2013 Preqin Private Equity Performance Monitor: Executive Summary

This month's lead article features the Executive Summary from the 2013 Preqin Private Equity Performance Monitor, the industry's most comprehensive guide to private equity performance.

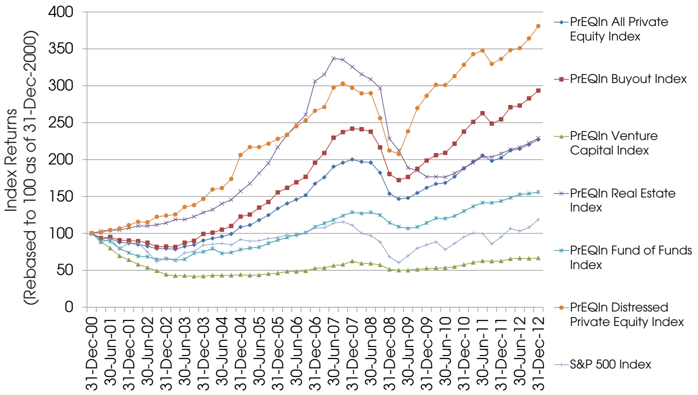
Continued Recovery

The private equity industry continually faces challenges due to the uncertainty of the world economy. The industry weathered the financial crisis of 2007/2008, showing recovery in 2009 and 2010. The escalation of the European sovereign debt crisis of 2011 caused a small decline in growth but 2012 has seen continued recovery in the private equity industry. In last year's edition of the Preqin Private Equity Performance Monitor we asked the question: can private equity investments provide returns to investors in times of economic uncertainty? Looking at the data, the answer is yes.

The PrEQIn Index, shown in Fig. 1, tracks the quarterly movements in the performance of the private equity industry since December 2000, illustrating the impact of the financial downturn as well as the subsequent rebound of private equity returns. We see a decline start in 2007 in the PrEQIn All Private Equity Index, and a subsequent recovery starting in 2009. Although a small dip can be seen at the start of 2011, since then, the PrEQIn All Private Equity Index has recovered steadily, increasing quarter on quarter. Looking at the indices of specific strategies shows that buyout and distressed private equity are currently outperforming other fund types. Additionally, the PrEQIn Real Estate Index shows that the recovery of private equity real estate has been a slower and more gradual process compared to other fund types.

Fig. 2 shows the annual capital called and distributed by all private equity funds, as well as the unrealized value of their currently held investments, since 2000. 2012 was a very healthy year for private equity-backed exits, with an estimated $373bn being returned to investors, although it did not quite surpass 2011's level of $392bn distributed to investors. Healthy distribution levels are essential to the private equity industry, as distributions allow investors to reinvest capital into new funds. During 2012, an estimated $472bn was called up by fund managers, the highest level since 2007, meaning that many fund managers are making new investments.

Fig 1: PrEQIn Index: All Strategies



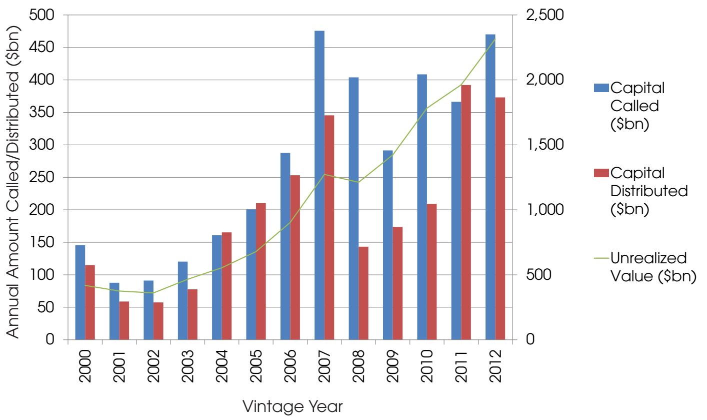
Source: 2013 Preqin Private Equity Performance Monitor

The Long-Term Picture

By definition, private equity is a long-term investment prospect. With investors locked in for 10 years or longer, it is vital to look at the performance of the industry over a 10-year period. Although looking at short- and medium-term performance can be interesting, the key question for investors is: how do private equity investments perform over the long term?

