

2021
PREQIN GLOBAL
**PRIVATE EQUITY &
VENTURE CAPITAL**
REPORT

SAMPLE PAGES



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A Note on Our Theme

Plants have evolved to thrive in conditions that many would describe as incredibly harsh. Surviving in full sunlight, freezing temperatures, or rising seawater are just some examples of this adaptation and resilience in action. Similarly, we've seen alternative asset classes continue to grow and mature as the world faces a challenging pandemic, political instability, and change.

Executive Summary

AUM has grown, despite a slight drop in fundraising, and 89% of investors plan to maintain or increase commitments in 2021

Despite the economic slowdown triggered by the pandemic, global private equity & venture capital AUM has increased by 6.1% from the end of 2019, to \$4.74tn as of June 2020. The growth rate was lower than the 9.9% average of the past decade, but Preqin believes this slowdown will be temporary, with growth accelerating toward our estimate of \$9.11tn in 2025. Indeed, Preqin's *Future of Alternatives 2025* study forecasts a CAGR of 15.6%¹ in AUM for the next five years.

With interest rate rises pushed even further into the future, investors will continue to be attracted by expectations of high returns. Forty-four percent of those we surveyed toward the end of 2020 expect to commit more capital to private equity over the next 12 months (36% to venture capital), with 46% expecting to maintain investment levels (50% for venture capital).

Emerging Investors Step up Allocations

Private equity is now firmly established as a core component of institutional investors' portfolios. In the US, the most developed market, the median allocation is 6.3% of total AUM, but investors in other regions are catching up fast. Asia-based investors have been aggressively deploying capital; the median allocation rose from 3.6% to 5.0% over 2020.

Family offices are the most committed to private equity, with a median allocation of 20.0%. Scope for future investment growth is limited, however, as most have reached their allocation targets. Endowment plans and foundations have the most room for growth and are currently 5.0% and 3.3% below target allocations.

Private equity funds turned cash flow negative for investors in 2017, repeating the pattern seen through

the Global Financial Crisis (GFC). This could slow down fundraising over the next few years, although the drivers of increasing allocations will likely outweigh the negative cash flow impacts.

Buyout Deals Slowed; Venture Capital Broke Records

Private equity investment activity fell in 2020, with the number of deals down 5%, at 5,607, and their value down 7%, at \$436bn. COVID-19's impact was most strongly felt in Q2 2020, when the aggregate value of buyout deals plummeted from \$120bn in Q1 to \$64bn, with larger deals particularly affected. Investment activity picked up again in H2, however.

Venture capital, on the other hand, had a blockbuster year. A total of \$297bn was invested and \$391bn realized through exits. This smashed the previous high of \$177bn set in 2018, and will fuel fundraising activity in 2021. Preqin is currently tracking 2,469 venture capital funds in the market, seeking in excess of \$200bn. In 2020 a total of 732 venture capital funds reached a final close, raising an aggregate \$121bn.

Private Equity Continued to Outperform

The long-term performance of private equity remains strong. Over a 10-year horizon as of June 2020, buyout has an annualized net IRR of 15.1%, while growth has 17.5% and venture capital 12.4%. It is too early to gauge the full impact of the pandemic, but buoyant stock markets, the resumption of economic growth, and prolonged low interest rates augur well for future performance. The rapid rebound of stock markets, lack of cash flow pressure at LPs, and abundant liquidity in debt markets point to immediate post-crisis vintages struggling to outperform to the extent seen in vintages from the mid-1990s, after the dot-com crash, and after the GFC.

¹ Preqin: *The Future of Alternatives 2025*

Private Equity Megatrends

Key themes shaping the private equity industry



Growth in Allocations to Private Equity

We expect the inflationary environment over the medium to long term to remain benign, despite the near-term risk of transitory pressures. This should allow long-term government bond yields to remain anchored to low levels and incentivize the continued increase of investors' private equity allocations.



