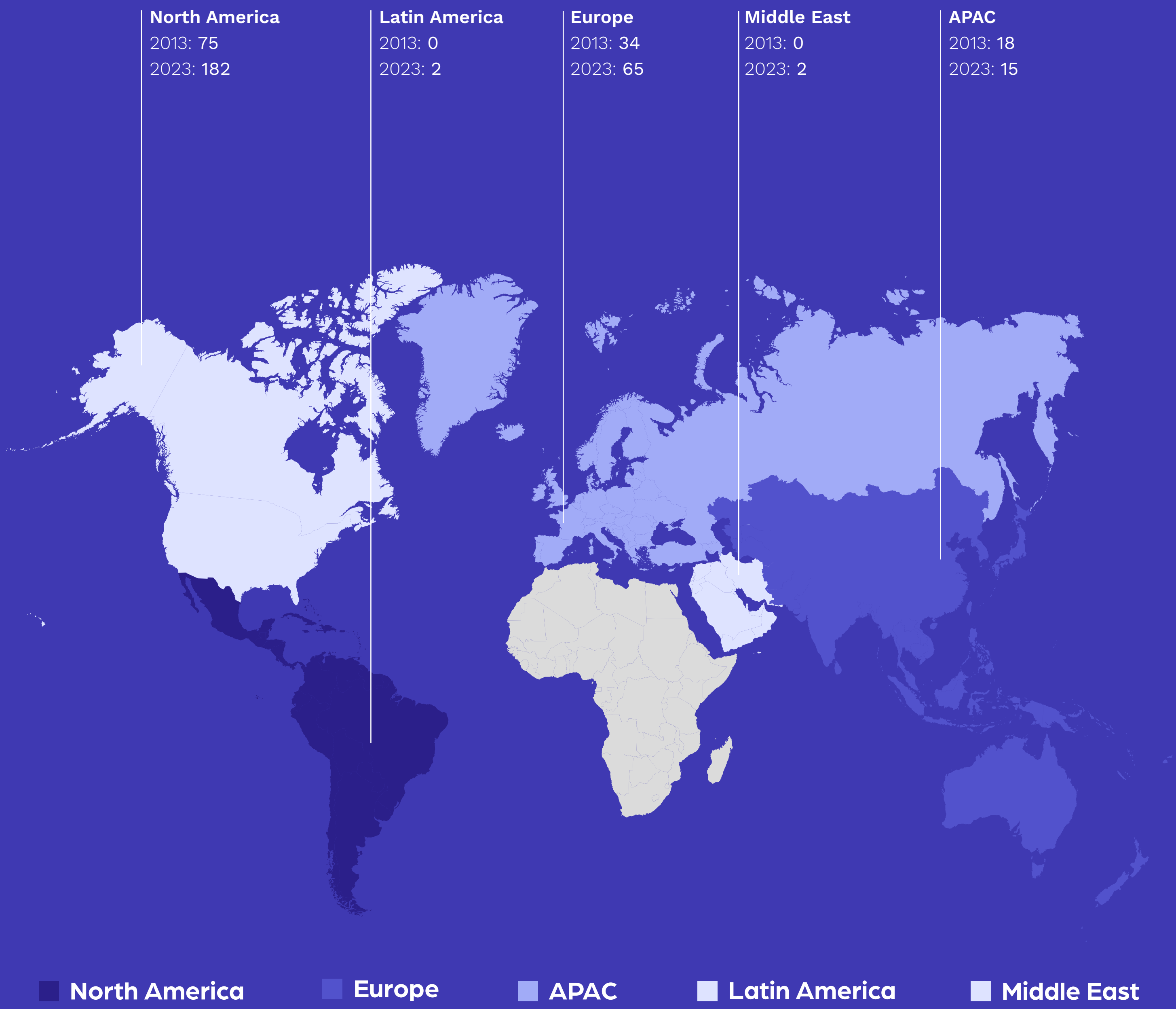
PRIMER

SEP 2024 | Trending topics in alternatives

PERFORMANCE → PRIMER 007

Does performance attract capital?

Number of $1bn-plus funds in 2013 vs. 2023, per region



PREQIN

Source: Preqin Pro. Data as of August 2024

Executive summary.

The era of consolidation. How did we get here?

At the midpoint of 2024, GPs out on the road fundraising are still facing many of the difficulties that dominated 2023. Although inflation pressure has abated and interest rates are not rising, the data shows that the liberating force of increased deal-making has yet to fully help turn the wheel of distributions and recommitments.

