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Research Paper

Private Markets Winter Update

Our Semiannual Update on Activity in Private Markets

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Key Observations

After an unusual start to 2020, the second half of the year seemed more like prior years in terms of recent activity and pace for fundraising; transaction activity; and exits across private markets. Purchase multiples and debt multiples (relative to EBITDA) continued to expand, largely taking their lead from public markets, which continued to rise. As we move into 2021, competition around allocations remains relatively high and time spent fundraising has shrunk.

As with most asset classes in 2020, private markets were a tale of two halves. The pandemic caused severe market dislocation and activity froze the first half of the year while investors tried their best to navigate the crisis. Despite some lack of clarity concerning the duration and overall severity of the COVID-19 pandemic, private markets managers adapted to the situation in the second half of the year and showed resilience.

Notwithstanding the upheaval of professional and personal lives, many professionals quickly acclimated to a new way of conducting business. Both General Partners ("GPs") and Limited Partners ("LPs") embraced technology to conduct meetings, persist with due diligence and eventually engage in new deal activity. Internally, Fiducient Advisors spent a significant amount of time talking with GPs about when and how they moved from defense to offense. We gauged how quickly they were able to identify issues, move toward fixing those issues and get back on track. Stimulus packages and a general recovery undoubtedly aided this effort, relieving part of the pressure.

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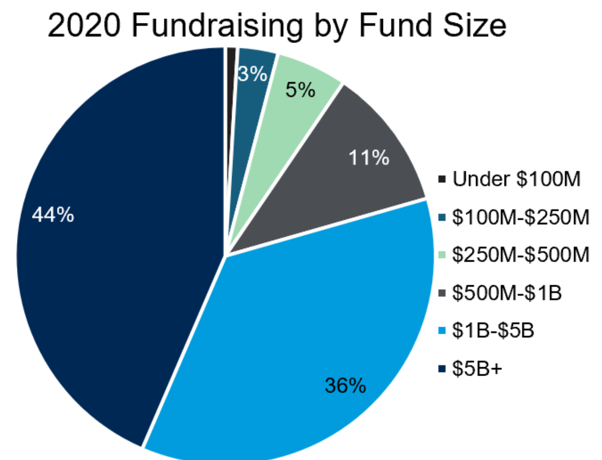
As a result, private markets activity, including deal value, deal count, fundraising and exits, gained momentum over the last two quarters of the year as sponsors and investors maintained or increased activity. The "backlog" of activity was certainly real as both GPs acted to complete deals that were put on hold during the first half of the year and LPs sought to finalize allocations for 2020.

Private Equity

Fundraising Activity

Fundraising activity hastened its pace notably in the second half of 2020 after a substantial stall in the second quarter. Total capital raised in U.S. Private Equity firms closed 231 funds accumulating $203 billion, marking a dollar decline of 37 percent. Although this was the lowest total in the past five years (2016-2020), it is still higher than the eight years prior (2008-2015). Mega funds, defined as those $5 billion and larger, accounted for 44 percent of all capital raised. This is a similar share to years past; however, there were fewer mega funds having their final close in 2020 (10 versus 14 in 2019). The only size segment to grow their share of fundraising dollars was funds in the $500 million to $1 billion range which increased by a slim margin.



Source: Pitchbook's 2020 Annual U.S. PE Breakdown

The average time for private equity funds to be in market fundraising decreased by almost a month even though very few closes occurred in the second quarter of 2020. Over the past two years, time to close decreased by more than three months. This is a testament to the increasing amounts of competition within private markets, particularly with groups raising limited amounts of capital. Overall, on average, this was the least amount of time spent closing all PE funds since 2006.

First-time funds accounted for 11 percent of the fundraising amount ($6 billion) compared to 12 percent in 2019. While many LPs intentionally avoid first-time funds and newer firms, this particular group of early funds had a distinct advantage that may have lasting effects. These early funds do not have any (or at most, very few) portfolio companies to manage through the pandemic. So, while many GPs are spending more time with their portfolio companies than they would during pre-pandemic times, new GPs can spend a substantial amount of their time sourcing new opportunities.

