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Overview of Tech-Focused PE Funds

As tech continues eating market share, specialist investors rethink the PE playbook

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Methodology

For this analysis, we discuss funds with a dedicated tech focus, such as Carlyle Europe Technology Partners, as well as funds managed by GPs that have completed at least 70% of their aggregate deals in the tech space, such as Accel-KKR.

Key takeaways

- **Tech-focused PE funds are rising in prominence.** As PE investment into tech companies continues to swell, a cohort of specialist investors has emerged. These GPs have accounted for over 20% of capital raised across North America- and Europe-based PE funds YTD and have already experienced a record year in terms of capital raised.

- **Although dry powder has nearly quadrupled since 2011, firms with tech-focused PE funds are investing the proceeds quickly.** There does not appear to be a glut of uninvested capital in the strategy.

- **The rate at which tech-focused PE funds call down capital does not materially differ from that of traditional buyout funds.** On average, these GPs call down around 70% of committed capital by Year Four. LPs investing in the strategy should be able to model their contributions off past data for traditional buyout funds, though the distributions of tech-focused PE funds display a unique return profile.

- **Tech-focused PE funds based in North American and Europe have outperformed other types of PE strategies in North America over time when looking at cash multiples as well as IRRs.** Over the past 10 years, tech-focused PE funds have produced IRRs that are more than five percentage points higher than those of non-tech buyouts and more than twice those of non-tech growth funds.

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Introduction

Tech has permeated business models in every industry. Similarly, tech has become pervasive in PE dealmaking. In the US, tech as a proportion of overall PE deal count surpassed 18% in 2018 and has nearly approached 20% as of 3Q 2019. Many industry stalwarts and generalists list TMT as a preferred industry in fund documents, but a breed of tech-focused specialists account for a mounting proportion of PE investments in and total capital raised for the sector. North America- and Europe-based tech-focused PE firms have raised $56.7 billion across 25 funds YTD, already capturing the most capital ever raised for the strategy on an annual basis. This note is intended to help LPs planning to allocate to tech-focused PE funds better understand the investment environment, examining first the strategy's evolution and then breaking it down by fundraising activity, dry powder, cash flows and fund performance. We then spend some time looking at tech-focused debt funds and the Big Three tech-focused PE firms setting precedent for the strategy.

Strategy evolution

With the ability to grow quickly, have a profound impact on non-tech businesses and produce enormous returns, tech companies will continue eating market share. Investors seeking access to this specialized segment of the market often choose to invest with specialists, which can range from $10 billion+ mega-funds to funds of just a couple hundred million dollars.

These newer players—and the more established GPs in the space—have found success in tech investments by rethinking the PE playbook. The strategy has evolved because tech companies are different from non-tech companies in several ways. They are often asset-light businesses, requiring little capital to scale, and can achieve rapid growth for prolonged periods of time. Additionally, tech companies with the SaaS business model, for example, produce highly standardized recurring revenue with products that are very sticky. Tech-focused PE funds and traditional buyout funds are also differentiated by their geographic mix. The former is primarily a North American phenomenon. Although there are some Europe-based vehicles dedicated to this space, most PE tech capital is raised in the US, which is home to a more mature venture ecosystem and myriad tech companies.

PE is infamous for its use of leverage and cost cutting; however, when investing in tech companies, PE firms often use less leverage, around two to three turns compared to six to seven turns in non-tech buyouts. When Vista Equity Partners acquired Cvent, an enterprise software company, for $1.7 billion in 2016, Cvent's CEO and founder, Reggie Aggarwal, said, "You don't pay that kind of premium and then squeeze it for a profit." Instead, PE firms must continually reinvest in the company and try to grow the top line in order to achieve superior investment returns, because companies in the space are often valued based on revenue multiples. And while growth certainly plays a part in traditional buyouts, the focus is far more explicit in tech investing.

Select tech-focused PE managers

Investor name	Closed funds	Capital raised ($B)	Open or upcoming funds	Country
Vista Equity Partners	11	$44.2	4	USA
Silver Lake Partners	7	$42.8	1	USA
Providence Equity	12	$35.2	2	USA
Thoma Bravo	11	$32.2	2	USA
Insight Partners	7	$16.5	1	USA
Francisco Partners	6	$14.3	0	USA
Siris Capital	6	$7.0	0	USA
Marlin Equity Partners	8	$6.8	0	USA
Accel-KKR	9	$6.1	1	USA
Carlyle Europe Technology Partners	4	$3.3	0	UK

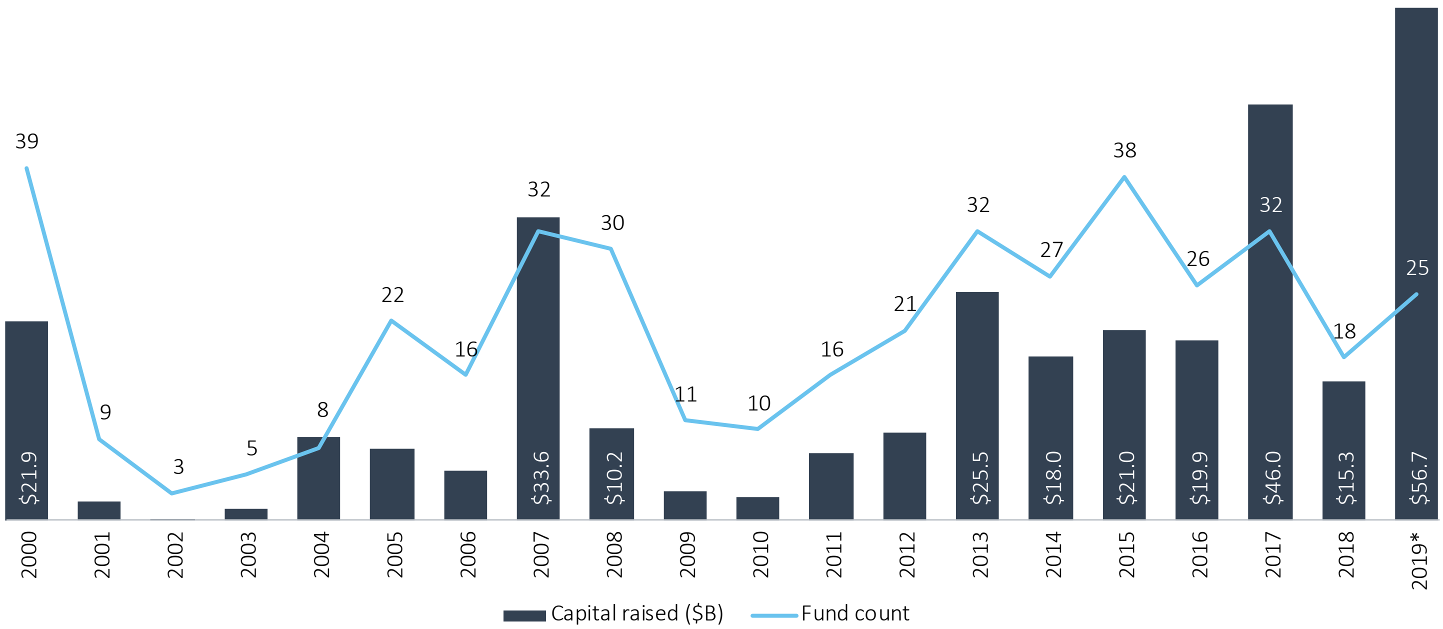
Source: PitchBook | **Geography**: North America & Europe
*As of October 14, 2019
Note: Capital raised is for tech-focused PE strategies only. It does not include debt.