Veterans of a certain vintage will likely recall that the industry has been here before. Although fundraising has been tough and the long-mooted resumption of deal activity arrived – albeit as more of a steady fizz than a bang – in 2024, the inherent qualities of private capital at all levels haven't just disappeared during this short but tough period. Preqin predicts that year-on-year fundraising growth will return in 2025, rising steadily to hit the highs of 2021 in 2028. During that same year, we forecast assets under management (AUM) will hit $26tn (see Preqin's State of the Market: H2 2024) as the growth of alternatives continues.

However, there's no escaping the fact that for many the tough times of 2023 have continued into 2024. For GPs on the road fundraising, the consolidation of commitments to a small pool of well-known names remains a reality. Preqin's fundraising data, broken down into five fund-size clusters, points to an increasing percentage of the total capital committed going to the top 50 largest funds of that given year.

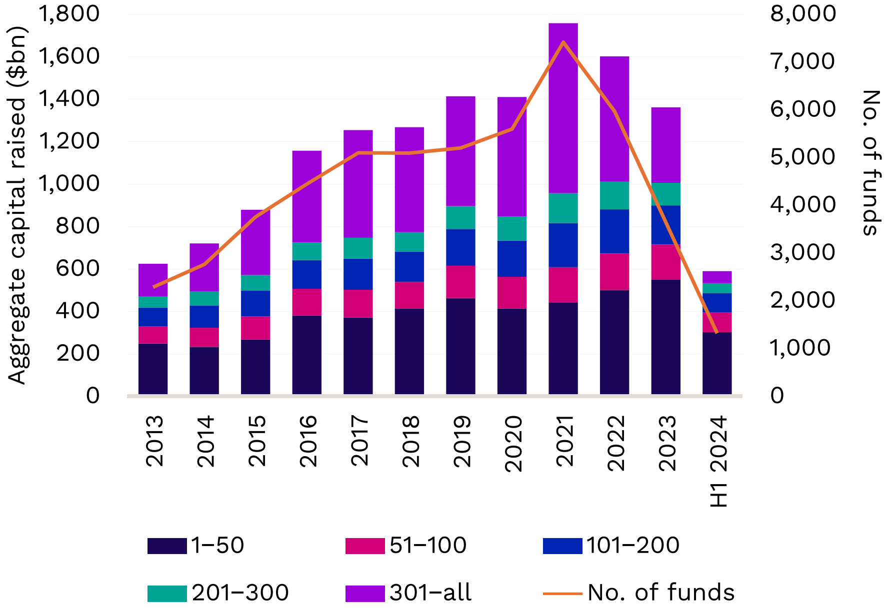
Consolidation in 2023 and 2024

"There are several forces at work. On one hand, LPs hate to miss any vintage because they understand that the most challenging fundraising environments can yield the best-performing vintages. On the other hand, LPs are having trouble making many new commitments, because they are not getting much back in distributions. This makes for a harsh fundraising environment, especially for new or smaller market entrants. The LPs know that no one ever got fired for buying a Xerox machine, as they used to say, and perceive it to be safest to stick with market leaders. Meanwhile, as compliance costs rise, it's easiest for big shops to maintain back-office overhead. We worry that this consolidation won't be good for LPs over the long term."

Joseph A. Smith
Partner
Schulte Roth & Zabel

Fig. 1: Aggregate capital raised across all private capital funds by top fund size, 2013 – H1 2024

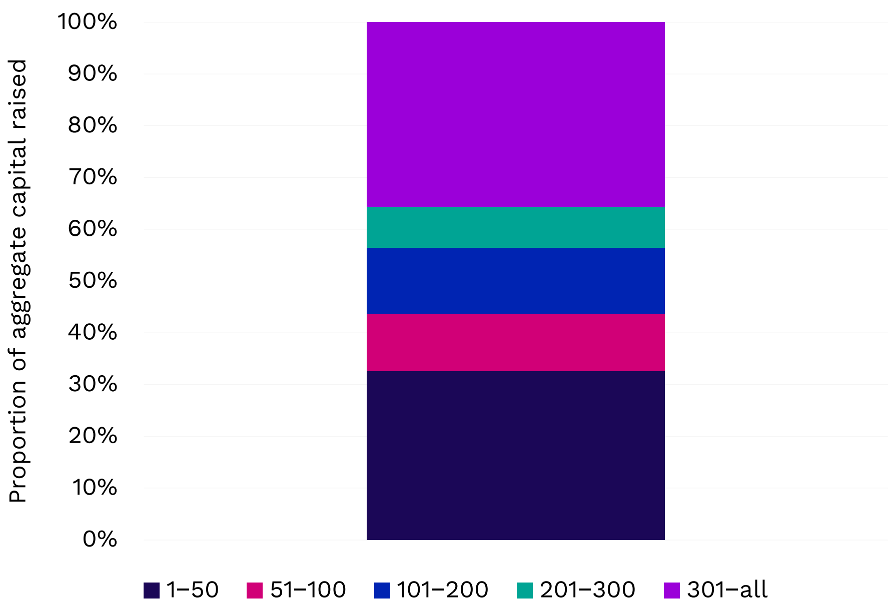
Following the major fundraising trend of 2023, the pattern of consolidation so far in 2024 has seen a much larger amount of capital committed to the 50 largest funds



