Analysis of Public PE Firm Earnings: Q3 2020

Thematic investing continues to pay off

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Credits & contact

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

Design
MARA POTTER

Contact PitchBook

RESEARCH
reports@pitchbook.com

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Key takeaways

- The five largest publicly traded PE firms posted healthy performance numbers for their PE strategies. Blackstone and KKR posted double-digit gains in the quarter. Most of these managers' funds have positive performance on the year now, and this healthy recovery is likely a sign to come for other managers that report later.

- Concentrated investments among a few key themes including technology and life sciences drove performance figures for Blackstone and KKR. These managers credited tech investments as the primary drivers of returns in the quarter. All five firms discussed how they were approaching investments in high-growth areas of the economy, although some have been more bullish on these concentrated bets than others. Going forward, it seems as if these managers will continue to allocate as much or more capital to high-growth sectors.

- Permanent capital was a principal talking point again this quarter. While KKR, Carlyle, and Ares seem focused on trying to replicate a similar strategy that has proven effective at Apollo with insurance assets, Blackstone is deviating. The largest private capital manager is rolling over a $14.6 billion real estate holding into a new perpetual life vehicle that could prove to be a method of growing permanent capital that others may follow.

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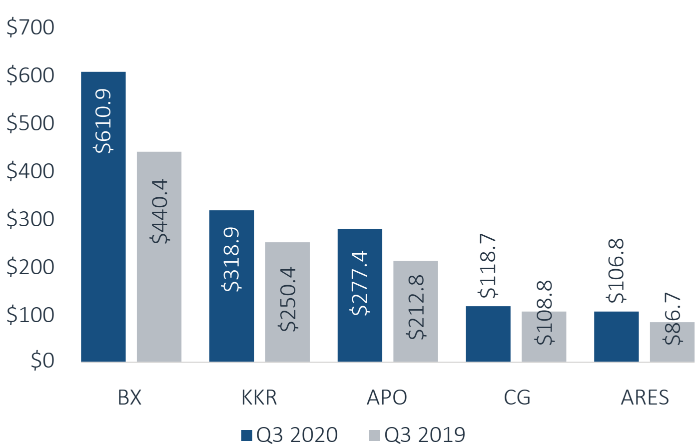
Financial metrics

The five largest public PE firms—The Blackstone Group (NYSE: BX), KKR (NYSE: KKR), Apollo Global Management (NYSE: APO), The Carlyle Group (NASDAQ: CG), and Ares Management (NYSE: ARES)—reported healthy financial results in Q3 amid a rebounding global economy. Fee-related earnings (FRE) have sustained for all five firms, despite the negative effects of the pandemic on most businesses. Blackstone reported a sizable leap in FRE on a quarterly and LTM basis. The firm's record-breaking $26.0 billion Blackstone Capital Partners VIII vehicle exited its fee holiday in June, driving the bulk of the firm's lift. Blackstone's $4.6 billion Life Sciences Fund V and $4.2 billion Energy Partners III funds also began collecting fees.

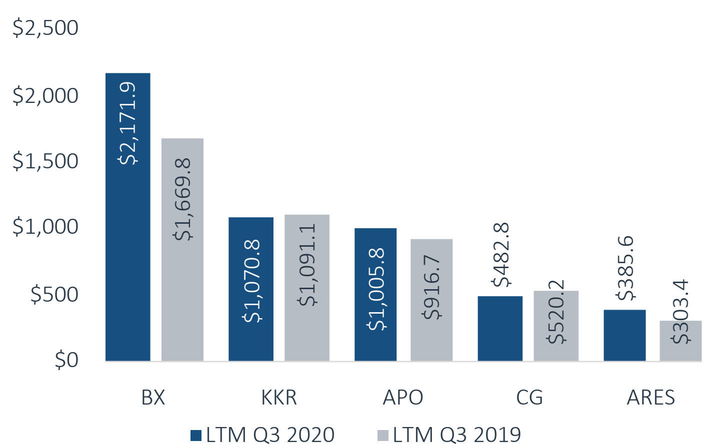
Each of the firms in this cohort also reported elevated distributable earnings (DE) over the past year, which is even more impressive given realized performance revenue (i.e., carry) typically constitutes around a third of their DE. After realizations came to a near halt between March and July, a rallying public equities market and an accommodating Fed have underpinned exit activity. Several managers said on the calls that sales processes were restarting and that these realizations should lift DE in the quarters ahead.

