Private Markets: A Decade of Growth

The convergence of public and private markets

This report details the proliferation of private markets—private equity and venture capital, in particular—over the last 10 years and explores a few of their current intersections with public markets. Data for the report comes from the PitchBook Platform and a survey of 101 institutional limited partners (LPs) and public equity investment managers we conducted during 2Q 2019. The report concludes with an outlook for private markets.

Content

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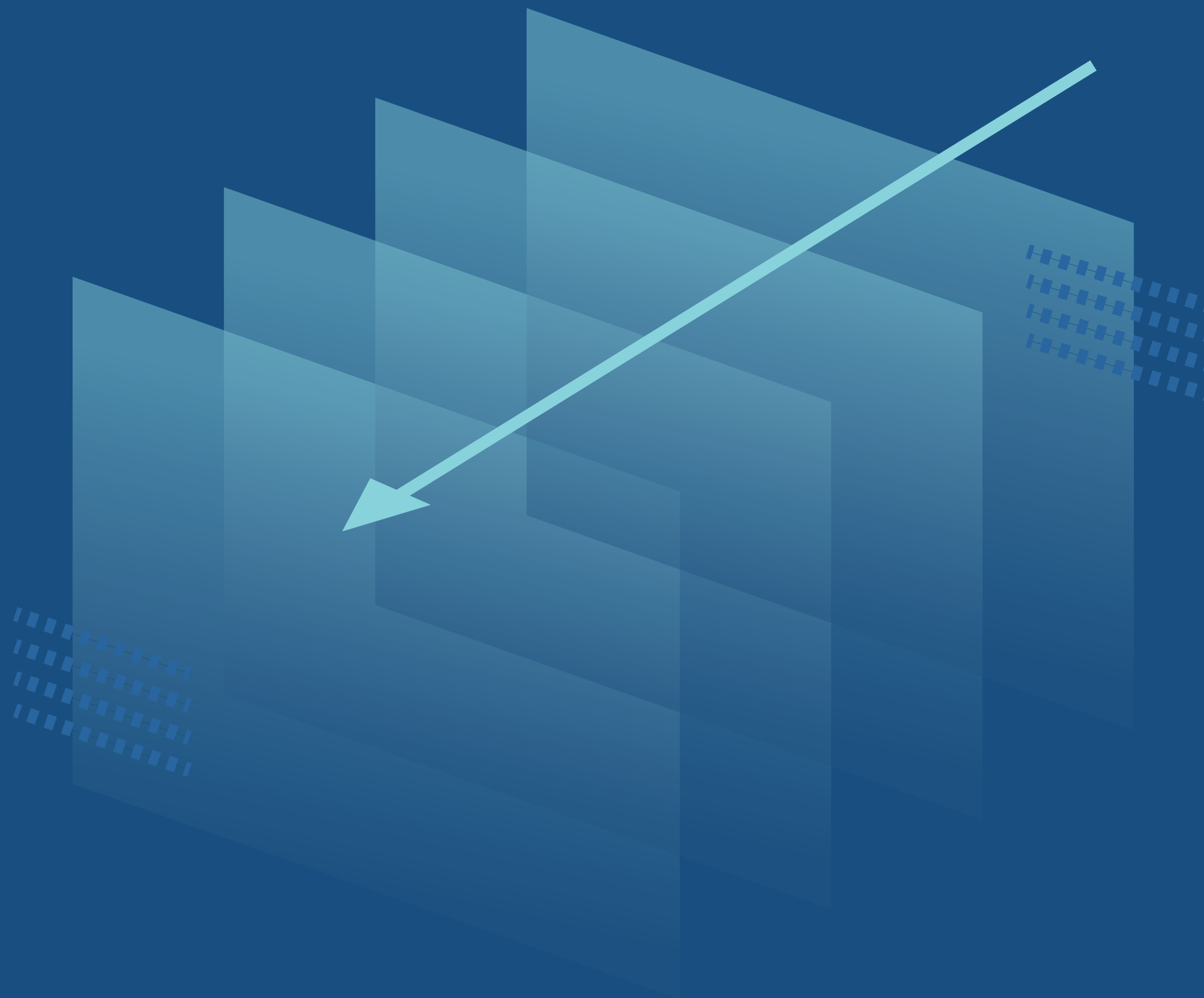


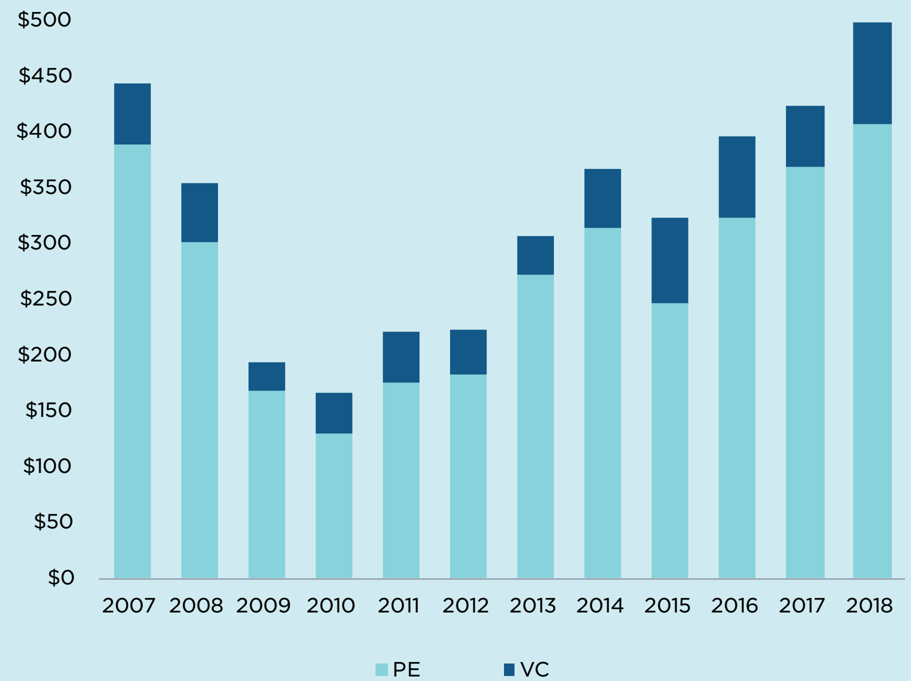
Private market overview

Nearly $500B raised in 2018

Private markets, confined to the PE and VC asset classes in this report, have never been as large as they are today. Looking across PitchBook's private market data, a clear theme across nearly every metric—from number of managers, to capital investment, to privately backed companies—is the steady ascent to what are now record levels. Our observations and data have led us to believe that the amount of capital and level of activity in the private markets are fundamentally changing the overall investment landscape. The following series of charts and tables provide a snapshot of this growth over the last 10 years.