Alternatives Rise in the East

As the world's economic center shifts eastwards, the alternatives landscape is changing with it. The percentage of private equity AUM in Asia moved into double figures in 2011 and has climbed steadily since to a record 28% in 2020. Asia's share of capital coming into the asset class has increased rapidly, from 8% in 2016 to 15% in 2020. Negative cash flow to investors from Asia-based funds may slow growth over the next few years, but the long-term drivers will prevail.



ESG Investing

Integrating environmental, social, and governance (ESG) principles is increasingly vital for the alternative assets industry. Fund managers are responding to growing demand from institutional investors seeking to allocate to ESG-committed funds.



Digital Transformation

Disruptive technologies such as artificial intelligence are helping fund managers to improve operational efficiencies and identify new opportunities. The rich pipeline of companies that are successfully innovating with these technologies will also attract investors' attention.



The Rise of Permanent Capital

Larger asset managers have been carrying out strategic acquisitions of insurance companies in order to raise a captive supply of permanent capital to manage. With insurance companies trading at depressed valuations, the environment is conducive to further acquisitions.

Mid-Market Private Equity: 2.0

We hear from Eric Deram, Managing Partner at Flexstone Partners, on solving the challenge of geographical diversification in the middle market

Mid-market private equity has grown in popularity as investors seek to invest in the high-growth companies that drive economies.

The relatively small scale of deals compared with the large buyout funds means the focus of mid-market private equity is local. That is, the segment is dominated by domestic private equity funds investing primarily in domestic companies. Investing in single countries or regions can make sense – the closer you can get to investee companies, the more likely you are to select the ones with the greatest potential. However, the model lacks diversification; investors are potentially exposed to countries and regions that have structurally slow growth or suffer from geopolitical problems.

Exposure to companies in a larger number of countries, across geographic regions, strengthens diversification, potentially providing protection against underperforming national economies and benefiting from faster-growing ones.

But is it possible to both invest locally and, at the same time, have a global focus?

Why Invest in the Mid-Market?

The small- and mid-market private equity sector has historically provided outperformance across most phases of the economic cycle.¹ Investors also like the fact that they usually pay lower entry multiples than for larger deals. In addition, it is a highly active segment with strong deal flow. In fact, 83% of the deals closed since 2014 were classified as mid-market.²

The strategy is good at adapting to changing market conditions compared to larger deals because smaller companies tend to be more agile and give the breadth of investment opportunities, allowing investors to nudge their investment strategy more easily. In addition, the mid-market reduces risk by relying less on leverage to generate returns. Whereas large-cap deal leverage is

¹ Preqin, global data Q2 2020

² Preqin Pro as of March 31, 2019

³ LCD data [S&P Global Market Intelligence], 30/06/2020

⁴ Preqin Pro



Eric Deram
Managing Partner

Flexstone Partners
[www.im.natixis.com/
flexstone-partners](http://www.im.natixis.com/flexstone-partners)

Flexstone Partners is a global private investments firm delivering customized solutions across small- and mid-cap private equity, real estate, private debt, and infrastructure. The firm seeks to actively capture responsible growth opportunities in compelling, hard-to-access markets across North America, Europe, and Asia. With more than 27 years of private market average experience, Flexstone Partners has over 40 institutional clients with more than \$7.8bn under management across primary, secondary, and co-investment funds in North America, Europe, and Asia-Pacific.

5.4x a company's profits, leverage is just 5.0x profits for smaller deals.³

There is a wider array of exit opportunities in the mid-market too, including selling a portfolio company to a larger fund or peer-group competitor.

Mid-Market Is Well Placed to Withstand Headwinds

Of course, there are currently potential headwinds amid the pandemic shock to the global economy. But the long-term perspective may be some consolation to private equity investors. Put simply, no buyout vintage has ever failed to produce positive returns on capital, no matter how severe the downturn.⁴ Even vintages

launched in the years immediately before the Global Financial Crisis (GFC) produced positive IRRs; however, there is no guarantee that future vintages will produce similar returns.