Quarterly FRE by manager ($M)



Source: Public filings
*As of September 30, 2020

LTM FRE by manager ($M)



Source: Public filings
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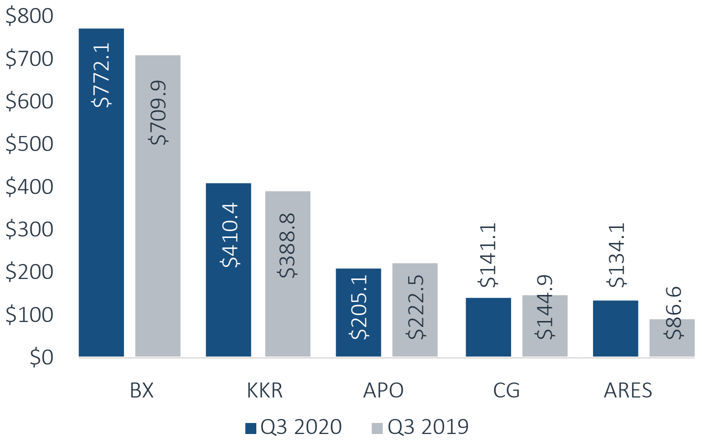
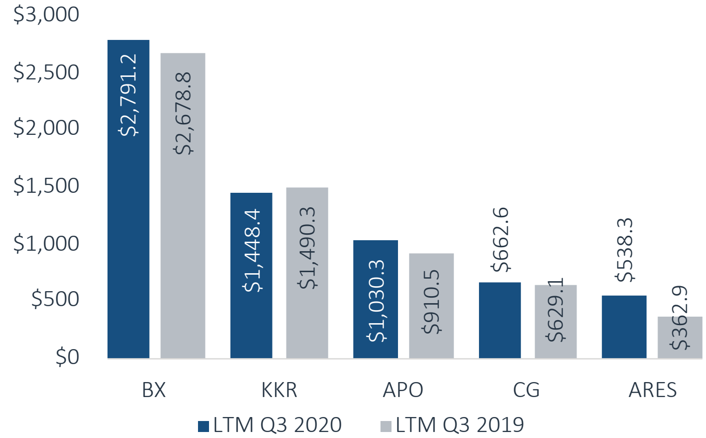
Quarterly DE by manager ($M)



Source: Public filings
*As of September 30, 2020

LTM DE by manager ($M)



Source: Public filings
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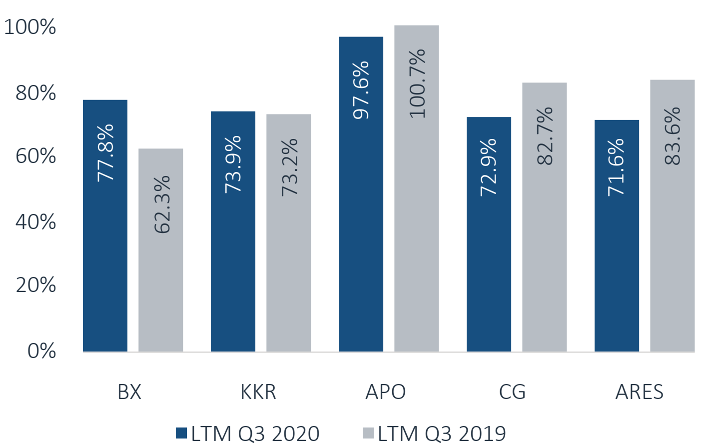
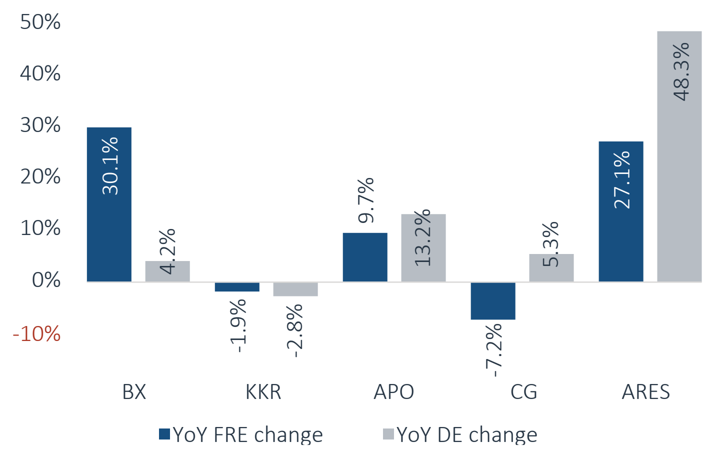
For most firms in this cohort, the recent realization activity has propelled performance fee revenues to a larger proportion of DE than a year ago. If realization activity continues at this pace for the next few quarters, FRE as a proportion of DE is likely to further shrink. However, as the heaps of cash these PE firms have raised during the pandemic enter the fee-earning stage, FRE will probably account for a larger proportion of DE.

