

Fund Managers Struggle to Realize Investments Made in Buyout Boom

Average holding period for private equity-backed portfolio companies sold in 2012 reaches 5.0 years, compared to 3.9 years in 2008.

Preqin's data shows that the average holding period for private equity-backed portfolio companies increased year on year between 2008 and 2012. Mega deals (over \$1bn) exited so far in 2013 had an average holding period of 6.2 years, up from just 2.1 years in 2008.

Increased average holding periods have impacted the amount of capital distributed back to investors. After six years, 2001 vintage buyout funds had distributed 95% of paid-in capital to investors, compared to just 33% of paid-in capital after six years for vintage 2007 buyout funds

Other Key Facts:

- A significant 63% of portfolio companies purchased in 2006 and 73% purchased in 2007 have yet to be sold, as fund managers have struggled to exit companies purchased during the buyout boom.
- The average holding period for deals exited so far in 2013 has dropped slightly to 4.9 years.
- European portfolio companies have the longest average holding period at 5.2 years for deals exited so far in 2013, compared to 4.8 years for North American portfolio companies.
- The aggregate value of exits dropped to just \$5.2bn in Q1 2009, but has been on an upward trend since, reaching a high of \$126bn in Q2 2011.
- Distributions to investors exceeded contributions for the first time in 2011 since 2005, with fund managers keen to return capital to investors.
- Buyout funds closed in 2012 secured an aggregate \$91bn in capital commitments, compared to \$79bn and \$77bn raised by buyout funds closed in 2011 and 2010 respectively.
- Investors continue to favour buyout funds. 51% of LPs looking to make new commitments in 2013 plan to target small to mid-market buyout funds and 23% expect to commit to large or mega buyout vehicles.

For more information and analysis, please see the article that follows.

Comment:

"With buyout fund managers now holding portfolio companies for a year longer on average than before the financial crisis, exit conditions clearly remain difficult. Fund managers are still struggling to sell investments for a sufficient profit that were purchased at peak prices during the buyout boom, and consequently are holding portfolio companies for longer. However, exit activity seems to be on the increase and the fact that distributions have outweighed contributions more recently, means investors are likely to have more capital available to commit to new private equity funds in the near future."

Ignatius Fogarty – Head of Private Equity Products, Preqin

About Preqin:

Preqin is the leading source of information for the alternative assets industry, providing data and analysis via online databases, publications and bespoke data requests.

Preqin has built a reputation in the alternative assets industry for providing the most comprehensive and extensive information possible. Leading alternative assets professionals from around the world rely on Preqin's services daily, and its data and statistics are regularly quoted by the financial press. For more information, please visit: www.preqin.com

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Note to Editors:

- Preqin is spelled without the letter 'U' after the 'Q'.

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Private Equity-Backed Portfolio Company Holding Periods

As average holding periods for private equity-backed portfolio companies have increased in recent years, [Jonathan Parker](#) examines the impact this has had on the wider private equity industry, including investors and fundraising.

The holding period of portfolio companies can have a significant effect on the private equity cycle, as it determines how soon investors are able to receive distributions from their commitments. Due to tough economic conditions, the average portfolio company holding period for private equity-backed buyout deals has increased, as buyout fund managers have increasingly found it difficult to make a profitable exit from their investments. The result of this is that the amount of capital distributed back to investors has diminished, which has affected the amount of capital that investors can recycle back into the asset class through new fund commitments. However, over the last year or so there have been signs of improvement with exit activity starting to pick up.

Deals Yet to Be Exited

Fund managers typically look to sell portfolio companies within three to five years, having increased the value of the company enough to make a sufficient profit. Based on this practice, it was expected that the majority of portfolio companies purchased during the buyout boom of 2006-2007 would have been exited by now. However, as Fig. 1 shows, 62% of companies purchased in 2006 are yet to be realized, while almost three-quarters of those purchased in 2007 have not yet been sold. This backlog of ageing portfolio companies is likely to take time to sell and therefore continue to drive up holding periods in the next few years.

Average Holding Period

The average holding period for portfolio companies held by private equity buyout fund managers has increased from 3.9 years for deals exited in 2008 to 5.0 years for deals exited in 2012, as Fig.

2 displays. This means that many of the companies exited in 2012 were purchased at peak prices prior to the onset of the financial crisis. With the subsequent drop in portfolio valuations due to the deteriorating economic environment, fund managers have found it increasingly difficult to exit investments made during the buyout boom.