As PE firms have adapted to this new investment opportunity, they have become a more enticing buyer option to tech founders and VC firms. In a post on Madrona Venture Group's website, the managing director, Matt McIlwain, wrote, "New PE owners offer a high degree of autonomy and flexibility to executives who are meeting or exceeding agreed-to milestones (admittedly with greater EBITDA emphasis over growth), as well as additional capital to take advantage of strategic opportunities." Tech companies exiting to PE firms is likely to be a more frequent occurrence as founders and their investors become more comfortable with this option, further propelling PE deal activity in the space.

Fundraising activity

The record amount of capital raised in the tech space isn't simply the result of an increase in PE commitments more broadly; tech-focused PE funds have accounted for a higher proportion of total capital raised in each of the last several years, comprising nearly 21.8% of PE capital raised across North America and Europe in 2019.

Tech-focused PE fundraising activity



Source: PitchBook | **Geography**: North America & Europe
*As of October 14, 2019

The inconsistent nature of fund closings influenced much of 2019's fundraising results, with Thoma Bravo and Vista Equity Partners closing flagship funds in the same year.[1] With these vehicles now closed, LPs seeking to allocate to the largest PE tech-focused funds will have to wait until one of the few bigger players returns with a flagship fund. However, there are smaller GPs presently raising funds and larger players raising middle-market (MM) funds. Vista is currently raising capital for its premier long-dated vehicle, dubbed the Perennial Fund. Although long-dated funds are a new investment approach in tech-focused PE, they have been gaining momentum in the generalist buyout sphere. Additionally, Vista is seeking to raise its fourth MM Foundation fund, which may gather up to $4.5 billion. Accel-KKR is also pursuing a tech-focused fund targeting MM companies. And for LPs wishing to make a commitment to a tech-focused mega-fund, Thoma Bravo is expected to launch another flagship vehicle in mid-2020.

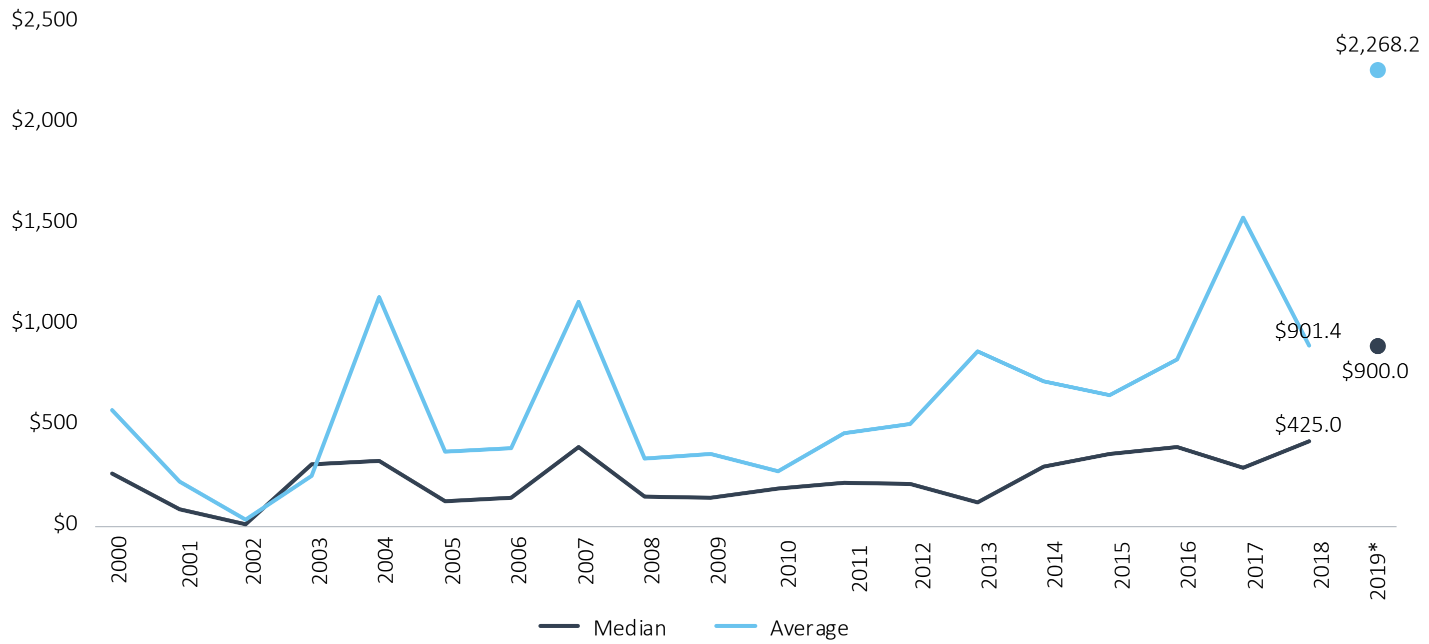
1: Though PE funds often raise capital across many months in successive "interim" closes, our data counts the entire fund size only in the period in which the fund held its final close.