LTM FRE as proportion of DE by manager



Source: Public filings
*As of September 30, 2020

YoY change in LTM financials by manager



Source: Public filings
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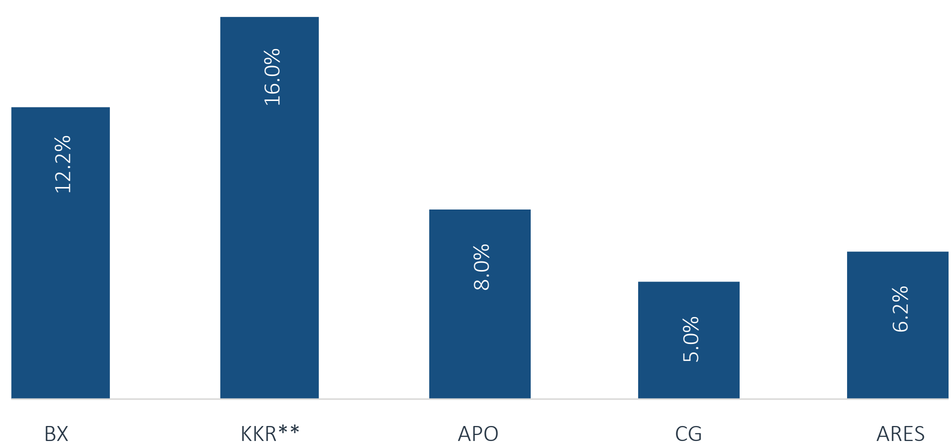
Thematic investing

Thematic investing (i.e., concentrating capital around one or more sectors based on long-term views) came up on the bulk of these firms' earnings calls in Q3 2020. Blackstone's president, Jon Gray, credited investments into technology firms such as Bumble and Refinitiv for the firm's quality PE fund performance in Q3. Life sciences office space and warehouse space—of which Blackstone has bought more than 1 billion square feet since 2010—also bolstered results for its real estate portfolios as ecommerce demand spiked. KKR also posted healthy returns in the quarter because of some concentrated bets in well-performing sectors as well as avoiding sectors that lagged. TMT accounts for 25% of its overall exposure, while Asia—where many economies have rebounded more quickly—represents around 30%. Energy, retail, hotels, and leisure together constitute just 8% of the firm's exposure. KKR also deployed the most capital into Asia-based companies during the quarter. This type of thematic investing helped Blackstone and KKR deliver double-digit gross PE fund appreciation in the quarter.

Carlyle and Apollo both indicated on their calls that they would also be focusing on high-growth sectors. Kewsong Lee, Carlyle's CEO, stated that he was pleased with the firm's investment activity in technology, healthcare, consumer businesses, and financial services and that the firm, like KKR, was pouring a lot of capital into Asia-based companies, primarily within China, India, and Korea. While Apollo appears to be trailing its peers in terms of investment into growth-oriented businesses, it may be participating on the credit side of things first. Apollo co-founder Josh Harris mentioned the loans the firm gave to Expedia and Airbnb during the depths of the crisis.

Q3 2020 gross PE returns by manager



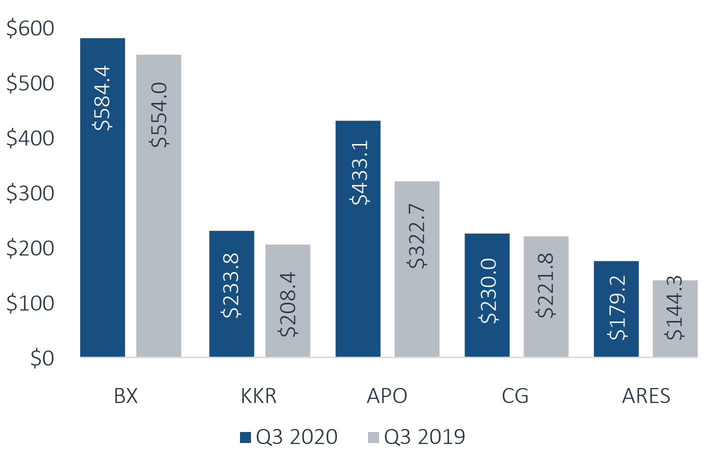
Source: Public filings
*As of September 30, 2020
***Includes only the firm's flagship American, European, and Asian PE funds*

