PitchBook

2020 Private Equity Outlook

Forecasting the primary trends that will shape PE in years to come

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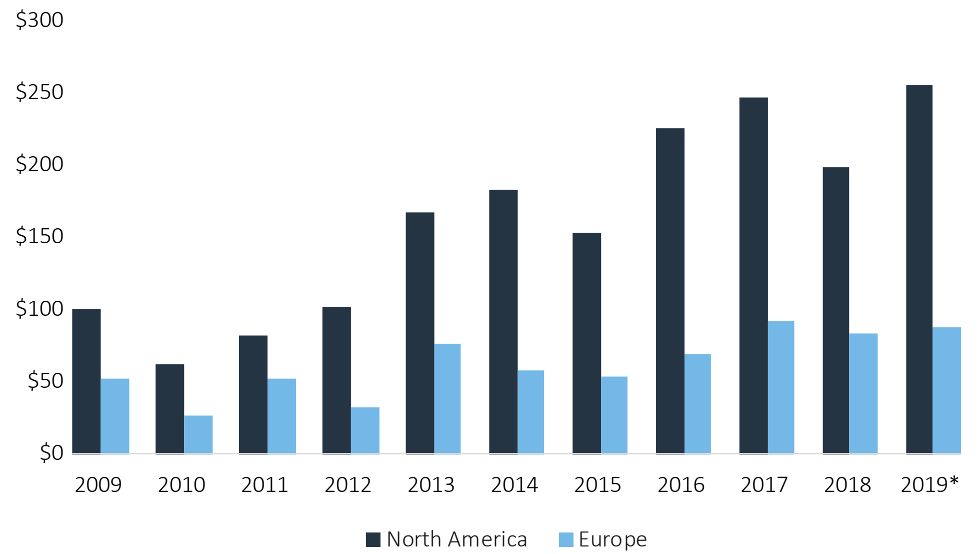
Prediction: PE fundraising will fall below 2019 totals.

> ***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 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.

PE fundraising in North America and Europe has already set an annual record in 2019, totaling $342.9 billion through mid-November.[1] If the dollar value of next year's fundraising totals falls below this mark, it doesn't necessarily mean that allocations have cooled. Rather, we know that fundraising data is inherently lumpy (the entire fund amount is counted in the quarter during which the fund holds a final close). Plenty of large funds could be on the road—even making investments in the meantime—but may not hold a final close until 2021. Another factor adding to the chances of a down year in fundraising is the possibility of a drawdown in public equities; we would then expect to see a "denominator effect" in which LPs must slow the pace of new commitment to PE since other parts of the portfolio have seen devaluations. If we do see another banner year in PE, it will be due in part to institutional investors increasing allocations to alternatives, through a combination of fund commitments, co-investments and direct investments.

1: As of November 14, 2019

PE fundraising ($B) by region



Source: PitchBook | **Geography:** North America and Europe
*As of November 14, 2019

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

> *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 incented 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.

GPs with scale can share best practices and back-office resources across portfolio companies, as well as grow AUM and accompanying fees and carry. For their part, many institutional investors want separately managed accounts with allocations across PE, private debt, real estate and hedge funds, and GPs are willing to scale to provide such exposure all under one roof. Many of the larger private market practitioners today began as buyout shops, so credit specialists are the most likely to be picked off since they allow GPs to participate in similar deals across all parts of the capital stack. Past examples include Blackstone's acquisition of GSO Capital Partners and Carlyle's purchase of Churchill Financial. We have also seen acquisitions outside of credit. In addition to Carlyle's purchase of Churchill, the firm purchased AlpInvest, a major player in funds-of-funds and secondaries, in 2011. Additionally, Blackstone bought Clarus Ventures in 2018 before renaming the entity Blackstone Life Sciences.