Select open tech-focused PE funds

Manager	Fund name	Fund target ($M)	Status	Strategy
Vista Equity Partners	Partners Perennial	$3,000	Open	Buyout
Vista Equity Partners	Foundation Fund IV	$3,250	Upcoming	Buyout
Thoma Bravo	Fund XIV	$15,000	Upcoming	Buyout
Accel-KKR	Capital Partners VI	$2,500	Open	Buyout
FTV Capital	FTV VI	$800	Open	Growth

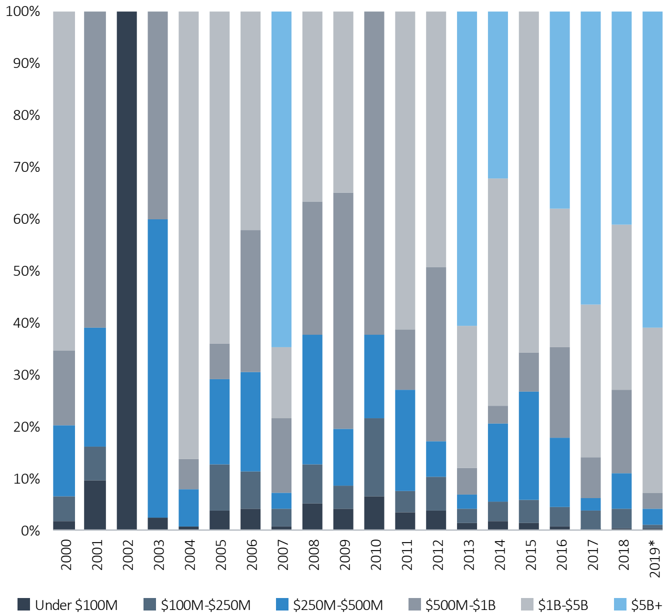
Source: PitchBook | **Geography**: North America & Europe
*As of October 14, 2019

Median and average tech-focused PE fund sizes ($M)



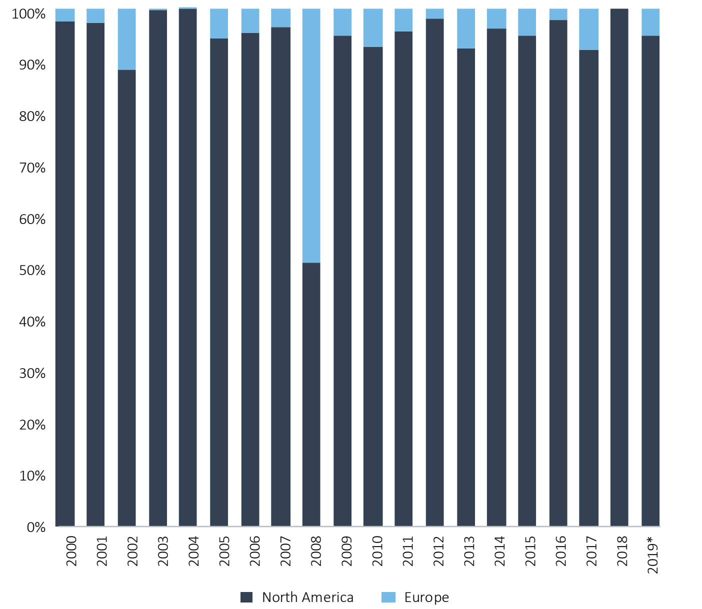
Source: PitchBook | **Geography**: North America & Europe
*As of October 14, 2019

Tech-focused PE funds ($) by size



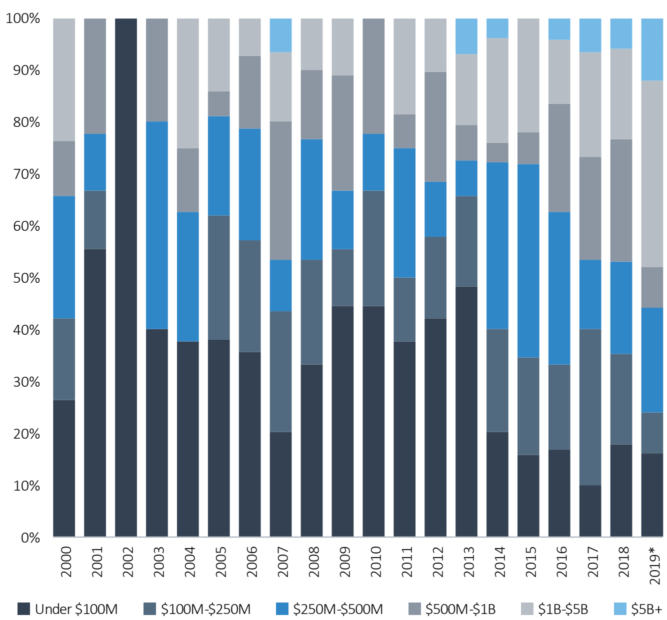
Source: PitchBook | **Geography**: North America & Europe
*As of October 14, 2019

Tech-focused PE funds ($) by region



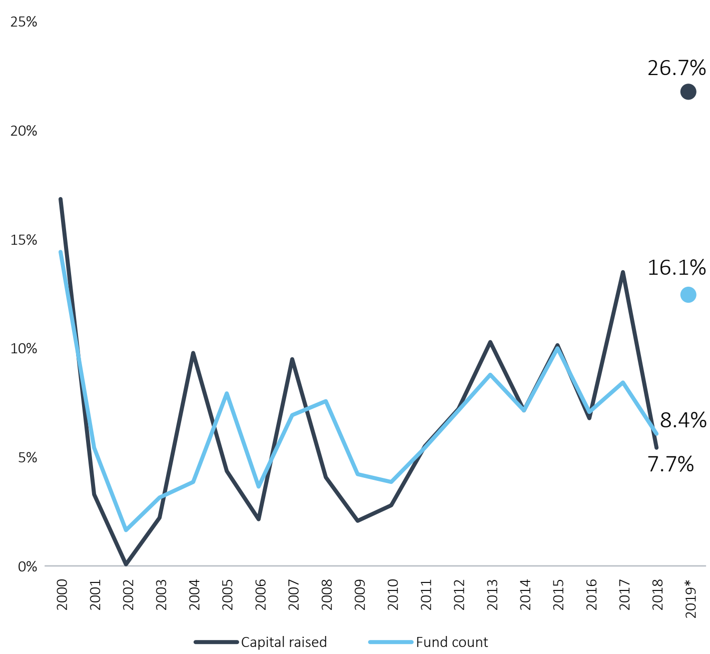
Source: PitchBook | **Geography**: North America & Europe
*As of October 14, 2019

Tech-focused PE funds (#) by size



Source: PitchBook | **Geography**: North America & Europe
*As of October 14, 2019

