2015 Preqin Global Private Equity & Venture Capital Report

Sample Pages

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The 2015 Preqin Global Private Equity & Venture Capital Report - Contents

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Private Equity & Venture Capital - 2014 Key Stats

PRIVATE EQUITY AND VENTURE CAPITAL HIGHLIGHTS

$3.8tn

Private equity and venture capital assets under management reach a new high as of June 2014.

11.9%

Increase in dry powder on 2013. Total dry powder now stands at $1.2tn as at December 2014.

$495bn

Aggregate capital raised by private equity and venture capital funds in 2014.

$444bn

Total capital distributions in H1 2014. Momentum continues from the record distributions seen in 2013.

25.9%

One-year rolling horizon IRR to June 2014 shows venture capital outperforming all other strategies.

Buyout Activity

$332bn

Aggregate buyout deal value in 2014.

LARGEST BUYOUT DEAL IN 2014

The $11.53bn Tim Hortons Inc. add-on in August by 3G-backed Burger King.

$428bn

2014 saw 1,604 buyout exits, with an aggregate value of $428bn.

LARGEST BUYOUT EXIT IN 2014

The trade sale of Alliance Boots GmbH, acquired by Walgreen Co. for $15bn.

Venture Capital Activity

$86bn

Aggregate venture capital deal value in 2014.*

LARGEST VENTURE CAPITAL DEAL IN 2014

TAXI

Uber Technologies Inc. received $1.2bn in Series D financing in June, and a further $1.2bn in Series E in December.

$120bn

2014 saw 1,049 venture capital exits, with an aggregate value of $120bn.

LARGEST VENTURE CAPITAL EXIT IN 2014

The $25bn IPO of Alibaba Group in September 2014.

**Figures exclude add-ons, grants, mergers, secondary stock purchases and venture debt.*

Private Equity & Venture Capital in 2015 – A Competitive and Sophisticated Market

- Christopher Elvin, Preqin

Strong Fundraising and Continued Growth in AUM

The record levels of capital returned to investors in 2013 helped to facilitate another healthy year of fundraising in 2014, with $495bn of aggregate capital raised by 994 funds over the course of the year. This figure is likely to increase as more information becomes available, which means 2014 is on a par with fundraising levels seen in 2013, when $528bn was secured. 2014 also saw a $128bn increase in dry powder since December 2013, and combined with an increase in the unrealized value of portfolio assets, the industry's total AUM stands in excess of $3.8tn. As of January 2015 there were 2,235 funds looking to raise an aggregate $793bn; when compared against 2014 fundraising figures, this gives a clear indication of the level of competition currently in the market.

Returns

The PrEQIn Index, shown on page 62, confirms that the private equity and venture capital model is working, with superior returns compared to the public markets delivered over the long term. Preqin's latest investor survey also confirmed this, with 75% of respondents stating that they are satisfied with the returns they have seen from their portfolios, and a further 17% stating that returns have exceeded expectations.

Of particular note in 2014 was the improvement in venture capital performance. Previously tarnished by generally underwhelming returns for all but a few managers since the burst of the dot-com bubble, venture capital returns registered a one-year horizon IRR to June 2014 of 25.9%, the highest of all private equity strategies. Some institutional investors appear to have taken note of this change in fortunes, with 26% of investors surveyed in December intending to commit to venture capital vehicles in the next 12 months, a considerable increase from the 15% of respondents to the same survey the year before.

Deals and Exits

Improved market conditions in 2014 resulted in the highest ever aggregate exit value for private equity buyout fund managers, with a total of 1,604 exits globally valued at $428bn, 30% more than the total value of exits in 2013. This meant that as of June 2014 (the latest data available) $224bn had been returned to investors in buyout distributions, nearly the same as the full-year 2013 amount of $226bn and significantly more than total capital called, resulting in ongoing liquidity for investors.

The total value of buyout deals in 2014 reached $332bn globally, the highest annual amount since 2007, while a total of 7,475 venture capital financings were announced globally with an aggregate value of $86bn. This represents an 11% fall in number compared to 2013, but a 58% rise in aggregate value.