Transaction Activity

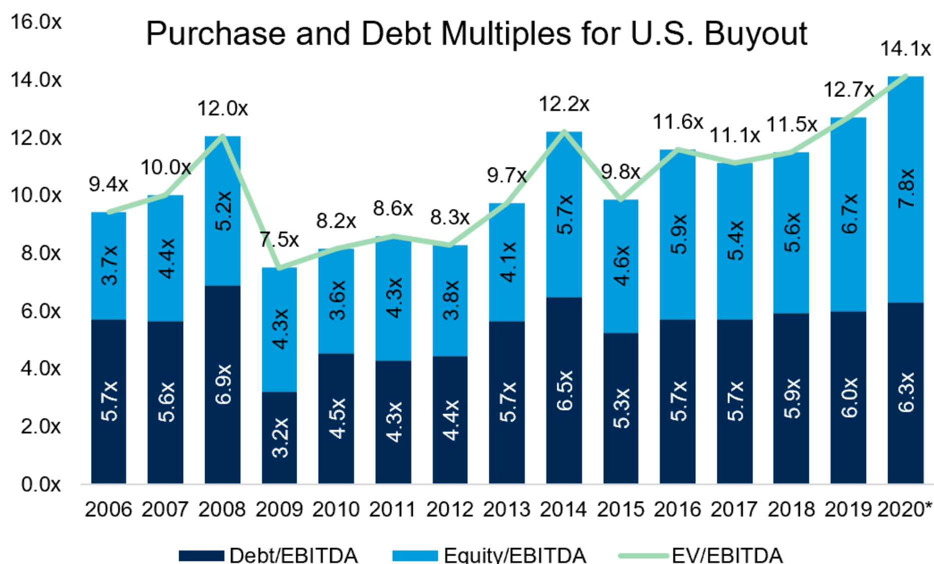
Transaction activity told a very similar story as fundraising – a second half that was largely playing catch up to a muted first half. While closed and estimated deal activity for the full year fell approximately 30 percent, the second half was the strongest in more than a decade and accounted for roughly 60 percent of total deal value for the year. In

what was a difficult year to grow companies organically, in-aggregate funds increasingly looked to build growth through add-on activity. Such transactions were robust during the year, accounting for approximately 72 percent of total buyout deal value, the highest percentage on record.

Despite fundraising from mega funds accounting for slightly less than half of total dollars raised, deals greater than $1 billion accounted for 1 percent of total transaction activity while deals less than $500 million in total transaction value accounted for 97 percent of activity. Even by dollar value, the largest deals only accounted for 27 percent of total value, suggesting that the largest funds continue to chase less opportunities relative to the smaller end of the market.

The healthcare and technology industries became front and center for transaction activity, in part because they were least impacted, or potentially most benefitted, by the environment. These two sectors accounted for 38 percent of overall deal value and 37 percent of overall deal count during 2020. Both percentage shares are about 400 basis points higher than 2019. Unsurprising given the environment, energy accounted for the fewest deals.