Tech-focused funds as proportion of overall PE fundraising activity

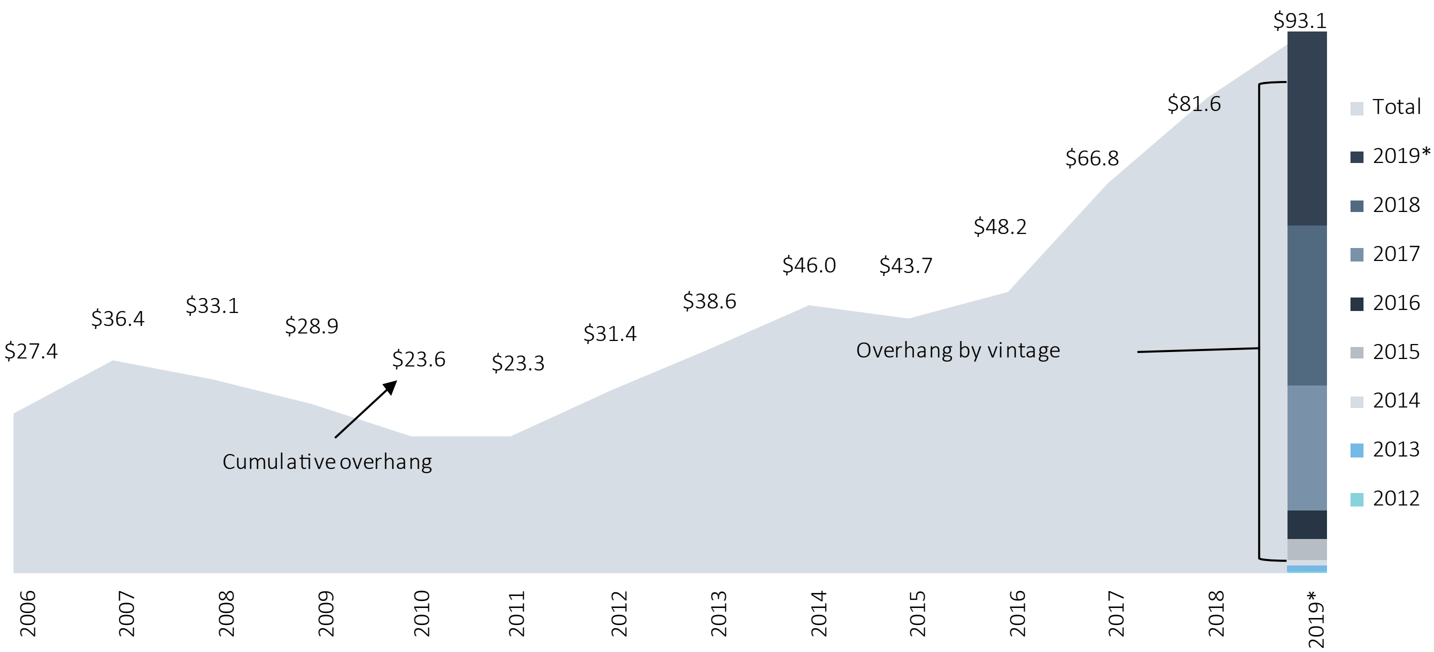


Source: PitchBook | **Geography**: North America & Europe
*As of October 14, 2019

Dry powder

After a quick succession of colossal funds closing, tech-focused PE dry powder has reached an all-time high YTD. Over $100 billion has been raised for the strategy in the past three years, more than had been raised for the strategy between 2008 and 2016 altogether. After a prolific bout of fundraising, many in the industry are asking if these GPs are sitting on too much cash and calling attention to potentially excessive pricing due to the surfeit of capital.

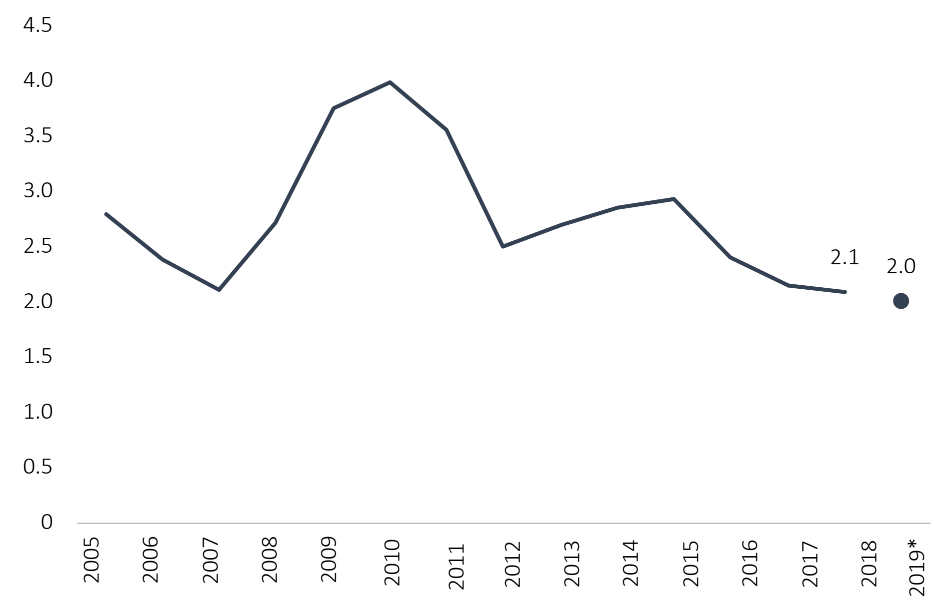
Tech-focused PE capital overhang ($B)



Source: PitchBook | **Geography**: North America & Europe
*As of March 31, 2019

Although absolute dry powder shows explosive growth since 2011, opportunities abound for tech-focused PE funds, and GPs have been spending down this surfeit at a breakneck pace. Not only have these firms been inking multibillion-dollar tech buyouts at a rapid clip, but tech buyouts often use less leverage than similarly sized buyouts, meaning capital is drawn down even more quickly to fund these deals. Thoma Bravo has been deploying cash so swiftly that, as we discussed earlier, the firm is expected to launch a $15.0 billion flagship vehicle in mid-2020 after having already closed on a $12.6 billion fund in January 2019.

