PitchBook

GP Stakes Deployment Opportunities

Assessing the industry's capacity to invest additional capital

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

Credits & Contact

PitchBook Data, Inc.

John Gabbert Founder, CEO
Nizar Tarhuni Senior Director, Institutional Research & Editorial

Institutional Research Group

Analysis
Wylie Fernyhough Senior Analyst, PE Lead
wylie.fernyhough@pitchbook.com
Zane Carmean, CFA Quantitative Research Analyst
pbinstitutionalresearch@pitchbook.com

Publishing

Designed by **Kelilah King**

Published on July 26, 2021

Contents

Key takeaways

- Despite the tens of billions of dollars raised and deployed into minority stakes in private capital firms, the GP stakes strategy still has ample deployment opportunities. We estimate the total enterprise value of the firms we track to be more than $800 billion. Assuming a select percent in each size bucket sells a 20% stake, that would still be a massive $100 billion+ opportunity set.

- The middle market appears to be especially appealing for capital deployment. Of all the segments as we define them, this space has the best combination of market size and ability to deploy capital, with approximately $400 billion in firm enterprise value. The $8.25 billion being raised to invest in the middle market makes the supply-and-demand dynamics more favorable than at the top end, while the risk profile is less than that of investing in smaller GPs.

- Buyout has long been the favored strategy of GP stakes investors because of firms' ability to scale funds quickly, hold assets for longer, and earn healthy profits from each dollar in AUM. Going forward, we expect more interest in growth equity as the strategy expands and matures. Additionally, growth equity's profitability and holding metrics closely align with buyouts. However, buyouts will continue to attract the most capital.

- Despite the number of firms at the top end that have sold stakes, more eligible firms now reside in that cohort than ever as private capital firms continue to amass capital at a breakneck pace. Moreover, firms that are categorized as middle market today may be managers with $10 billion+ in AUM five years from now, meaning the investable universe is still expanding.

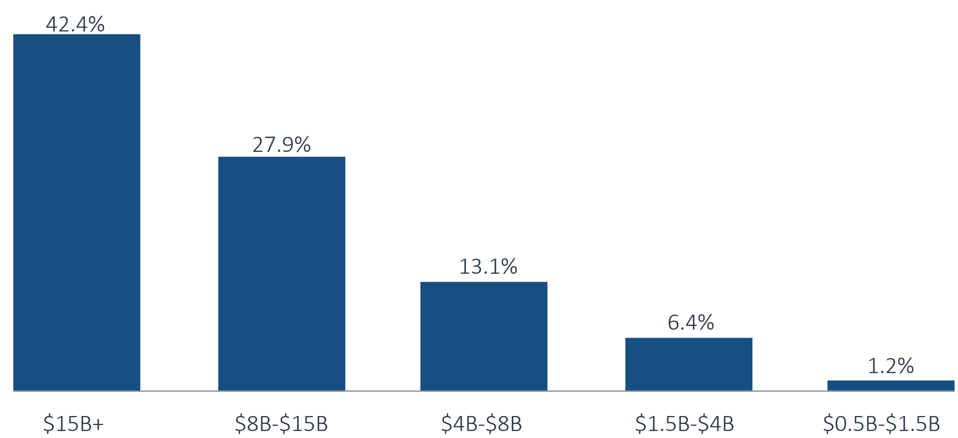
Introduction

As GP stakes deals have proliferated over the past five years, many industry observers are questioning whether there are still enough opportunities to deploy capital. Dozens of the largest and highest-profile private capital firms, from direct lending firms to buyout shops, have already sold a stake. However, there are far more firms that have not sold a stake than there are firms that have, and hundreds of new firms are founded each year. Moreover, many of the largest managers to have sold a stake retained 85%+ of the equity, meaning a subsequent GP stake deal is not out of the question. In this analysis, we will compare the opportunity set of firms that have not sold stakes by firm size and strategy to better understand which segments present the most greenfield prospects.

Investable landscape

At first glance, it would appear that much of the opportunity set at the larger end of the market is tapped out. Many firms that have not sold a stake, such as TA Associates or Bain Capital, have publicly stated their intention to never do so because of their partnership models. Others, including Thoma Bravo, appear uninterested—for now. This appears to leave a modest cohort of willing and interested firms. However, the opportunity set at the top end is larger than one may assume; some firms, such as H.I.G. and Vista, have sold stakes multiple times. Furthermore, we believe the cohort is set to expand, both in the number of firms that qualify—as more firms raise massive funds—and the percentage of firms that are open to selling a stake. The IPO announcement of Bridgepoint and potential IPO or SPAC merger of TPG signal how large managers are shifting their perception toward firm ownership. These immensely valuable and profitable companies see private rounds (GP stakes) and public listings as tools of choice for financing their firms, and we expect a higher percentage will pursue GP stakes deals in the coming years. Elsewhere, the middle market and smaller end certainly present a better supply-and-demand balance, despite the dozen or so active buyers targeting the space.

