As we move into the final quarter of 2019, the challenges that private equity has faced throughout the year are persistent. US-China trade tensions and the uncertainty of the Brexit outcome are, for many, foreshadowing a global recession. With these macroeconomic factors impacting a range of investment markets, successfully navigating the private equity market is getting harder. Activity has contracted across the investment cycle over 2019, and the amount of capital deployed in the market is declining.

That said, investors continue to turn to the private equity fund model, which has proven its ability to provide protection in times of market downturn, and fundraising remains robust in terms of capital secured. Private equity funds have secured $417bn in the first three quarters in 2019, up from $345bn over the same period in 2018.

In this uncertain environment, investors are also flocking to established brands; in fact, the 10 largest funds closed in Q3 secured 77% of total capital raised in the quarter. With competition high and the market environment challenging, fewer funds are entering private equity: the number of funds in market has dropped since the beginning of 2019.

Private equity-backed buyout deal value in Q3 2019 increased from a three-year low in Q2 2019. However, at $86bn, the total value of deals in Q3 2019 was down 15% in comparison with Q3 2018 – every quarter of 2018 recorded over $100bn in deals. In venture capital, the aggregate $52bn in financings recorded in Q3 2019 marks the lowest quarterly total in over two years.

Industry players will recognize, though, that private equity is a long-term asset class. Performance over the long term is strong and the private equity model has proven to withstand market cycles. While activity is not currently matching the record highs seen in recent years, investors continue to allocate to the asset class in search of long-term value.

Contents

3 Tokenization: Private Markets for Everyone – George Salapa, bardicredit
5 Fundraising
6 Funds in Market
7 Investors
8 Buyout Deals
9 Venture Capital Deals
10 Performance & Dry Powder

All rights reserved. The entire contents of Preqin Quarterly Update: Private Equity & Venture Capital, Q3 2019 are the Copyright of Preqin Ltd. No part of this publication or any information contained in it may be copied, transmitted by any electronic means, or stored in any electronic or other data storage medium, or printed or published in any document, report or publication, without the express prior written approval of Preqin Ltd. The information presented in Preqin Quarterly Update: Private Equity & Venture Capital, Q3 2019 is for information purposes only and does not constitute and should not be construed as a solicitation or other offer, or recommendation to acquire or dispose of any investment or to engage in any other transaction, or as advice of any nature whatsoever. If the reader seeks advice rather than information then he should seek an independent financial advisor and hereby agrees that he will not hold Preqin Ltd. responsible in law or equity for any decisions of whatever nature the reader makes or refrains from making following its use of Preqin Quarterly Update: Private Equity & Venture Capital, Q3 2019. While reasonable efforts have been made to obtain information from sources that are believed to be accurate, and to confirm the accuracy of such information whenever possible, Preqin Ltd. does not make any representation or warranty that the information or opinions contained in Preqin Quarterly Update: Private Equity & Venture Capital, Q3 2019 are accurate, reliable, up to date or complete. Although every reasonable effort has been made to ensure the accuracy of this publication Preqin Ltd. does not accept any responsibility for any errors or omissions within Preqin Quarterly Update: Private Equity & Venture Capital, Q3 2019 or for any expense or other loss alleged to have arisen in any way with a reader’s use of this publication.
Imagine if people could invest in alternative assets with the ease of a peer-to-peer lending platform. Security tokenization has the potential to make that happen.

Tokenization is about ‘cutting’ assets into tokens. These digital securities have emerged out of the hype over initial coin offerings (ICOs) – a method of raising funds through the use of cryptocurrencies. Security tokens are intelligent and regulated securities that give small businesses the ability to raise funds from investors globally, 24/7/365. As they are ‘pre-programmed’ with smart contracts, security tokens could remove middlemen like central depositaries, automate dividends, and govern trading rules and voting rights among other things. In short, security tokens are transforming securities into computer programs.

Tokenization has the potential to disrupt how private companies and private investment projects find capital, allowing them to offer intelligent ownership titles from their desktop. It could be just as impactful for the alternative investment funds: venture capital, private equity and hedge funds. These investment vehicles are out of reach for the vast majority of investors. That’s why tokenization is such an exciting development. Tokenizing alternative assets, such as venture capital funds, would open the market to a more diverse range of investors, not just pension funds and high-net-worth individuals. Even more importantly, tokenization could empower independent fund managers and young talent looking to raise capital.

Here’s a closer look at the benefits of tokenization, for fund managers and investors alike.

**A More Efficient Fundraising Process**
Tokenization would create a more digitized fundraising process. Currently, documents such as the offering memorandum, subscription agreement, investor questionnaire and other formation paperwork must be reviewed multiple times by multiple middlemen, leading naturally to a lengthy chain of email ‘back and forth.’ At each stage of intermediation, agents will hold their own ledger of information, creating additional security risk. This level of bureaucracy can be both time-consuming and costly.

Tokenized funds, on the other hand, can take advantage of smart contracts to automate away these sorts of ‘paperwork-heavy’ functions. A pre-programmed security with rules encoded within through the smart contracts – specifying who exactly can buy the security, where it can be traded and how it should distribute returns – will remove the need for middlemen.