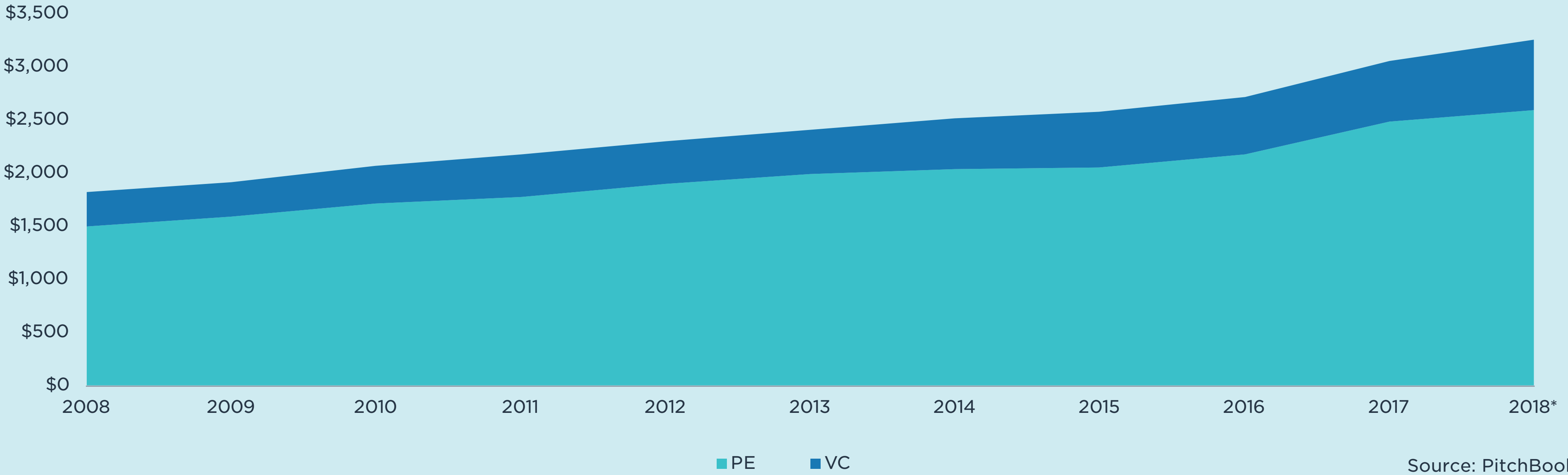
Between 2009 and 2018, over $3 trillion has flowed into PE and VC funds globally. PE funds have raised the lion share of that capital, for a total of $2.6 trillion. In comparison, equity ETFs attracted $2.2 trillion over this same period, according to Morningstar. 2018 was a record year for combined PE and VC fundraising with $497.4 billion raised in total, topping the previous record of $442.6 billion set in 2007. This mass of capital was raised across over 8,300 funds spanning a wide range of strategies. This includes everything from funding nascent ideas coming to fruition in a garage to acquiring large-cap household name companies.

Global PE & VC fundraising ($B)



Source: PitchBook

Global PE & VC AUM ($B)

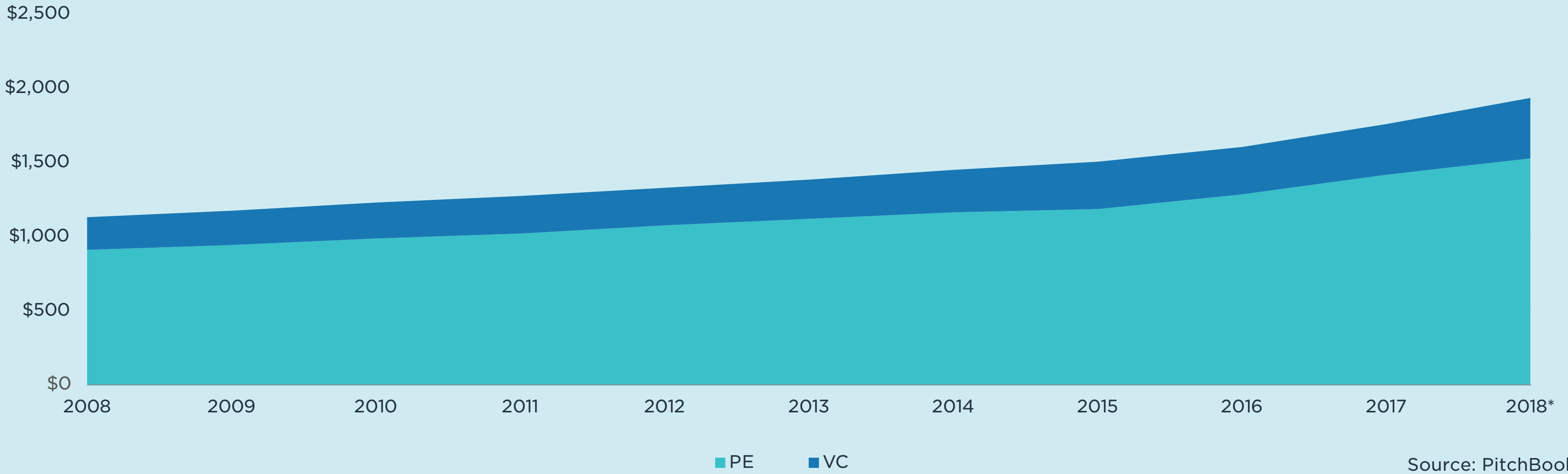


Source: PitchBook
*As of September 30, 2018

By the end of 2018, PE and VC managers amassed a total of $3.3 trillion in assets under management (AUM). $1.1 trillion of this AUM is dry powder—capital raised but not yet invested—and the remaining $2.2 trillion is the summed net asset value (NAV) of currently held investments. Total private market AUM has grown nearly 70% since the beginning of 2009, which is even more impressive when factoring in the $3.6 trillion that PE and VC funds have distributed back to their investors over the same period.

It is important to note that PE and VC funds have a 10-year structure that requires them to return all invested capital plus any investment gains, minus fees, within 10 years. (Many funds have extended this a few years). This means that the AUM calculation behaves differently for the private markets than it does for most public market vehicles (mutual funds, ETFs, etc.) that can hold and compound net inflows.

US PE & VC AUM ($B)



Source: PitchBook

*As of September 30, 2018

Private markets extend globally, but the largest region for activity has always been the US, which has consistently held around 60% of global AUM over the last decade. Between 2009 and 2018, US managers contributed $761 billion of the $1.3 trillion increase in global private market AUM. Another near constant over that decade has been the split between PE and VC AUM, with PE constituting 80% and VC 20%, even with the $1 trillion+ flowing into the space.

