Private Equity Update: Capital Calls, Distributions, and Valuations

Kelly Meldrum, CFA
Partner & Head of Primary Investments

Since April, many of Adams Street's clients have asked what we're seeing in terms of private equity valuations, liquidity, and new deal activity. We hope our perspective will provide a helpful point of view on cash flow planning for private equity portfolios, gauge the likelihood of capital calls, and assess whether there will be any distributions to offset cash needs.

At the onset of the pandemic, we looked back at prior dislocations, particularly the Great Financial Crisis (GFC), to see what capital call patterns were post crisis. We also asked our global buyout managers to look forward and provide their best forecast for the next several months. I'm happy to report, six months later, that our April global buyout forecast was mostly accurate, and our venture managers provided an upward surprise.

Capital Call Activity Relatively Flat

For buyouts, our experience has shown overall capital calls were down about 10% in Q2 versus Q1. While we expected a decline, there actually was more activity than we anticipated. In particular, we saw buyout managers continuing to complete add-on acquisitions. We also saw some capital calls early in the quarter related to the repayment of lines of credit. There was a flurry of activity in the first two weeks of the second quarter, and then a slow build of activity as we approached Q3.

The biggest surge in capital calls occurred in the US venture segment, driven by a flight to quality and the rebound in the public market tech sector. Buyout capital calls also reflected an emerging new source of deal flow, as many closely held private companies approached PE shops to see if there might be opportunities to partner. We believe this interest in potentially selling part or all of a company was likely motivated by the expectation of tax changes in the US after the election, and that deal flow has continued into Q3.

One notable bright spot was that fewer companies required equity infusions. Liquidity across the portfolio was much better than we originally anticipated back in the dark days of March. Overall, buyout activity was better than expected, however, capital calls were down.

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With venture activity up, and buyouts down overall, our aggregate capital calls received for Q2 were consistent with Q1. Looking at the trend for Q3, capital calls exceeded Q2 by about 12%, this time fueled by buyout activity.

Distributions Decline Overall, But Stronger in Venture

Buyout distributions were down about 70% globally in Q2 versus Q1. Most managers seemed to be focused on their portfolios, and it would have been very difficult to sell a company during that time except for a very few specific sectors. However, venture distributions were down only 14% quarter over quarter. But, since Q1 was a big quarter for venture distributions, we observed Q2 distributions in the aggregate were still healthy. As public tech stocks rebounded, we started receiving distributions from underlying managers of public stock in our venture portfolios. That has continued into Q3 and underscores the benefits of a globally diversified portfolio, because venture was an upside surprise and certainly helped with liquidity.

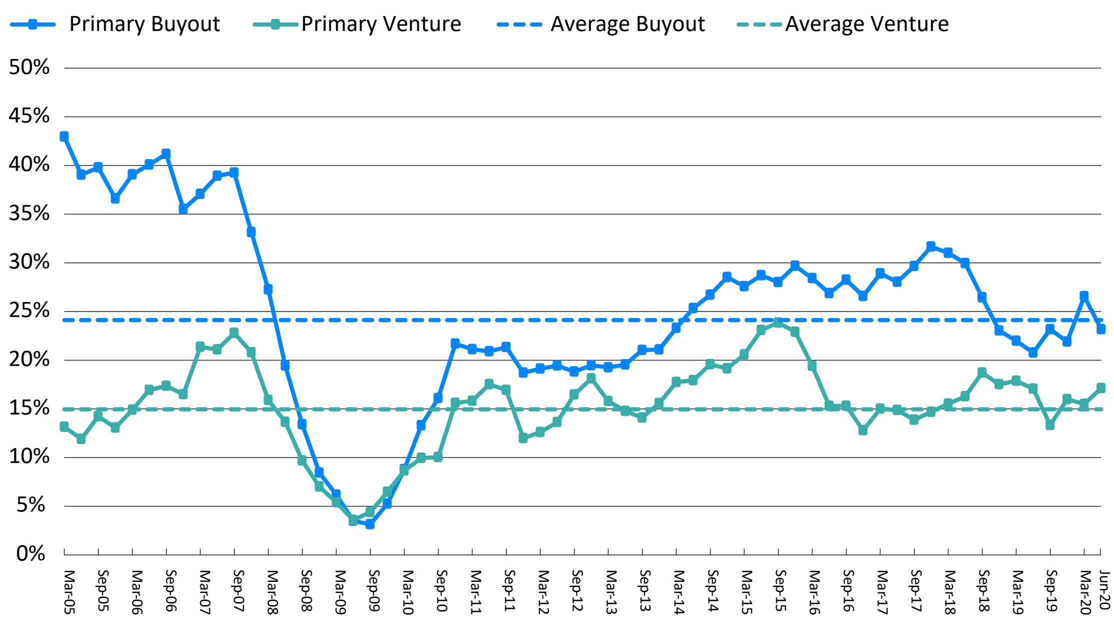
As we look into Q3, distributions were relatively flat compared to Q2, although venture distributions from our managers based in Europe and Asia accounted for a larger portion relative to Q2.

The following chart looks at the rate of distributions over beginning period NAV, going back prior to the GFC. The long-term averages for buyout and venture are about 25% and 15%, respectively. Distribution rates for Adams Street's buyout and venture portfolios are close to the long-term averages. For the rolling four quarters ending Q2 2020, buyouts distributions ticked down, while the rate on venture ticked up.