Years of tech-focused PE dry powder on hand

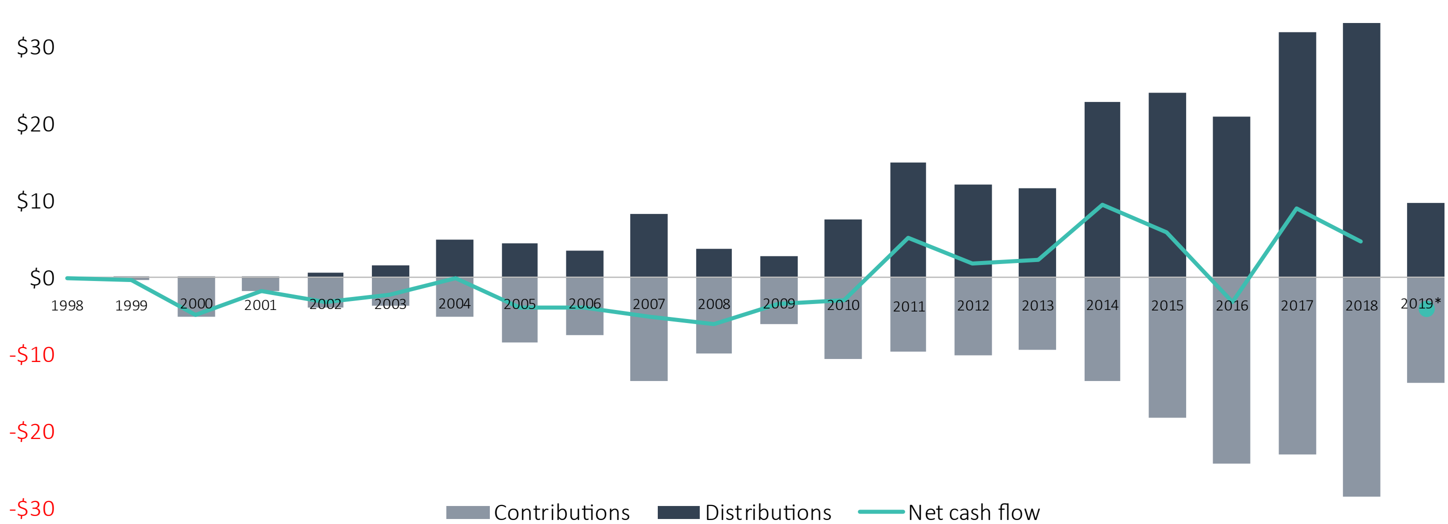


Source: PitchBook | **Geography**: North America & Europe
*As of March 31, 2019

Cash flows

The maturation of the tech-focused strategy within PE can be seen through the growth in global cash flows. The magnitude has grown exponentially and generally been in the positive as of late. The current negative reading is due to massive contributions to Vista and Thoma Bravo's recently raised mega-funds.

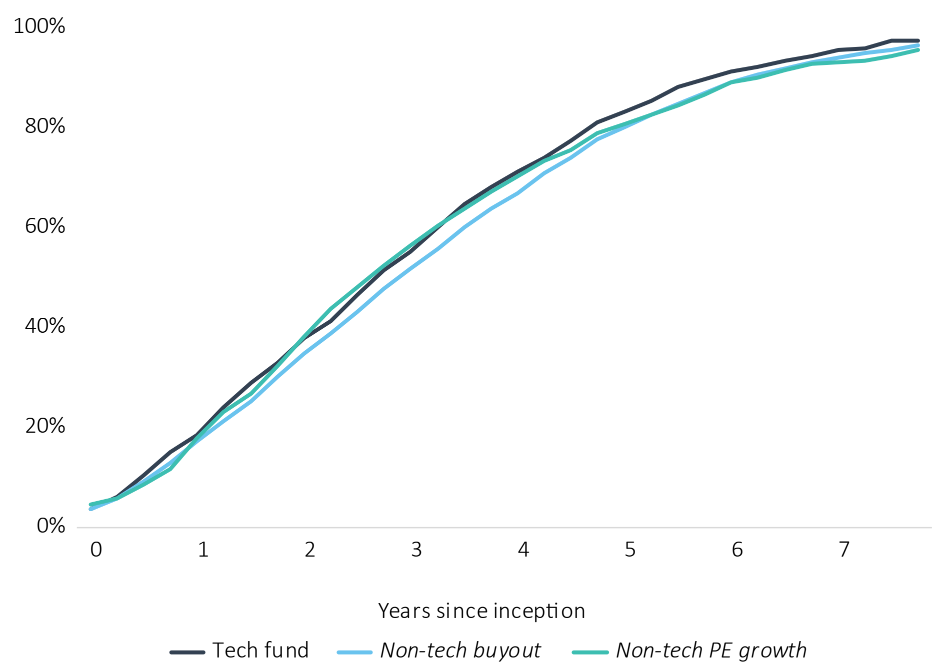
Tech-focused PE cash flows ($B)



Source: PitchBook | **Geography**: North America & Europe
*As of March 31, 2019

To benchmark the contribution and distribution schedules of tech-focused funds against other PE funds, we compared tech-focused PE funds to non-tech buyout and non-tech growth funds because we frequently see tech-focused funds pursuing these two strategies most often with their investments. We expected call down rates for tech-focused PE funds to differ from other PE strategies—with their turnaround or cost-cutting approach—as tech-focused funds typically pursue returns by heavily investing in the underlying growth of portfolio companies. However, call down rates do not seem to materially differ from other PE strategies, calling down around 70% of committed capital by Year Four. It appears the general shift to operational improvements and add-ons has aligned call down rates for all PE strategies, tech-focused or not.

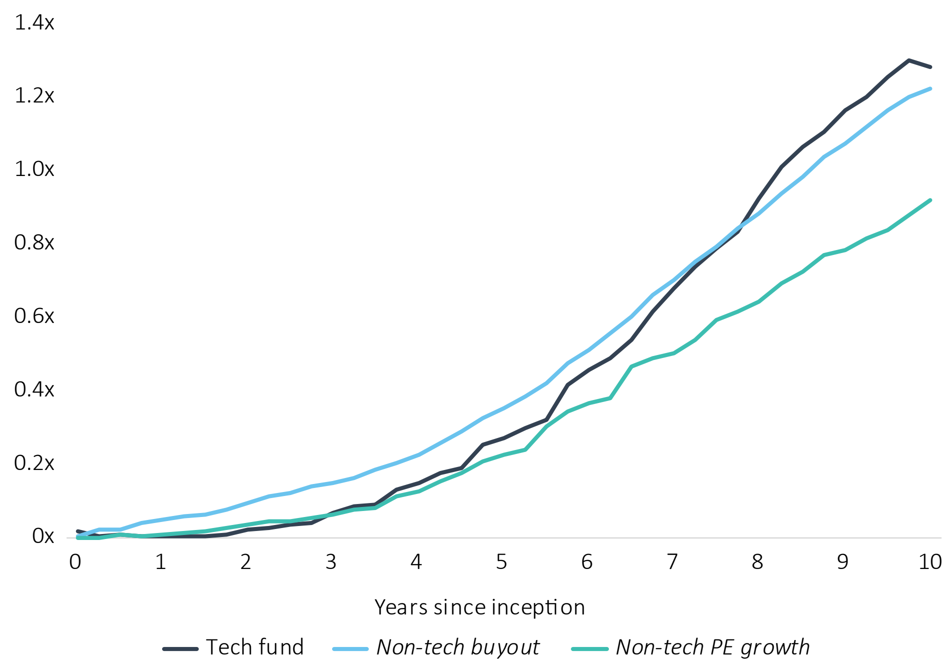
Call down rates for PE funds by strategy



Source: PitchBook | **Geography**: North America & Europe
Exclusively North America | *As of December 31, 2018

Although call down rates were constant among the compared PE strategies, non-tech PE growth dramatically fell behind tech-focused PE funds and non-tech buyout funds in returning capital. We expected tech-focused PE funds to lag in cash distribution because many companies require high reinvestment rates and see fewer recaps, delaying distributions to the end of the fund life. We did find that tech-focused PE funds were slower to return capital early in their lifecycle, similar to non-tech PE growth funds, but tech-focused funds eventually outpaced non-tech buyout funds in total capital distributed. While contributions mirror other PE strategies, distributions for tech-focused funds exhibit a unique return profile. This means LPs investing in tech should model contributions as they normally would but pay close attention to their distribution models givem their variances.