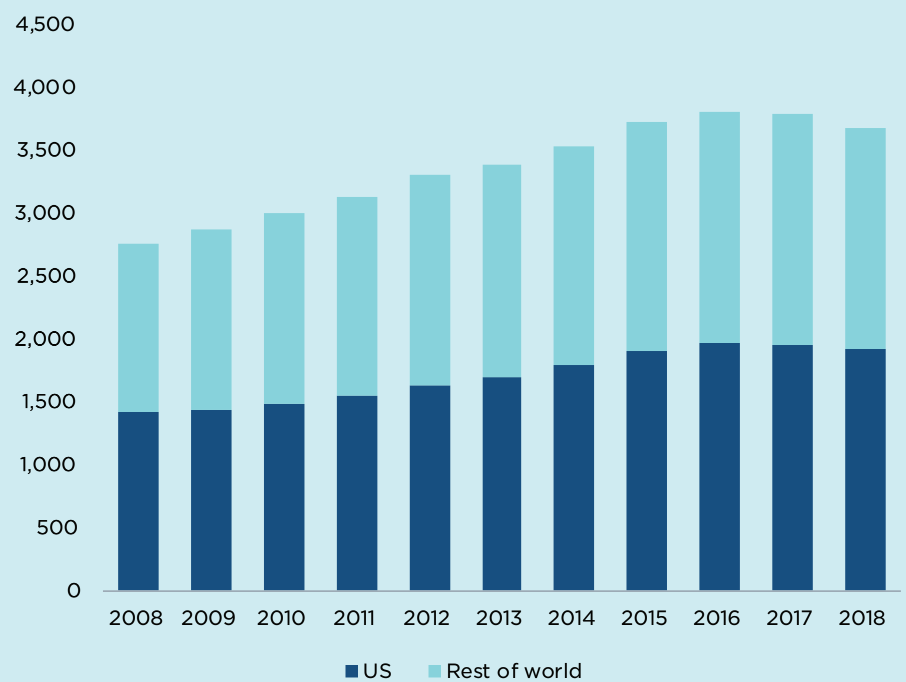
80:20

PE retains 4x the percentage of AUM than that of VC

Private market investors remain very active

There were 3,682 active PE managers as of year-end 2018, a 28% increase over the last decade. Given overall AUM has grown by 70% over the last decade, this smaller growth in number of managers indicates that the expansion of the PE industry has resulted from both new managers and existing managers attracting larger amounts of capital. At a time when active equity managers of all types have struggled, this success has caught the attention of major Wall Street firms such as BlackRock, Goldman Sachs and even Vanguard.

Active PE investors by region



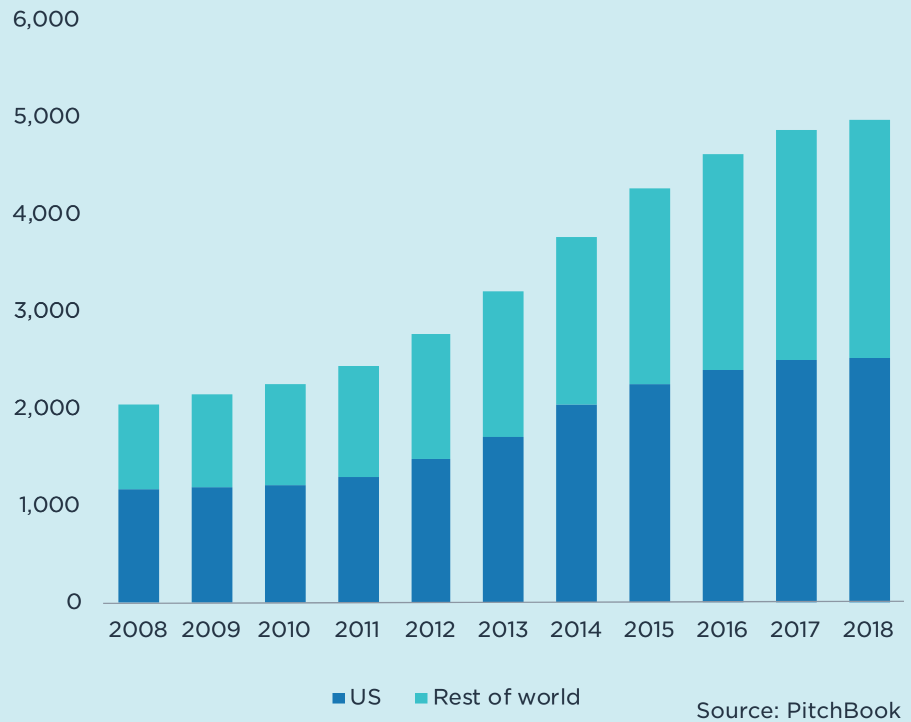
Source: PitchBook

Note: An investor is considered active if they have completed a PE deal in the trailing three years or raised a PE fund in the trailing five years.

VC has experienced the most change

The venture landscape has seen a larger transformation over the last decade. This has played out across all measures, including the number of active venture investors, which doubled between 2011 and 2018. One unique aspect of the venture landscape driving growth in the asset class is corporate venture capital (CVC), a form of VC in which corporates directly invest capital in external private companies. Increased globalization of venture also bolstered growth, especially the rise of China's innovation ecosystem.

Active VC investors by region

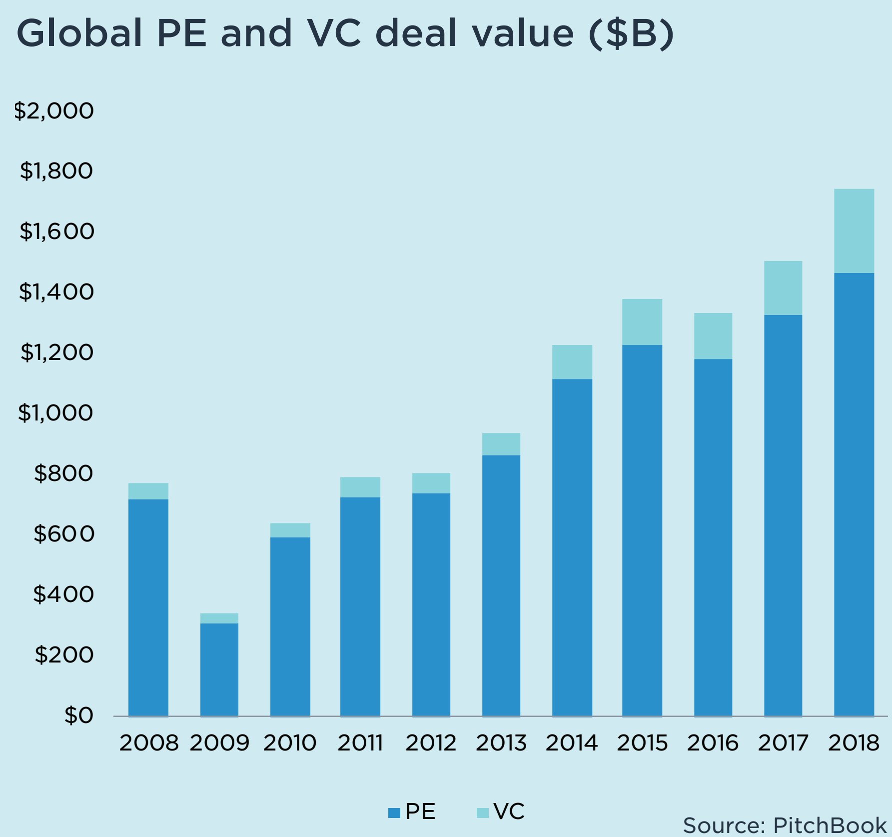


Source: PitchBook

Note: An investor is considered active if they have completed 4 or more VC deals in the trailing 3 years or raised a VC fund in the trailing 5 years.

More capital deployed than ever before

The proliferation of private market investing can best be seen in the dealmaking data. Between 2009 and 2018, PE and VC investors deployed $10.7 trillion (including equity and debt) into companies globally. The $1.7 trillion invested into these asset classes in 2018 represents a 5x increase from 2009 and is the highest combined annual total on record. To put this in perspective, Canada, the 10th largest national economy, had a GDP of $1.7 trillion in 2018, according to the World Bank Group.