Mid-market funds are particularly resilient to downturns, given their relatively low leverage and greater potential to refocus companies. To protect value, we think it is also vital to transact only deals that are within the 'sweet spot' of the lead private equity investor. That is, the GP has demonstrable skills and knowledge of the deal type and is not transacting opportunistically.

When a buyout fund makes a sweet spot investment, average returns are 2.2x the price paid. When the fund strays from the sweet spot, returns are just 1.3x the price paid.¹ We cannot stress this point too strongly and have developed a systematic sweet spot framework to address it. This framework helps avoid style drift, conserve resources, and produce more accurate decision-making. It is an important defense against the kind of crisis we have seen in 2020.

The Challenges of Geographic Diversification

Even if the mid-market has great potential to create superior value, geographical diversification is key to secure this value creation while mitigating the downside risk.

There are challenges to achieving geographic diversification, not least because of the diversity of the private equity environments in different countries and regions. In Europe, for instance, the bulk of the private equity markets are driven by smaller deals, while in the US, average fund sizes tend to be larger. Meanwhile, in Europe debt levels for mid-market deals have fallen markedly since 2016, while in the US they have remained more or less stable.

From a regional and cultural standpoint only the US is homogenous. Europe and Asia are both fragmented so you need a local partner. Each country in Asia and Europe has different codes, cultures, structures, and laws. It is possible to take a blanket approach and target only larger, highly visible companies that operate across Europe or across Asia, but this risks missing the value created by fast-growing, lesser-known enterprises in niche sectors.

¹ Bain & Company, *Global Private Equity report, 2016*

Global Presence, Local Focus

To unearth the most promising mid-market companies worldwide requires a global team with local expertise in the world's major regions: Europe, US, and Asia. Accessing a global opportunity set necessitates feet on the ground, and proximity to companies and deal networks. With subscriptions to the best-performing mid-market funds in high demand, access to managers is critical. None of this can be achieved by operating remotely.

Flexstone Partners was conceived expressly to bring a global perspective to the private equity mid-market. Constructed by the combination of three existing Natixis affiliates present in the three largest private equity markets in the world, its management team has decades of experience in the mid-cap buyout and growth segments.

A la Carte Investing

Investors have told us they want globally diversified portfolios that are tailored to their particular needs. Some want certain geographical exposures to dovetail with existing exposures in their portfolios. For others, the priority may be to take more risk, perhaps by investing in first-time funds or by loading up on emerging markets. We think it is important to respond to this and provide an a la carte menu for investment strategy, research and selection, structuring, tax, accountancy, and reporting.

This approach allows investors to diversify by region, but also by manager type, sector, and size of deal. The resulting portfolios respond to the objectives of clients, with assets matching these objectives.

Some institutional investors have the resources and experience in private equity investing to make their own global allocations. Many others, however, would like to tap the historically high returns from the private equity mid-market, but seek a partner to steer them through the complexities.

This is where a global private equity advisor, with a local presence on the ground in all the major regions of the world and 20+ years' experience of investing the mid-markets, can prove its worth.

Asia-Pacific: Private Equity's Promised Land

Fundraising in Asia-Pacific has slowed as capital remains locked in investments. But the region's appeal is clear and the COVID recovery presents a once-in-a-generation opportunity

Asia-Pacific's pull on private equity investors is strong. Within the region, fund managers surveyed by Prequin feel Southeast Asia presents the best opportunities for 2021 (50% of respondents), followed by China (38%) and India (35%, Fig. 3.1). Private equity investors had a different order of preference, with China in the lead (55%), followed by Southeast Asia (37%) and India (25%), but the same three were preferred over other emerging markets.

In many respects, Asia is private equity's 'promised land.' The strengthening of intraregional trade following the signing of the Regional Comprehensive Economic Partnership (RCEP)¹ in November 2020, December's EU-China investment agreement, a large and rapidly growing middle class, urbanization, productivity improvements, and technological

innovation and leadership will create countless opportunities for private equity investors.