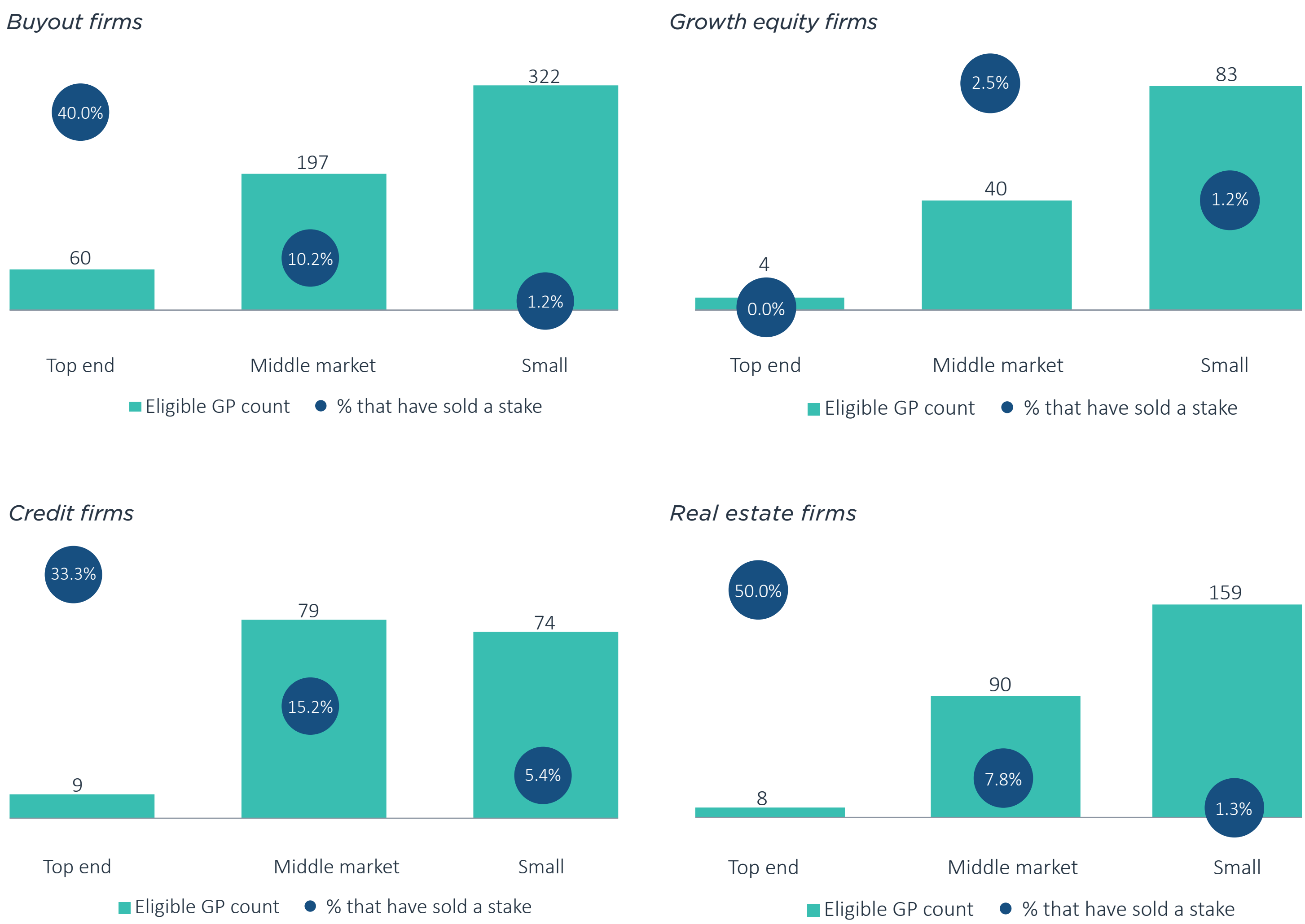
Share of firms that have sold a GP stake by fund size bucket



Source: PitchBook | **Geography:** Global
*As of June 30, 2021
Note: Closed-end fundraising from 2011–H1 2021

To better understand the market dynamics, we broke out GPs into our three standard fundraising buckets[1] and categorized the GPs by strategy—including buyouts, growth equity, credit, real estate, infrastructure, and secondaries. A couple of things to note: While we use hard lines to segment GPs in these size buckets, GP stakes investors view firms on more of a continuum. Also, active buyers regularly purchase stakes in firms outside of where we may have categorized them. For example, Petershill and Blackstone completed deals with buyout firms that were in the $3 billion–$5 billion AUM range, despite those firms being placed in the "top-end" bucket, and Bonaccord completed a stakes deal with Monroe Capital, a firm with nearly $10 billion in AUM, despite Bonaccord typically pursuing middle-market firms.