Source: Preqin Pro. Data as of August 2024

Fig. 2: Aggregate capital raised across all private capital funds by top fund size, 10-year average, 2013 – H1 2024

Over the last decade capital raised has been evenly distributed between large, medium, and small funds



Source: Preqin Pro

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Fig. 3: Average final close size ($bn) by fund size bandings, for funds closed 2013 – H1 2024
The average size of the 1-50 biggest funds has doubled between 2013 and 2023, from $5bn to $11bn

	1–50	51–100	101–200	201–300	301–all	All funds (avg.)
2013	5.0	1.6	0.9	0.5	0.09	0.31
2014	4.7	1.8	1.1	0.7	0.11	0.30
2015	5.4	2.2	1.2	0.7	0.10	0.27
2016	7.6	2.5	1.3	0.8	0.12	0.30
2017	7.4	2.6	1.5	1.0	0.12	0.28
2018	8.3	2.5	1.4	0.9	0.12	0.28
2019	9.3	3.0	1.7	1.1	0.12	0.32
2020	8.3	3.0	1.7	1.1	0.12	0.29
2021	8.8	3.3	2.1	1.4	0.13	0.27
2022	10.0	3.4	2.1	1.3	0.13	0.33
2023	11.0	3.3	1.8	1.1	0.14	0.48
H1 2024	6.0	1.9	0.9	0.5	0.07	0.51

Source: Preqin Pro

The question for many GPs lacking a panoramic view of the industry is just how much, if any, of this fundraising success can be attributed to performance? And how have the evolving expectations of LPs changed as rates have risen?

Understanding consolidation: Does performance attract capital?

‘Performance is certainly important,’ says Daniel Roddick, founder of independent private equity placement specialist Ely Place, ‘But I don't think consolidation is entirely performance driven.’

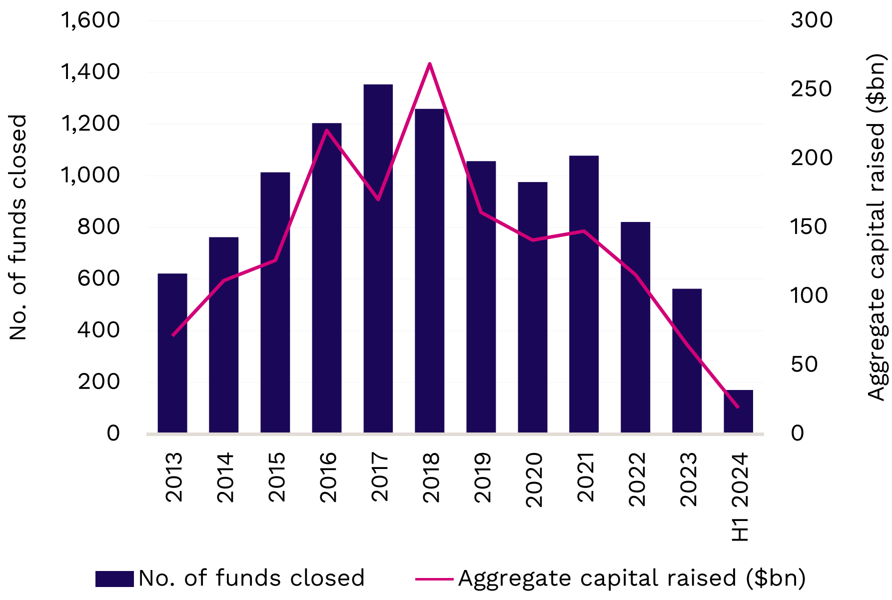
‘The flow to alternatives has grown so much that LPs just have bigger tickets to write nowadays,’ Roddick says, adding that consolidation is certainly linked to a ‘familiarity element’ and brand recognition of the largest funds, but also simply that the larger funds can absorb the biggest commitments.