Average DPI for 2000-2009 vintage PE funds by strategy

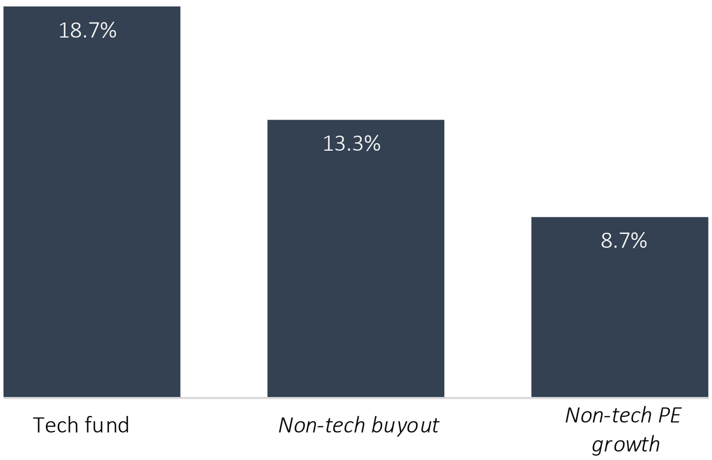


Source: PitchBook | **Geography**: North America & Europe
Exclusively North America | *As of December 31, 2018

Fund performance

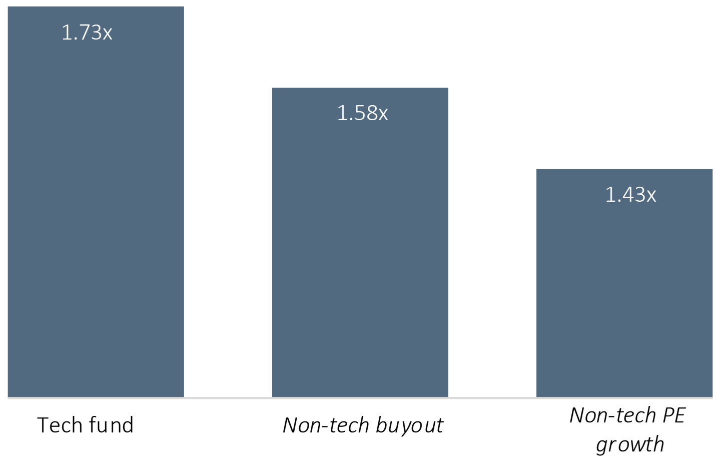
Over the past 20 years, North America has contributed over 95% of capital raised for tech-focused PE funds based in North America and Europe. Because of this, we decided to compare performance for tech-focused funds to non-tech PE funds based in North America only. Tech-focused PE funds based in these two continents have outperformed other comparable strategies in North America when looking at 10-year horizon IRRs as well as TVPIs. These vehicles, by concentrating their investments in quickly growing tech companies, really do deliver on the most important thing: performance. The outperformance has been substantial, with tech-focused funds creating more value and doing so in a timelier manner. The 18.7% 10-year horizon IRR figure is nearly five-and-a-half percentage points higher than that for non-tech PE buyouts and more than double that for non-tech growth funds.

Equal-weighted 10-year horizon IRRs for PE funds by strategy



Source: PitchBook | **Geography**: North America & Europe
Exclusively North America | *As of December 31, 2018

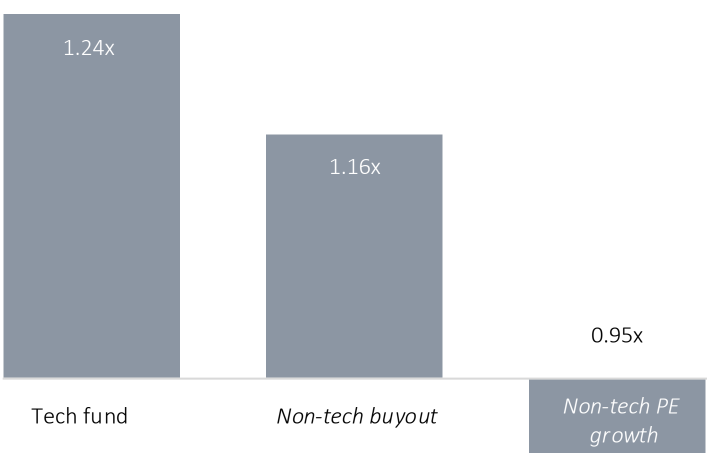
Equal-weighted TVPIs for PE funds by strategy



Source: PitchBook | **Geography**: North America & Europe
Exclusively North America | *As of December 31, 2018

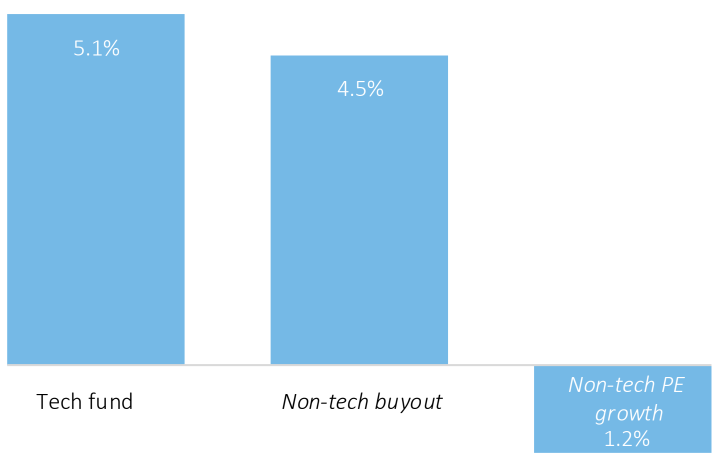
As expected, PMEs and Direct Alphas show the most outperformance by tech funds. Not only does the strategy of investing in high-growth, scalable companies produce high rates of return, but it appears to happen more quickly in private markets. These results clearly show tech-focused PE funds compounding capital faster over a prolonged time frame than public market alternatives.