Ultimately, tokenization will streamline the fundraising process. Instead of a structure involving multiple actors (issuer-lawyer-authority-investor), fundraising via tokenization will be very direct: from issuer to investors. What’s more, a fundraising process that is streamlined, and therefore more affordable, could reduce the barriers to entry and enable more investors to participate.
Another major advantage of tokenization is that it eliminates the pressure to achieve urgent exits. One issue that all traditional venture capital firms face (micro- to big-brand venture capital funds alike) is that they have to make exits within a set period of time according to their investment mandate. Investors in tokenized funds, however, can sell their stake at any time and are therefore freed from the 8-10 year lock-up. Removing the urgency to exit also gives fund managers more freedom to operate and to be transparent about their fund investments. They can allow their portfolio companies to grow at a more natural pace and build sustainable businesses for the long term.

The tradeable nature of tokenized funds is also expected to bring much-needed liquidity to today’s illiquid alternatives market. In recent years, there has been massive growth in the private equity secondaries market, highlighting the hunger for liquidity. This market was tiny just 20 years ago. Since then, Europe-based private equity secondaries assets under management has risen significantly, more than doubling from €43bn in 2015 to €87bn in 2018. Tokenization could further boost liquidity in private markets by making it easy and simple to trade stakes in funds.

Tokenization could also open doors for a new generation of fund managers. We live in the digital age. The improved access to knowledge and the ability to attain celebrity status and win followers through social media have paved the way for fresh talent to emerge as fund managers. Tokenization is set to further strengthen this trend by reducing the complexity and overheads associated with fundraising.

Preqin data shows that first-time venture capital funds have largely outperformed funds that are part of a more established series over the past decade. This suggests the potential that tokenization could offer in bringing more first-time funds to market.

**Tokenization in 2019**

For decades, the alternatives industry has been closed to most investors apart from institutional funds and high-net-worth individuals. Today we are seeing some of those barriers to entry start to fall.

For all these reasons, tokenization looks set to be incredibly disruptive. However, anyone who is considering this method for fundraising requires a good understanding of law and regulation.

Tokenization is becoming possible in countries that are recognized for wealth management: Switzerland, Liechtenstein and Luxembourg. These countries have begun forming their own versions of ‘blockchain law’ which will recognize the representation and transfer of securities on blockchain without intermediaries. Thanks to the progressive, if strict, procedures being put into place in these countries, it is becoming possible to tokenize a fund and attain legal certainty in a regulated manner that is compliant with the new framework.

A recognized European fund structure – SICAV – will thus be represented in the form of security tokens, one-to-one (fund units in the form of tokens), fully regulated and operated by a licenced fund manager, with scalable, private-label sub-funds for independent fund managers.

---

**bardicredit**

bardicredit provides turn-key tokenization services. Our services cover legal, regulatory, and ultimately the tokenization process.

Before bardicredit, George was in consulting (PwC), banking (Sberbank) and tech (smart data Braintribe). He co-founded a technology company (Shout) and he was a guest writer for Forbes US.

www.bardicredit.com
Appetite for private equity remains strong, despite escalating US-China trade tensions and an impending Brexit. The third quarter of 2019 saw private equity funds securing $163bn in aggregate capital, far surpassing the $138bn raised in Q2 2019 (Fig. 1). The number of funds closed has declined significantly though: 260 funds closed compared to 319 in Q2 2019, marking a five-year low in the quarterly number of funds closed. The concentration of capital among a small number of large funds continues its trend.

Asia-focused funds have rebounded from a fundraising lull in the first half of 2019; 59 funds secured $40bn in investor commitments, surpassing the $38bn raised collectively in Q1 and Q2 2019 (Fig. 2). In contrast, 31 Europe-focused funds raised a modest $14bn in Q3 2019, less than half the capital secured in Q2 2019.

Private equity vehicles globally have had a successful fundraising for the first three quarters this year. Among funds closed in Q1-Q3, 34% were in market for six months or less, and more than half were on the road for less than a year (Fig. 3). With more investors committing to experienced fund managers, the larger funds are becoming oversubscribed, allowing the more established GPs to complete their fundraising speedily.
Funds in Market

As of October 2019, 3,637 funds are seeking an aggregate $751bn, compared with 3,749 funds targeting $972bn in January 2019 (Fig. 4). The size of this decrease indicates that the fundraising market remains highly competitive. Notably, 2,111 vehicles currently in market have held at least an interim close, securing $239bn in total commitments so far.

While venture capital funds constitute the highest number of funds (2,195) in market, buyout funds are targeting the most capital ($308bn, Fig. 5). North America continues to dominate with 1,652 funds on the road, and 50% ($379bn) of the total capital targeted is focused on the region. Following this, 1,165 funds are focused on Asia seeking a total of $159bn.

Funds in market constitute a mixture of fund sizes. Even though 5% of funds are targeting $1bn or more, they make up more than half (52%) of all capital sought (Fig. 6). Interestingly, the 10 largest funds are seeking an aggregate $113bn, which constitutes 15% of the total capital targeted. At the other end of the spectrum, almost half (46%) of funds in market are seeking less than $100mn, representing just 5% of capital targeted.