There is ongoing concern that high dry powder levels are increasing competition for deals, making it harder for GPs to find attractive investment opportunities which may ultimately impact returns. Sixty percent of buyout managers, 44% of growth managers and 39% of venture capital managers surveyed confirmed that they had seen a rise in competition for transactions compared to 12 months ago. Page 14 of this report provides some evidence that the asset class is managing to deal with the overhang; however, with GPs armed with readily available capital, competition for the best deals in 2015 is likely to remain rife.

Investor Appetite

Investor appetite for the asset class remains robust and many LPs are below their target allocations as a result of the disparity between distributed and called capital.

Forty-six percent of respondents to Preqin's latest investor survey are currently below their target allocations, compared to 39% of respondents in 2013 and 28% in 2012. Given LP satisfaction with returns, it is unsurprising that 79% of LPs surveyed are looking to maintain or increase their allocations to the asset class in the next 12 months.

The dominance of established managers continued in 2014, with just 7% of aggregate capital raised by first-time managers, the same level as in 2013. The percentage of LPs looking to increase the number of GP relationships in their portfolio fell by 11 percentage points compared to 2013, indicating new managers will have to present an even more compelling argument in order to secure LP capital.

LPs are becoming increasingly sophisticated and many are seeking alternative ways in which to access the asset class. More tailored solutions such as co-investments and separate accounts are attracting LPs due to lower fees, greater transparency and greater liquidity. Many GPs are responding accordingly; 53% of firms surveyed in December confirmed they are looking to offer more co-investment opportunities to investors.

Regulation

Regulatory reform continues to be a topic of concern and confusion among fund managers and investors alike. Forty-five percent of fund managers recently surveyed believe that changes in regulation will have a negative effect on the industry in 2015, 39% believe it will have no impact and 16% believe any changes will be positive. LPs also appear to be concerned with the impact such changes may have on their investments, with 21% of survey respondents citing regulation as one of the biggest challenges facing investors in the year ahead.

Outlook for 2015

2014 has been a successful year for the private equity and venture capital asset class and with healthy market conditions, cash-rich fund managers and generally content investors, 2015 has the potential to follow suit. However, significant challenges face both GPs and LPs.

While investors will be enjoying the liquidity delivered to them by ongoing high levels of distributions, the market is saturated with a record number of funds seeking capital, and investors consequently face the challenge of identifying the best investment opportunities. On the other hand, fund managers are confronted with intense competition, not only with fundraising, but also in finding attractive deal entry prices while at the same time having to meet increased demands from both investors and regulatory bodies.

Post-Trade Valuations: Is Outsourcing Becoming the New Norm?

- Kevin O'Connor, Director, Markit

In the post-Alternative Investment Fund Managers Directive (AIFMD), world deal teams remain focused on target selection, while the provision of valuations is moving to become the responsibility of finance or middle office teams. Yet the provision of independent valuations can be used as a point of differentiation to attract investors, as well as a tool to identify areas to mitigate costs.

This shift in focus has seen funds perform the valuation function in-house or outsource this to third parties, which presents an opportunity to address a range of issues:

- Increasing regulator focus on the allocation and disclosure of fund costs;
- Increasing investor demand for independent valuations;
- Increasing auditor scrutiny of Level 3 valuations;
- Increasing complexity of investor regulatory reporting.

Fund agreements need to provide clarity as to which costs will be borne by the fund and which will be a charge to the fund manager. In both cases, the requirement is to minimize costs while meeting investor and regulatory requirements.

In studies reported by Preqin, investors indicate that they are going to maintain or increase their allocation to private equity over the longer term. GPs are raising new funds at an increasing rate, and the aggregate capital raised continues at a high level.

The increased appetite from investors is exerting pressure on fund managers for independent valuations. This is often a critical component of the operational due diligence performed when an investor is considering whether to commit to a fund. In an increasingly competitive environment, being able to satisfy this requirement is a basic step fund managers should take to help them win new mandates.

If independent valuations are required in order to raise funds, then it makes sense to also use these valuations for post-trade reporting and so minimise fund costs. Regulators will require that the fund retain staff that can critique valuations provided by third parties, but outsourcing the preparation of valuations is an increasingly attractive option for many funds. This enables the fund to focus on management of its investments and the delivery of quality investor reporting, rather than staff to provide what is becoming a standardized service.

