Private Equity’s Cautious Cash Pile

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2013 was a record year for capital distributions to investors and private equity firms are comfortably raising new money, but are they putting it to work?

KKR & Co., the private equity behemoth well known for its mega deals and ability to raise funds, managed to pull together a record US$6 billion for an Asia fund last year. Former investors returned in droves to a firm with a strong track record in Asia, having successfully invested in and exited China Modern Dairy Holdings, Singapore tech company Unisteel and Japanese recruitment firm Intelligence. It has just sold Oriental Brewery of South Korea back to Anheuser-Busch InBev.

It managed to close its fundraising round after only six months. To put this in context, average fundraising time for private equity firms post-crisis has been in the range of 20-24 months versus the “golden period” of 8-12 months before the financial crisis.

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Our latest quarterly **Private Equity Navigator** report, produced in partnership with Pevara, a private equity data provider, illustrates why there is renewed appetite for private equity funds.

The state of play

2013 saw capital distributions, or the money returned to investors by private equity firms after exiting their investments increase by 27.9 percent year on year to US$247.7 billion in our very broad market sample, the highest level over the last ten years. This was reflective of a much more liquid market place which gave funds the ability to exit their investments either by selling their holdings or listing them on the stock market.

On the other hand, capital calls, or the deployment of money raised by private equity firms from their investors actually fell by 34.6 percent compared to 2012 to US$83.6 billion in our sample, the lowest level in the last 10 years.

Cash is coming

Exits are accelerating as market conditions continue to be favourable to sales and listings. This gives tailwind to the fundraising efforts of the established private equity firms (it remains difficult for new firms to find investors) that can point to strong realisations and improving fund returns.

As this happens, more money is being earmarked for private equity by institutional investors now their investments are bearing fruit. They have also experienced somewhat of a cycle of exposure to private equity in recent years. Post-financial crisis, many institutional portfolios started to slim down their public equity exposure and other mainstream investments, which meant their exposure to private equity (investments and commitments to private equity are, in general, illiquid for the life of the fund) as a percentage of the overall pie went up. But as equities have seen a bounce in the developed world, overall exposure to private equity is starting to look underweight again. So institutional investors are anxious to put money into private equity, especially given the overall low interest environment.

The PE party poopers

So why is there a disconnect between what private equity firms are giving back to investors, funds they raise and what they’re putting to work? For the third year running, distributions comfortably outstripped capital calls and the

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difference between capital distributed and capital called has never been greater over the past ten years.

It has been a prolonged seller's market, yet private equity firms remain cautious about putting new money to work in the face of high asset prices and a certain amount of scepticism towards the sustainability of economic recovery globally. While this discipline is to be applauded, funds raised need to be invested over a limited investment period and debt financing continues to be abundant underpinning the economics of the buyout market. This raises questions for future performance.

It is easy to fault private equity firms for raising too much money, yet being optimistic and willing to take risks is what makes them successful in the first place. We would argue that the limited partners (investors who commit capital to private equity funds) should avoid the pro-cyclical behaviour exhibited in previous years, when capital was withdrawn when asset prices were favourable and invested back into the industry at valuations that might very well be at a cyclical high.

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