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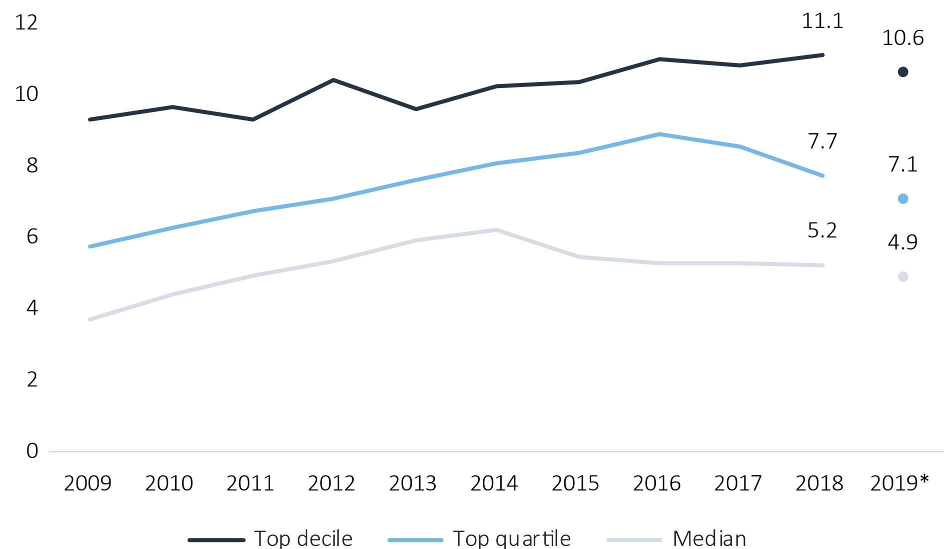
Prediction: GPs will increasingly hold some of their top-performing assets longer.

Rationale: With many PE holding times stretching past a decade, fund lives often bump up to the end of the alloted 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.

PE holding times (years)



Source: PitchBook | **Geography:** US
*As of November 14, 2019

We have seen an unprecedented rise in PE holding times for the top quartile and decile. LPs and GPs have accepted this new reality and are pursuing a litany of longer duration PE funds. In the US, the top-quartile holding period now stands at 7.1 years, while the top-decile holding period is 10.6 years, extending longer than many traditional buyout funds are set up to last.

Not only are holding times up, but the number of lucrative opportunities is down, with mountains of capital chasing fewer high-quality deals. For investors already locked into typical 10- to 15-year funds, many GPs believe fewer profitable investment options exist than in years past, potentially making companies within a PE firm's current portfolio the most attractive place to commit fresh capital.

GPs are finding creative ways to hold on to their winners. We have seen TA Associates raise a dedicated fund to buy minority positions in companies the flagship fund exits. Firms such as Vista Equity Partners have taken a different approach and executed partial sales, selling a piece of the company while retaining a stake. This lowers risk in the investment while leaving upside potential. Dividend recaps, another method of providing liquidity on extended holdings, have also spiked in usage.

Secondaries are also seeing a marked uptick in activity. It seems like each year is a new all-time high in secondaries transactions, and 2019 is no different. What once was a market for LPs to sell stakes in funds has recently seen the GP-led side come into focus. GP-led secondaries, whereby the GP will roll one or more portfolio companies into a continuation fund, are projected to overtake the LP side in the coming years. In general, GPs are increasingly holding fast to their top performers and continually searching for ways to profit from their winners for longer.

Prediction: The big four public GPs[2] will expand their strategy offerings at twice the rate of comparable GPs.

