The Pulse of Private Equity: Is Kessler Right?

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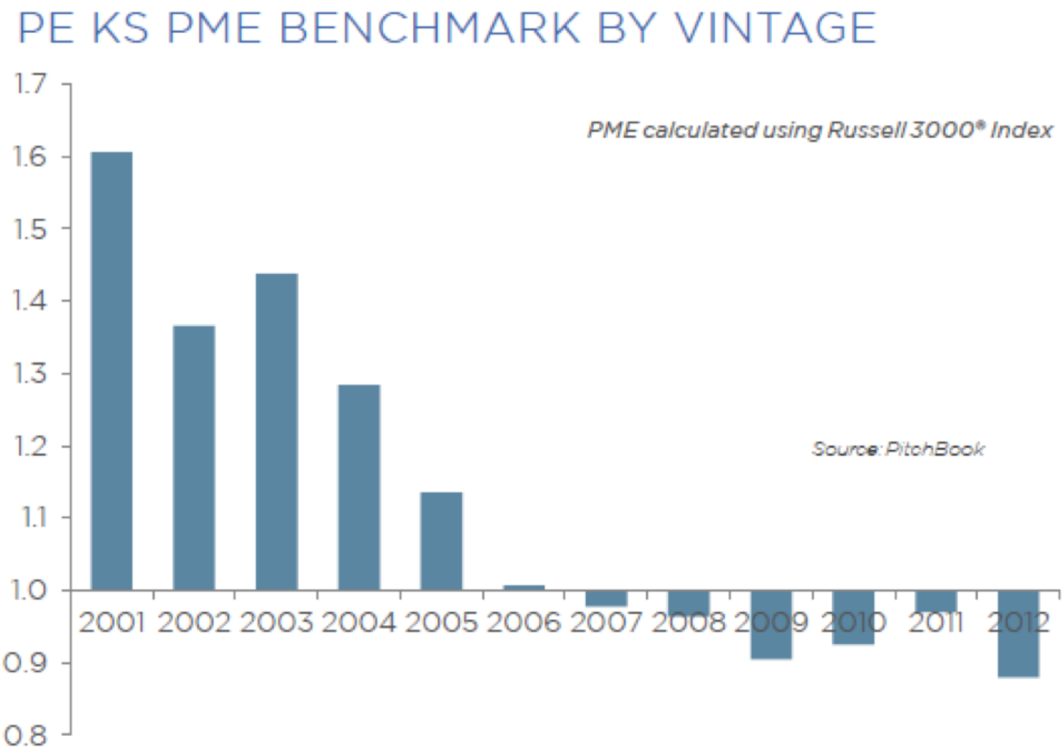
Andy Kessler published an attention-getting op-ed in the Wall Street Journal this week. “The glory days of private equity are over,” he says, citing rising interest rates, more PE firms competing for the same deals and less available leverage as crippling factors. The criticism isn’t new—we and many others have noticed PE’s recent struggles catching up with public market returns. The last set of vintage funds to outpace public equities was the 2005 vintage. 2006 and later funds—essentially every fund raised over the last decade—have matched or underperformed the stock market.



Kessler’s well-written critique made a bigger splash than most, but private equity has been upfront about its headwinds for a while. Back in February, Carlyle bigwig David Rubenstein predicted that PE returns “will drift down” over the next ten years. That doesn’t mean PE returns won’t be worth it to LPs, even if deals don’t look the same today as they did ten or twenty years ago. Carlyle’s investment in Beats, for example, returned about 80% on its $514 million minority stake. Other PE firms have noted that add-on deals can boost returns by 1x to 1.5x on a fairly consistent basis. These are smaller deals, of course, and to Kessler’s point, PE probably won’t return to pre-crisis performance based solely on investment returns. But the PE industry has been transitioning out of the “strip and flip” model for a few years now, and if “strip and flip” coincides with PE’s “glory days,” many investors would happily agree with Kessler, perhaps for different reasons.

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