PitchBook

2021 US Private Equity Outlook

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2021 Predictions

Introduction

It’s safe to say that 2020 defied expectations for most investors, and PE managers were no exception. Deal flow nearly ground to a halt in March but has since recovered rather quickly. Fundraising is on track for another banner year, although emerging managers—in particular first-time funds—have had a difficult time in a virtual environment. Exits have slowed too, but there are potential bright spots in the IPO market. Last, despite the widespread business disruption caused by the pandemic, private market transaction multiples have remained stubbornly high.

How these trends play out over the course of the next year depends largely on what happens with COVID-19. As we make these predictions, the promise of broadly distributed vaccines still seems a ways off, and lockdowns are underway in many parts of the world. It is with this uncertainty that we submit our predictions for the 2021 PE landscape. We hope you find these useful and welcome your feedback.

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Prediction: PE fundraising will surpass $330 billion, setting an all-time high

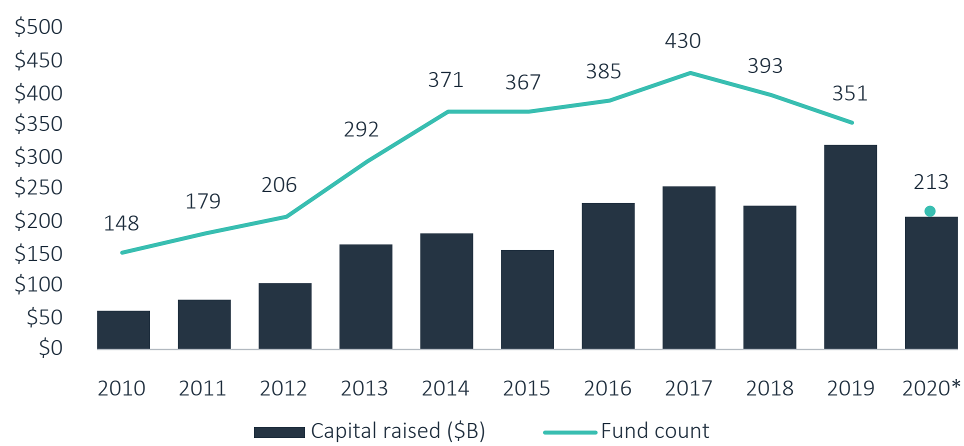
Rationale: US PE fundraising is on track to slow modestly in 2020, doubtlessly dampened by the pandemic, but we expect it to rebound next year, surpassing the $316.9 billion high-water mark set in 2019. Institutional investors—both in surveys and anecdotally—say they plan to increase their allocations to alternatives, of which PE is the largest chunk. A higher average allocation to PE means more investors will be looking to write larger checks. Fund managers have been happy to oblige in recent years; the median fund to hold a final close thus far in 2020 is about 50% larger than its predecessor, a trend we expect to continue next year.

In addition to raising larger funds, GPs are increasingly offering more strategies that fall under the PE umbrella. For example, in 2019 Blackstone launched its growth equity platform, a strategy that has seen increasing investor appetite by filling the void between traditional venture capital and leveraged buyouts.

Last, the boom in public equities witnessed since March 2020 is likely to be a boon for PE managers, through a mechanism known as the reverse denominator effect. When the value of other parts of an allocator's portfolio grow in value, the commitments needed to maintain a target allocation to PE grow in lockstep. In November, the Federal Reserve affirmed its intention to continue its asset purchase program, which is likely to drive investors toward risk-on assets, including PE.

Caveat: The major question mark in any predictions for 2021 pertain to what happens with the COVID-19 virus. If the pandemic drags on, allocators—especially university endowments and healthcare systems—may pause new allocations to conserve cash. Further economic carnage could drive investors away from risky assets, which would hamper new fundraising efforts.