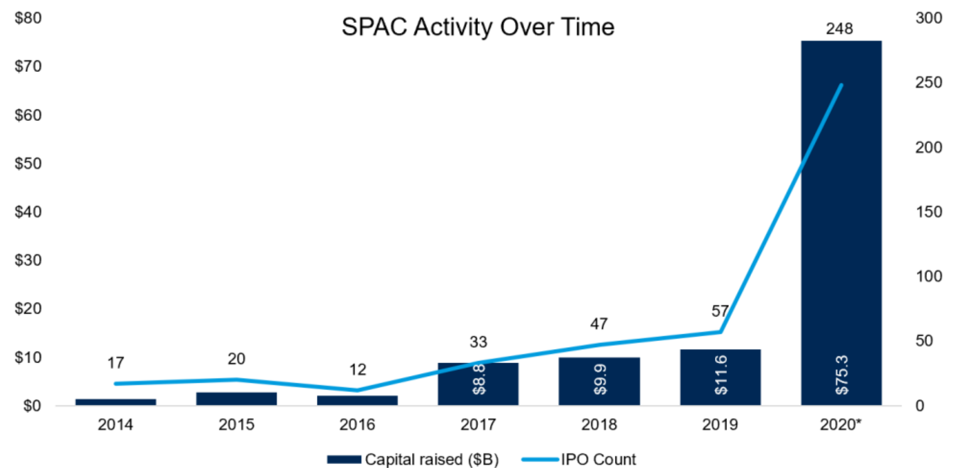
Multiples increased across private equity, partially due to the greater fraction of healthcare and technology deals, which generally trade at higher multiples. Most surprising is that amid extreme uncertainty, lenders became increasingly liberal as debt/EBITDA increased for the fifth consecutive year. While buyers were putting in a great share of equity (i.e., they funded the increased valuation), the credit seemingly became more susceptible to potential go-forward earnings pressure.



Source: Pitchbook's 2020 Annual U.S. PE Breakdown

Exit flow also gained momentum in the back half of the year rising from $125 billion in the first two quarters to $205 billion in the third and fourth quarter. The total number of exits increased from 371 in H1 to 412 in H2 of 2020. Interestingly, IPOs, which accounted for just 9 percent of the overall exit value in 2019, made up for 31 percent of that in 2020.

Related to a portion, and seemingly growing amount of exit activity, SPACs, or Special Purpose Acquisition Companies, were front and center in headlines throughout much of 2020. The chart to the right explains why that was the case. 2020 witnessed an explosion of SPAC activity with 248 companies raising $75 billion compared to just 57 companies raising $12 billion in 2019. SPACs are viewed as an easier way for a company to go public, as it acts more like a transaction for the seller compared to the typical, drawn-out IPO process. In addition, it is easier for the SPAC to go public in the first place (because it has no operations and owns nothing) and the economics are quite favorable for sponsors to raise capital in this way. While investment in an SPAC comes through public markets, there are an increasing number of hedge funds and private equity firms sponsoring the IPOs[1].



Source: Pitchbook's 2020 Annual U.S. PE Breakdown; as of December 31, 2020

Private Debt

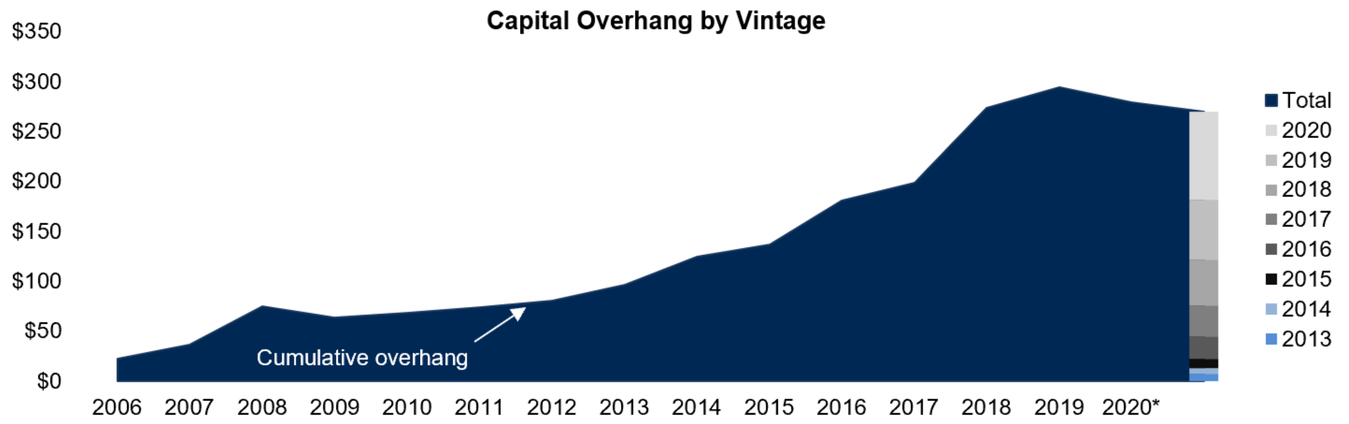
Private debt faced many of the same underlying pressures that plagued private equity, including the pandemic, coupled with the closing of many mega funds in 2019. As a result, global fundraising for private debt slumped by 28 percent on a year-over-year basis to $110 billion in 2020. Similarly, fund count, which has been falling since 2017, continued its downward trend as 111 funds closed globally during the year.