There are two other post-trade reporting costs which are often under estimated:

- Auditor scrutiny of Level 3 valuations arising from the increased focus of the Public Company Accounting Oversight Board (PCAOB) on this topic. This means that audit reviews are taking longer and that there is more discussion about the assumptions used in valuing these illiquid assets. Having an independent and comprehensive valuation report to support the valuations used in fund reporting helps minimize the time taken for the review.

- Regulators are placing additional reporting requirements on investors in Level 3 assets, for example the prudent valuation requirements contained in the EU Solvency II Directive. Although this is not a direct concern for fund managers, it can be viewed as a differentiator. If a fund can provide data which can be used by an investor to meet their reporting requirements this will aid the investor and reduce the time they need to spend collating data or, worse still, repeating work already performed by the GP.

A further consideration is the growth in codification of industry reporting best practice, such as the Institutional Limited Partner Association (ILPA) Reporting Standards. Adoption of industry best practice creates opportunities to provide a more standardized valuation service that will meet investor requirements. A more standardized service will deliver cost savings to fund managers and transparency to investors.

It could be argued that a more standardized service will mis-value investments on the assumption that valuations of illiquid debt and unlisted equity already contain assumptions which could be worse than the existing approach. On the other hand, there are cost and consistency benefits from this approach which will assist both fund managers and investors. Separating deal team pricing from post-trade valuation highlights the different drivers at work: on the one hand there is a need to obtain data which is actionable and can drive management decision making, while on the other hand, investors need to be able to make good, long-term investment decisions and report fair value to their clients.

Taken all together, the need to perform post-trade valuations away from the deal team, the requirement for comprehensive valuation reports, investor demands for reporting, and the need to adopt industry reporting standards makes use of an outsourced third-party valuation service increasingly attractive.

Markit

Markit is a leading global diversified provider of financial information services. We help customers reduce risk, improve operational efficiency and benefit from enhanced transparency.

Markit's Private Equity service provides valuations for a range of hard to value asset classes including illiquid debt, private companies, infrastructure and employee share options. Our customers include investment banks, private equity funds, hedge funds, asset managers, central banks, regulators, auditors, fund administrators and insurance companies.

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Performance Overview

The private equity industry has seen a healthy recovery since the market turmoil of 2008 and 2009, becoming an integral part of institutional investors' portfolios. By choosing the best performing fund managers, investors can generate premium, long-term returns in order to boost the performance of their overall portfolio; therefore for fund managers, being able to stand out in the crowd and demonstrate a strong and consistent performance track record is imperative when raising capital for new vehicles.

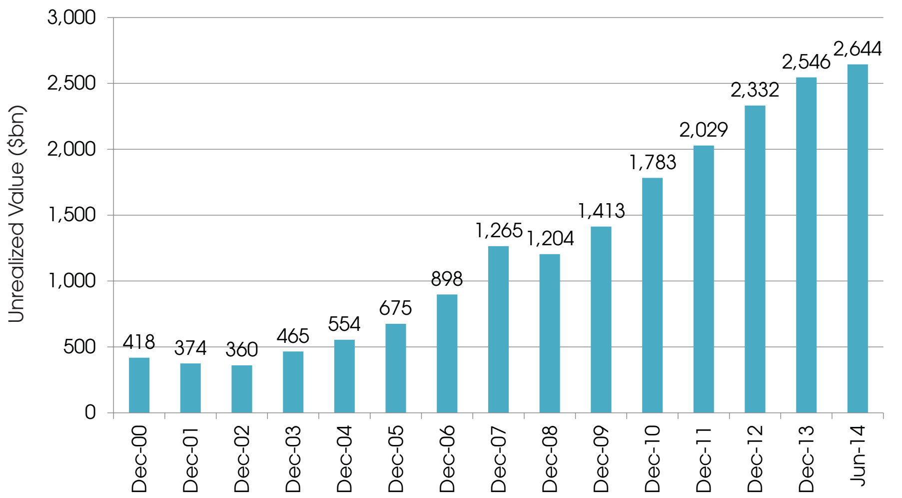
The importance of gaining access to reliable, consistent and up-to-date performance data is clear for all private equity and venture capital professionals. Preqin provides net-to-LP performance data for over 7,200 private equity and venture capital funds raised by over 2,200 fund managers. By examining this data, investors, fund managers and service providers alike can gain a valuable insight into the industry. The following analysis highlights the recent trends in the industry and shows some of those insights available to Preqin's subscribers.