Source: PitchBook

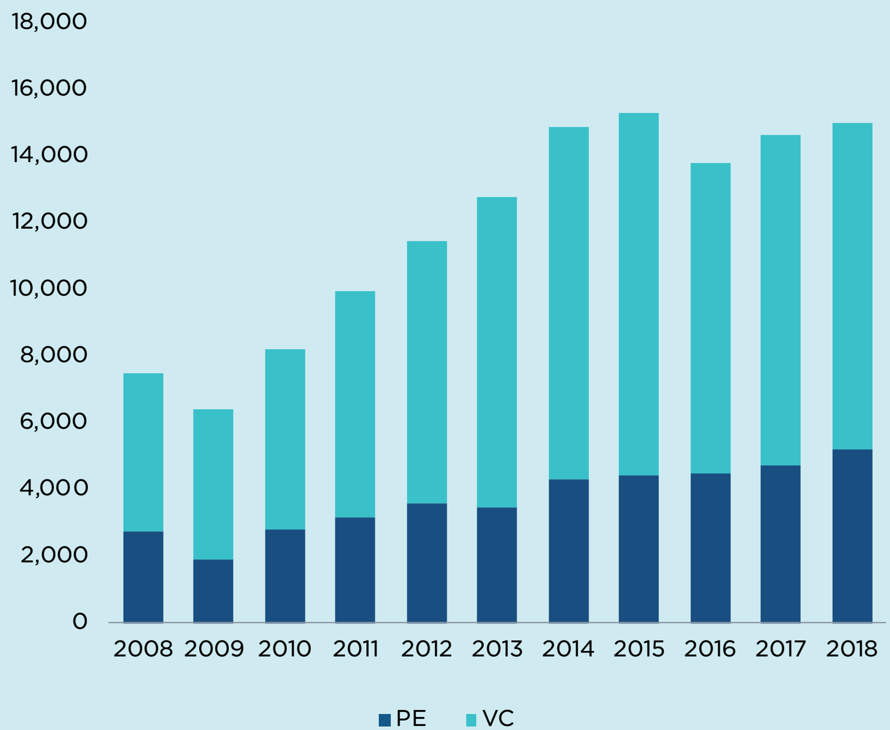
$1.7T

A 5x increase from 2009

Volume has proliferated at a relatively slower rate

PitchBook has tracked 234,550 PE and VC deals between 2009 and 2018. Venture investments, which are much smaller and typically spread out over a company's growth, account for 65.2% of this total volume. The boom in venture activity over the last decade has pushed yearly deal counts from 6,876 in 2009 to 18,228 in 2018. PE has seen a much more modest doubling of annual deal totals, nearing or eclipsing 10,000 deals each year for the last five years. PE buyouts are much larger, of course, as they take majority control of mature companies but happen much less frequently, only once or twice in a typical company's lifetime.

Global PE and VC deal counts

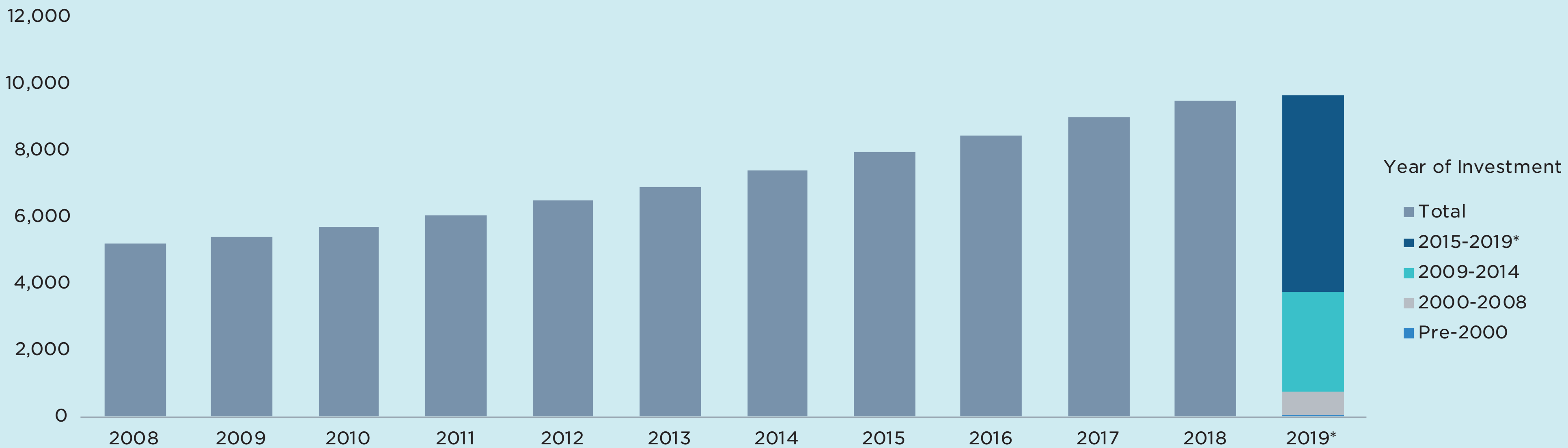


Source: PitchBook

65.2%

VC accounts for bulk of all deal activity between 2009 and 2018

US PE company inventory by year of investment



Source: PitchBook
*As of June 27, 2019

These intensified levels of investment have resulted in a record number of private companies that are institutionally backed by PE or VC. By year-end 2018 in the US, the number of PE-backed companies stood at a high of 9,470 companies. With late-stage venture-backed companies added to the mix, the total count was 13,695. This compares to 4,397 publicly listed companies as of year-end 2018, down from 6,917 in 2000, according to the World Bank Group.

9,470
PE-backed companies in the US at 2018's end

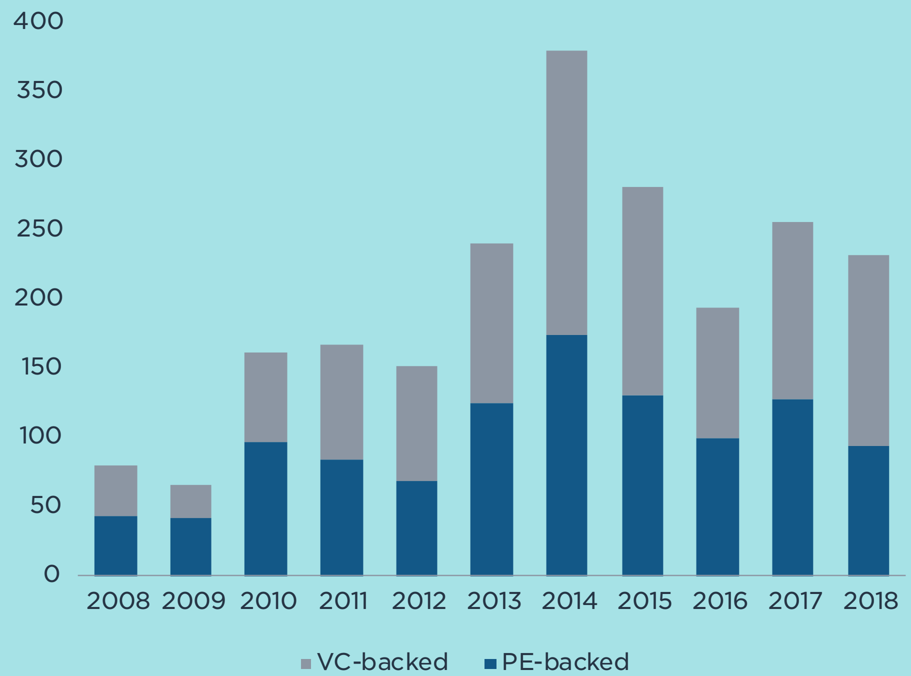
Intersection of public and private markets

Private markets contributed $1.4T in value via IPOs

Gone are the days in which private markets were a small corner of global markets with little impact. As they have steadily grown over the last decade to their current record levels, private markets have increasingly converged with public markets. We are seeing companies and investors begin to navigate between the two in a way they haven't before as they seek out the optimal market for operating and investment. In this section, we will spotlight a few of the many areas where public and private markets have begun to intersect directly.