Investable GP stakes universe by strategy and size cohort

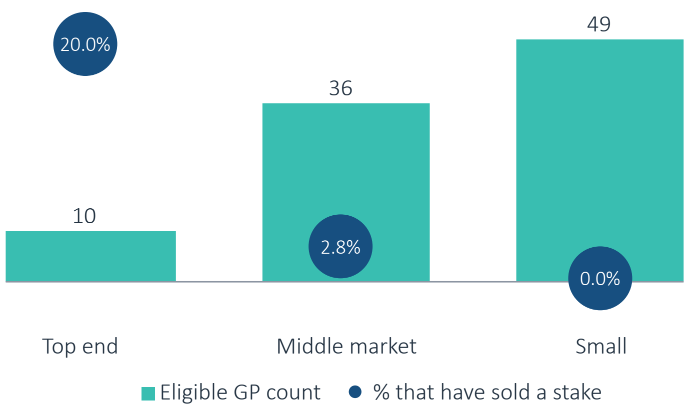


Source: PitchBook | **Geography:** Global
Note: To qualify for a specific strategy, the largest strategy had to account for at least 50% of the capital raised in the previous decade.

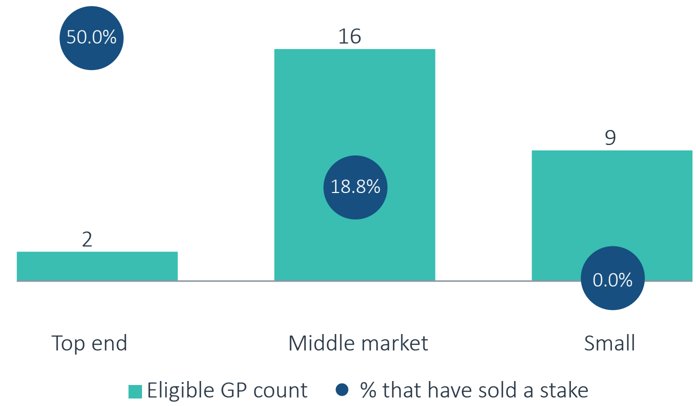
(chart series continues on the next page)

1: Top end = $8+ billion fundraising from 2011-H1 2021. Middle market = $1.5 billion to $8 billion fundraising. Small = $500 million to $1.5 billion.

Infrastructure firms



Secondaries firms



Source: PitchBook | **Geography:** Global
Note: To qualify for a specific strategy, the largest strategy had to account for at least 50% of the capital raised in the previous decade.

The composition of firms that have been targeted so far makes intuitive sense because of the buyer makeup. Most of the active GP stakes buyers are either sponsors, such as Petershill, Blackstone, and Bonaccord, or on the spectrum of strategic-sponsor hybrids, such as Azimut Alternative Capital Partners (AACP), RidgeLake, and Hunter Point Capital. These two types of buyers are after predictability, which tends to favor strategies with longer holding periods and a healthy capital deployment capacity. Not only are GP stakes predicated on investing in profitable firms, but buyers also want to have maximum confidence in their fee-related earnings (FRE) and carried interest projections for at least the first three to five years—although many deals are underwritten to a decade or longer. This is because even if performance diminishes considerably—meaning the firm does not generate carried interest in the future—fee-related earnings and anticipated, high-probability, near-term carry realizations will recoup much of the initial investment. Because of the longer holding times, deployment opportunities, and management fee rates, buyout and real estate managers have long been favored. Infrastructure firms would appear to be even better, but there are just so few, and they require the most scale of any strategy to be successful and investable.

Credit and growth firms have not seen as many stake sales, although for varying reasons, despite both strategies making for lucrative targets. There is a huge demand by LPs for yield, especially with such low rates. This has driven hundreds of billions of dollars to credit strategies and is one reason these firms are highly sought after by sponsors as well as strategics, such as insurance companies. However, there are some difficulties with credit, namely that it takes more dollars of AUM to make the same profits that PE firms do—around 2x—and there are fewer standalone credit platforms. Additionally, trying to balance growing AUM while not taking on too much risk may hamstring sustainable growth rates for many, but not all, credit firms. Growth firms have had fewer deals because growth equity only recently became a more popular target. Investors find the return profile, fees, and holding period for growth equity funds highly attractive, although fund sizes have usually been smaller than buyout. Since there are many firms up and coming that may sell stakes in the future, growth equity is likely to be a hot area of focus for GP staking firms.