Growth of the Asset Class and Strong Short-Term Performance

Notably, in the past few years, the private equity asset class has been steadily growing in size. Fig. 6.1 highlights the growth in terms of capital invested in the industry year-on-year. The data shows that during 2013, the total value of unrealized investments grew by 9.2% and by a further 3.9% during the first half of 2014, as favourable market conditions during this time saw rising valuations for portfolio companies lead to further increases in the value of assets owned by the industry, despite the continuing high rate of realizations. Favourable conditions and continued investment in the industry has produced sustained growth in the asset class, despite record distributions during 2013 (as shown in Fig. 6.2).

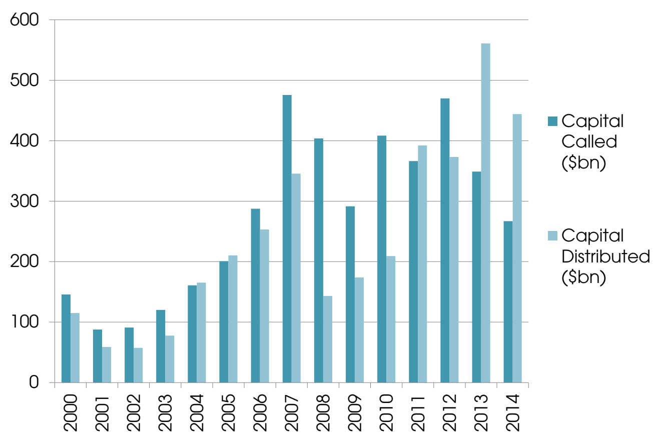
Recent market conditions combined with high levels of distributions over the last 18 months are driving short-term performance within the asset class. To highlight the performance of various asset classes in relation to an institutional investor's portfolio over fixed periods of time, Preqin reviews the financial statements of over 100 public pension funds. Fig. 6.3 shows the median one-year returns generated by public pension funds (for more in-depth analysis, see page 65). The analysis shows that private equity generated a one-year return of 19.9% to 30 June 2014, with only listed equity generating a greater return during this time period, indicating that investors are seeing the benefit of this favourable short-term performance within their private equity portfolios.

Fig. 6.1: All Private Equity: Unrealized Value, 2000 - 2014



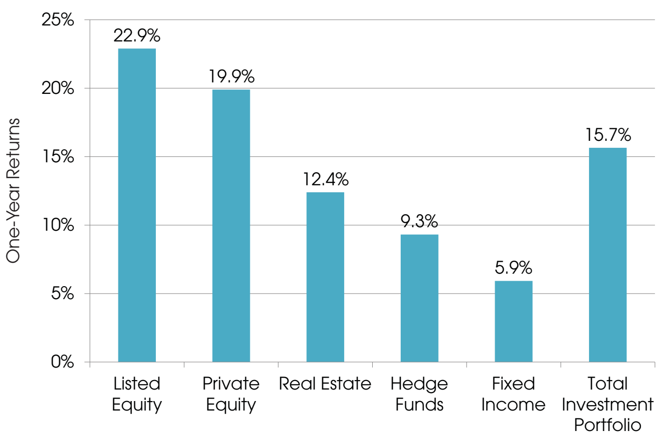
Source: Preqin Performance Analyst

Fig. 6.2: All Private Equity: Annual Amount Called and Distributed, 2000 - 2014



Source: Preqin Performance Analyst

Fig. 6.3: Public Pension Funds: One-Year Returns by Asset Class (As at 30 June 2014)



Source: Preqin Performance Analyst

Preqin also generates horizon IRRs for the whole private equity and venture capital industry by fund type using cash flow data for over 2,600 funds. Further examination is shown on page 64. Fig. 6.4 shows strong performance over the recent one-year periods for each fund type, with venture capital funds in particular showing a one-year return of 25.9% to 30 June 2014.