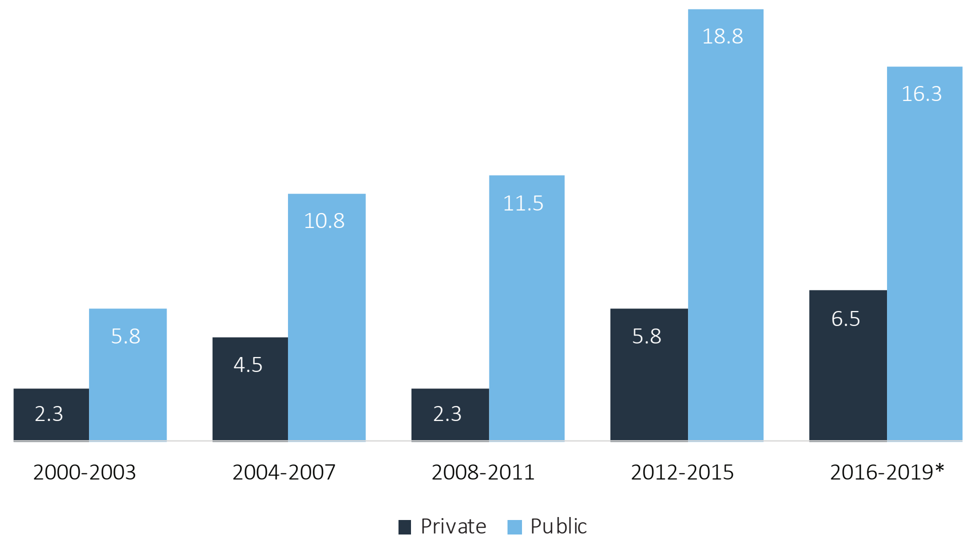
> ***Rationale:*** The large public GPs have taken steps, including converting from public partnerships to C-Corporations, to boost the value of their shares. Expanding into new strategies not only helps these GPs grow AUM at a quicker pace, it also allows for a more diverse revenue stream that can weather 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.

We have already noted that the public PE firms prioritize AUM growth more than comparable privately held PE firms. Since LPs are only comfortable with moderate step-up sizes, which tend to decrease as fund sizes grow, many of the largest GPs are turning to strategy expansion to augment AUM figures. We have seen how substantially step-ups can lag at the top end with Blackstone's flagship buyout funds. The firm's 2006 vintage Blackstone Capital Partners (BCP) V fund closed at $21.7 billion; its 2019 vintage BCP VIII fund closed at $26.0 billion. 13 years and three funds later, there was minimal growth in the fund's relative size. To continue using Blackstone as an example, it has recently diversified its strategy offerings by purchasing Clarus Ventures and using the platform for the creation of Blackstone Life Sciences, and the firm is also looking to raise its first growth-equity fund.

Beyond just growing AUM, a broader strategy offering allows for a more stable income stream and could dampen carry's volatility as multiple funds may be realizing carry at different times. Public investors tend to value the stability that comes with managing multiple strategies more highly than volatile and specialized managers, meaning these GPs are likely to achieve a higher valuation if they successfully broaden their offerings. Beyond the more stable cash flows that come with managing multiple funds—especially for large funds—management fees are likely to make up a higher percentage of revenue, which investors value higher because of their predictive nature.

2: 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 strategy offerings by vintage bucket and backing status



Source: PitchBook | **Geography:** Global
*As of November 14, 2019

The general trend of the public GPs becoming one-stop-shops for LPs is supported on the LPs' end as well. Many of the largest LPs, such as CalPERS and the New York State Common Retirement Fund, are seeking to write larger checks to fewer GPs. This minimizes due diligence costs and shortens monitoring time. One example of this was CalPERS's $750 million allocation to BCP VIII, which was larger than most PE funds raised in the US in 2019. With LPs looking to access private markets strategies beyond the vanilla buyout fund, big public GPs are in pole position to expand offerings and meet the needs of the largest LPs.