‘It is not possible for most LPs to screen the entire market, and if they write large tickets, they will start by looking at funds over a certain threshold. Arguably, they may miss out on outperformance in the lower end of the market, but that is the reality of how many LPs do it.

'So add all these things together and there's just a natural migration there of more capital to the bigger managers.

‘But I would also add that I think most managers have found it difficult to fundraise over the last two to three years, not just the smaller ones.’

Fig. 4: Number of private capital first-time funds closed and aggregate capital raised, 2013 – H1 2024
The fall in first-time funds since 2017 is sharp, partly down to the evolution of private capital in China



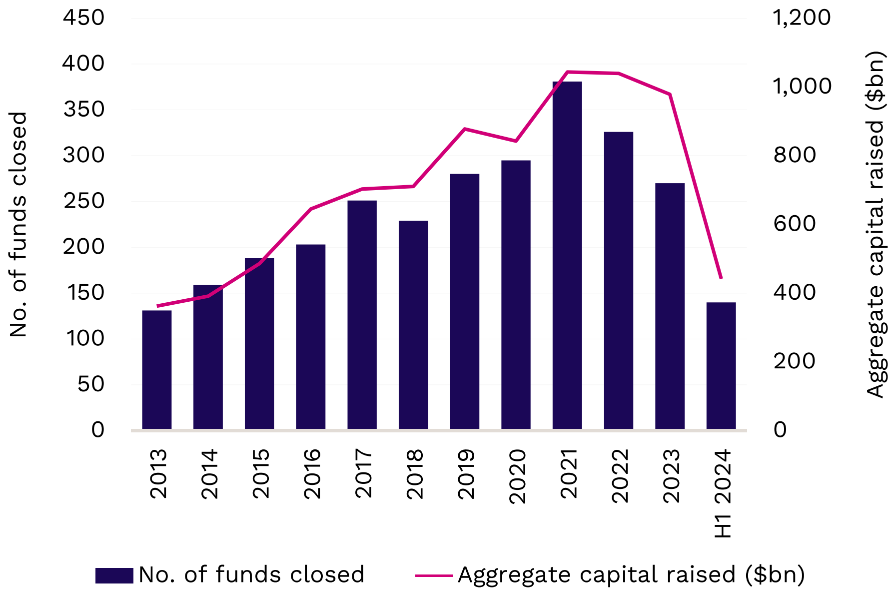
Source: Preqin Pro

How fundraising consolidation is shaping the industry

The downward trend (bar 2021) for first-time funds since the high of 2017 points to an era where larger managers, often with multiple strategies, have enjoyed more fundraising success than smaller and single-strategy managers (Fig. 4).

According to keen-eyed observers of private capital from the legal world, the last few years have highlighted how difficult it has been for even for the most well-pedigreed first-time fund managers to attract capital. This in turn extends the cost of the runway and the need for more C-level support to get off the ground.

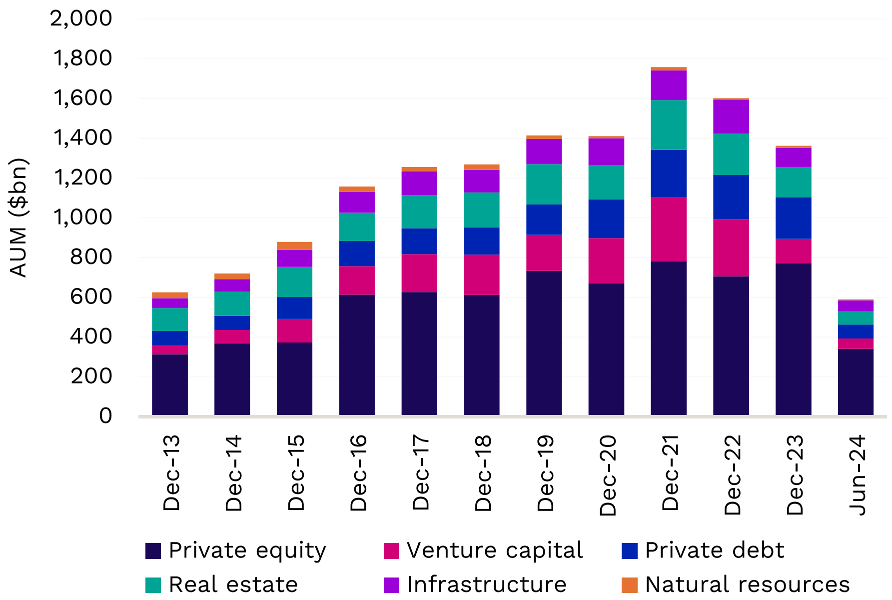
Fig. 5: Number of $1bn+ private capital funds closed and aggregate capital raised, 2013 – H1 2024
New commitments and re-ups have been harder to win across 2023 and 2024