Assets under management

AUM and fee-generating AUM are up YoY for all five managers. Apollo recorded the most notable jump in AUM and permanent capital, boosted by recent insurance acquisitions. In fact, the firm now reports that permanent capital accounts for 60% of AUM. This is a distinct advantage for Apollo and has been a key growth engine in previous years. KKR, Carlyle, and Ares seem to be taking a similar approach. KKR is one to two quarters away from closing its acquisition of Global Atlantic (GA), which is likely to add $70 billion or more to the firm's AUM, pushing it over the $300 billion mark. GA tacked on an additional $8 billion in reinsurance assets during the quarter, which will eventually flow through to KKR's AUM. Carlyle's Fortitude Re, which is the centerpiece to the firm's insurance strategy according to Lee, continues to plow cash into the firm's funds. By year end, Fortitude is expected to commit or invest more than $4 billion into Carlyle funds. Ares insurance subsidiary Aspida is acquiring the reinsurance subsidiary of FGL Holdings, which it will use to grow insurance AUM organically and inorganically.

While all of this has unfolded, Blackstone also made a splashy announcement regarding its permanent capital strategy. However, while the four other large public PE firms are tackling the issue one way, Blackstone appears to have a different approach. Playing to the firm's real estate strengths, Blackstone announced the launch of a new perpetual life vehicle on the firm's core plus platform. In a unique recapitalization, Blackstone is transferring BioMed—one of the largest owners and developers of lab space—into the new vehicle at a $14.6 billion valuation. This massive transaction gives LPs the option for liquidity while keeping BioMed under Blackstone's leadership and adding to its perpetual capital. This strategy, whereby Blackstone rolls over massive, successful investments into new thematic perpetual capital vehicles, could be a sign of things to come. The firm could target a similar approach with its gargantuan warehouse holdings and any large investments out of its record-setting PE fund. If Blackstone's real estate strategy can compound capital more quickly than firms employing insurance strategies, others may follow.

AUM ($B) by manager



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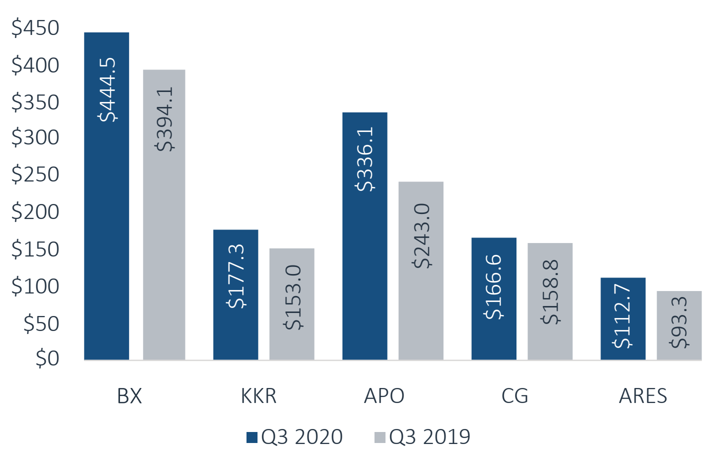
Fee-generating AUM ($B) by manager



Source: Public filings
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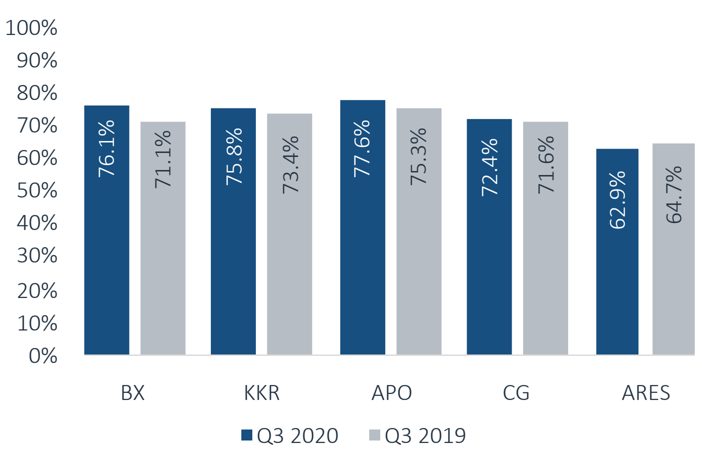
Fundraising