PE fundraising activity



Source: PitchBook | **Geography:** US
*As of November 22, 2020

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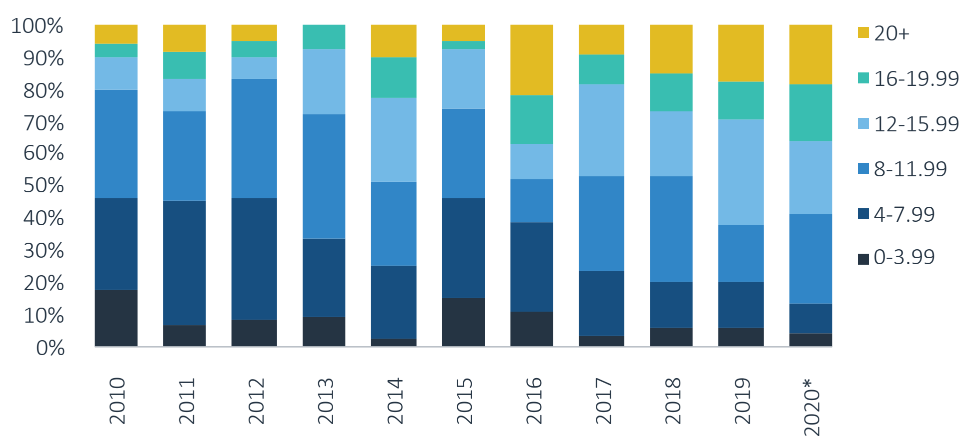
Prediction: 20% of buyouts will be priced above 20x EBITDA

Rationale: There are two main reasons we foresee an increase in deals completed at the pricier end. First, price multiples in both public and private markets have been elevated for some time, and we foresee no reason for this to change in 2021. The S&P 500 now trades at a cyclically adjusted price-to-earnings ratio (CAPE) of 33.07[1] due to a plethora of factors including monetary easing, widespread risk-on appetite, and the emergence of large growth-oriented companies that trade at high multiples of revenue, let alone earnings. On the private side, the median EV/EBITDA multiple for buyouts was 12.7x through Q3 2020, tying its record high. Although debt/EBITDA multiples have been slightly lower this year, we expect the use of leverage in 2021 to be propelled by low interest rates, strong demand for high-yield debt, and a surfeit of dry powder in direct lending funds.

Second, buyout funds are increasingly targeting growth-stage technology companies that tend to trade at a much higher multiple of earnings than the traditional PE target. For example, software specialist Thoma Bravo acquired UK-based cybersecurity firm Sophos for about 46x TTM EBITDA in January 2020, an eye-popping figure that is becoming less infrequent. Many of these internet-native businesses have seen bottom-line improvements from the accelerated move to a digital economy during widespread lockdowns. Even if pricing stays the same for most businesses, a higher proportion of buyouts taking place in sectors such as software and biotech should boost the proportion of deals taking place in this pricier range.

Caveat: If the world quickly goes back to normal after a COVID-19 vaccine arrives, we would expect to see multiple compression for those businesses that have benefitted from the lockdown, thereby decreasing the number of deals completed above this threshold. Alternatively, the COVID-19 pandemic could worsen, dampening not just economic activity but also the appetite for riskier assets more broadly.

PE deal activity by EV/EBITDA bucket



Source: PitchBook | **Geography:** US
*As of November 22, 2020
**Low sample size for 2020

1: "Online Data," Yale University Department of Economics, Robert Shiller, November 2020.

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Prediction: At least 20 PE-backed companies will enter US public markets through a reverse merger with a SPAC.