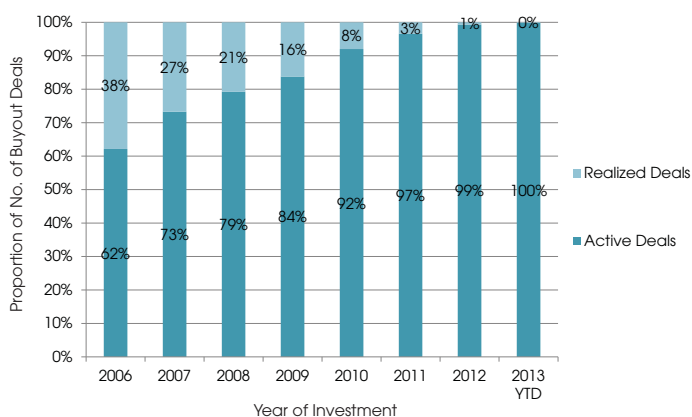
Despite the typical holding period for private equity-backed portfolio companies being three to five years, there are some notable exceptions to this trend. In July 2011, Castle Harlan acquired Norcast Wear Solutions for \$190mn and announced the sale of the company less than seven hours later, for \$217mn.

Geographic Variations

There are notable geographical variations in average holding periods for private equity-backed deals. As shown in Fig. 3, since 2006, the average holding period for portfolio companies based in North America has increased from 3.9 years in 2006 to a high of 4.9 years in 2012. At present, Europe has the longest average holding period at 5.2 years, compared to a low of 3.8 years in 2008, demonstrating that over the past few years difficult economic conditions have had a considerable impact on the ability of fund managers to exit their investments.

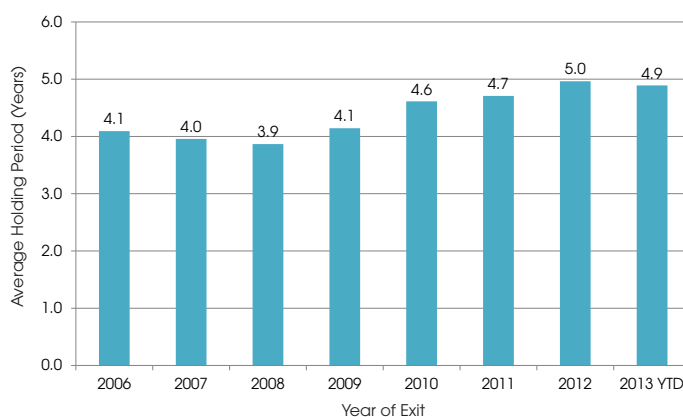
The holding period for Asia-based portfolio companies has increased from a low of 2.6 years in 2007 to 4.7 years for deals exited so far in 2013. Holding periods in the Rest of World region have fluctuated since 2006, from a high of 4.9 years, to 3.8 years for deals exited so far this year.

Fig. 1: Proportion of Private Equity-Backed Portfolio Companies Currently Held by Initial Investment Date, 2006-2013 YTD (As at 17 April 2013)



Source: Preqin Buyout Deals Analyst

Fig. 2: Average Holding Period for Private Equity-Backed Portfolio Companies by Year of Exit, 2006 - 2013 YTD (As at 17 April 2013)



Source: Preqin Buyout Deals Analyst



Size of Deals

Large cap deals (\$1bn or more) have seen the largest change in average holding periods since 2006. Deals exited in 2008 had an average holding period of just 2.1 years compared to deals exited in 2013, when the average holding period reached a high of 6.1 years, as Fig. 4 illustrates. A significant amount of large cap deals took place prior to 2008, with fund managers purchasing companies at peak prices during the buyout boom. Large cap deals accounted for 14% of the number and 82% of aggregate deal value in 2006, compared to 2009, when large cap deals only accounted for 3% of the number and 35% of aggregate deal value. Many are reluctant to sell until company valuations haven't risen sufficiently.

The average holding period for small cap deals (less than \$250mn) exited between 2006 and so far in 2013 has consistently been between 4.0 years and 5.0 years. Mid cap deals (\$250-\$999mn) have seen slightly more variation, from an average of just 2.9 years in 2006 to 4.2 years for deals exited so far in 2013.

Exit Trends

In Q1 2009, the aggregate quarterly value of private equity-backed exits fell to a low of just \$5.2bn as fund managers struggled to realize investments in the immediate wake of the onset of the financial crisis, as shown in Fig. 5. In recent years however, the number and aggregate value of exits has generally been on an upward trend, reaching a high of 352 exits valued at an aggregate \$126bn in Q2 2011. Despite the fact that a large number of portfolio companies purchased in 2006 or 2007 are still being held, some fund managers have still found exit opportunities in the challenging economic climate.

