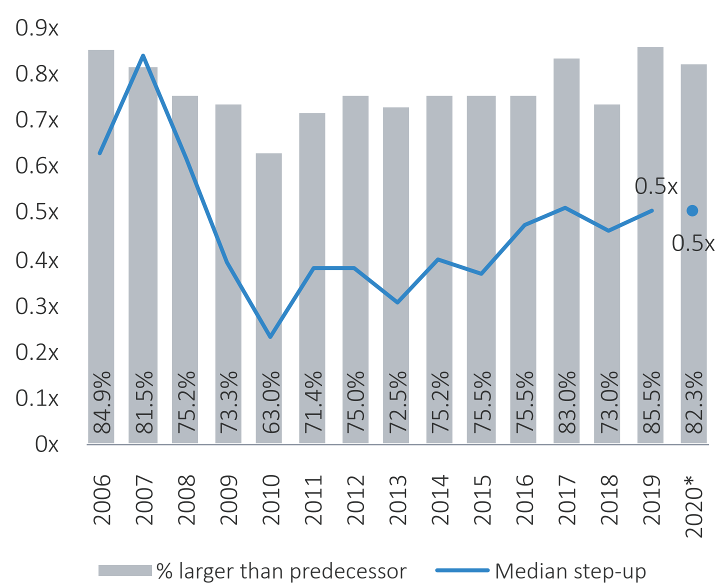
As we look to close out the remainder of 2020, we expect LPs are looking to further boost their allocation to alternatives, including PE, debt, real assets, secondaries, and more. The gap between the median US public pension plan's assumed rate of return and the 10-year Treasury is wider now than any point in the last 15 years, meaning pensions and other LPs will be forced to take more risk and/or allocate more capital to alternatives in order to meet these return expectations. A recent Invesco survey of global sovereign asset managers notes that just 12% of respondents intend to decrease allocations to PE in the next 12 months while 43% plan on raising their target PE allocation.[14] Raising allocations in the near term may be tricky though because exit activity has been anemic through the pandemic. LPs typically recycle the bulk of their distributions, which are driven by exits, into new capital calls. As valuations continue to recover, we may see exit activity improve in tandem, helping LPs fund additional commitments.

## Median step-up from previous PE fund in fund family

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14: "Invesco Global Sovereign Asset Management Study 2020," Invesco, Terry Pan, July 2020