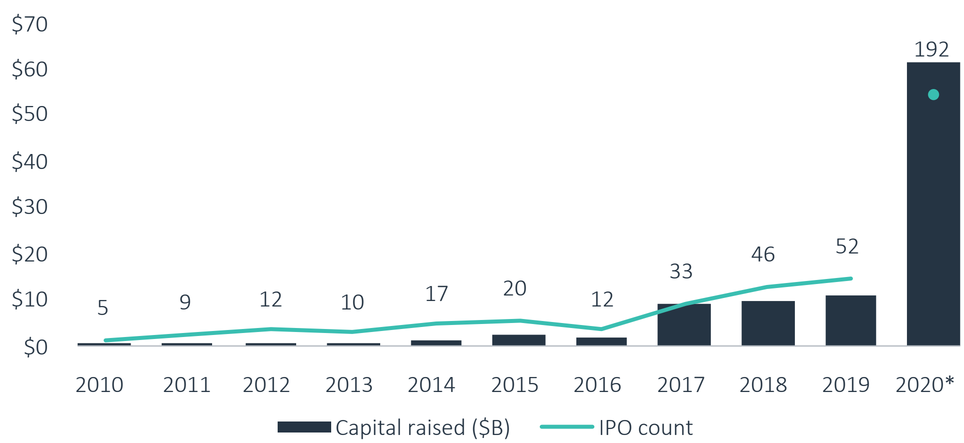
Rationale: Over 200 special-purpose acquisition companies (SPACs) launched in 2020,[2] more than tripling the year prior. These blank check companies typically have two years to complete a deal before returning their capital to shareholders, meaning there are hundreds hunting for deals. PE firms have shown increased appetite for SPACs, with several PE firms launching their own SPACs, although the exit activity has been more subdued. PE firms are attracted by the speed with which SPACs can bring portfolio companies public—typically in less than half of the time it takes to do an IPO. As PE firms become more comfortable with SPACs and the quality of SPAC sponsors rises, PE firms will look to this option with increased frequency.

Only a few PE-backed companies went public with the assistance of a SPAC in 2020, including Hellman and Friedman-backed GCM Grosvenor. Another instance was Advantage Solutions—backed by CVC Capital Partners, Bain Capital, and Leonard Green—which agreed to go public via a reverse merger with Conyers Park II Acquisition Corp.

An additional point that could propel SPAC interest for PE firms is the rise in growth-oriented investments, especially in the tech and healthcare realms. These companies find the ability to be priced on forward earnings attractive in the valuation process, something that SPACs allow for while traditional IPOs do not.

Caveat: PE firms may take longer to get acquainted with SPACs and not jump into the action in 2021. Further, the dynamic with founder shares could be seen as leaving too much capital on the table and dissuade PE firms from pursuing this exit strategy.

SPAC IPO activity



Source: PitchBook | **Geography:** US
*As of November 22, 2020

2: As of December 9, 2020.

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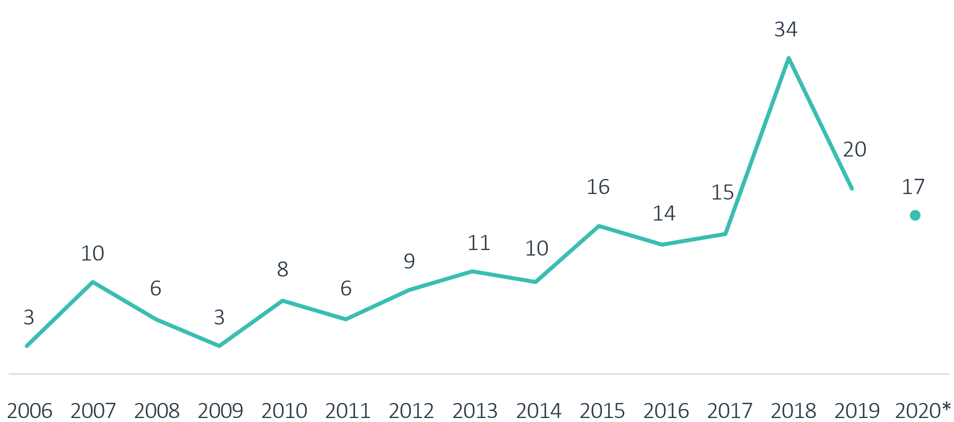
Prediction: There will be at least one new type of exit from a GP stakes portfolio in 2021.