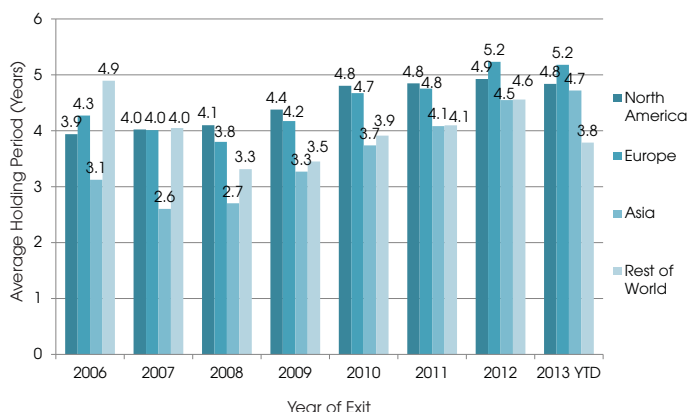
Although holding periods are lengthening, partial exits have become an increasingly valuable tool for fund managers, allowing them to sell part of their stake in a company and distribute some capital to LPs. In 2012, 33% of exits were classed as partial compared to approximately 20% in 2006-2008. The prevalence of partial exits serves as another potential contributory factor towards the increase in holding periods, as fund managers are able to hold portfolio companies for longer, while still drawing value before fully exiting the investment.

Contributions vs. Distributions

The investment strategy of investors can be impacted significantly by the increased holding period of portfolio companies. Fig. 6 shows that for vintage 2007 buyout funds, the median level of distribution was 33% of paid-in capital after six years; however, after the same time period, vintage 2001 buyout funds had distributed around 95%, which is nearly all of an investor's paid in capital. If investors base their annual commitment pace on expected contributions and distributions, then this could have been affected given the fact that fund managers are holding companies longer than the historical average. Faced with less liquidity in their portfolios, many LPs are likely to make fewer new commitments, or put their programs on hold, until sufficient amounts of capital are returned, unless they increase their target allocations to private equity.

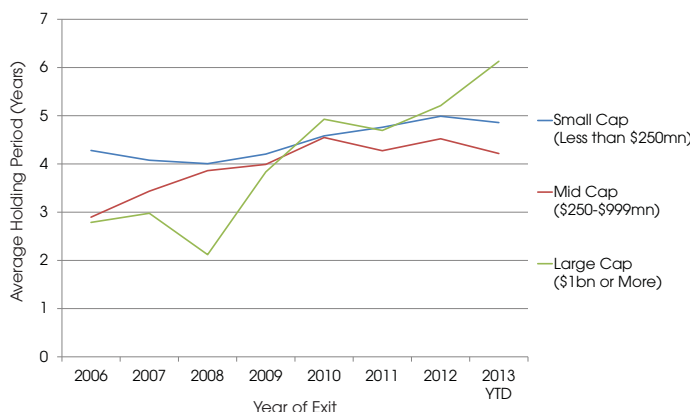
The situation looks broadly the same for funds of more recent vintage years. For example, after three years of investment, the median level of distributions for vintage 2010 buyout funds stood at 2.6%, but for vintage 2003 buyout funds after the same time period the figure was 18% of paid-in capital.

Fig. 3: Average Holding Period for Private Equity-Backed Portfolio Companies by Region, 2006 - 2013 YTD (As at 17 April 2013)



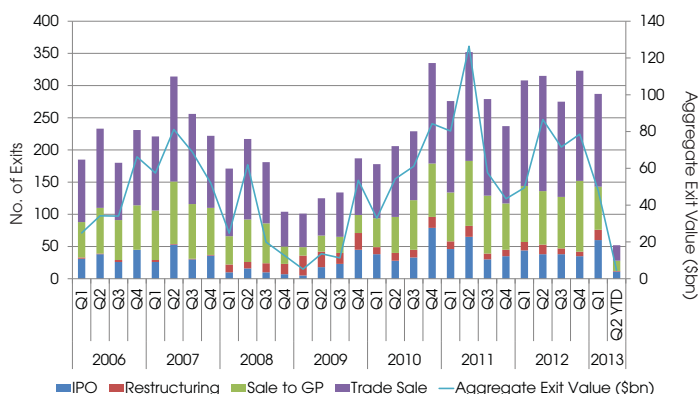
Source: Preqin Buyout Deals Analyst

Fig. 4: Average Holding Period for Private Equity-Backed Portfolio Companies by Deal Value, 2006 - 2013 YTD (As at 17 April 2013)