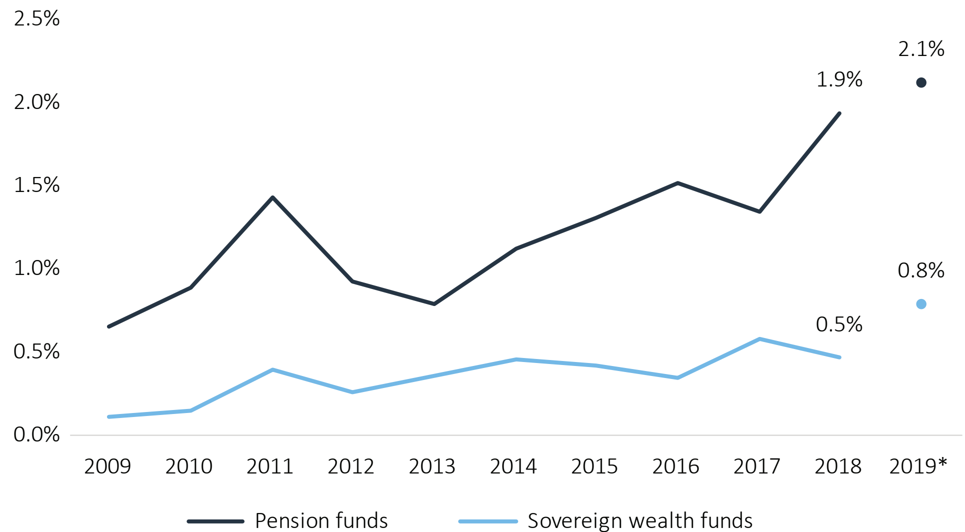
Prediction: Sovereign wealth funds and pension plans will become more sophisticated investors, increasing control over investments.

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 CPPIB and GIC, are already active in the direct space, perhaps encouraging others to join in.

Caveat: Some poorly performing direct investments, such as PIF's investment into Uber, may cause SWFs to act with increased caution and forego direct investments and co-investments for fund commitments. Additionally, 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 thereby 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.

Large public pensions in the US have expressed enthusiasm about "The Canadian Model." In this model, some of the largest Canadian pension plans have become sophisticated institutional investors with high allocations to private markets, through the traditional fund structure and direct deals and co-investments. Their efforts have been rewarded with long-term outperformance compared to similar pension plans. CalPERS, the largest US pension of its kind, acts as a bellwether and is pursuing structures that would allow for a more active in-house team, though it recently stalled these efforts. The firm has considered establishing its own asset management team as well as hiring an in-house deal team. However, dealmaker salaries, which may stretch into the millions of dollars annually, are not palatable to US pensions, despite the success of Canadian counterparts. If CalPERS—or any other massive pension plan in California, Texas or New York—can bring in a team and complete more PE deals outside the fund structure, we believe other large pensions would follow suit.

Proportion of PE deals (#) with SWF or pension fund direct investments and/or co-investments



Source: PitchBook | **Geography:** US
*As of November 14, 2019

Dozens of SWFs are looking to the Canadian pension plans as well as GIC and ADIA for inspiration. Those actors often complete dozens of direct deals annually and are paving the way for smaller (or occasionally larger, such as Norway's $1 trillion SWF) funds. Most SWFs do not have the same issue with public disclosures of salaries as US pension plans do, helping them to more quickly build an in-house team. While we believe US pension plans will follow suit, SWFs will likely do it sooner and scoop up high-quality talent. We are already seeing some sophisticated SWFs pair up with PE firms and complete direct deals. GIC linked up with Brookfield to take Genesee & Wyoming private for $8.4 billion and ADIA teamed up with Cinven and Astorg to purchase LGC Group from KKR for £3.0 billion. These massive institutional investors also want to do more in-house because it gives them additional control over their unfunded liabilities. This may help these investors avoid 2008-like liquidity crunches when some investors had billions in unfunded liabilities to PE funds and had to meet capital calls while their portfolio of public investments collapsed.

Direct deals happen outside of PE as well. While building out an in-house PE team may be a tough pill to swallow for some pension plans, an in-house real estate team may require less capital outlay. Though this prediction is focused on PE, we may see US pension plans foray into direct real estate first as a primer for PE-style dealmaking down the road.