VC—which we discuss here but exclude from the market sizing or firms that have sold stakes datasets—and secondaries firms have also done fewer deals than buyout firms. GP stakes deals with venture firms are quite rare for several reasons. Their returns are very difficult to underwrite when a high proportion of deals go to zero and the difference between a 2.5x and a 6.0x multiple-of-invested-capital (MOIC) fund is a single investment. Additionally, it can be difficult to underwrite a firm based on projections that it will continually get in on the Series A of an Airbnb or Facebook, for example, because there is no sure way to know which firms will get those types of opportunities in the future. The few deals that have been done are in late-stage-focused firms, where return dispersion is slightly lower, and the firms manage multibillion-dollar funds. Because of this, some venture firms turn to selling a slice of their unrealized carry for individual funds rather than an equity stake in their business. There are not many secondaries firms, and many of them have remained largely independent. The LP-led side is becoming commoditized, and there is worry of mounting fee pressures, which have turned away some would-be buyers, but the GP-led side, which is still relatively new, appears promising. Moreover, many secondaries firms have primaries businesses, which are challenging to underwrite given the funds-of-funds (FoF) industry dynamics over the past decade-plus. Many LPs have become more sophisticated and invest directly in funds, meaning FoF have seen their share of private markets diminish and have had to alter their value proposition as a result. As this segment of the secondaries market develops and we see more pure-play firms—especially on the GP-led side—there will likely be several deals.

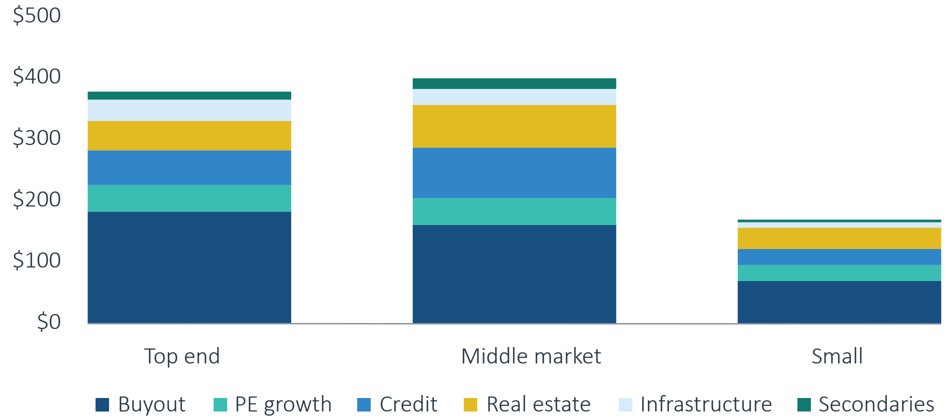
Deployment opportunity

Beyond looking at the number of firms left, we used our in-house GP valuation model to estimate the remaining investment dollar capacity of each size and strategy cohort.[2] We assumed 90% of the largest firms were in play, 50% of the middle-market firms, and just 25% of the smaller firms. We see a massive opportunity across the size spectrum, although the middle market is the largest by our estimated total equity value, coming in just above the top end at more than $400 billion. For comparison, Blackstone, Owl Rock, KKR, Apollo, Carlyle, and Ares had an equity market cap of just under $250 billion as of June 30, 2021. The middle market and top end are also notable with more than $150 billion in estimated equity value for buyout shops in each size cohort.

Buyout firms represent the largest share of equity value—nearly half of the total—for private capital firms. At the top end, this percentage is slightly higher as firms such as Thoma Bravo have yet to sell a stake but are likely worth $10 billion+. Despite containing hundreds of billions in equity value, the deployment opportunity for these size buckets is just a fraction of the whole, as not all firms will sell a stake, and we are assuming stake sales of just 20%. The decline in the middle-market bucket compared to the top end illustrates how important market saturation is, because it dramatically boosts deployment capacity.

2: Our methodology section at the end of this analysis describes some of the underlying assumptions.

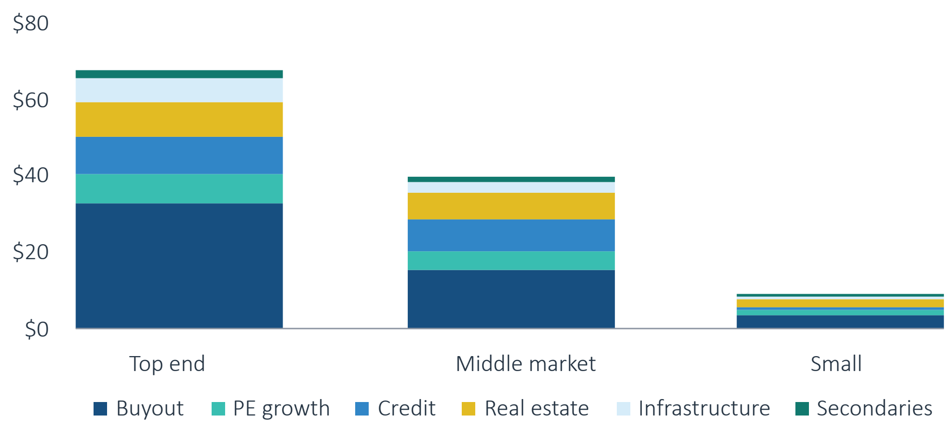
Estimated equity value ($B) of all GPs that qualify for a stake sale by size cohort and strategy*