Indeed, Prequin expects Asia-Pacific to drive growth in overall private equity AUM over the next five years. We forecast a CAGR of 28.2%², taking AUM from \$1.26tn in 2020 to \$4.36tn in 2025 (Fig. 3.3).

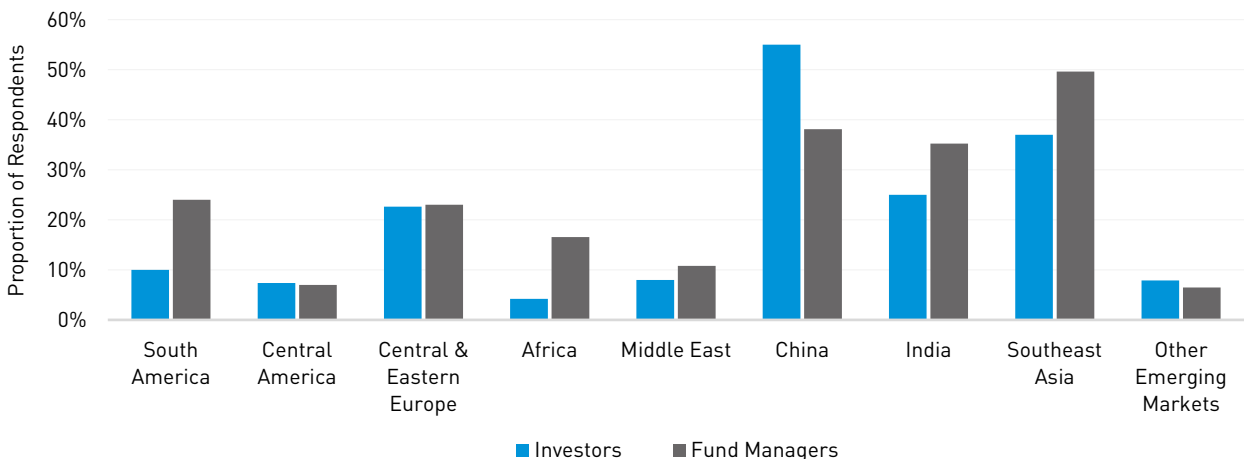
Growth is a key attraction, with the IMF forecasting a 6.9% increase in GDP in Asia in 2021³, following a 2.2% contraction in 2020. While the IMF was cautious on Asia's rebound from a "severe recession," the region's economies fared better than most. The Asia-Pacific region is expected to grow by 6.34% in 2021 according to Oxford Economics (Fig. 3.2), following a relatively mild 1.33% contraction in 2020.

¹ <https://rcepsec.org/>

² <https://www.prequin.com/insights/research/reports/prequin-special-report-the-future-of-alternatives-2025>

³ <https://www.imf.org/en/Publications/REO/APAC/Issues/2020/10/21/regional-economic-outlook-apd>

Fig. 3.1: Emerging Markets that Will Present the Best Opportunities for Private Equity in 2021: Investors vs. Fund Managers