Equal-weighted PME for PE funds by strategy



Source: PitchBook | **Geography**: North America & Europe
Exclusively North America | *As of December 31, 2018
Note: The S&P 500 was used as the comparable public market index.

Equal-weighted Direct Alpha for PE funds by strategy

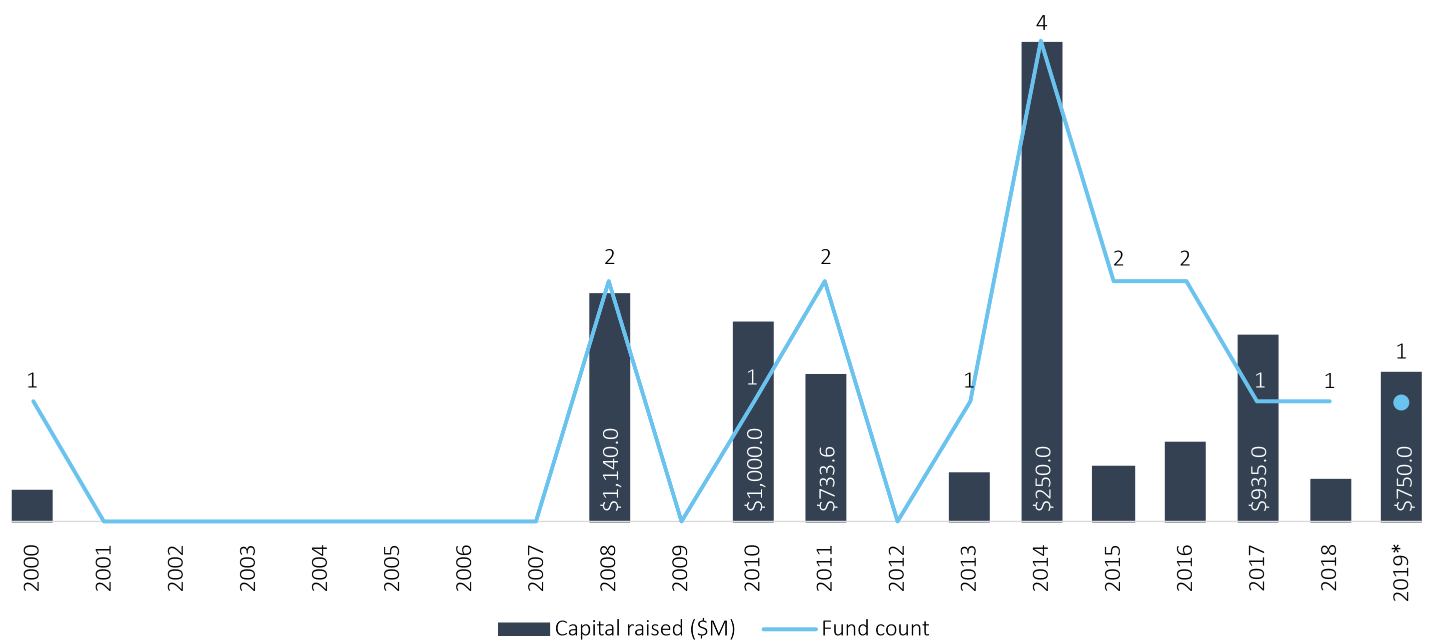


Source: PitchBook | **Geography**: North America & Europe
Exclusively North America | *December 31, 2018
Note: The S&P 500 was used as the comparable public market index.

Debt funds

LPs wanting to pursue investments in tech companies through private capital funds have options beyond PE, which of course focuses primarily on equity but can include fixed income components in mezzanine funds. Much of the capital for these debt funds also comes from specialists. Vista, Thoma Bravo and Silver Lake have all closed tech-focused credit funds and each currently has debt funds open. Although most fundraising in this space belongs to the major players, smaller GPs, such as Accel-KKR, offer credit funds in the tech space as well. Additionally, broader private credit exposure can be gained through certain generalist direct lending funds, some of which work closely with tech-focused sponsors.

Tech-focused debt fundraising activity



Source: PitchBook | **Geography**: North America & Europe
*As of October 14, 2019

Tech-focused debt funds often entails these massive managers to lend to current portfolio companies. The GPs have unencumbered access to financials and understand the landscape better than non-specialists. Not only do they have an edge with their depth of knowledge, but growing tech companies often have low loss rates. Lending to VC-backed companies, which is seen as riskier than lending to PE-backed companies, is estimated to have just a 2% loss rate.[2] However, since banks are typically unfamiliar with underwriting tech companies, private debt funds—from generalist lenders and

2: "New Evidence on Venture Loans," Juanita Gonzalez-Uribe & William Mann, November 21, 2017 tech-focused specialists—can provide debt financing, helping to produce attractive rates of return relative to other credit strategies. For their part, the owners of tech companies loath to give up equity and forego potential returns. While this is the case in many industries, the potential value of capital left on the table is extremely high in tech, where highly scalable companies can achieve double-digit growth rates for over a decade.

Open tech-focused debt funds

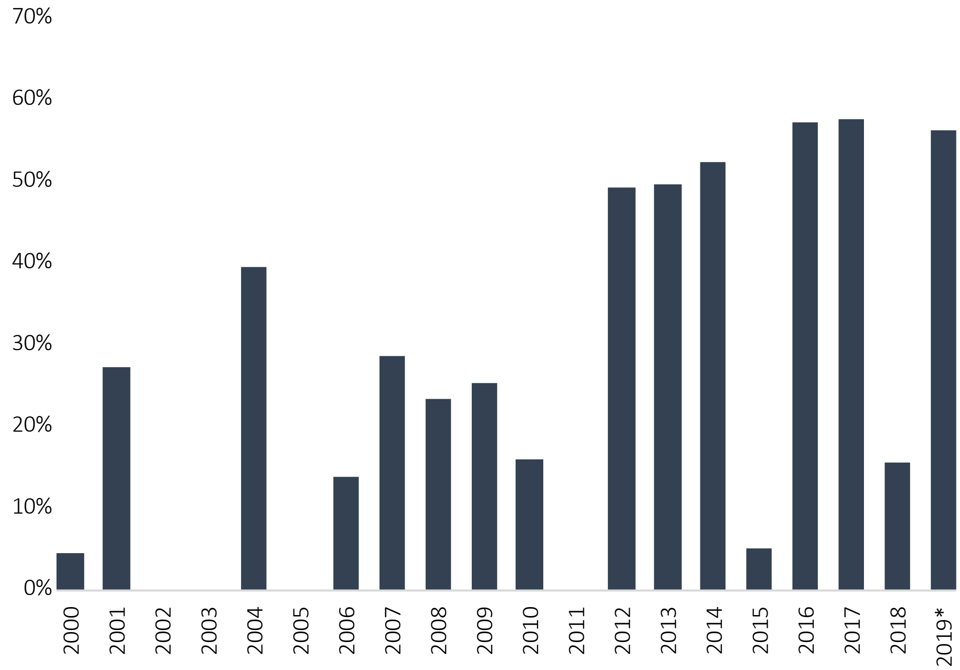
Manager	Fund name	Fund target ($M)	Strategy
Vista Equity Partners	Vista Credit Opportunity Fund II	Unknown	Debt-general
Vista Equity Partners	Vista Credit Opportunity Fund III	$2,000	Special situations
Thoma Bravo	Thoma Bravo Credit Fund II	$1,000	Debt-general
Silver Lake	Silver Lake Waterman Fund II	$750	Direct lending
Providence Equity	Providence Debt Fund IV	$2,000	Direct lending