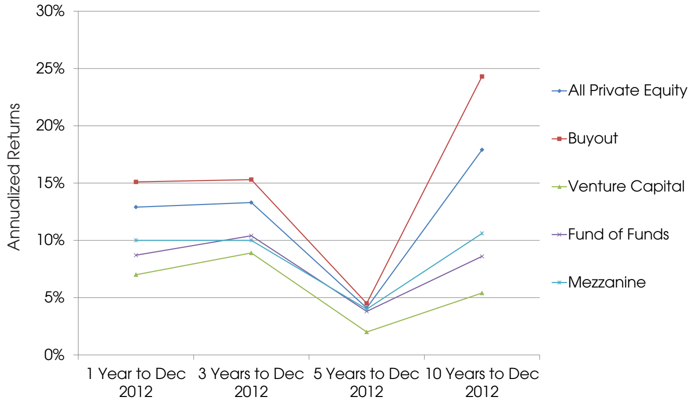
Fig. 3 shows the horizon IRRs for all private equity, as well as specific fund types, as of December 2012. Private equity horizon returns provide a snapshot of the performance of the private equity industry over a set period of time, rather than looking at the

Fig. 2: All Private Equity Annual Amount Called up, Distributed and Unrealized Value



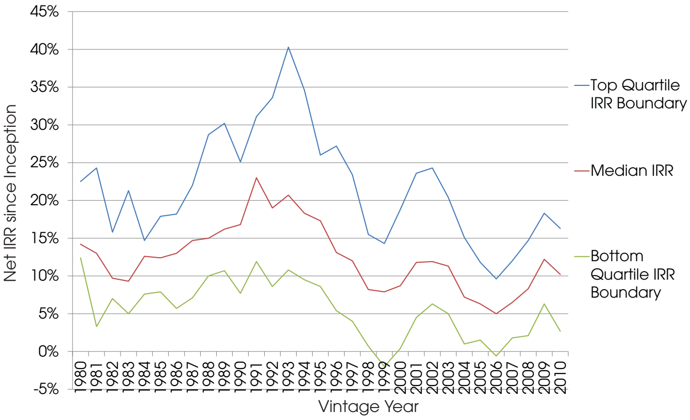
Source: 2013 Preqin Private Equity Performance Monitor

Fig. 3: Private Equity Horizon IRRs as of 31 December 2012



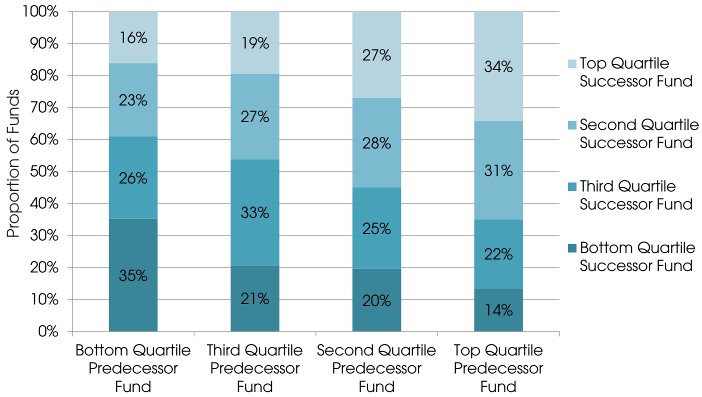
Source: 2013 Preqin Private Equity Performance Monitor

Fig. 4: All Private Equity - Median Net IRRs and Quartile Boundaries by Vintage Year



Source: 2013 Preqin Private Equity Performance Monitor

Fig. 5: All Private Equity - Relationship between Predecessor and Successor Fund Quartiles



Source: 2013 Preqin Private Equity Performance Monitor

performance of an individual fund over its lifetime. Using Preqin's quarterly cash flow data, we are able to calculate horizon IRRs for various time horizons; the calculation uses the net asset values at both the beginning and the end of the period, and takes into account all cash flows during the period.

For the 10 years to December 2012 the annualized returns for all private equity stand at 17.9%. Among the different fund types, buyout funds have been performing the best in this period, with an annualized IRR of 24.3%. Returns between the different types of funds vary significantly, with mezzanine funds reporting an annualized IRR of 10.6%, funds of funds 8.6% and venture capital funds 5.4%.