One of the most prominent intersections is the significant pipeline of companies transitioning from the private markets into the public markets. Between 2009 and 2018, there have been 1,087 VC-backed IPOs and 1,043 PE-backed IPOs across the US and Europe. These exits were valued at a combined $1.4 trillion on a pre-money valuation basis. Of the 13,695 PE-backed and late-stage venture companies in the US, we estimate that around 700 will likely become the next immediate generation of public companies, based on recent percentages of PE- and VC-backed companies to execute an IPO. With the shrinking number of public companies, this pipeline should be welcomed by public markets.

US & European PE and VC IPO counts

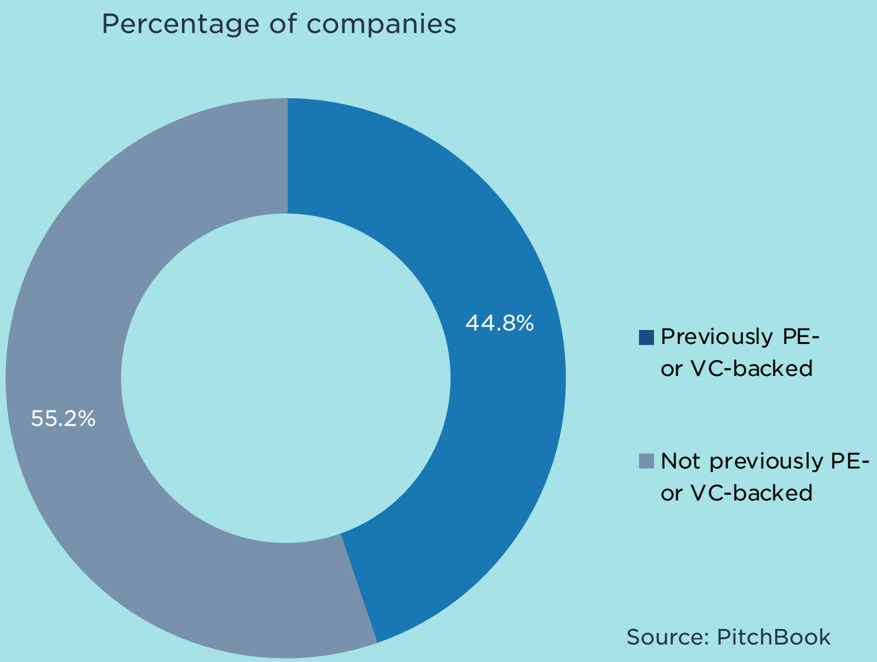


Source: PitchBook

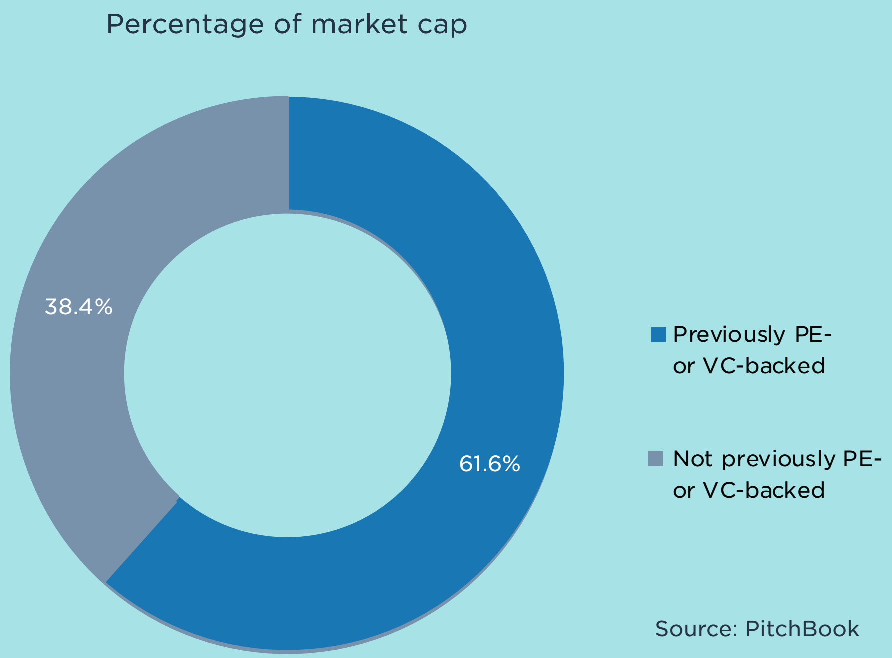
PE- and VC-backed 44.8% of NASDAQ companies

Private companies seeking an exit via public markets is not a new trend by any means. In fact, 44.8% of companies currently listed on the NASDAQ were formerly backed by PE or VC. Former PE- and VC-backed companies make up roughly two-thirds of NASDAQ company market caps. Among these are tech giants such as Facebook, Alphabet and Netflix, but also companies such as Kraft Heinz, lululemon athletica and the Dunkin' Brands.