Source: PitchBook | **Geography:** Global
*As of June 30, 2021

As discussed earlier, large private capital managers going public is illustrative of a changing perception toward outside ownership, and this may cause more large firms to be open to selling a minority stake. In addition to TPG, Paris-based Antin Infrastructure Partners is also reportedly considering a public listing despite managing less than $20 billion, and consumer growth investor L Catterton is reportedly eyeing public listing options and has around $30 billion in AUM. This shift may not be a positive

Assumed deployment opportunity ($B) for GPs that qualify for a stake sale by size cohort and strategy*

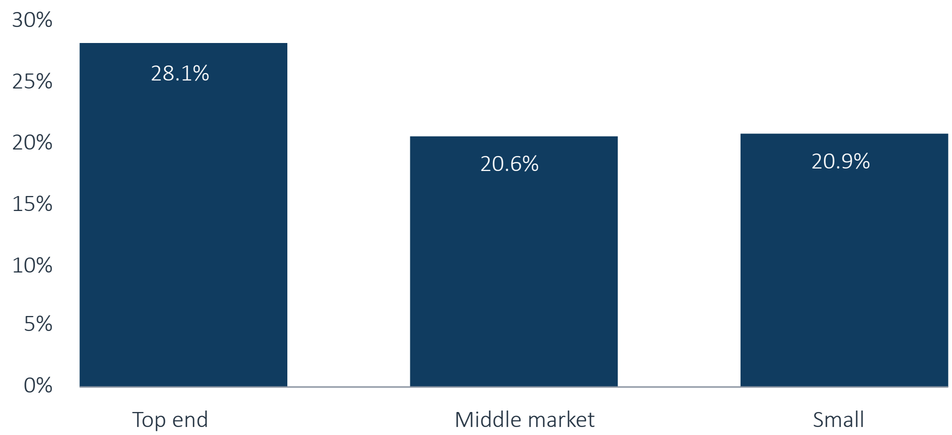


Source: PitchBook | **Geography:** Global
*As of June 30, 2021

for the top end of the GP stakes market because it also means firms such as Hellman & Friedman and Advent International, for example, may have outgrown the need to sell a stake and may instead choose to go public. This would diminish the deployment opportunities in top-end GPs.

Taking this a step further, we then compare the deployment opportunity set by size bucket against the current fundraising efforts. For simplicity, we assumed all firms deployed capital within their predefined size cohorts. Despite the concern by some that there is too much capital chasing too few opportunities, we believe GP stakes firms targeting managers in the top end, middle market, or smaller end are all raising far less capital than their target-size cohorts can absorb. This is just one point in time, though, and firms such as Dyal and Blackstone will be right back fundraising

Share of capital being raised to deployment opportunity by size cohort*



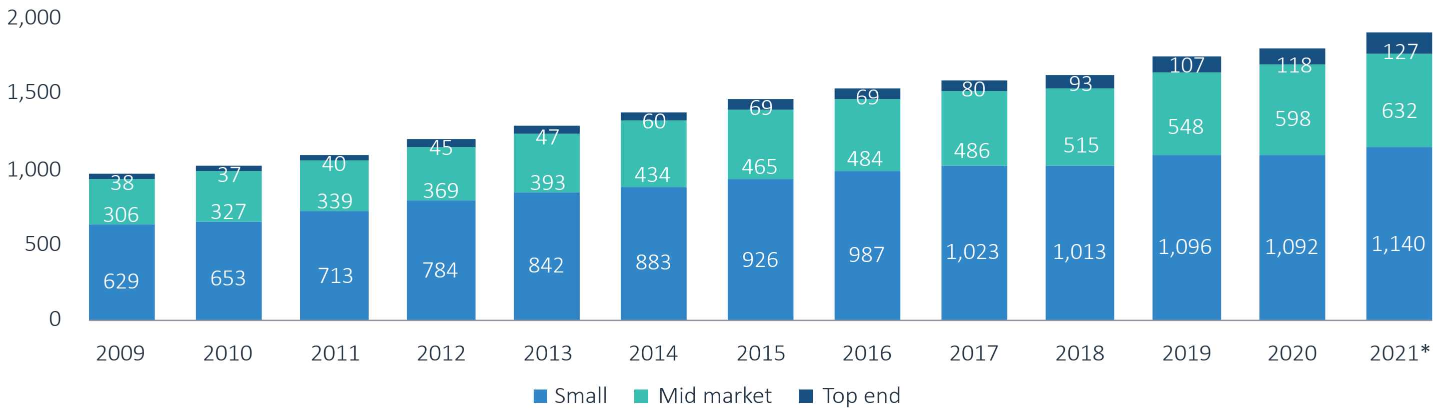
Source: PitchBook | **Geography:** Global
*As of June 30, 2021

and deploying capital once their current offerings have been deployed. Depending on how quickly new managers join each size bucket, these figures may change meaningfully in the coming years. However, the deluge of new GPs ought to keep pace with deployment trends, at least in the short term.