Source: Preqin Pro

Looking at funds over $1bn as a barometer for activity at the mid to high end of the fundraising market supports the point made by Daniel Roddick of Ely Place that in 2023–24 fundraising has been hard for a large swathe of the industry, and not just the boutique participants. The number of funds that closed above $1bn fell from 326 in 2022 to 270 last year in a trend that's on track to continue to the end of 2024 (Fig. 5).

Fig. 6: Aggregate capital raised by asset class, 2013 – H1 2024
Private equity has taken a larger percentage of the capital raised as appetite for buyouts has increased in 2023 and H1 2024

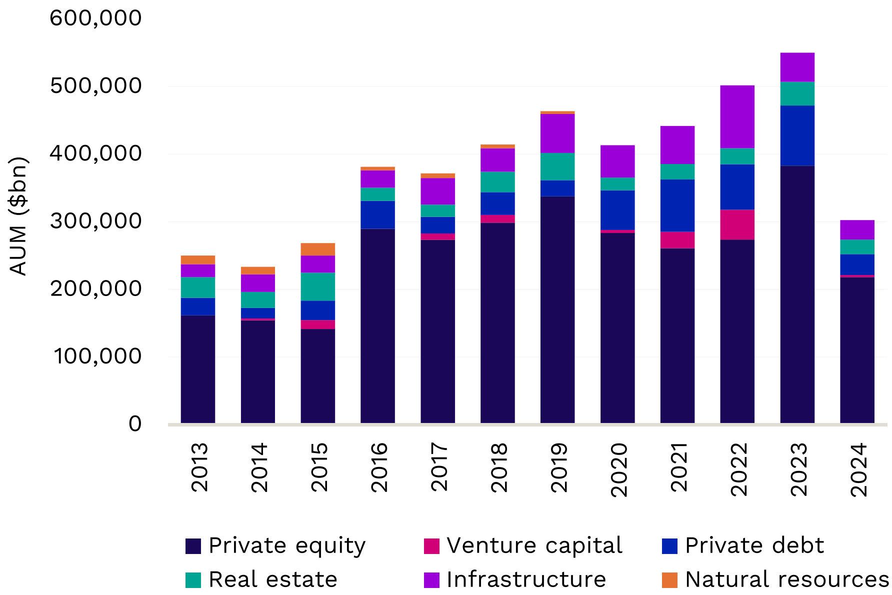


Source: Preqin Pro

Fig. 6 and Fig. 7 show the asset class breakdown of aggregate capital raised between all private capital funds captured by Preqin and the 50 largest funds over the same period. This pent-up demand for private equity and buyouts is even clearer when looking at the top 50 largest funds, with 69.6% of the total capital raised in 2023 and 72.2% in the first half of 2024 allocated to private equity.

Fig. 7: Asset class breakdown of top 50 largest funds, 2013 – latest available data*

The weighting toward private equity is even more pronounced among the largest funds



*Due to methodology change, VC data not distinguished from private equity in 2013, 2016, 2019, and 2023

