

Private equity liquidity – Is a distribution wave coming?

Private equity liquidity was a key concern amongst investors following the global financial crisis in 2008. Exit markets were virtually closed in late 2008 and 2009. However, this situation has subsequently improved. Global buyout and venture capital distributions in 2012 totaled USD 125 billion or 97% of the previous peak in 2007. Moreover, distributions from buyout funds reached USD 115 billion, the highest ever on record. Despite this development, there is a distinct difference between investors' current perceptions of private equity liquidity compared with 2007.

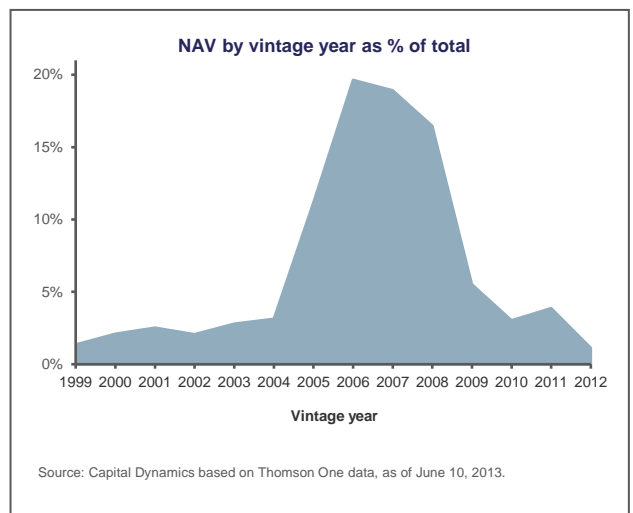
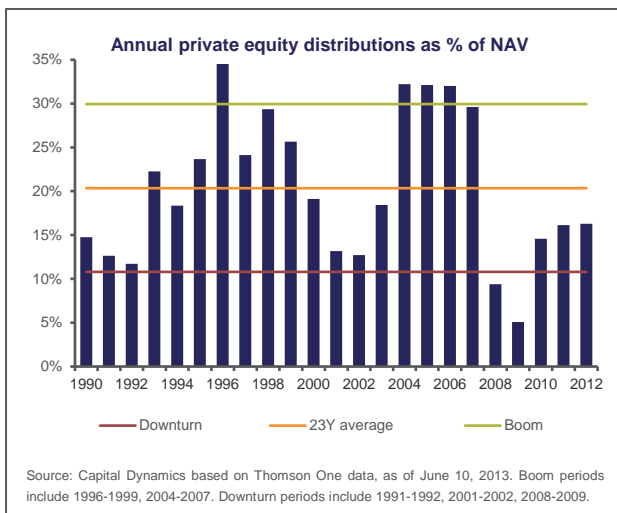
Why didn't investors' perceptions of private equity liquidity dramatically improve?

During 2004-2007, liquidity in private equity was at its peak, with 31% of the previous years' net asset values (NAV) being distributed during the year. In 2012, despite a high absolute value of distributions, relative to the NAV rate it was only 16%, below the long-term average over the last 23 years. Whilst looking into distribution amounts in relation to NAV, we observed that during downturn periods, distributions averaged 11% of NAV. In contrast, distribution rates almost tripled during boom periods to 30%. In 2011 and 2012, distribution rates were slightly above the downturn level, but substantially below the boom period, which reconciles with investor perceptions.

Where is the money tied up?

A moderate recovery of exit activity during the last three years has driven the unrealized value of US and European buyout funds to USD 738 billion, the highest level ever. A closer look at the vintage year NAV composition of buyout funds in the Thomson One database reveals that 70% of asset value or some USD 516 billion is tied up within funds dating back to 2007 and older. Half of the NAV in the private equity industry are concentrated in the three vintages: 2005-2007. These vintages are currently in their harvesting period and portfolio investments have to be realized soon.

Larger investments made by those vintage years demanded a longer holding time from General Partners (GPs) to create value. This was also impacted by the slow M&A activity of larger corporations and relatively soft IPO markets during 2009-2012 – typical exit channels for larger buyouts. The average holding period has gradually increased since 2007 from 3.6 to 5.4 years in 2012, according to Pitchbook data. Due to the sheer size of investments by those vintages, we could reasonably expect absolute distribution amounts to be very high even if investments are disposed of at lower returns.