Source: PitchBook | **Geography**: North America & Europe
*As of October 14, 2019

The Big Three

Although there are dozens of GPs that specialize in tech buyouts and a swelling cohort of generalist managers raising tech-focused funds, there are three firms that stand out as the biggest fish in the proverbial sea: Silver Lake Management, Thoma Bravo and Vista Equity Partners. These three have raised a combined $43.6 billion in their most recent fund offerings and have accounted for over half of all tech-focused PE capital raised since 2016. Each of these three firms has earned a name for itself with high-profile deals, including Silver Lake helping to take Dell private for $24.9 billion, Thoma Bravo buying a plethora of cybersecurity companies and Vista selling Marketo to Adobe for $4.8 billion. For LPs looking to write checks of $500 million or more, allocating to funds from these three GPs is likely the best bet.

Big Three funds as proportion of overall tech-focused PE funds ($)



Source: PitchBook | **Geography**: North America & Europe
*As of October 14, 2019
Note: The Big Three includes Silver Lake Partners, Thoma Bravo and Vista Equity Partners.

Silver Lake's only buyout strategy is its flagship fund family, but Thoma Bravo and Vista have expanded beyond their flagship funds with smaller buyout funds targeting the MM. As their gargantuan vehicles outgrew the MM, Vista returned with its Foundation and even smaller Endeavour funds while Thoma Bravo continues with its Discover and Special Opportunities strategies. These smaller vehicles target sub-$1 billion buyouts, which are too small for the flagship funds, while leveraging the in-house infrastructure built out over the past two decades. These funds are closer in size to those raised by Accel-KKR and Siris Capital. Over the coming years, we will watch relative performance on two fronts. First, we will monitor Thoma Bravo and Vista's flagship funds to see if they outperform their own MM and other firms' MM funds, which would reveal whether scale leads to superior returns. Second, we will also monitor their MM funds to see if they outperform the likes of Accel-KKR and Siris, which would indicate if MM funds from these two mega-managers can effectively leverage the additional resources the larger shops have.

Another differentiator between these three GPs is how quickly they are raising new funds. Vista and Thoma Bravo have been spending down cash and raising funds at a significant rate, whereas Silver Lake has taken a more cautious approach. Silver Lake closed its fifth flagship fund at $15.0 billion in April 2017. More than two years later, the fund still has nearly $9 billion in dry powder, or about 60% of the fund. Meanwhile, Vista closed its seventh flagship fund at $11.0 billion in May 2017 and has completely depleted its dry powder, already investing out of its newly closed fund. Similarly, Thoma Bravo closed its twelfth flagship fund at $7.6 billion in September 2016 and now has less than a billion, or just over 10% of the original fund size, remaining in dry powder.

Select fund family history

Silver Lake Management	Menlo Park, CA	First vintage 1999		
Fund family	**Strategy**	**Total raised ($M)**	**Fund count**	**Last close year**
Partners Fund	Buyout	$40,800	5	2017
Waterman Fund	Direct Lending	$250	2	2015
Alpine Fund	Mezzanine	$2,500	1	2019
Vista Equity Partner	**Austin, TX**	**First vintage 2000**		
Fund family	**Strategy**	**Total raised ($M)**	**Fund count**	**Last close year**
Partners Fund	Buyout	$38,300	6	2019
Foundation Fund	Buyout	$4,250	4	Upcoming
Endeavor Fund	Buyout	$1,350	2	2019
Perennial Fund	Long hold buyout	--	0	Open
Opportunistic Credit	Debt-general	$200	1	Open
Credit Opportunities	Credit special situation	$1,135	2	2016
Thoma Bravo	**Chicago, IL**	**First vintage 1998**		
Fund family	**Strategy**	**Total raised ($M)**	**Fund count**	**Last close year**
Thoma Bravo Fund	Buyout	$27,721	8	Upcoming
Discover Fund	Buyout	$3,470	2	2018
Special Opportunities	Buyout	$1,478	2	2015

Source: PitchBook | **Geography**: North America & Europe
*As of October 14, 2019
Note: We track two closed funds in the Waterman Fund family, but one of them has an unknown size that isn't reflected in the total.

Lastly, the headline-grabbing exits and deals seem to have translated into significant outperformance for the Big Three. Combining results for these GPs, 15 of their 26 (57.7%) PE funds landed in the top quartile, and 22 of 26 (84.6%) were top-half performers compared to other North America-based buyout funds by vintage year. Having fund sizes dramatically larger than their competitors has not led to a deterioration in fund performance, though this bears watching. Additionally, we will observe if the more measured approach utilized by Silver Lake produces any results substantially different from the more aggressive Vista and Thoma Bravo.

Conclusion

Going forward, we expect to see tech-focused PE fundraising further proliferate, and additional growth in the number of VC-backed companies will only expand the pool of investments for tech-focused GPs. With the success of the Big Three firms in the category, it is likely that more firms will see similar fortune. We will be watching whether MM tech-focused funds can deliver performance on par with these mega-managers. And while other tech managers will grow with success, Vista Equity Partners and Thoma Bravo seem poised to leave Silver Lake behind in terms of sheer scale. They'll likely be the 800-pound gorillas in the tech space for a long time coming with their head start and apparent desire to become the one-stop shops of tech-focused PE. It seems clear that LPs want a private market investment option that lets them tap into the growth of the digital economy led by proven managers that can create value and outperformance.