FUND FINANCE FRIDAY

McKinsey and Bain Publish Annual Reviews

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Two in-depth reports recently published expanded on the remarkable capital-raising environment while pointing to the challenges posed by high valuations, the growing stock of committed but uninvested capital and the potential for a more difficult investment environment. Here's what stood out to us from McKinsey's ***A New Decade for Private Markets: McKinsey Global Private Markets Review 2020*** and Bain & Co.'s ***Global Private Equity Report 2020.***

- Growth in the capital markets has been weighted heavily toward the private side. McKinsey reports that the private market AUM expanded 170% over the past decade while global public markets grew by 100%. U.S. sponsor-backed companies rose by 60% over the period while the number of publicly listed companies held flat.
- After a banner year in 2019, the outlook for fundraising remains robust, with announced targets by sponsors running above the year-end 2018 total, according to McKinsey. Roughly half of LPs report being below their targeted private equity allocation, according to Preqin data cited by Bain.
- Distributions again outpaced contributions in 2019. High fundraising volume, however, meant investors were only marginally cash flow positive, with the distribution-to-contribution ratio holding at 1.1x at mid-2019, according to Bain.
- Persistency in outperformance of public markets has declined, according to McKinsey, with the individual partner explaining a greater amount of investment performance than the firm.
- For the first time ever, private market performance for the past decade matched the broad public market, according to Bain. On the other hand, McKinsey cites Burgiss and Cambridge data to show that 2009-2016 vintage PE funds have outperformed public market equivalent (PME) benchmarks. We don't see these findings as incompatible given the potential impact of fund sample/vintage mix and the selection effect for PME comparisons. Suffice it to say, private market outperformance is not improving.
- U.S. buyout valuations reached a new all-time high of 11.9x on the back of rising leverage, according to McKinsey. Pro forma leverage for U.S. buyouts moved higher to 6.6x.
- Despite the increase in AUM, the McKinsey report indicates that deal volume held flat in 2019 at $1.47 trillion. Dry powder as a multiple of deal volume rose to nearly 2.0x, a significant increase from the 2016 low but in line with historical norms.

- In real estate, McKinsey notes, capital flows have favored open-end funds and core over value-add and opportunistic strategies.
- A downturn looms large in the GP mindset, according to McKinsey and Bain, but is not necessarily driving decisions at this point.