The Challenge for Investors

While private equity investments can offer long-term rewards to investors, there is a significant spread between the performance of individual funds, with a particularly large gulf between returns generated by the best and worst performing funds.

Fig. 6: Top Six Consistent Performing Buyout Fund Managers

Firm	Location	Overall Number of Funds with Quartile Ranking	Number of Funds in Top Quartile	Number of Funds in Second Quartile	Average Quartile Rank
Inflexion	UK	3	3	0	1.00
Veritas Capital	US	3	3	0	1.00
Vista Equity Partners	US	3	3	0	1.00
Wynnchurch Capital Partners	US	3	3	0	1.00
FIMI	Israel	4	3	1	1.25
Waterland	Netherlands	4	3	1	1.25

Source: 2013 Preqin Private Equity Performance Monitor

Fig. 4 shows the median net IRRs after fees and carry, along with the top and bottom quartile boundaries, for all private equity funds by vintage year, and provides a representation of how significant the difference can be between the performance of top quartile funds (any fund with an IRR above the top line) and bottom quartile funds (any fund with an IRR below the bottom line). For example, for vintage 2002 funds the gap between the top and bottom quartile boundaries is a difference of 18.0 percentage points. For vintage 2006 funds, vehicles at or above the top quartile boundary have an IRR of 9.6% or above, and the median net IRR is 5.0%. However, vintage 2006 funds at or below the bottom quartile IRR boundary all generate a negative return of -0.6% or lower.

For private equity investors, selecting funds likely to perform well in the future can be challenging, particularly given the wide variety of private equity investment opportunities available. Examining a fund manager's track record is one way for investors to evaluate a fund's potential future success – despite the fact that past performance is not a guarantee of future success, there is clear evidence to suggest that managers of top-tier funds are more likely than their peers to continue to produce top-performing funds in the future.

Fig. 5 highlights the relationship between predecessor and successor fund quartiles, showing that track record is an important component of fund selection. It shows that 34% of fund managers with a top quartile fund go on to manage a top quartile successor fund, and 65% outperform the median benchmark. In contrast, 36% of bottom quartile fund managers remain in this quartile with their next offering, while a significant 61% underperform the benchmark.

As institutional investors look to identify, evaluate and select top performing funds for their private equity portfolios, the 2013 Preqin Private Equity Performance Monitor can assist in this challenging task by providing access to transparent and accurate fund-by-fund returns data for over 6,300 private equity vehicles.

Consistent Performers

Finding consistent performing fund managers is no easy task, particularly in the private equity industry, which is known for its lack of transparency. Despite improvements made in the level of disclosure across the private equity space, it remains challenging for investors and fund managers to access the reliable, accurate and fully transparent data necessary to effectively benchmark funds.

Preqin's tables of consistent performing managers, featured in the 2013 Preqin Private Equity Performance Monitor, can help with this task. Each fund that Preqin has performance for is assigned a quartile ranking using Preqin's Performance Analyst online service, which contains performance data for over 6,300 private equity funds worldwide. These rankings are based upon the peer group of each vehicle and take into account vintage, strategy and region focus. Both the multiple and IRR are used as key indicators and equal emphasis is placed on both metrics.

Fig. 6 shows a list of the top six consistent performing buyout fund managers and their average quartile rank. Funds ranked in the top quartile are given a score of one, funds in the second quartile are scored a two, and so on. The table is compiled using only funds for which Preqin holds performance data and has assigned a quartile ranking. Additionally, 2011, 2012 and 2013 vintage funds have been excluded as these funds are too early in their fund lives to generate meaningful IRRs. The list only includes fund managers that have raised at least three funds of a similar strategy.

Four buyout fund managers – Inflexion, Veritas Capital, Vista Equity Partners and Wynnchurch Capital Partners – have all of their funds ranked in the top quartile, and therefore have achieved the best possible average quartile rank of 1.00. FIMI and Waterland follow, each with a score of 1.25. Extended lists of consistent performing fund managers, broken out into various fund types, are available in the 2013 Preqin Private Equity Performance Monitor.

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The Monitor also features:

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- Private equity returns examined against public markets.
- Benchmarks across different fund types by vintage year.
- Examination of listed private equity.
- Data on private equity dry powder and assets under management.

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