All five firms opined that the current environment is favorable for raising capital, and it appears mega-managers are continuing to capture higher wallet share from LPs. KKR's strong Asia franchise appears to be growing especially nicely. The firm commented on how its fundraising momentum has sustained as it collects capital for Asian real estate, infrastructure, and PE funds. In fact, KKR's Asia Fund IV has already collected more than $13 billion in commitments, which would make it the largest Asia-based buyout fund ever, solidifying KKR's prominence in Asia.

While KKR, Blackstone, Carlyle, and Ares appear to be having a relatively easy time fundraising, the story is more complicated at Apollo. The business relationship between Apollo's Leon Black and the late, disgraced financier Jeffery Epstein is clearly making fundraising more difficult for the time being. Just days before the earnings call, Pennsylvania Public School Employees' Retirement System (PSERS)—which has $59.0 billion in AUM and more than $900 million invested with Apollo—said it would halt all new investments with Apollo and was tracking the internal investigation into the matter.[1] The Connecticut State Employees Retirement System, which committed $125.0 million to Apollo's 2017 vintage $24.7 billion buyout fund, said it will also pause new commitments.[2]

Other investors are also exhibiting caution. California Public Employee Retirement System (CalPERS) and Teachers Retirement System (TRS) of Texas have reached out to Apollo for more information and may pause new commitments.[3] We expect public pensions to be the most cautious around this type of bad press, and others may pause their investments to Apollo as well. It seems Apollo's leadership feels the same, with CFO Martin Kelly commenting, "We expected that some investors may look to pause new commitments to Apollo over the near term, at least until the independent review being conducted by the Conflicts Committee has been completed." According to Apollo's Harris, the review could be wrapped up by the end of the year, but it could very well take longer.

Fee-generating AUM as proportion of AUM by manager



Source: Public filings
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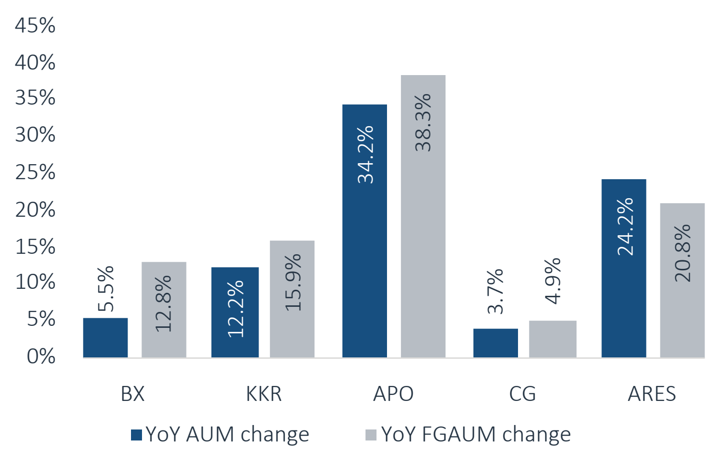
YoY change in AUM by manager