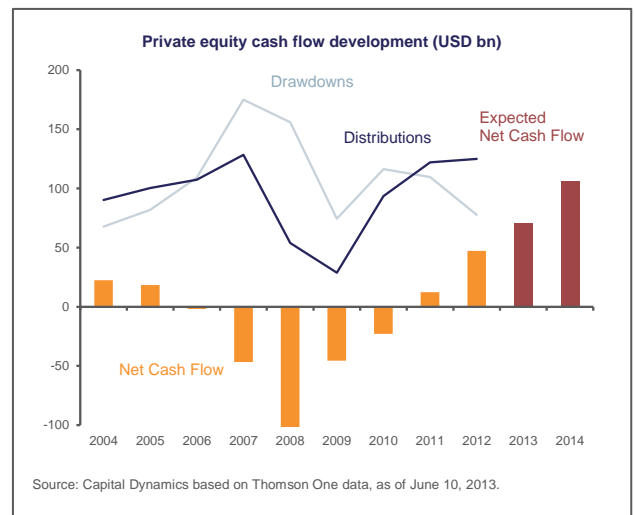
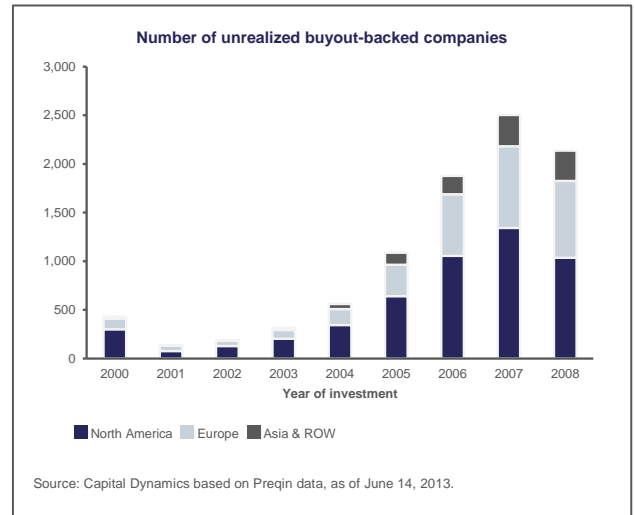


How big is the company exit pipeline?

A closer look at the inventory of buyout-backed companies in the Preqin database indicates that the near term exit pipeline, only including companies held by GPs for four years and longer, reached a record level of 7,074 companies. About half of the portfolio companies are located in the US, a third in Europe, and the rest in Asia-Pacific and other regions. A concentration within 2006-2008 investments suggests that in 2012 we only saw the tip of the iceberg as about 5,000 companies from those years are still in the exit pipeline. In 2012, global private equity exit activity increased, with the number of exits reaching 1,429 – the highest during the past decade. However, the pace was not commensurate with the inventory size, as it would take a further five years to fully dispose of the current aged holdings at the current pace.

Conclusion

Therefore, we expect further substantial exit acceleration in 2013 and 2014, provided that exit markets continue to stabilize, as GPs are willing to monetize their holdings; also partly due to time pressure on IRRs and the fundraising cycle. In our opinion, these factors should drive a distribution cycle, with the industry as a whole seeing substantial positive net cash flows to Limited Partners. Investors wishing to at least maintain their allocations to private equity should consider these potential cash flow dynamics in their future allocation plans.



About us

Capital Dynamics is an independent, global asset manager, investing in private equity and clean energy infrastructure. We are client-focused, tailoring solutions to meet investor requirements. We manage investments through a broad range of products and opportunities including separate account solutions, investment funds and structured private equity products. Capital Dynamics currently has USD 17 billion¹ in assets under management.

Our investment history dates back to 1988. Our senior investment professionals average over 20 years of investing experience across the private equity spectrum. We believe our experience and culture of innovation give us superior insight and help us deliver returns for our clients. We invest locally while operating globally from our London, New York, Zug, Beijing*, Tokyo, Hong Kong, Silicon Valley, Sao Paulo, Munich, Birmingham, Seoul, Brisbane, Shanghai* and Scottsdale offices.

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