US fundraising in 2022 – is private equity weathering the storm?

After record-breaking fundraising in 2021, the private equity market – along with the wider economy – has faced unprecedented challenges so far this year including record inflation, the end of near-zero interest rates, and global political uncertainty. *Lynne Westbrook* and *Michael Wood* explore what effect these factors have had on fundraising in 2022 to date, which market segments may have benefited, and what the future could hold for private markets.

According to PitchBook's *'Q2 2022 US PE Breakdown'*, 191 US private equity funds raised $176.0 billion in the first half of 2022. By comparison, in 2021, 577 funds raised a total of $339.8 billion. So, is 2022 on track to be a record-breaking year if H1 activity is maintained?

In a world that looks dramatically different to last year, these headline figures suggest that the private equity industry is weathering the storm. Under the surface, however, the increasing economic uncertainty, public market sell-off and geopolitical tensions which have characterized the year so far, are causing a shift in the dynamic between GPs and LPs.

2021: a highwater mark and a change in the tide

Alongside the unprecedented fundraising in 2021, deal activity also set records. PitchBook recorded close to 9,000 deals with an aggregate value of $1.2 trillion, comfortably the most active deal-making year on record. To put this into context, annual deal value in the years between 2016 and 2022 averaged $682bn, with 2021 recording a 75% increase. This rapid uptick in deal activity, particularly for buyout managers, has meant that managers are deploying funds faster and are back on the fundraising trail sooner than ever before.

However, the impressive fundraising performance of the private equity market in the year to date is unlikely to be repeated in the second half of 2022. Many commitments to these funds will have been signed in 2021, before the significant change in the macro environment. The uncertainty that this shift has engendered, combined with the speed of firms coming back to market, has left many LPs in a difficult position.

LPs under pressure

With managers launching successor funds faster than ever before and therefore seeking re-ups from their existing investors, the cyclical nature of fundraising is breaking down. In the past, managers in LPs portfolios would raise funds in different vintages, making annual commitment planning relatively straightforward. In 2021 and 2022, however, many LPs have seen significant percentages of their managers back on the fundraising trail, more so than their annual allocation capacity can allow. This has left LPs facing difficult decisions in terms of which managers they should re-up with and, perhaps more importantly, who makes their priority list in terms of previous fund performance and returns.

The struggle many managers currently face in fundraising is amplified by the denominator effect. While public equities are down by around 17% in the year to date (as at September 2022), private valuations are faring better, with an increase in the percentage value of private equity as part of LPs' overall portfolios. While the fire sales on the secondaries market that accompanied a similar scenario during the global financial crisis are no longer a necessity, the future allocations of many LPs are restricted, and reductions are being made to upcoming vintages.

Fundraising timelines for many GPs are also being influenced by LP allocation restrictions; with allocation budgets for this year mostly committed, closing dates and even launch dates are being pushed into 2023, allowing managers to access next year's allocation dollars.

Beneficiaries

When it comes to LPs making new commitments in a highly competitive fundraising environment caused by macro uncertainty, the segment of the market that benefits the most – or perhaps is impacted the least – are megafund managers (defined in PitchBook's data as those managing $5+ billion funds).

In the first half of 2022, megafunds accounted for 58.4% of all capital raised, up from 44.1% in 2021 – the first time the 50% threshold has been crossed since

2008, according to the PitchBook report. PEI also report that the 10 largest funds to close so far this year have raised a cumulative $133 billion, 40% of total capital raised.

Notable closes in 2022 to date include KKR's $19 billion flagship fund, Leonard Green & Partners' $14.7 billion Green Equity Investors IX, and Advent International's $26 billion fund Advent International GPE X, which is the second largest PE fund on record this side of the global financial crisis. Along with Advent Tech II, which closed in December 2021 on $4 billion, the firm has collected more than $30 billion in the past 12 months. From the point of view of LPs, these established, larger managers are perceived as a safer bet during uncertain times. They are also likely to be some of the longest-standing relationships in the portfolio, and ones that may be difficult to rekindle in future should a vintage be skipped due to the competition with other LPs for access to top-performing, brand-name managers.

In tandem with a restriction on future allocations, the macro uncertainty in 2022 is having a significant impact on the distributions received by LPs. The lack of attractive exit options for assets in existing funds has seen exit events decline significantly, especially IPOs. With distributions being a key source of capital that LPs recycle to meet unfunded commitments, many are reportedly turning to the secondaries market to generate liquidity.

In June, *Secondaries Investor* reported that Dutch pension giant APG, which manages a private equity portfolio of around €26.3 billion, was in the process of selling a portfolio of fund interests worth up to €2 billion ($2.1 billion at the time), to keep pace with fundraising. This follows its sale of a portfolio of about €1 billion in fund stakes which was executed earlier in the year. The article also referenced other LPs which were in the process of selling large portfolios. With the exit environment showing little sign of improvement, the GP-led secondaries market is likely to see even more activity during the rest of this year because of the optionality and liquidity it provides for LPs, as well as opportunity to add capital, and therefore increase asset valuations. This was discussed in our review of the secondaries space piece, as well as in our article around the rising use of continuation funds, both published recently.

What the future holds

In the short to medium term, fundraising for private equity managers will probably be as challenging as most people in the market can remember. Larger managers are likely to fare best during this time, and less established or smaller managers will have to rely on carving a niche to differentiate themselves from the competition. However, they are likely to face challenges in securing commitments due to LPs focusing on the managers they know well and who have a proven track-record across economic cycles.

Over the long term, however, the rapid growth of the private equity market since the turn of the century will likely continue. Data provider *Convergence* tracks eight signals across capital raising, fund launches, and LPs to gauge the health of the market. In H1 2022 it recorded all but one as bullish, with capital raised by existing funds clocking in as neutral, perhaps an indication of the shifting priorities of LPs discussed above.

Private equity has become an essential part of investors' portfolios, offering access to market-leading businesses that generate consistent returns throughout the economic cycle. As Bain's recent Midyear 2022 Private Equity Report points out, returns from buyout investments made during the recovery years after recessions have consistently outperformed long-term averages. LPs are well-aware of this fact and are anxious to have money at work to catch the recovery upswing.