Former PE and VC companies on the NASDAQ

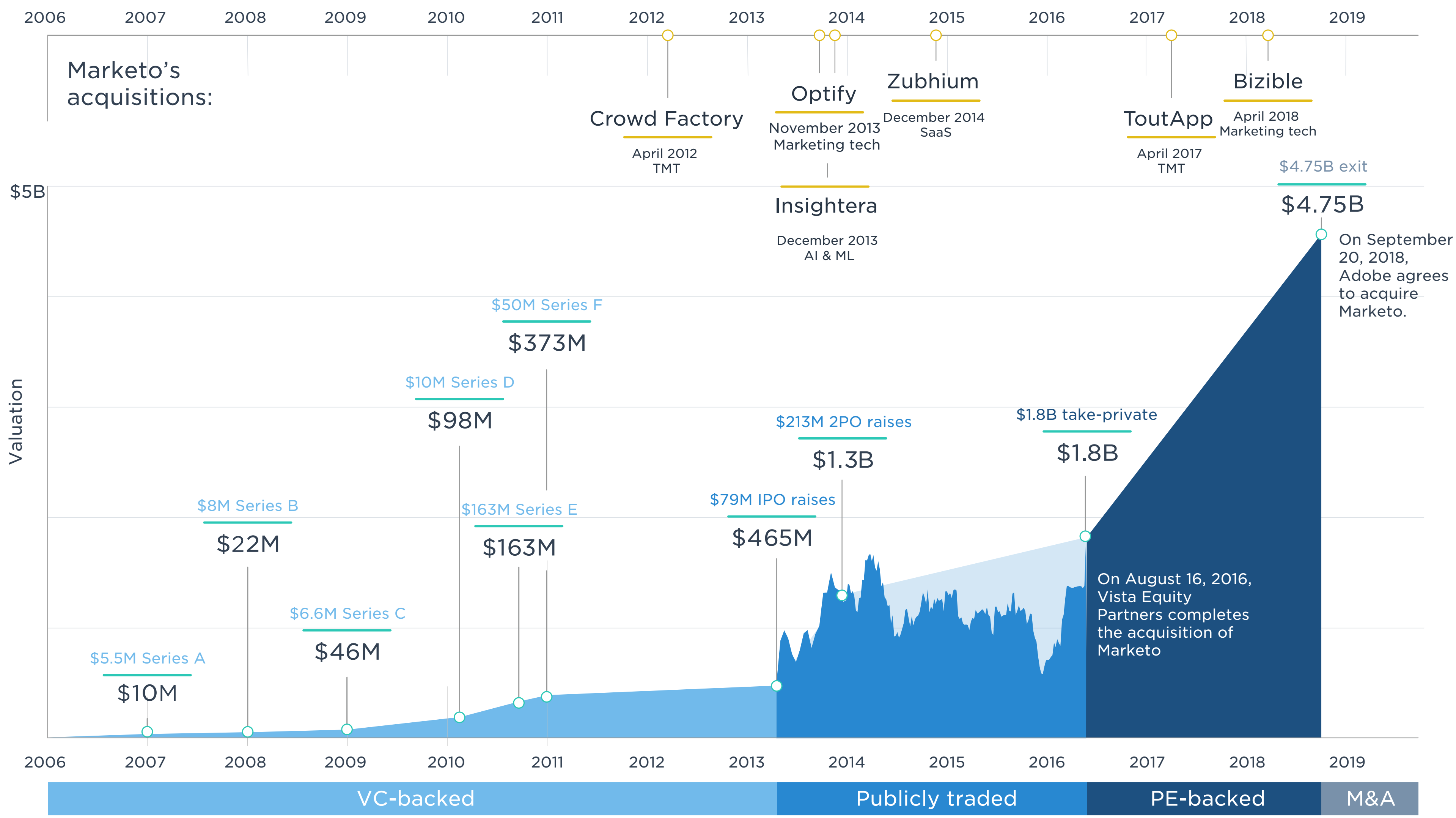


Source: PitchBook



Source: PitchBook

Marketo's journey from founding to Adobe's acquisition



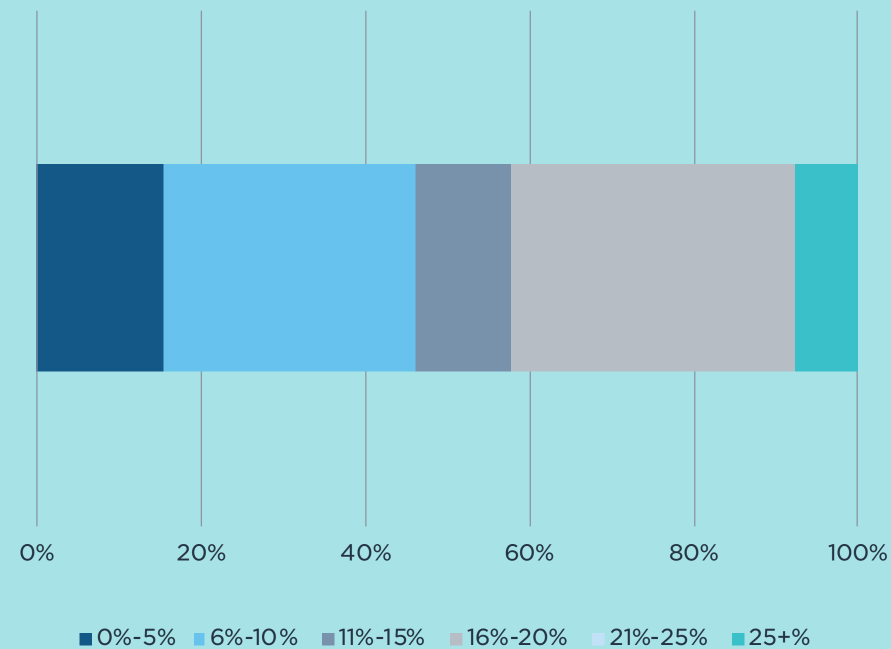
Source: PitchBook

Private companies better prepared to disrupt ...

Another intersection point that has emerged is the trend of companies and investors moving between the private and public markets based on what best fits their operating needs. As a result, there has been a shift in which investors are capturing value throughout a company's lifecycle. An example of this is the marketing automation company Marketo. It was founded in 2006 and raised $105 million of VC before going public in 2013 at a $465 million pre-money valuation. It was a public company with mixed performance for three years before a PE firm (Vista Equity Partners) acquired it for $1.8 billion in 2016. Vista held the company for two years before selling to Adobe for $4.75 billion in 4Q 2018. Of the total $4.75 billion in value created by Marketo since inception, only 27% ($1.3 billion) accrued to public market investors.

A third intersection point is the disruption of public companies and established industries caused by private companies. In our survey of equity buyside investors, over half of the sample indicated they spend between 11% and 25% of their research process evaluating disruption risks from startups and new technologies to a given company, industry or sector in which they are looking to invest. With the massive quantity of capital and expertise available to private companies, they can now effectively challenge established incumbents across all industries at a speed that was previously not thought possible.

How much time in your research process is dedicated to evaluating disruption risk?

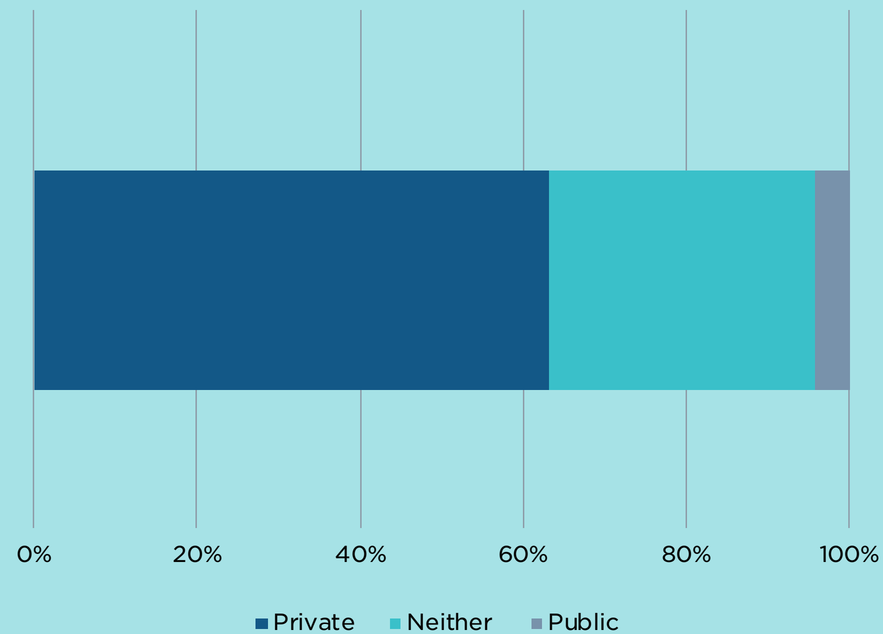


Source: PitchBook

... and poised to benefit more from disruption

LPs that are considering allocating to private markets are compelled by the growth and innovation presented by these companies. Two-thirds of LP respondents believe private companies are better positioned to benefit from technologic advancements. For an investor, this is attractive for several reasons, especially in today's low-growth economic environment. In addition, private companies aren't subject to many of the regulatory barriers or investor-relations-focused time constraints that can hinder the ability for public companies to innovate at scale. For an investor focused on the public markets, this viewpoint should be concerning.

Are public or private companies better positioned to benefit from the rapid rate of technological disruption?