Source: Preqin Pro

Fundraising: in numbers

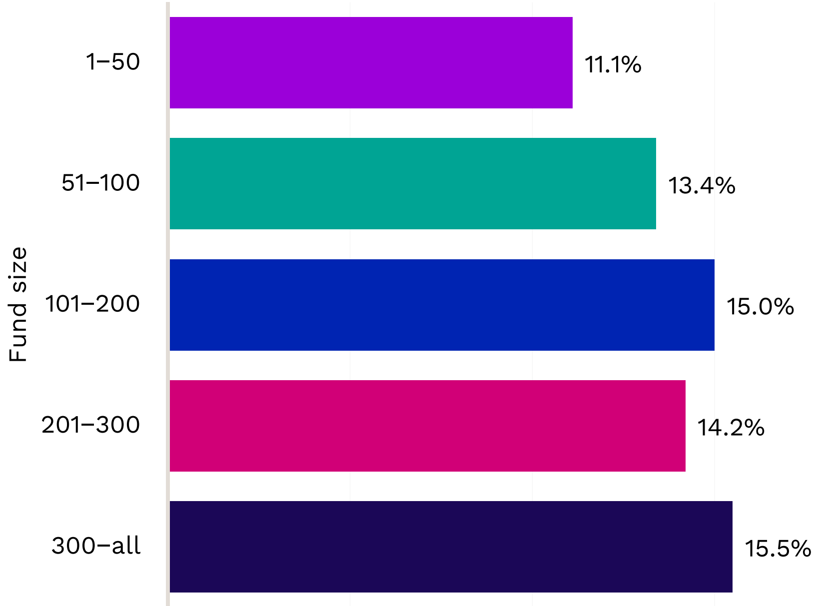
- **$550bn**
  Aggregate capital raised by the largest 50 funds in 2023
- **43.8%**
  10-year average of total committed capital to the top 100 funds between 2013 and H1 2024
- **1,354**
  First-time funds closed in 2017, falling to 562 in 2023

In 2023 and 2024 private equity opportunities have attracted significant capital and put those commitments in the hands of the largest funds. The number of first-time funds has been falling since 2017 as the pattern of consolidation from 2023 has continued into 2024, with a larger amount of capital committed to the 50 largest funds tracked by Preqin.

The largest vs. the best-performing funds.

The link between performance and fundraising success
The assumption that the largest* funds are the best-performing is tested here when looking at the net average internal rate of return (IRR) over the last decade.

Fig. 8: Net IRR average by top fund size, 2013 – 2023
Over a decade-long period the largest funds are not the best-performing when looking exclusively at net IRR



Source: Preqin Pro

Fig. 8 shows what's widely known but rarely discussed, as the net IRR average dips as the fund size expands, with those in the 101–200 bracket the exception to the trend.

The question for LPs is whether two or three percentage points of IRR is enough in the current climate to nudge them away from what they know.

Daniel Roddick of Ely Place told Preqin that increasingly, 'LPs tend to assign more value to consistent returns, than to potentially more upside but with higher risk.

'If you are a serious allocator to private markets, you want an element of predictability when managing risk. So why not go for a big brand name that has consistently delivered?'

* Those with an average size of over $6bn in H1 2024 in this specific slice of Preqin data

Fig. 9: Top 10 largest funds closed with IRR and percentage above target, 2013 – latest available data
'Big' names are above target and delivering well for investors

Fund	Vintage	Fund manager	Target amount ($mn)	Final close amount ($mn)	% above target	IRR
Apollo Investment Fund VIII	2014	Apollo Global Management	12,000.0	18,380.0	153.0%	10.0%
CVC Capital Partners Fund VI	2014	CVC	12,243.2	13,988.7	114.0%	16.4%
Carlyle Partners VI	2014	Carlyle Group	10,000.0	13,000.0	130.0%	13.0%
Warburg Pincus Private Equity XI	2012	Warburg Pincus	12,000.0	11,213.0	93.0%	11.6%
Silver Lake Partners IV	2013	Silver Lake	7,500.0	10,300.0	137.0%	21.9%
KKR North American XI Fund	2012	KKR	8,000.0	8,468.4	106.0%	18.9%
Riverstone Global Energy and Power Fund V	2012	Riverstone Holdings	6,000.0	7,713.0	129.0%	-4.5%
Apax VIII	2012	Apax Partners	8,000.0	7,517.0	94.0%	13.6%
Cinven V	2012	Cinven	6,129.0	7,054.4	115.0%	20.5%
Brookfield Infrastructure Fund II	2013	Brookfield Asset Management	5,000.0	7,000.0	140.0%	10.0%
Lone Star Real Estate Fund III	2013	Lone Star Funds	6,000.0	7,000.0	117.0%	14.4%

Source: Preqin Pro

When drilling down into the performance data of the most notable closed funds since 2013, it shows net IRR consistently over 10%, with an average of just over 15% and aggregate capital at close of $112bn (Fig. 9). These well-known funds have attracted a large proportion of the available capital and hit the sweet spot of risk and return. This proof point of performance data alongside a well-oiled fundraising and investor relations machine has given these GPs a convincing case when pitching to LPs.