The Distribution Rate as a percent of NAV remains close to long-term averages, significantly higher than the post-GFC period

Private Equity Fund Distribution Rate (From Q1 2005 to Q2 2020)[1]

Rolling 1-Year Distribution Rate over Beginning NAV



As of June 30, 2020, roughly one quarter into the pandemic, distributions from underlying managers have held up pretty well. That compares to the GFC, when we experienced higher highs and lower lows. But, if we compare our recent performance to December 31, 2008, when the economy was about one quarter into the GFC, we are already at 7% or 8% distribution rates for both venture and buyout. So, this crisis is certainly playing out very differently than the GFC.

Valuations Recover, Driven by Venture and Tech

When we first set out to model what our valuation marks would be for Q1, it was late March. That was a tough time to be forecasting because companies were performing well until the last two weeks of the month, and then public markets had a significant downdraft. We anticipated that our marks could come in at about half the public market decline of 20%. The portfolio actually did better than we had anticipated: down 8.4%.

We saw a rebound in Q2 across most sectors and in the public comps. The portfolio was up 11% in Q2 versus Q1, and we're now essentially flat year-to-date. As we noted in our July 2020 look at the buyout market, performance has been very sector dependent. It has helped that our portfolio is overweight tech and healthcare – areas that have proven to be resilient in this environment. Also, many of our general partners and portfolio companies were proactive in revising operating budgets back in late March/early April. As a result, we are seeing many portfolio companies meet or exceed their post-COVID onset plans.

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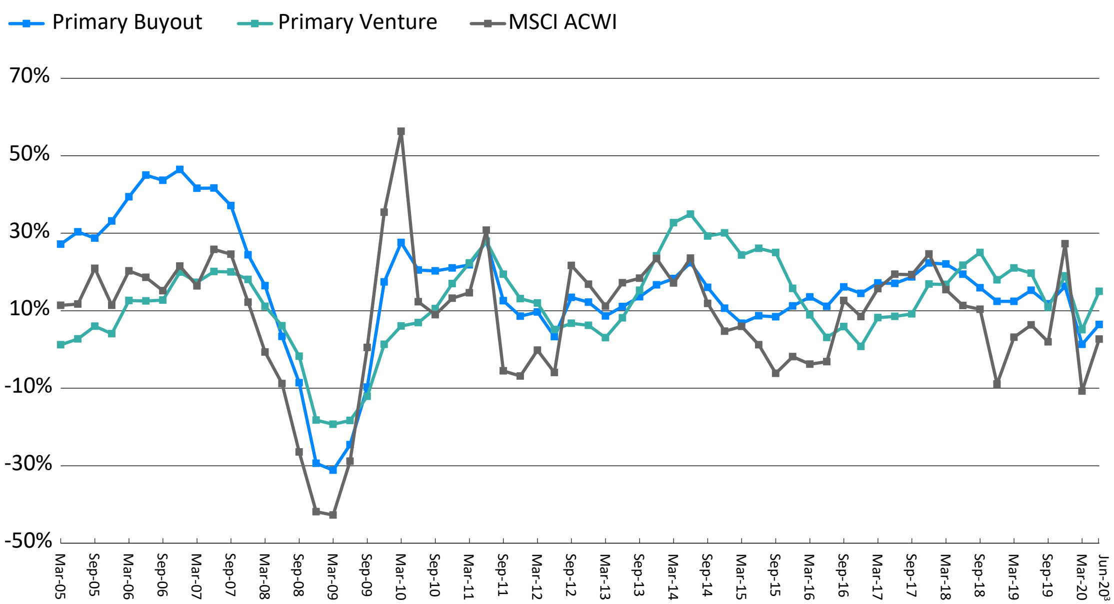
Private Equity Fund Valuations and Returns (From Q1 2005 to Q2 2020)[2]

Private Equity and Public Market Rolling 1-Year Return



If we look back before the GFC, we see how the rolling one-year returns for our buyout and venture portfolios compared to the public market comparable, the MSCI All Country World Index (ACWI).

During the period around the GFC, the MSCI ACWI was down almost 43%, with buyouts down 30% and venture down 20%. Moving forward to June 30, 2020, the public markets had a nice rebound and we captured a portion of that both in venture and buyout. But, we didn't have the significant downturn in Q1.

In Conclusion

We continue to feel comfortable with our allocations in buyouts and venture – including our focus on globally diversified portfolios – and we believe the pandemic has reaffirmed the value of that approach.

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1. Private equity performance is represented by aggregate cash flows and valuations of all partnership funds in Adams Street Core portfolios. "Core Portfolios" are funds and separate accounts (excluding special mandate funds and non-discretionary separate accounts) of which Adams Street Partners is the general partner, manager, or investment adviser (as applicable) and for which Adams Street Partners makes discretionary investments in private equity funds. Core Portfolios include separate accounts no longer with Adams Street Partners. Partnership funds are from vintage years 1980-2018. Distribution rates = rolling 1-year fund distributions over beginning NAVs. Average is taken from Q4 of 2001 through Q2 of 2020 for all partnership funds in Adams Street Core portfolios. Past performance is not a guarantee of future results.
2. Private equity performance is represented by aggregate cash flows and valuations of all partnership funds in Adams Street Core portfolios. "Core Portfolios" are funds and separate accounts (excluding special mandate funds and non-discretionary separate accounts) of which Adams Street Partners is the general partner, manager, or investment adviser (as applicable) and for which Adams Street Partners makes discretionary investments in private equity funds. Core Portfolios include separate accounts no longer with Adams Street Partners. Partnership funds are from vintage years 1980-2018. Public equity market performance is represented by MSCI ACWI Index. Returns = rolling 1-year returns. Past performance is not a guarantee of future results.
3. The Primary Buyout and Primary Venture performance figures for June-20 are Adams Street estimates provided for reference only. Actual performance figures for June-20 may vary.