Source: Preqin Buyout Deals Analyst

Fig. 5: Number of Private Equity-Backed Exits by Type and Aggregate Value, 2006 - 2013 YTD (As at 17 April 2013)



Source: Preqin Buyout Deals Analyst



Despite this, there is evidence to suggest that the annual level of capital distributed to investors is increasing. As can be seen in Fig. 7, 2011 was the first year that overall distributions exceeded contributions since 2005, whereas from 2007 to 2010, contributions outweighed distributions quite significantly. In addition, the data currently available suggests that for the whole of 2012, distributions may exceed the figure for 2011. This is positive for the overall private equity cycle and will allow for many LPs to make new private equity fund commitments.

Investor Appetite for Private Equity

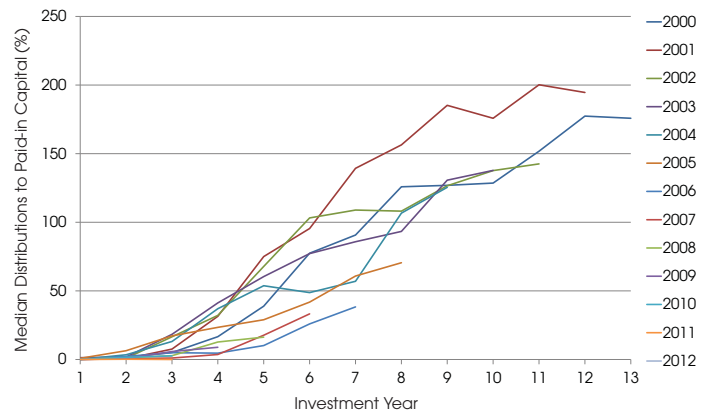
The increase in distributions more recently is likely to have contributed to increased levels of buyout fundraising over the past year. Buyout funds closed in 2012 raised an aggregate \$91bn globally compared to \$79bn and \$77bn raised by buyout funds closed in 2011 and 2010 respectively.

Furthermore, investor appetite for buyout funds remains strong with Preqin's Investor Outlook: Private Equity, H1 2013 report showing that over half (51%) of LPs expecting to make new private equity commitments in 2013 planned to focus on small to mid-market buyout funds. Additionally, investor appetite for large to mega buyout funds has increased more recently, with 23% of LPs looking to make new commitments in 2013 expecting to commit to such funds, compared to 13% in 2011.

Outlook

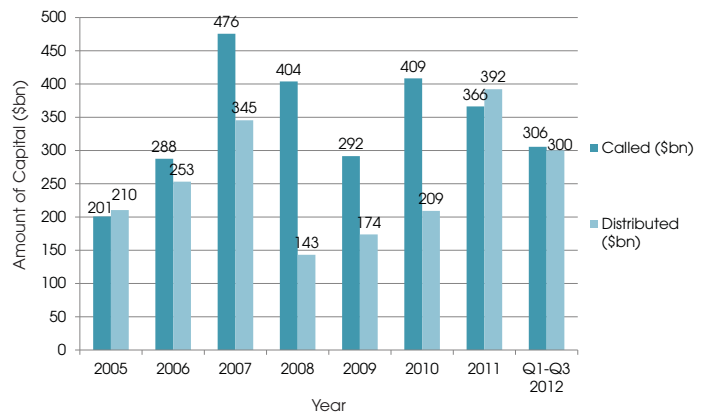
The drop in portfolio valuations as a result of the onset of the financial crisis has caused fund managers to struggle to make a profitable exit from their investments, resulting in portfolio company holding periods increasing over recent years. This consequently resulted in a sharp fall in the number and aggregate value of exits and meant the distributions LPs received fell short of contributions. However, since 2011, exit activity has been increasing and therefore distributions have exceeded contributions; this has allowed investors to increase their private equity investment activity which has resulted in an uptick in fundraising. Therefore, if this continues in 2013 and beyond, the rate at which capital moves through the private equity cycle may be set for further improvement.

Fig. 6: Historical Buyout Fund Median Distributions to Paid-in Capital (DPI) by Vintage Year



Source: Preqin Performance Analyst

Fig. 7: Annual Amount of Capital Called and Distributed by Buyout Funds, 2005 - 2012



Source: Preqin Performance Analyst

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