Consistent performance, rather than eye-catching outperformance, has been the foundation of fundraising success for a number of the biggest and most notable funds. However, there is clearly more focus on execution of strategy and distributions back to investors – a point unilaterally agreed upon by GPs, LPs, and service providers – in today's market. Performance clearly still matters for fundraising success, but so does the ability of GPs to demonstrate that they can sell portfolio companies and return capital to LPs, and show that distributed to paid-in capital (DPI) is rising.

Performance: in numbers

→ **11.1%**
Net IRR for the largest 50 funds, climbing to 14.2% for funds 201–300

→ **15.0%**
Average performance of the 10 most notable funds closed since 2013

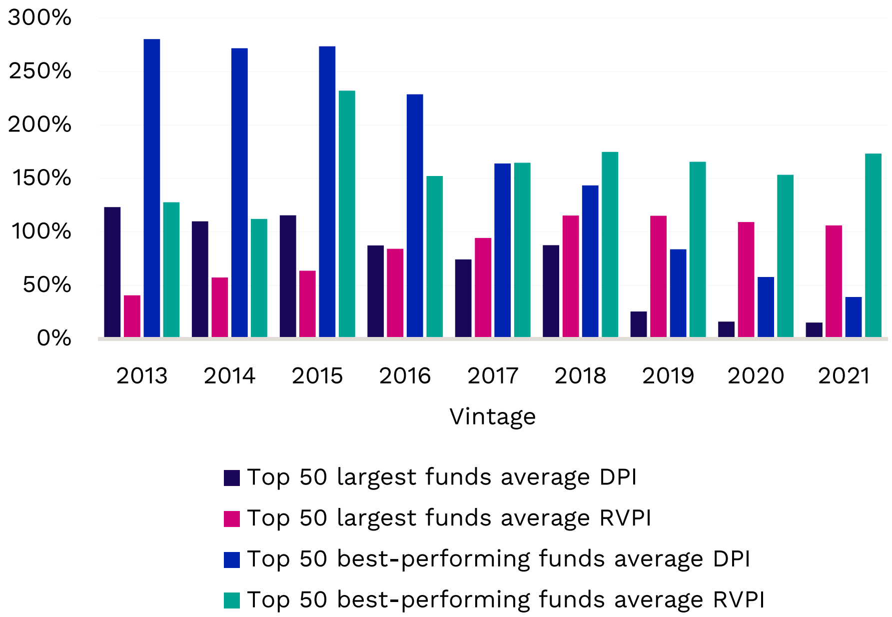
→ **4.4%**
Net IRR difference between the 50 largest funds and those in the 300–all category

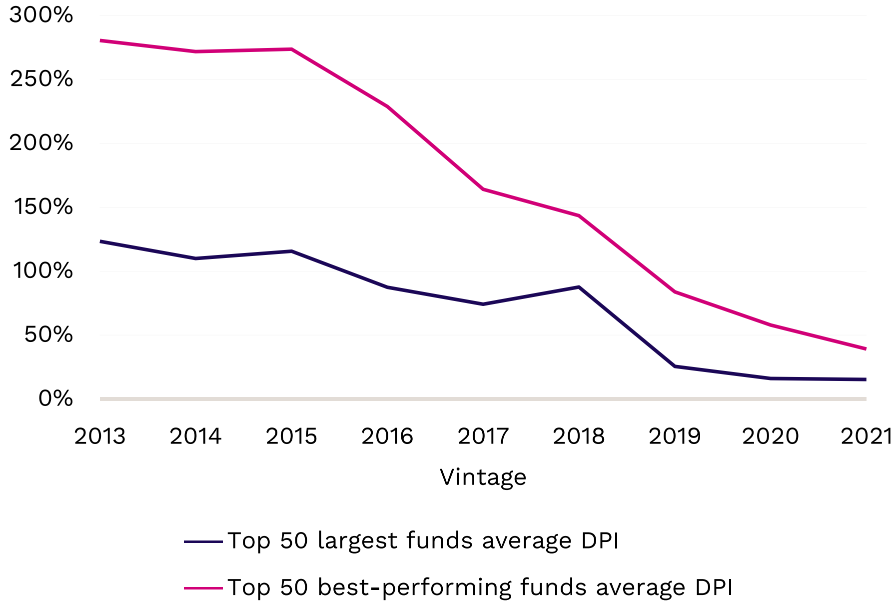
Demonstrating consistent performance remains an important metric for GPs, especially for those seeking over $5bn in commitments. However, simply being able to show LPs that you can return capital has become a key metric for those out on the road raising funds at a time when many LPs have liquidity constraints, as the difference in performance between the 50 largest funds and those in the 300–all bracket is just 4.4%.