Market expansion

As mentioned earlier, much of our analysis focuses on a single point in time despite private capital markets continuing to develop. As an illustration of how far we have come in just the last decade or so, we looked at the composition of the top end and middle market from 2009 to today. The top-end segment has exhibited the highest percentage growth, expanding by more than 3X in that time, while the number of middle-market firms more than doubled. This means approximately net 27 firms were added to the middle-market category each year—net because some graduated to the top end each year as well. In total, there are more firms around today than ever before, and while we may peg the deployment opportunity in the middle market at around $30 billion today, that number will only continue to grow. The same holds true for smaller and top-end GPs as well.

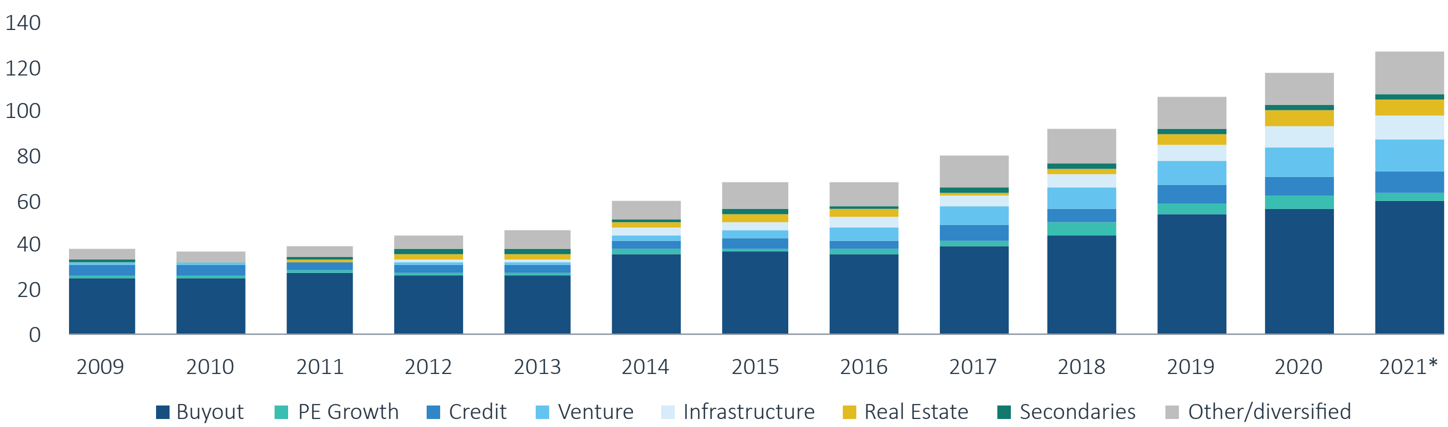
GPs that qualify for a stake sale by size cohort



Source: PitchBook | **Geography:** Global
*As of June 30, 2021

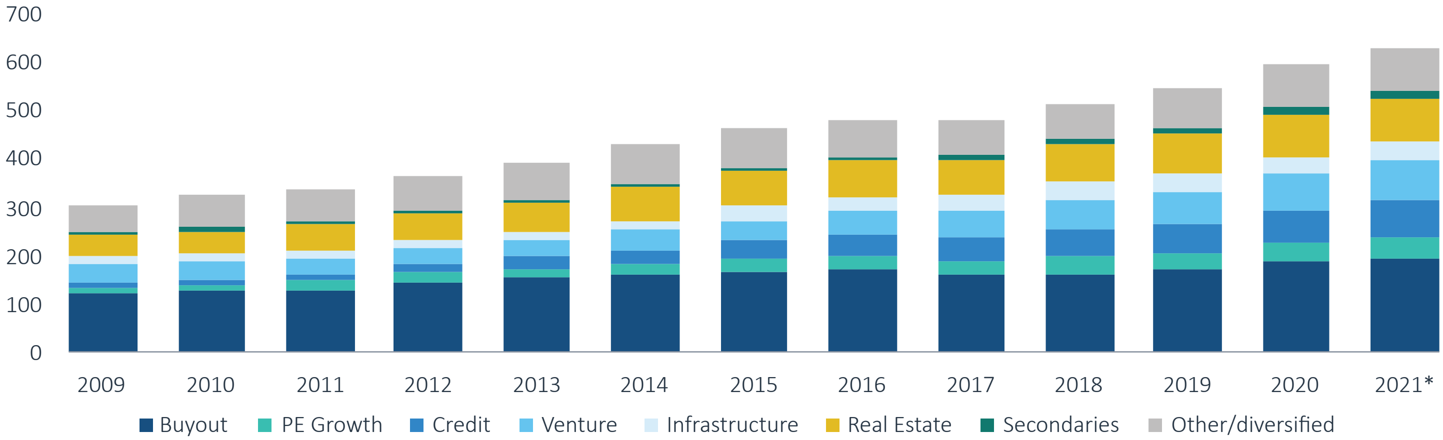
All strategies in each size cohort grew from 2009 until today. The number of eligible top-end buyout firms ballooned from 25 to 65 between 2009 and 2021, which means three new buyout firms entered the top end per year, on average, over the past 12 years. Not only are the deployment capacity figures set to expand as AUM does, but more firms are poised to join the ranks each year. Our conversations with one industry participant confirm this. They had spoken with one buyout firm that recently launched a $4 billion+ fund, and each of its previous funds hit a MOIC of well above 3x, but the firm was unwilling to sell a stake until the next fund, which they expected to be $7 billion plus—firmly placing them in the top-end bucket.