Rationale: There have been more than 100 GP stakes deals in recent years with innovation centering around deal types and target GPs, although the innovation on the exit side has been lacking. Pricing in the GP stakes market remains competitive, and the specialized PE firms will be looking to capitalize on whatever is available to achieve the best outcome for fund investors. A lift in pricing, whether it be through a strip sale, securitization, portfolio IPO, or something else, will help with future fundraising efforts and potentially bring in more LPs.

Funds including Dyal II and Petershill II are getting older and to the point that LPs may pressure them for a liquidity option. Dyal and Petershill have proven to be first movers, and we believe all options are on the table. Dyal was reportedly seeking to complete a strip sale earlier in 2020, and our analysts have heard talks that one unnamed GP is looking to securitize an entire portfolio. The potential tie up between Dyal and Owl Rock (backed by Dyal), which intends to go public via a reverse merger with a SPAC, shows the appetite for exit innovation. We believe 2021 will be a year for ingenuity in GP stakes monetizations.

Caveat: There are several fine options for monetizing GP stakes already, including sales to strategics or other sponsors. The fear of the unknown may dissuade GP stakes firms from pushing the envelope. Additionally, the GPs that sold stakes to those funds may push back on certain exit options if they believe they would be adversely impacted (i.e., sold to a non-amenable party, publicly floated, or securitized, for example).

GP stakes deal activity (#)



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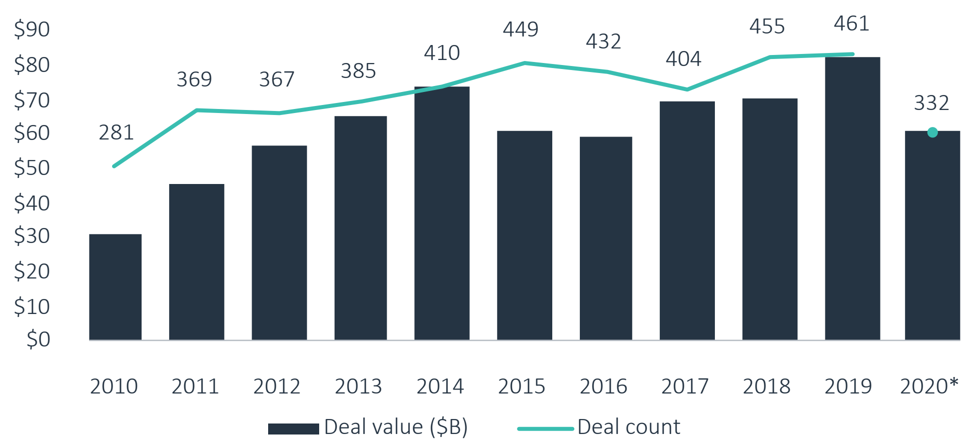
Prediction: Carveout deal value will hit the highest level on record.

Rationale: Hundreds of large public companies are struggling because of the economic burden brought on by the pandemic. This economic strain has forced many companies to put all options on the table, including selling non-core businesses. Further adding to the strain, many of these large companies added to their debt load early in the pandemic, expecting this leverage to get them to the other side. These same companies are seeing revenues continue to be pressured nine months later and do not want to risk becoming overly indebted.

While many large companies are struggling, PE firms have been raising hundreds of billions of dollars and sit on around $1 trillion in dry powder. These PE firms have seen dry powder mount throughout the crisis as traditional LBO activity diminished but fundraising remained healthy. PE firms are now seeking massive transactions to swiftly spend down this cash pile. On the company's earnings call in Q3 2020, Carlyle CEO Kewsong Lee stated that the company is busy working on many large divestitures, meaning many other PE firms are likely in the same boat.

Caveat: Fed liquidity injections will keep rates down enough to dissuade large companies from selling non-core assets. Alternatively, a new administration could do a better job of keeping a lid on the spread of the virus. This, combined with an accelerated schedule for a new vaccine, could see the economy recover more quickly, negating the need to divest these businesses.