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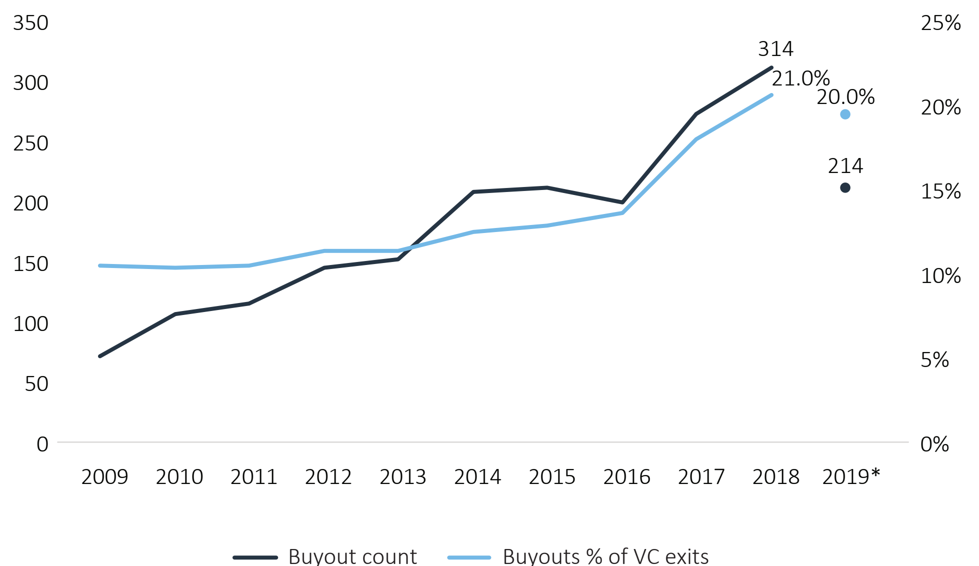
Prediction: VC-to-PE buyouts will continue to proliferate.

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 (e.g. WeWork) 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 that these high-profile failures may also deter investment in nascent tech companies and push PE firms to target more established (i.e. no longer VC-backed) tech companies, which we see as the biggest threat to VC-to-PE buyouts.

Buyouts (#) as proportion of VC exits



Source: PitchBook | **Geography:** North America & Europe
*As of October 26, 2019

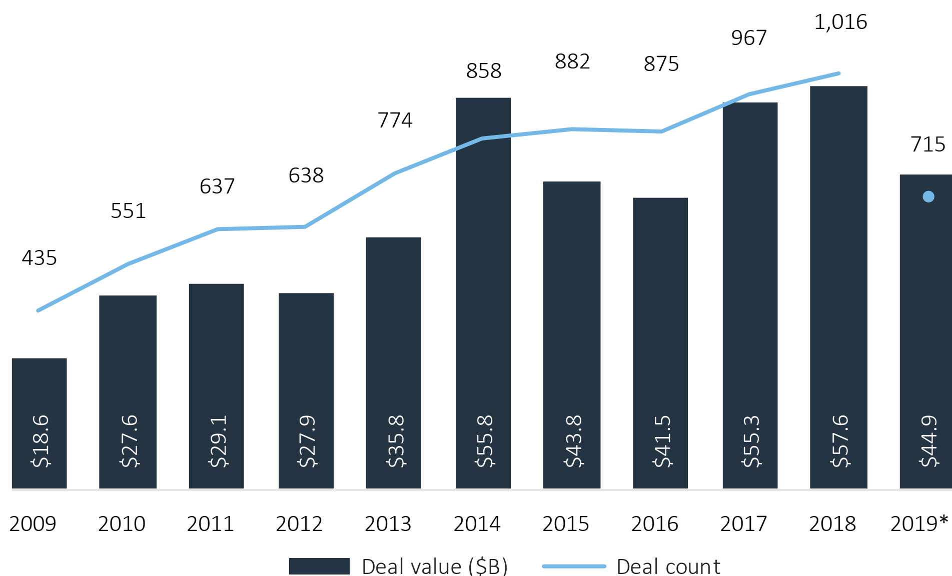
Traditionally, GPs have targeted mature companies, which have stable EBITDA and assets the GP can use as collateral to leverage the company. The movement toward technology investment has changed this playbook because tech companies tend to have low levels of tangible assets. Buyout shops, realizing the potential for profit, have taken to buying out younger, high-growth, asset-light companies (that sometimes are unprofitable), as the market has allowed for lucrative returns when exiting these companies. Tech-focused PE funds—which are some of the largest buyers of VC-backed companies—have also outperformed non-tech buyout funds and non-tech growth equity funds, causing LPs to pour capital into the space, another indication that the number of VC-to-PE buyouts will continue to grow. Vista Equity Partners, perhaps the most prominent tech-focused PE firm, raised the largest tech-buyout fund to date at $16.0 billion in 3Q 2019. Vista has been involved in the buyouts and subsequent successful exits of a bevy of formerly VC-backed companies such as Marketo and Ping Identity. Thoma Bravo, another prominent tech-focused PE investor, also raised $12.6 billion in 2019 and reportedly plans on raising another $15.0 billion in 2020. These two firms are likely to play a pivotal role in VC-to-PE buyout activity next year.