Recent Trends in Summary

- The private equity and venture capital industry continues to grow with unrealized investment value growing a further 3.9% in H1 2014.
- Record high levels of distributions over the 18-month period to Q2 2014, along with strong market conditions, have resulted in favourable short-term performance.
- Venture capital funds show the strongest one-year performance compared to other fund types with a one-year horizon IRR of 25.9% to 30 June 2014.

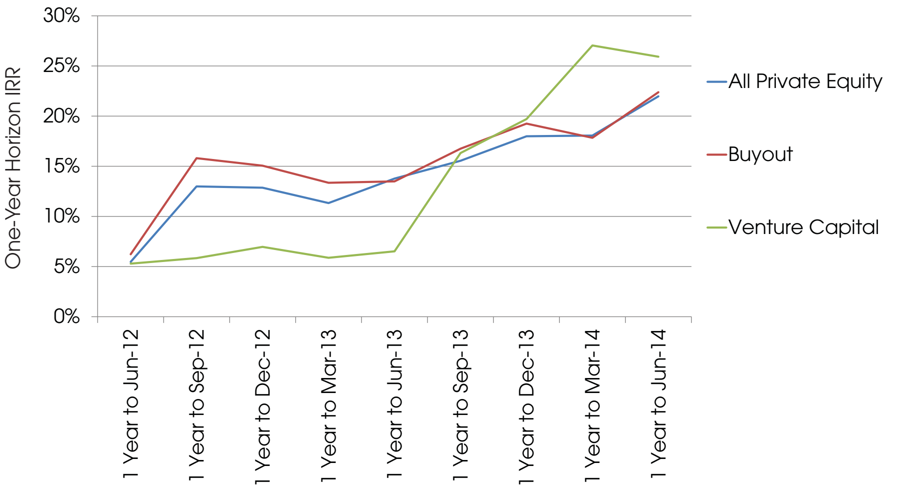
Due Diligence and Fund Manager Track Record

With strong short-term performance and high levels of recent distributions, investors may have capital to re-invest back into the industry; a recent Preqin survey of LPs discovered that 33% of investors surveyed were planning to increase their allocation to private equity within the next 12 months.

Fig. 6.5 shows that the difference between the higher and lower performing funds can be vast, with an average spread of seven percentage points between the median and upper/lower quartile boundaries. With this wide range of returns being achieved by fund managers, it is imperative for investors to be able to distinguish between fund investment opportunities and select those opportunities most likely to deliver upper quartile performance. For investors looking to make new fund commitments, fund manager track record analysis plays an important role in their due diligence processes. With returns information for over 7,200 fund vehicles, Preqin's Performance Analyst database is a vital tool for any investor or service provider to gain insight into the past performance of a fund manager. We have analyzed each fund manager's performance track record from fund to fund to determine whether the top performing fund managers are consistent in their performance.

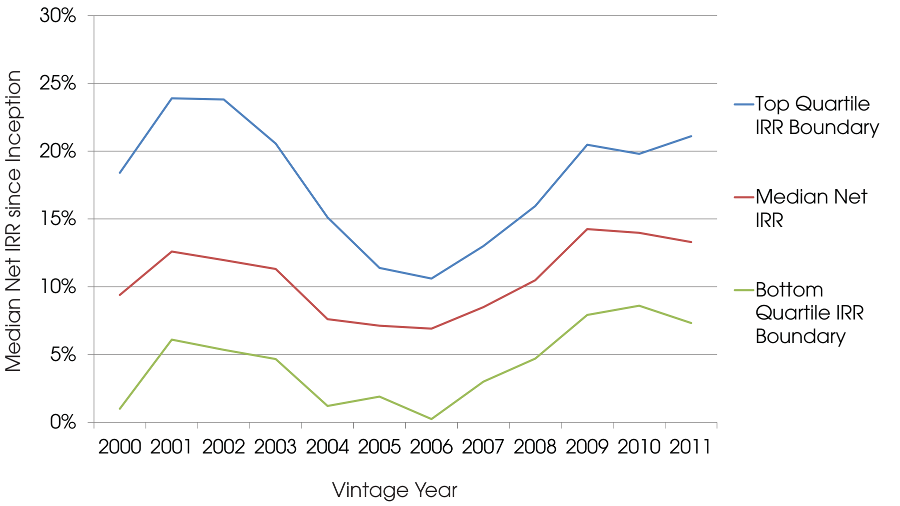
Fig. 6.6 shows that a third of fund managers with a top quartile fund go on to have their next fund ranked in the top