While the number of debt funds raised in North America decreased from 117 in 2019 to 74 in 2020, the capital raised increased slightly from $75 billion to $76 billion. Europe, on the other hand, experienced a drastic fall in the number of funds as well as capital raised. In 2019, Europe had 56 funds raising a total of $62 billion that dwindled to just 27 funds raising $29 billion.

Direct lending platforms, which continue to make up most of the private debt capital raised, declined by 54 percent compared to 2019, to raise $40 billion in 2020. Not surprisingly, special situations credit fundraising was up 55 percent year-over-year as LPs tried to take advantage of what many expected to be an impending and potentially deep distressed cycle. Similarly, distressed debt saw an increase of 9 percent in capital raised during 2020. Despite both categories of debt seeing an increased amount of capital raised during the year, the number of funds closed actually

[1] All data in the private equity section is from Pitchbook's 2020 Annual U.S. PE Breakdown

lessened. This suggests that LPs likely opted to remain with larger names in market and those groups were successful in raising more capital.



Source: Pitchbook's 2020 Annual Global Private Debt

The capital overhang in private debt, similar to private equity, remains near all-time highs. Despite a slump in fundraising in 2020, the pace of investing seems to have also slowed. The amount of dry capital decreased by $9 billion to $269 billion during the year[2].

Private Real Estate

Real Estate was also unable to avoid pandemic-related fundraising effects as activity slowed globally in 2020 to 283 funds, raising only $118 billion versus 494 funds, raising $179 billion, during 2019. Only a quarter of the total dollars was raised by first-time funds and small managers, emphasizing the concentration of capital with the heavyweights and a preference for retaining existing managers rather than expanding. Furthermore, because of lesser fund closings in 2020, the number of funds in the market as of January 2021 hit a record high of 1,068 funds, seeking to raise a record $314 billion.

Following a similar trajectory as fundraising, the number of deals dropped by 39 percent year-over-year to 5,979, while their value dropped by almost 50 percent to $222 billion. As you would expect, activity around less disrupted areas of real estate, such as multifamily and industrial, continued to be in greater demand while retail and office currently face more uncertainty and unpredictability[3].

[2] All data in the private debt section is from Pitchbook's 2020 Annual Global Private Debt Report

[3] All data in the private real estate section is from 2021 Preqin Global Real Estate Report

In conclusion, while the year 2020 featured much uncertainty and volatility, overall the first half of the year was more challenging than the second half, which resulted in both General Partners and Limited Partners adapting to a new economic outlook.

For more information, please contact any of the professionals at Fiducient Advisors.

About the Author

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Pooja is responsible for performing due diligence on private equity managers for potential inclusion in client portfolios. She is a member of the firm's Global Private Markets Group. Prior to joining the firm in 2019, Pooja served as a Junior Analyst, Investment Research & Analytics at Aranca Pvt., Ltd. and an Equity Research Associate on the University of Rochester Simon Business School's student managed long-only Meliora Fund. Pooja holds a Bachelor of Business Administration from the Narsee Monjee Institute of Management Studies. She also earned a Master of Commerce, with a concentration in Accountancy, from the University of Mumbai and holds a Master of Science in Finance from the University of Rochester Simon Business School. In her free time, Pooja enjoys writing short poems and traveling.