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

> *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.

As the number of late-stage VC-backed companies continues to grow, more relatively mature companies will likely take growth equity investments. These companies still want to scale and expand; however, they are too mature for late-stage VC investments and do not yet want to raise capital in the public markets. The number of US-based growth equity deals grew nearly every year from 2009 to 2018, totaling $57.6 billion across more than 1,000 transactions in 2018.

PE growth deal activity



Source: PitchBook | **Geography:** US
*As of November 18, 2019

Both GPs and LPs also have a vested interest in the expansion of growth equity deals. LPs want to help finance this burgeoning cohort of more mature VC-backed companies because growth equity has typically translated to healthy returns and produced a differentiated return from LBOs and VC. While LPs are looking to expand private markets allocations, many of them are also intent on keeping a lid on the number of managers in their stable. This gives some of the major GPs the opportunity to meet the demands of their LPs who want access to growth equity funds but not new manager relationships. Expansion into growth equity also allows GPs to boost and diversify AUM, with the hope of lifting the asset manager's valuation. Blackstone is one example of a GP raising a growth fund in order to satisfy LP desire for diverse offerings and grow their own AUM. The firm's debut growth fund, which is aiming to raise between $3 billion and $4 billion, will generally execute minority investments, though they have the leeway to complete majority stakes, as well.

2019 predictions scorecard

Below we summarize our predictions for 2019 and how they fared.

Prediction	Result	Comment
GP stakes will experience ongoing innovation.	PASS	The GP stakes industry continued to innovate as market leader, Dyal, began pursuing a credit fund which would be the first of its kind for GP stakes. Other niche managers also emerged with innovative seeding solutions.
Secondaries activity will hit another all-time high.	PASS	Secondaries contributions indeed reached an all-time high by year-end 2018. While contributions have slowed in 1H 2019, increased leverage in the space indicates that dealmaking is still strong.
Multiples in public and private markets will converge further.	FAIL	Multiples diverged in 2019 as PE multiples rose, but to a lesser extent than public markets. The S&P 500 jumped in the year despite earnings lagging.
Short-term returns will fall for PE funds, but performance will improve relative to public markets.	SPLIT	The one-year rolling horizon IRR fell slightly to 9.6%, but PE's performance relative to public equities diminished due to a surge in public equities in the front half of 2019.
Take-privates will increase in prominence.	SPLIT	2019 and 2018 had the same number of take-privates above $5B close, but 2019 had fewer below the $5B mark. There are several $5B+ take-privates announced in 2019 that should close next year.
Private debt fundraising will rebound but remain below 2017 levels.	FAIL	Though still strong by historical standards, the dollar-value of global private debt fundraising is on track to fall by about 20% YoY.