---

*'Other Private Equity' includes balanced, co-investment, co-investment multi-manager, direct secondaries, hybrid, hybrid fund of funds, PIPE and turnaround funds.
Investors generally intend to commit less fresh capital to private equity funds over the next 12 months (Fig. 7). Nearly two-thirds (59%) of investors are looking to commit less than $50mn, an increase of eight percentage points on Q3 2018. Twenty-one percent of investors plan to commit a minimum of $100mn to the asset class over the next 12 months, a proportion notably smaller than this time last year (35%), which itself was down from the year before (50% in Q3 2017).

Buyout remains the most commonly targeted strategy among private equity investors, with 60% planning to target the strategy in the next 12 months, although this is down from 70% in Q3 of last year (Fig. 8).

North America remains the region targeted by the most private equity investors (45%) in the year ahead; 39% will commit capital to Europe-focused funds, while over a third (34%) will target Asia-Pacific (Fig. 9). All regions barring Asia-Pacific have experienced a decrease in investor interest compared with a year ago, indicative of a slowdown in the established markets and a shift in focus to those with predicted growth.
Buyout Deals

After a strong showing in 2018, global buyout deal momentum slowed in the opening quarters of 2019 amid challenging economic and geopolitical conditions. Q2 2019 recorded the second-lowest aggregate deal value since 2014 (Fig. 10). However, buyout deals have rebounded in Q3 2019 in terms of value: 1,157 transactions worth a combined $86bn were made globally. This was primarily driven by an uptick in activity in North America, Europe and Rest of World (Fig. 11). In contrast, Asia-based deals experienced a 48% fall in value from $11bn to $5.8bn.

Deal-making is not the only challenge facing managers, as buyout exits have also seen an appreciable drop in value and volume this year (Fig. 12). There were 408 exits in Q3 2019, marking the fifth consecutive quarterly fall. Although total exit value also fell from Q2, the seasonal uptick in Q2 bucked the overall trend: aggregate exit value rose $87bn on Q1, which was the largest quarterly increase in the last five years. The proportions of IPO & follow-on and restructuring exits have both followed a downward trend over the last few years, while sale-to-GP exits have increased from 28% in Q3 2014 to 40% in Q3 2019.

Fig. 11: Aggregate Value of Private Equity-Backed Buyout Deals by Region, Q1 2014 - Q3 2019

Source: Preqin Pro

*‘Other Private Equity’ includes balanced, co-investment, co-investment multi-manager, direct secondaries and turnaround funds.
After a record-breaking Q2 2018, venture capital deal activity has declined in every quarter since. Q3 2019 saw no respite from this, recording a total of 3,269 deals worth a combined $52bn (Fig. 13). This compares with 4,288 deals for an aggregate $70bn in Q3 2018.

The number of venture capital deals announced declined across most regions, especially in North America (down 16% on last quarter, Fig. 14). Greater China shares responsibility for the slowdown – 1,764 deals were recorded across both regions in Q3 compared to 2,886 in Q3 last year.

Activity across all venture capital exit types has been on a downward trend over the past five years. The underwhelming IPOs of some well-known venture capital-backed portfolio companies this year have done little to improve sentiment. Q3 2019 recorded the lowest number of exits (247) over the five-year period shown in Fig. 15, in contrast to a significant uptick in Q2 2019, which itself was the highest level in two years.

The total value of exits also decreased from $73bn in Q2 2018 to $26bn, reflecting the exit challenge for venture capital managers in the current environment.
Performance & Dry Powder

Private equity vehicles of vintages 2010 onwards have consistently produced median net IRRs above 14%, reaching a high of 15.5% for vintage 2012 funds. Although the asset class is performing well as a whole and median returns are relatively consistent across recent vintage years, there is some variation in returns. This is demonstrated by the average interquartile range of 13% across all vintages examined in Fig. 16.

Buyout funds have outperformed the private equity asset class as a whole over the three-, five- and 10-year horizons to December 2018, producing its highest return of 15.5% over the 10-year period [Fig. 17]. Venture capital funds underperformed against the asset class in each time period. Funds of funds exhibited the highest one-year return (+15.4%) of the strategies examined, but performed less well over the longer horizons, dipping to their lowest annualized return (+11.2%) over a 10-year period.

Global private equity AUM stood at a record $3.56tn as of December 2018, up 17% from the end of 2017 (Fig. 18). This marks the 10th consecutive annual increase in AUM for the industry, and the second highest since 2007.
Master your domain
Enhance your point of view with research, multimedia and events that provide insider access to the largest global network of alternative assets experts.

Interactions that create opportunities
Meet face-to-face with industry thought-leaders at industry events and conferences. Build your own network and uncover best practices.

Know where you are
Accurately compare yourself against the competition so you can outperform your peers. Access private and public benchmarks, surveys and exclusive compensation and fund terms benchmarks.

Create a free account at www.preqin.com/insights