Carveout activity



Source: PitchBook | **Geography:** US
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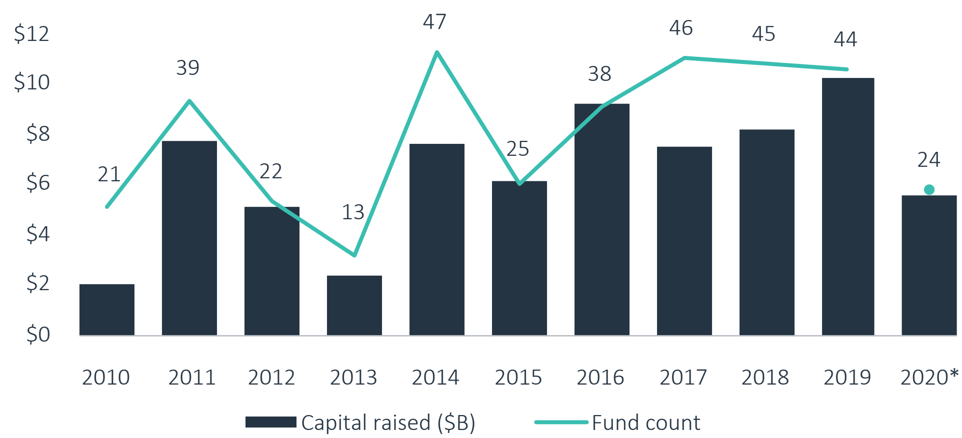
Prediction: First-time fundraising in the US will be the strongest since the GFC.

Rationale: First-time funds have struggled throughout the pandemic, putting up numbers similar to 2010. The lack of in-person due diligence has put PE firms without existing LP relationships at a disadvantage, making each incremental commitment multiple times harder than usual. LPs have been scrambling all through 2020 just to stand still, so adding a new GP has been lower on the priority list than it typically would be. However, many LPs are beginning to get their feet set under them as 2021 approaches. A pent-up demand for this product, with dozens of funds still in the market, is likely to lead to a healthy first-time fundraising environment.

The number of new PE firms may see a boost as well, adding to the number of GPs seeking to close a first-time fund. Other, more established PE firms are now seeing the prospect for future carry dim, whether it is through lower portfolio company valuations or extended exit timeframes. The prospect of a reduced payday may push current mid-level and junior executives to leave to start new firms.

Caveat: In-person due diligence will remain unlikely for much of the year. A delay in a COVID-19 vaccine could mean no in-person business meetings for the entire year, dimming prospects for first-time GPs. Further, a roaring public equity market may lift valuations in the private markets as well, boosting carry for these GPs and helping retain employees who otherwise may go launch a new fund.

First-time fundraising activity



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2020 outlook scorecard

PE fundraising will fall below 2019 totals.	Pass	Fundraising dipped in 2020 as fewer mega-funds closed and COVID-19 complicated the capital raising process.
We will see another acquisition of a major alternative asset manager.	Fail	There were smaller acquisitions, such as Blackstone's acquisition of DCI, and a large, proposed merger—Dyal and Owl Rock—but no major alternative asset managers were acquired in 2020.
GPs will increasingly hold some of their top-performing assets longer.	Draw	Top decile holding times came down slightly, but fewer exits occurred because of the pandemic as GPs held top-performing and poorly performing companies alike.
The big four public GPs will expand their strategy offerings at twice the rate of comparable GPs.	Fail	The large public and private GPs expanded strategy offerings at a similar rate in 2020.
Sovereign wealth funds and pension plans will become more sophisticated investors, increasing control over investments.	Draw	SWFs participated in a higher proportion of direct deal activity while pension plans had lower participation rates.
VC-to-PE buyouts will continue to proliferate.	Draw	The proportion of VC exits to buyout firms rose slightly in 2020, but the figure remained under its 2018 figure.
There will be continued expansion in growth equity deals.	Pass	Despite PE deal activity dropping in 2020, PE growth equity deal value rose in 2020 and hit a new high.