Top-end GPs that qualify for a stake sale by strategy



Source: PitchBook | **Geography:** Global
*As of June 30, 2021

Middle-market GPs that qualify for a stake sale by strategy



Source: PitchBook | **Geography:** Global
*As of June 30, 2021

Going forward

As we head into 2022, we foresee a healthy amount of change coming to the GP stakes landscape. With the prospect of coming tax changes, activity is already ramping up. We hear that bankers are having substantially more conversations with potential sellers, and the sellers appear to be highly motivated. Sellers understand they need to start the process immediately after Labor Day at the latest if they hope to close before year's end, and many are getting started even earlier. For this reason—as well as the billions of dollars available for dealmaking—we believe 2021 will be the busiest year to date for GP stakes, although 2022 may eclipse it. This bounty is expected to be broad based, as small, middle-market, and large GPs are open to selling in a way they may not have been even a year ago. Several strategics in the insurance space are also ramping up efforts to partner with credit firms through majority and minority stake deals, which may entice new sellers as well.

In the long term, we also see several trends coming down the pike. There is likely to be an increase in secondary deal activity, although less than may be expected. We may see full exits—that is, secondary sales to another sponsor or strategic—from a Fund 1, similar to Dyal and Petershill, to prove out a new manager's capability and to placate Fund 1 LPs. However, staking firms are incentivized to hold these assets into perpetuity, allowing the firm to continually collect fees and carry. After these Fund 1 exits, most GP stakes deals are likely to continue to be primary—other than a secondary deal here or there to give LPs liquidity and prove their marks are accurate. With a deep LP secondary market, selling a stake in the fund may be the best way to achieve liquidity. In the case where GP stakes firms invested out of a defined life fund and decide to hold on to these assets, the use of continuation vehicles is likely around the eight-to-12-year mark. These transactions give existing LPs the ability to roll their holdings into the new vehicle or to exit for cash, allowing new LPs to buy into a fully deployed fund—likely at a healthy valuation step-up. GP-led continuation funds have become increasingly frequent among top-performing funds with assets the GP wants to continue to hold.

As time passes and the GP stakes ecosystem becomes less niche, the more entrenched current buyers will become and the more difficult it will be for new entrants to break in. There are fewer new entrants rumored to be entering the market than a year ago as Bonaccord, AACP, Volunteer Park Capital, and a few others look to move beyond their first fund and appear to have staying power.[3] Despite the buyers remaining relatively the same, they will become more comfortable with strategies beyond buyout, real estate, and credit. These may include secondaries, venture, and growth equity, although each have their own hurdles to clear.

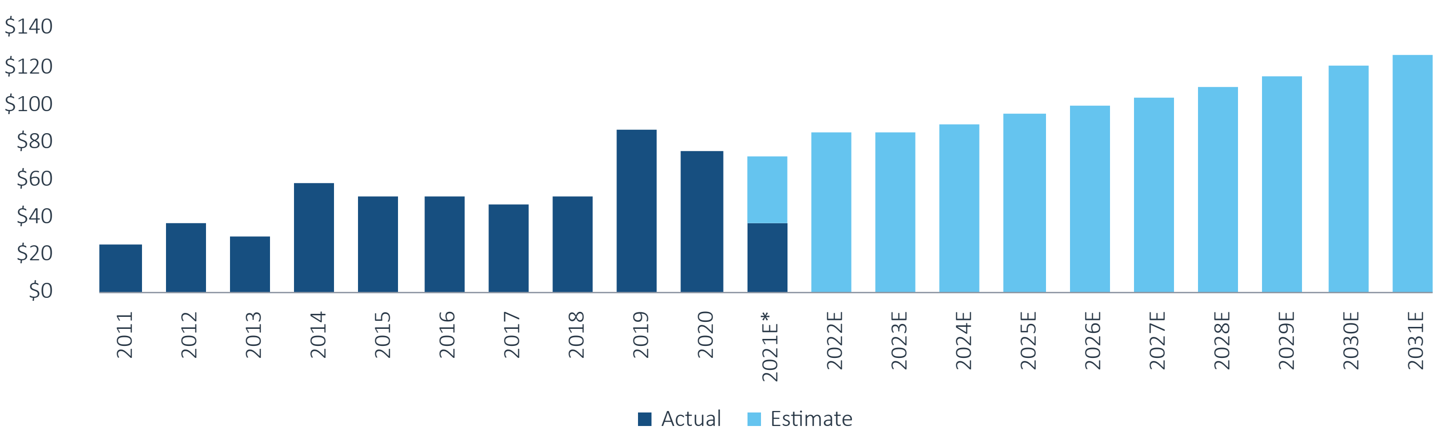
Even though much of the GP stakes space may be headed for some change, most will remain relatively the same. Dyal will continue to scoop up stakes in the largest managers as a half dozen or so GPs grow into their target size each year. Petershill and Blackstone will remain active in the top end as well, although the two firms appear to be focusing more on the middle market—Petershill in particular. Middle-market and smaller GPs will proliferate at a rate quicker than staking firms can invest, at least for the next decade or so.