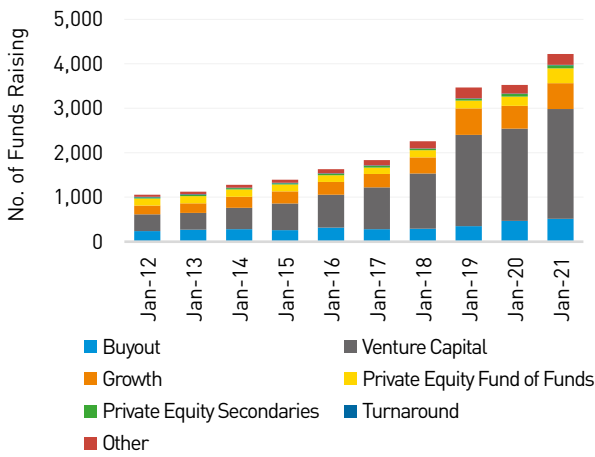


Source: Prequin Investor and Fund Manager Surveys, November 2020

The environment has been particularly tough for emerging private equity managers. First-time funds accounted for only 16% of the total number of funds closed and 6.4% of the total capital raised in 2020, a record low for both metrics. Indeed, competition among emerging managers for capital is particularly intense, which may tilt the balance of the LP/GP relationship in favor of investors for this subset of fund managers. We may therefore expect to see further downward pressure on fees in the coming years, particularly for smaller and emerging fund managers.

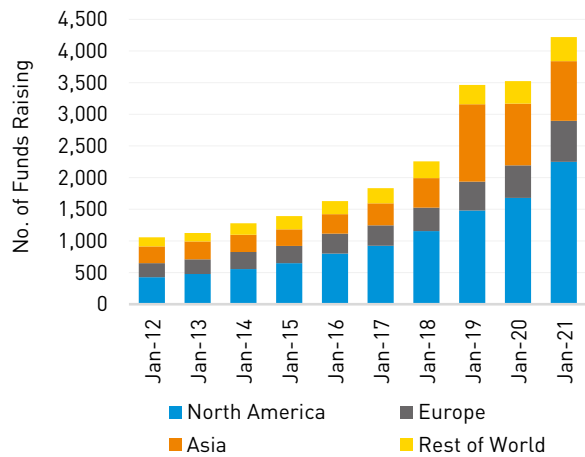
The largest funds in market include two China-focused government-backed growth funds. China Manufacturing Transformation and Upgrading Fund and Guohua Military and Civilian Integration Industry Development Fund plan to raise \$21bn and \$15bn respectively. In Europe, the largest fund currently on the road is EQT Partners' EQT IX buyout fund, which will focus on the Nordic region and German-speaking countries in Europe, and is targeting €14.8bn.

Fig. 4.14: Number of Private Equity Funds in Market by Primary Strategy, 2012 - 2021



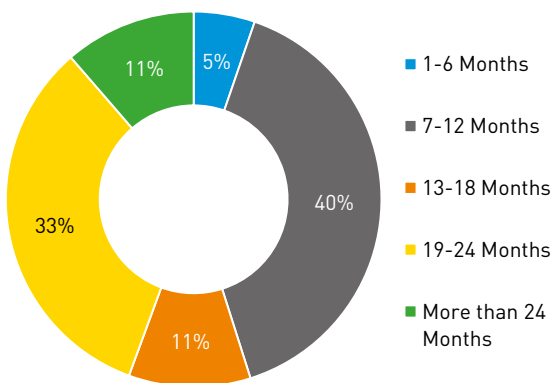
Source: Preqin Pro

Fig. 4.15: Number of Private Equity Funds in Market by Primary Geographic Focus, 2012 - 2021



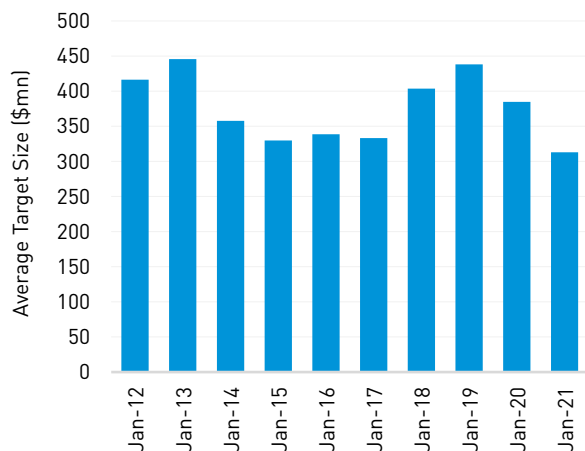
Source: Preqin Pro

Fig. 4.16: Private Equity Funds in Market by Time Spent on the Road



Source: Preqin Pro

Fig. 4.17: Average Target Size of Private Equity Funds in Market, 2012 - 2021



Source: Preqin Pro

Long-Term Performance Drivers Remain Intact

Growth, low rates, and a benign inflationary environment are likely to support private equity performance going forward

The investment case for private equity remains strong, if history is anything to go by. Vintages for the asset class in the past decade have consistently produced median net IRRs in excess of 10%, while top-quartile funds have exceeded 20% (Fig. 9.1). By comparison, the MSCI ACWI Index has produced an annualized total return of 12.86% over the period 2015-2020.