Fig. 6.4: One-Year Rolling Horizon IRRs, June 2012 - June 2014



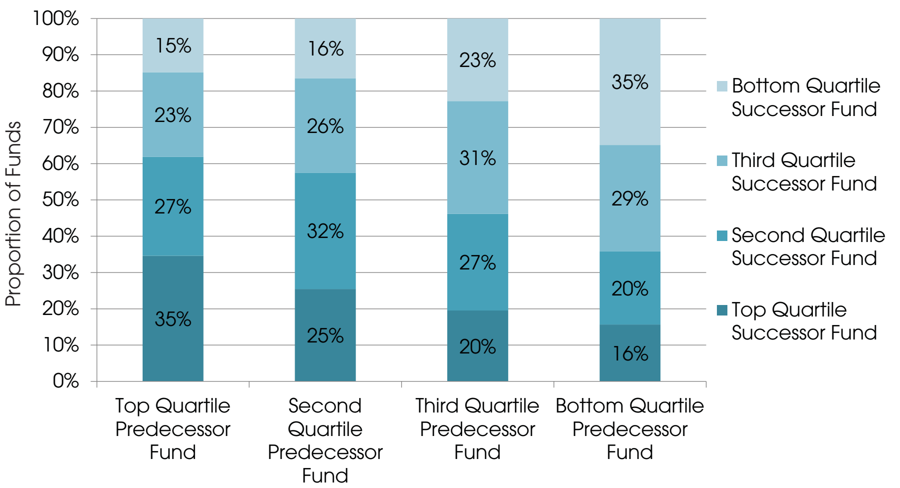
Source: Preqin Performance Analyst

Fig. 6.5: Median Net IRRs and Quartile Boundaries by Vintage



Source: Preqin Performance Analyst

Fig. 6.6: All Private Equity: Relationship between Predecessor and Successor Fund Quartiles



Source: Preqin Performance Analyst

quartile. Additionally, over 60% of top quartile fund managers go on to achieve above median performance with their next fund. In contrast, over 60% of bottom quartile fund managers fail to reach the median benchmark with their subsequent fund. The analysis highlights the clear correlation between the performance quartile rankings of successive funds, and while past performance is no guarantee of future success, fund manager track records continue to play an important role in investors' due diligence process, highlighting the need for fund managers to demonstrate consistently high performance.

Interim Fund Performance as an Indicator of Future Success

With a typical fund life of around 10-12 years, the overall performance of a fund is only fully known when it has been liquidated. For an investor, the importance of reviewing a fund manager's track record has been demonstrated, but how important is the interim performance of a fund manager's predecessor fund in determining the ultimate success of the fund? With fund managers typically starting the fundraising process of a new vehicle between four and six years after their immediate predecessor, how useful is the interim performance of this predecessor during an investor's due diligence process as an indicator of the final performance of the fund?

