The Pulse of Private Equity – 11/17/2014

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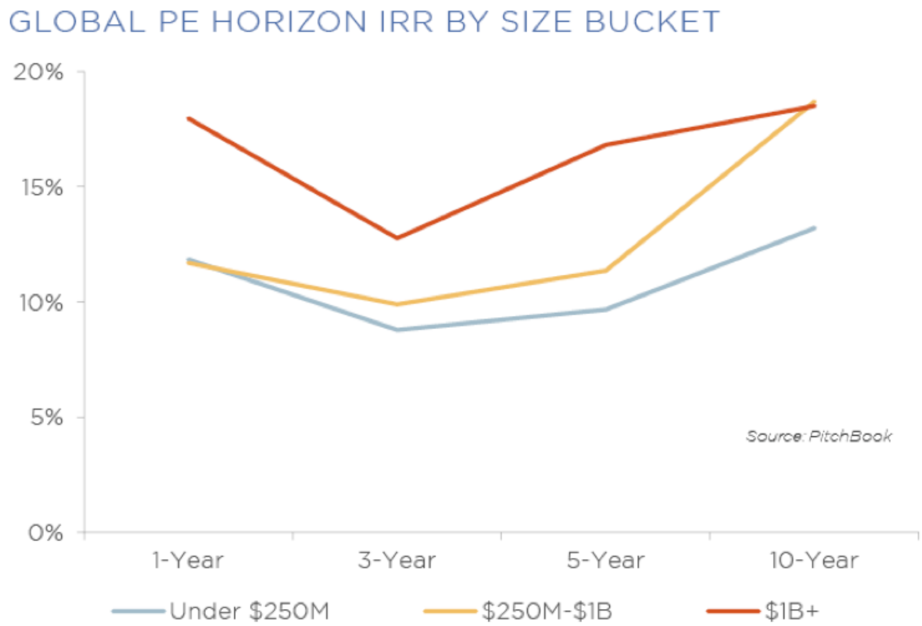
Bigger is Better in PE, but For How Long?

Bigger is still better in the global PE industry. Funds managing at least $1 billion are outpacing the $250 million–$1 billion and sub-$250 million size buckets at the 1-, 3-, 5- and 10-year IRR horizons, by significant margins in some cases. At the lower end of the spectrum, sub-$250 million funds are underperforming both larger size buckets at each horizon, and by about 5% at the 10-year horizon.



It will be interesting to see what effect, if any, the increased amount of LP commitments going into the lower middle market will have on those numbers. LPs have shifted their attention recently to middle-market and lower-middle-market funds, spurred in part by the competition and expenses incurred at the upper end of the market. They must be looking past the performance of sub-$250 million funds in recent years, which have historically trailed their larger counterparts. LPs may be betting that 2013 and 2014 vintages will fare better in the deal-making environment over the next few years, as smaller transactions in niche markets are more abundant and less pricy than bigger, bread-and-butter buyouts.

For LPs looking to remain exposed to the biggest funds in the market, past returns data looks positive. But IRRs for the largest PE funds may soften as future returns are released; GPs managing $1 billion+ funds have been lamenting this year that the current market isn't helpful to strong deal flow. The most recent vintages for $1 billion+ funds have had to sideline themselves in recent quarters, which will have an effect on their IRRs down the road. Time is money, after all.

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