Source: PitchBook

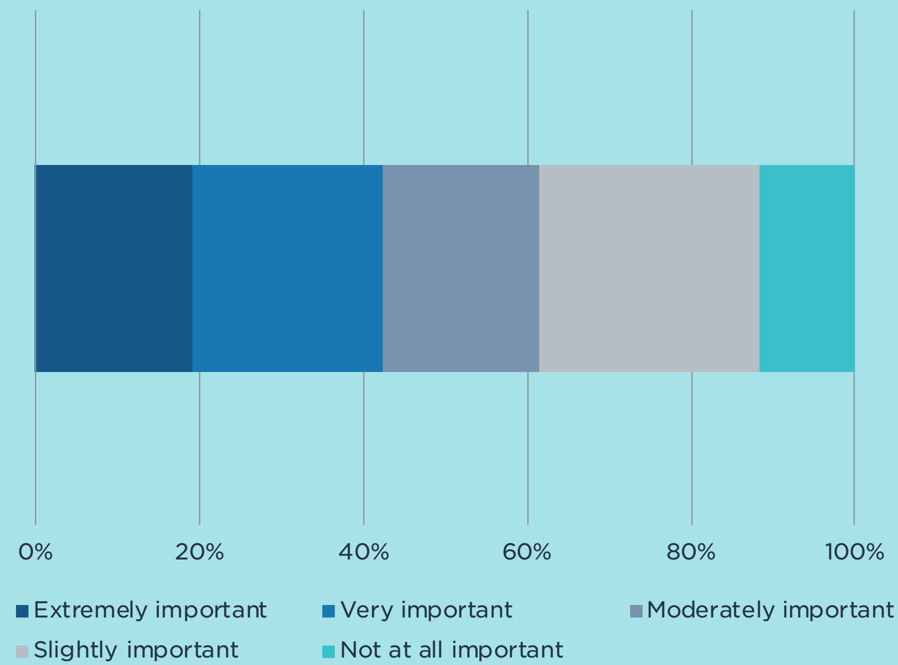
Public investors increasingly aware of PE & VC

Not only are public equity investors concerned with disruption risk from the private markets. 61% view understanding investment trends and capital flows within the private markets more broadly as important. 42% listed this as very or extremely important. It's clear that public market investors are increasingly seeing the impacts of private markets and are now spending considerable time looking for threats and opportunities presented directly, or indirectly, by private markets.

42%

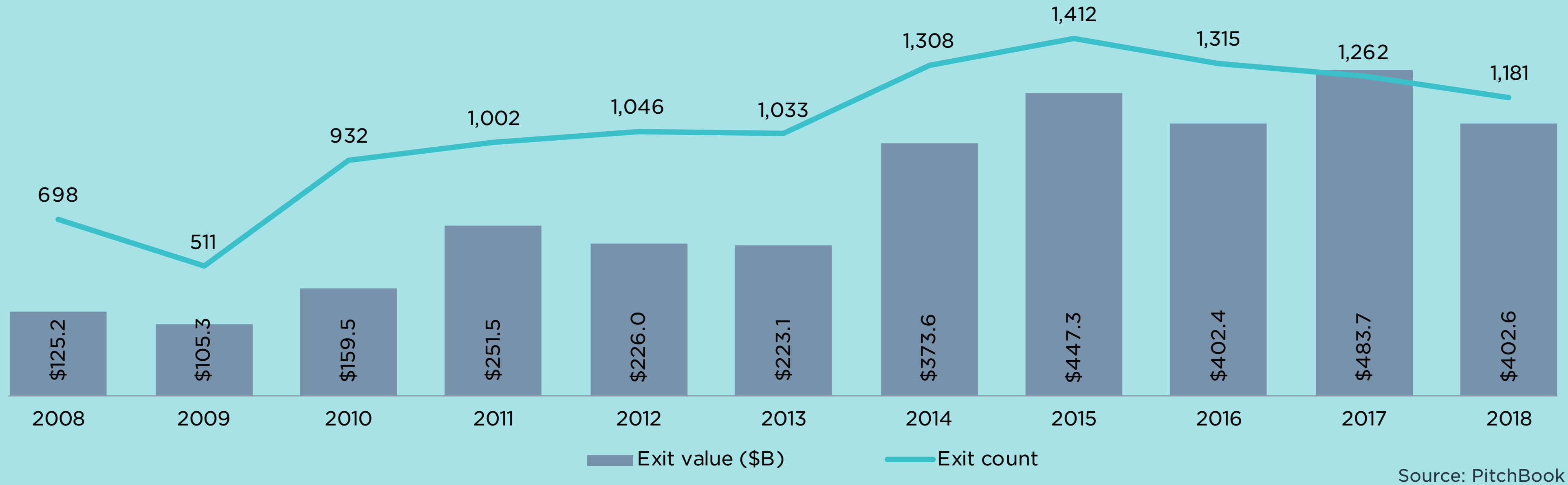
of public players regard understanding private markets as very to extremely important

How important is it to your investment strategy to understand investment trends and capital flows within the private markets?



Source: PitchBook

Acquisitions of global PE- and VC-backed companies by publicly held acquirers



Source: PitchBook

A final intersection point we will highlight is the amount of PE- and VC-backed companies acquired by public companies. Between 2009 and 2018, public companies have acquired over 11,000 PE- and VC-backed companies globally, totaling over $3 trillion. Much like the private market serves as a point of supply for eventual IPOs, it also serves as a fertile source for impactful acquisitions by public companies whether those transactions serve growth, intellectual property, talent or other strategic needs. This is also demonstrated in the number of companies that now have some sort of corporate venture arm and are seeking to identify interesting companies earlier and earlier in their respective lifecycles.

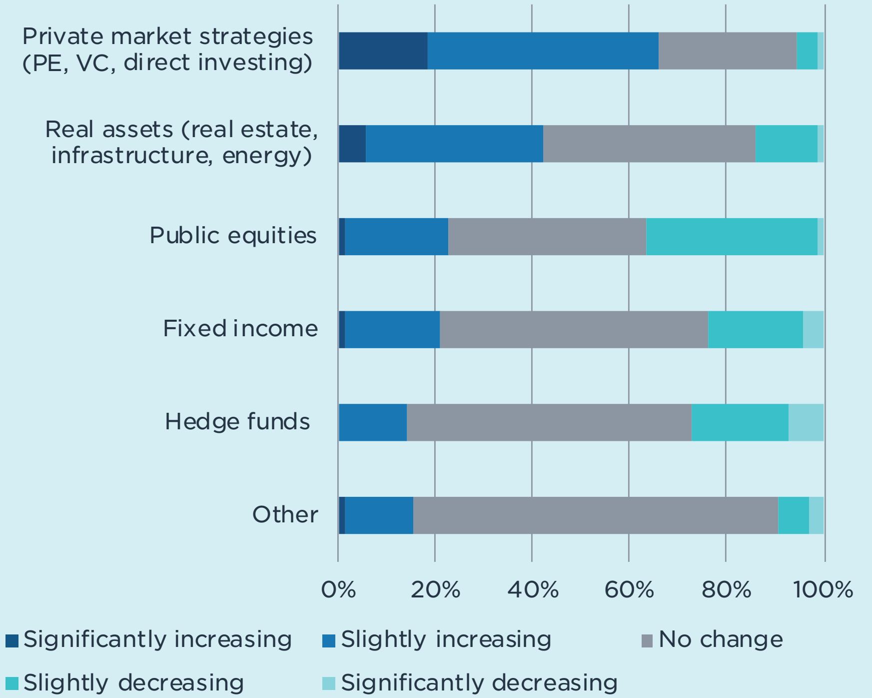
Outlook for private markets

Private markets only set to grow further

Looking forward, we believe private markets will continue to increase their role in global capital markets regardless of what happens macroeconomically over the next decade. This growth will be enabled by the robust ecosystem of investors, lenders, advisors and executives that has been built up over the last 20 years in the private markets. With this foundation now in place, we expect private markets to keep growing in size, sophistication and global impact. This means we also anticipate institutions, and potentially individual investors at some point, to maintain meaningful allocations to private markets as part of their overall investment strategies.