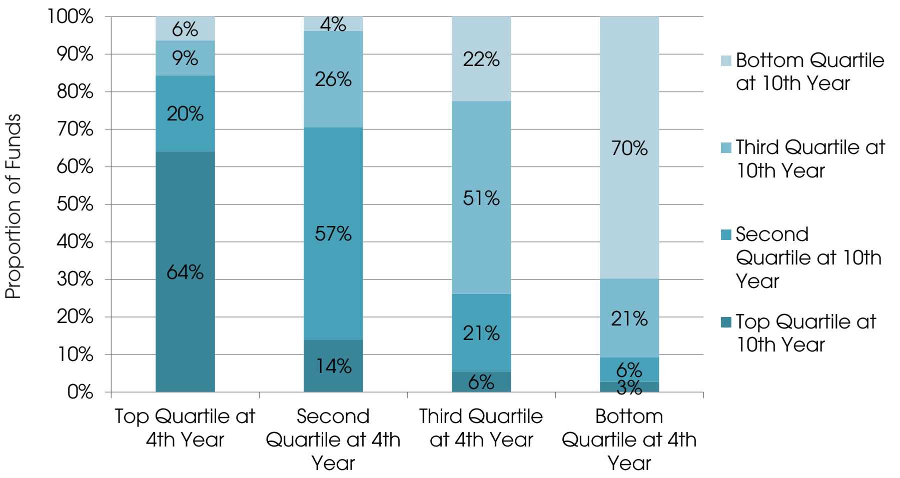
By examining over 50,000 lines of historical information from Preqin's Performance Analyst, it is possible to examine the interim performance of a fund in comparison to its final performance. Fig. 6.7 shows strong correlation between the quartile ranking of a fund in its fourth investment year and its ultimate quartile ranking at maturity.

This relationship becomes even stronger when examining interim performance after six years of a fund's life (Fig. 6.8), with the strongest association demonstrated by the best and worst performing funds.

Fund Manager Track Record

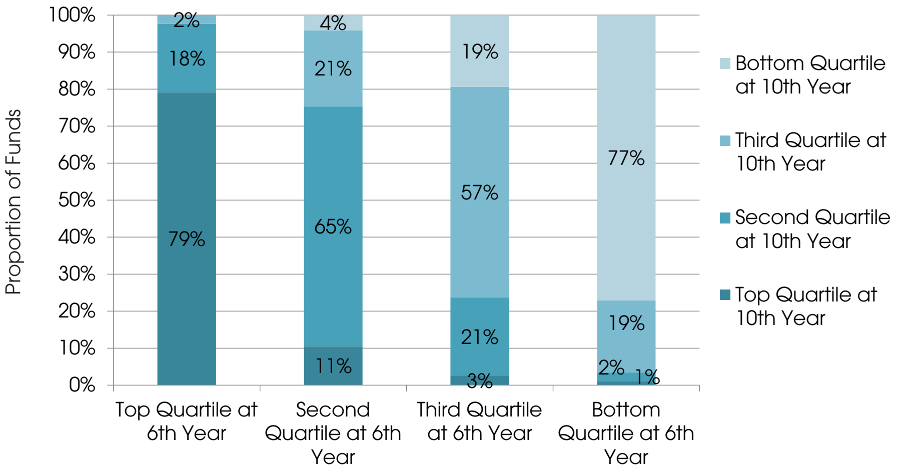
- Sixty-two percent of top quartile fund managers go on to raise a fund generating above median returns with their successor.
- In contrast, 64% of bottom quartile fund managers fail to achieve median performance with their subsequent fund.
- Sixty-four percent of funds which are ranked in the top quartile after four years and 79% after six years go on to be top quartile at maturity.

Fig. 6.7: Relationship between Private Equity Funds' Quartile Rankings at Fourth Investment Year and at Maturity



Source: Preqin Performance Analyst

Fig. 6.8: Relationship between Private Equity Funds' Quartile Rankings at Sixth Investment Year and at Maturity



Source: Preqin Performance Analyst

Outlook

The analysis presented here highlights the strong market conditions within the private equity and venture capital industry over the past 18 months, with continuing growth in fund valuations and high levels of distributions boosting short-term performance. With access to reliable and comprehensive performance data, investors and service providers alike are able to examine fund manager track records to provide real insights during their due diligence process. Similarly, for fund managers, the analysis highlights the importance of transparency of a track record when raising new vehicles in this increasingly competitive fundraising environment. The subsequent sections reveal the performance of the industry in more detail and highlight the metrics available to subscribers of Preqin's Performance Analyst database.

Data Source:

Preqin's **Performance Analyst** is the industry's most extensive source of net-to-LP private equity fund performance, with full metrics for over 7,200 named vehicles.

For more information, please visit:

www.preqin.com/pa