Market sizing methodology

Market sizing the GP stakes investable universe of an industry could have taken many forms as we tried to estimate the aggregate valuation of all eligible GPs. Like many traditional valuation frameworks, a useful starting point is approximating the expected cash flows, discounted to a present value. For the vast majority of GPs, the nature of cash flows is predicated on the management fees and carried interest generated over the lives of the private funds they raise.

Beginning with the source of the cash flows, we observed fundraising trends for each of the three GP size buckets (top end, middle market, and small) and across a variety of fund strategies (buyout, PE growth, infrastructure, and so on). We then applied an estimated growth rate over the rolling three-year average to approximate fund size expansion over the next 10 years, which will serve as our investment horizon. We repeated this process for each GP size bucket and strategy individually.

Fundraising estimates ($B) for hypothetical size and strategy cohort



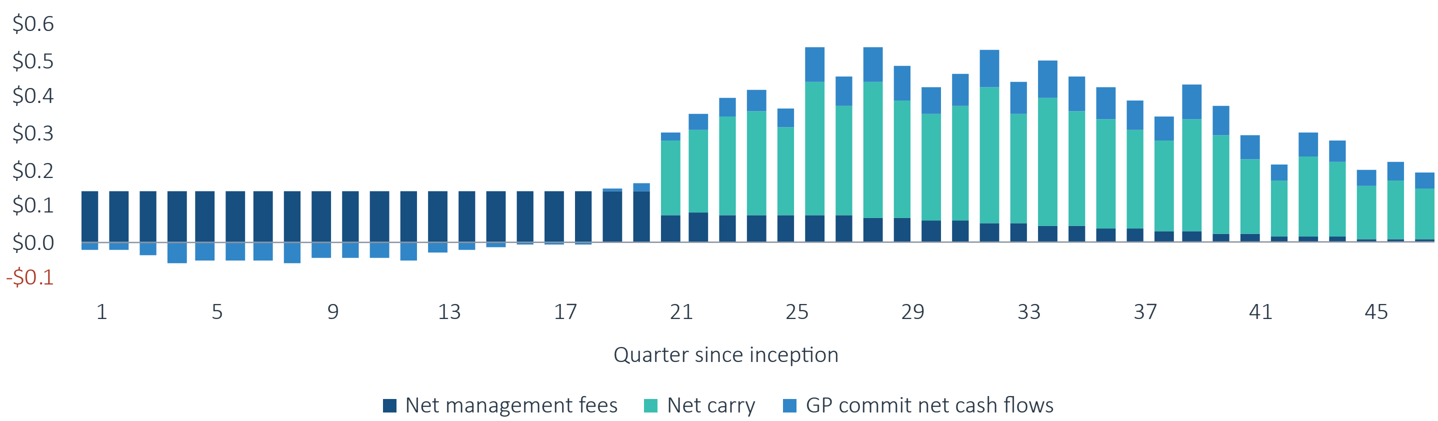
Source: PitchBook | **Geography:** Global
*As of June 30, 2021

3: AACP does not have a traditional GP stakes fund but invests from its parent company's balance sheet in these deals. The firm is launching another strategy, though, this one as a traditional fund.

Using the historical and forecast fundraising we then create a hypothetical, single "GP" to represent the entire size cohort plus fund strategy combination, that is, the present value of all top-end buyout firms. Another GP is created to represent top-end real estate fundraising, and so on for each major strategy and GP size combination. We employ this framework by assuming the rolled-up fundraising for a strategy and size cohort is a single GP and that each yearly fundraising total in the actual and estimated periods is represented by a fund in the model.

With the rolled-up cash flows, we created a valuation model using our proprietary GP Valuation framework, which allows us to estimate the cash flows generated by funds raised now and into the future. The valuation model works by estimating the cash flow profile of each fund raised, layering in assumptions for margins, and applying separate discount rates to management fees and carry to project the net cash flows that a GP receives from each fund. Aggregating those cash flows over time gives us a time series for the discounted cash flow model and an estimate for terminal value assumption in Year 10 of the assumed investment horizon, based on a multiple of forward earnings expectations in Year 11. Discounting the terminal value back to our starting point and adding that to the present value of cash flows generated creates the aggregate valuation profile of the GP.

Model of single-fund cash flows ($B) for hypothetical size and strategy cohort



Source: PitchBook

Valuation build-up ($B) for hypothetical size and strategy cohort

Source: PitchBook