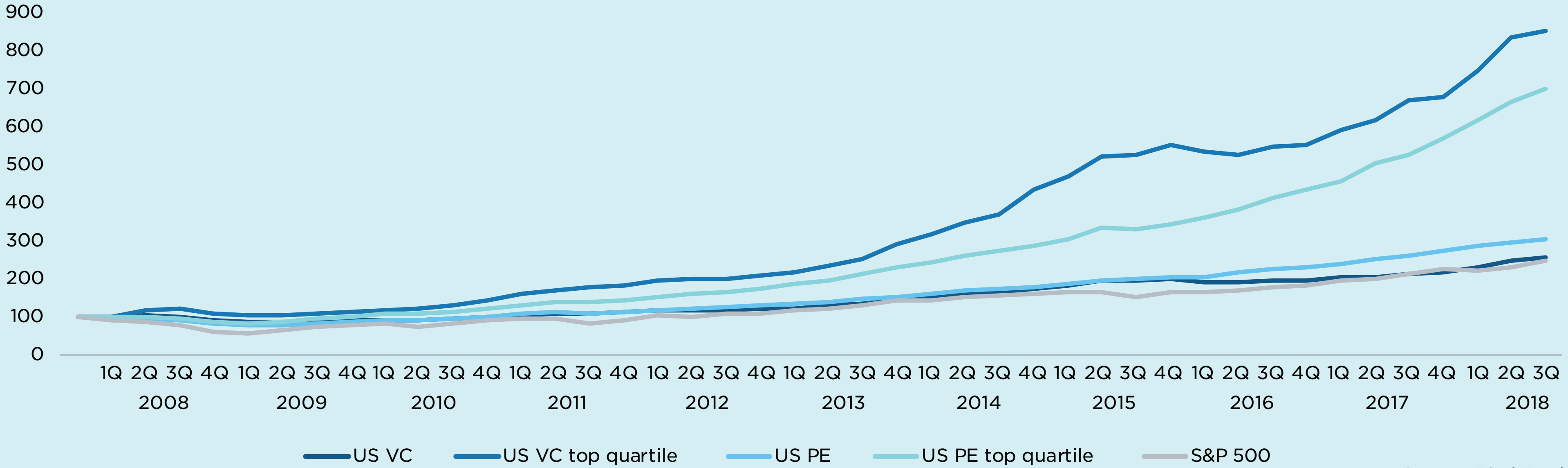
Investors must want exposure to private markets for them to exist, and for them to grow, they need to believe that opportunities for positive returns in the future will continue to exist. In addition, the long-term structure tied to private investment strategies along with the sheer count of private companies that will look for future investment provides a diversification factor that can benefit most investors. From the institutional investors we surveyed, it is clear these conditions currently exist as 66% said they would be increasing, slightly or significantly, their allocations as a percent of their AUM to private markets over the next five years, outstripping interest in any other asset class. It is important to note, however, that most institutional investors still have relatively modest allocations to the private markets. For example, today the median allocation to private markets from public pension plans stands at only 6.7% in North America and 3.9% in Europe.

How do you see your target allocations to the following asset classes changing over the next five years?



Source: PitchBook

Pooled quarterly aggregated changes to NAV (rebased to 100 in January 2008)



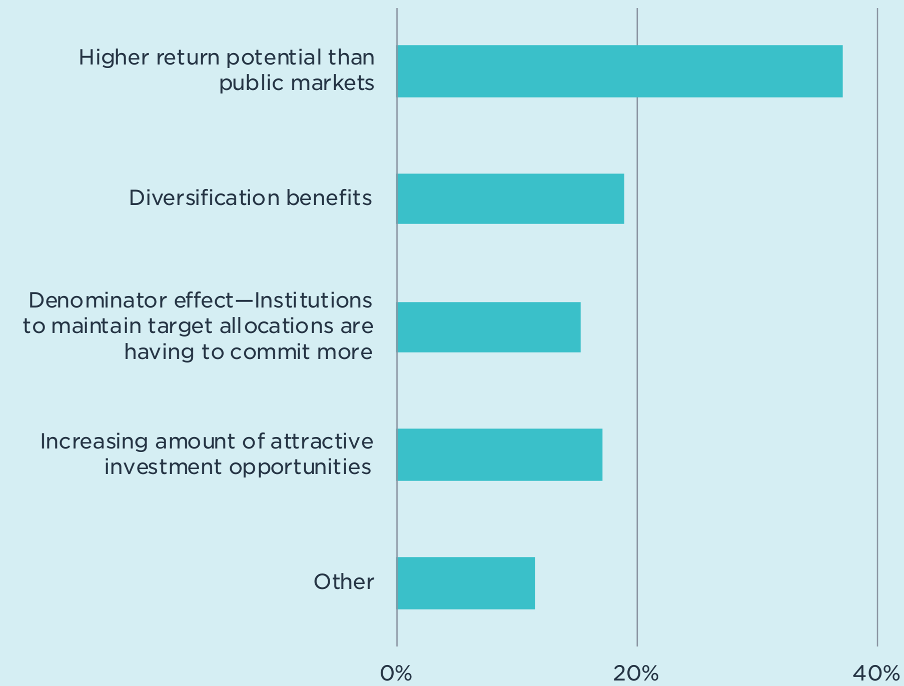
Source: PitchBook

The accompanying chart is an index based on the pooled quarterly aggregate changes to net asset values for PE and VC funds, top-quartile PE and VC funds (funds in the top 25% of performance) and the S&P 500. As illustrated, the top 25% of PE and VC managers have significantly outperformed to the tune of 5x or more. Note, private market NAV metrics include net fund inflows into private investment vehicles. This spans a full business cycle and includes both the financial crises and the last decade's record bull market. With return potential such as this, it is not surprising to see capital continue flowing into private markets. Our data has shown a relatively high correlation between PE and public markets. Correlation is lower for private real estate, debt, etc., but we don't include those asset classes here.

Private markets return potential is chief factor

The top three reasons why institutional investors believe private markets have continued to attract hundreds of billions in capital are higher potential returns than the public markets, diversification benefits and an increasing amount of attractive investment opportunities. Based on the data we have collected and analyzed, we believe these three elements will persist in private markets over the short and medium term. There remain questions about the overall capital capacity of private markets and the effects on returns as capital continues to flow into the PE and VC asset classes. So far, the data hasn't shown a significant weakening of performance with the capital inflows, but it will take another 10 years to ultimately understand if managers can invest 2019's record capital amounts and deliver the same performance as they did in the previous decade. Until then, we expect private markets to continue proliferating and for the relationship between public and private markets to increasingly tighten.

Why are private markets continuing to attract record amounts of institutional capital?



Source: PitchBook