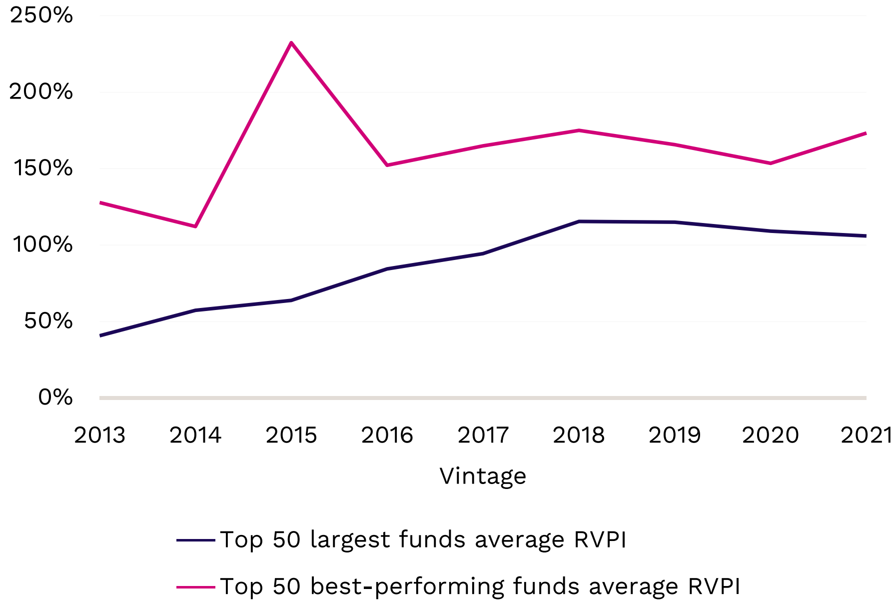
On distribution and liquidity.

If distributions in 2023–24 have pulled level – and even exceeded – performance as the key metric for future fundraising success, then what, if any, is the difference in DPI and residual value to paid-in capital (RVPI) (the value of unrealized investments in the portfolio) between the largest and best-performing funds?

Fig. 10: TVPI composition (DPI average and RVPI average) of top 50 largest funds (by fund size) vs. top 50 best-performing funds per vintage, 2013 – latest available data







Source: Preqin Pro

Fig. 10 shows the difference in DPI across vintage years of the 50 best-performing funds and the 50 largest funds. The best performers return capital faster, with 2018 vintage funds having already exceeded 100% of capital returned. The 50 largest funds see a bump in DPI at the same time, perhaps as investments are realized to boost fundraising prospects, but 2015 is the first vintage where capital returned exceeds capital invested.

Using DPI alongside performance (net IRR) as metrics in today's climate gives LPs the chance to analyze a fund manager's ability to deliver returns consistently across cycles, and the application of its strategy in the real world.

As Daniel Roddick of Ely Place says, 'For LPs it's about consistency of returns and consistency of strategy. And after that it's about simply delivering on what you promised. So it's all very well getting a great return, but if the returns are very mixed throughout the portfolio, with some losses but some outsized returns, was that really the intended strategy? A smart LP would analyze a GP's track record very closely, and not just rely on a crude single-figure number like IRR.'

Does performance attract capital?

As DPI emerged as a key metric in giving LPs a clear line of sight to future liquidity, a slice of the largest funds tracked by Preqin has demonstrated their ability to consistently deliver this whatever the economic weather may be. As the pent-up demand for deal-making is released, focus will shift as GPs put that capital to work, aiming to keep both DPI and consistent performance at the levels both promised and expected.

About Primers.

Preqin Primers are a series of short reports illuminating how key players – fund managers, investors, or service providers – are responding to the major trends shaping the alternative investment industry.

Combining key stats from Preqin Pro and interviews with experts, Preqin Primers provide an introductory overview of the trending topics in alternatives, along with industry perspectives from top players.

Preqin Pro can keep you updated on market movements with comprehensive data on institutional investors, fund managers, and service providers, and for each fund and transaction across all major asset classes.

Contributors:
Milan Hirani
Abel Fitsum Abraham
Elliott Donnelly
Christina Taufan

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Info@preqin.com

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