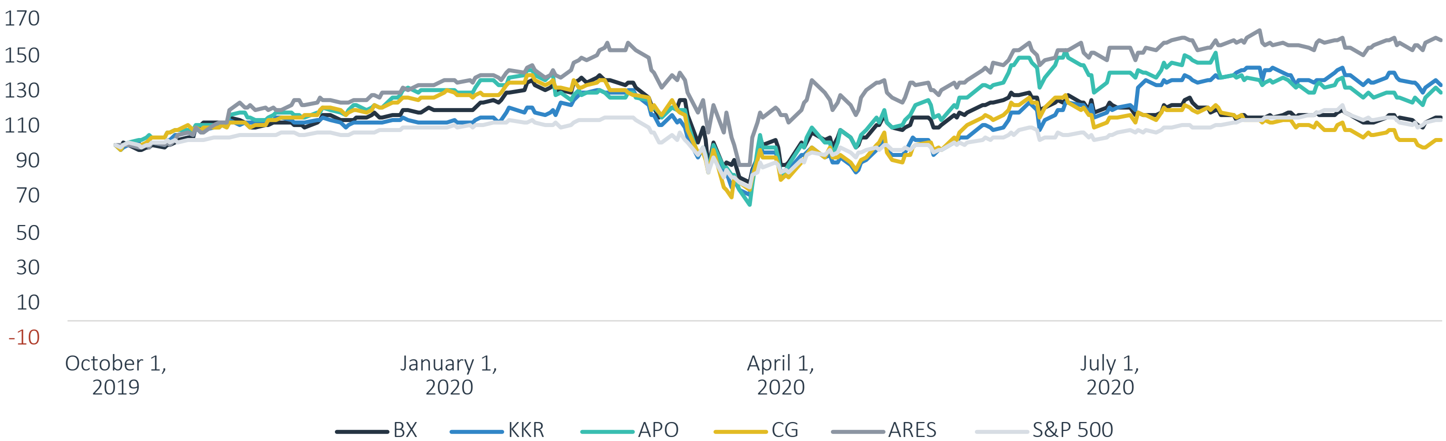
Source: Public filings
*As of September 30, 2020

1: "Apollo Investor Halts New Commitments over Leon Black's Jeffrey Epstein Ties," Financial Times, Kaye Wiggins, Mark Vandevelde, and Billy Nauman, October 21, 2020.
2: Ibid.
3: Ibid.

Share price performance

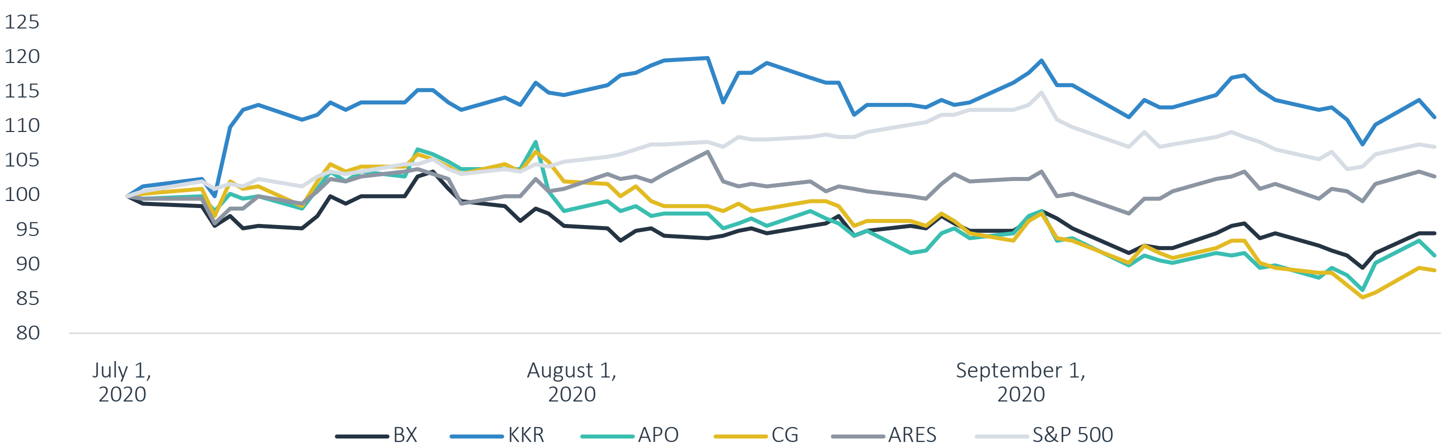
Each of these five PE firms other than KKR underperformed the S&P 500 during the quarter as tech companies continued to propel broader public indices higher. Longer term, though, this cohort has held up well against the index, with just Carlyle underperforming over the past 12 months. It is worth noting that Carlyle and Blackstone have not regained all the ground lost during the pandemic selloff while the others, and the S&P 500, have. We will be closely watching the firms' unique approaches to fundraising, permanent capital, and more to see which are rewarded by public market investors.

Share price total return rebased to 100 on October 1, 2019 by manager*



Source: PitchBook
*As of September 30, 2020

Share price total return rebased to 100 on July 1, 2020 by manager*



Source: PitchBook
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