Several Long-Term Drivers Should Remain Intact

The performance of private equity funds has been boosted by a number of factors in recent years. Advanced economies have expanded by 12.4% since 2010 and year-on-year growth is expected to return this year: Oxford Economics forecasts a 4.2% expansion following a 5.1% contraction in 2021. In addition, public equities have seen earnings multiples gradually expand over the past decade and now trade at a forward P/E multiple of 20.0x earnings. Although high by historical standards, the implied earnings yield of 5.0% remains attractive compared with prevailing bond yields: 10-year Treasury bonds yield close to 1%. There

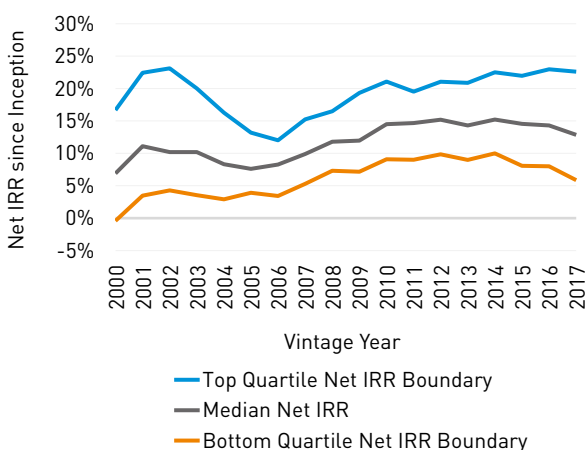
may therefore be room for further multiple expansion in some public and private markets.

Downside risks could stem from another severe public market correction, which may impact private equity valuations, or significant financial market stress, which would impede the flow of financing to managers. While the initial pandemic-induced market correction was brief, due to the powerful monetary and fiscal response from the authorities, concerns of another market correction may return once the effects of emergency measures begin to abate and any underlying solvency issues come to light.

North America Loses Ground to Asia

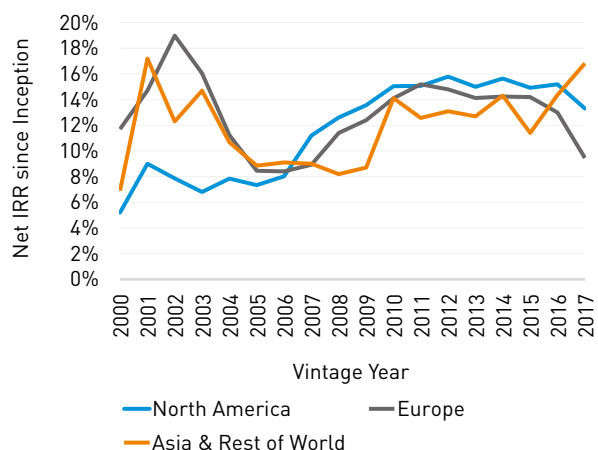
For the most part, median returns in North America have led other regions post-GFC. Sustained central bank support and the emergence of big tech have helped elevate public market valuations at a quicker pace than comparable markets for much of this period. This, in turn, has pulled up private market valuations.

Fig. 9.1: Private Equity: Median Net IRRs and Quartile Boundaries by Vintage Year



Source: Preqin Pro. Most Up-to-Date Data

Fig. 9.2: Private Equity: Median Net IRRs by Primary Geographic Focus and Vintage Year



Source: Preqin Pro. Most Up-to-Date Data

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