

Capstone Partners, A Mizuho Company Low DPI Environment Survey Results and Insights

Lower portfolio distributions make greatest impact on LP allocations in 2023

GPs face increased pressure with realizations now the foremost criteria for LPs - particularly in Europe and Asia Pacific

Despite the challenging economic environment and negative tone in the market, LP allocation levels have stayed relatively stable in 2023 to date, according to a new survey from global placement agent Capstone Partners, a Mizuho Company.

- Roughly half of global LPs surveyed across Europe (52%), North America (44%) and Asia Pacific (63%) are holding allocations steady versus 2022, with approximately 20% increasing their commitments.
- Just over a quarter of all LPs surveyed are reducing their allocations in 2023 (29% in Europe, 36% in North America and 20% in Asia Pacific).

Despite wide concern that the denominator effect would be the main cause of disruption, Capstone's survey finds that it is lower portfolio distributions that is having the greatest impact on LP allocations. It is closely matched by concern over an economic recession. This view is consistent across all markets, with a high proportion of LPs experiencing lower distributions in 2023.

- 77% of LPs in Asia Pacific, 72% in North America and 57% in Europe said they have experienced lower distributions relative to 2022.
- The denominator effect remains relevant but it has slipped in importance in LPs' minds, according to the survey.

While distributions have slowed for the majority of participants, the pace of capital calls has not slowed to the same degree, putting further pressure on LPs' ability to commit capital.

- 61% of European, 48% of North American and 40% of Asia Pacific participants said the pace of capital calls had not slowed; and for those that have seen a slowdown, the majority are down less than 25% relative to budget.

Global LPs have diverse views when it comes to their requirement for distributions to be made in prior funds before re-upping or investing in a new manager but in 2023, realizations are key even in established GP relationships, with the bar for new relationships remaining very high. The survey shows that this expectation is particularly high in Europe and Asia Pacific, placing considerable additional pressure on GPs who are looking to raise funds.

- For new manager relationships, only 20% of European and 14% of Asia Pacific LPs are willing to commit to a fund when there have been no realizations in the prior fund, while 38% of North American investors are willing to commit on this basis.
- 86% of European and Asia Pacific and 99% of North American participants are willing to commit to new managers if the prior fund DPI is up to 0.5x.

- Even for re-ups in trusted relationships, 46% of LPs in Europe and 41% in Asia Pacific expect meaningful distributions from the prior fund. This compares to 18% of North American LPs with similarly high expectations. All participants now expect a high DPI on earlier funds, but North American investors are more willing to commit to a re-up with minimal DPI, as long as there is strong underlying portfolio performance (66% North America vs 39% Europe and 28% Asia Pacific).
- In terms of the best indicators for investments, TVPI and DPI are seen as the most important for European and Asia Pacific LPs; and Net IRR and TVPI for North American LPs.

Despite the challenging economic conditions and pressure faced by LPs, the survey shows that the majority of investors are not being forced to change their allocation strategies and remain within their comfort zones this year. However, a reasonable proportion of LPs, particularly in Europe and Asia Pacific, are ready to reallocate to more yielding strategies as a result of the low distribution environment, which may pave the way for stronger appetite in these areas in 2024.

- 37% of European, 34% of Asian Pacific and 22% of North American participants said they would be inclined to favor more yield-oriented strategies.
- For those that said they favor yielding strategies, infrastructure and direct lending are seen as the preferred alternatives.

Capstone's LP survey also looks at whether the low DPI environment is likely to impact GP-led secondaries. Although the low liquidity environment is only one deciding factor, just over half of the LPs surveyed (52% in North America, 61% in Europe and 66% in Asia Pacific) said that the lower DPI environment would make them more inclined to cash out in a GP-led deal.

About Capstone Partners, a Mizuho Company

Capstone Partners, a Mizuho Company, is a global placement agent focused on fundraising and advisory services for private equity, credit, real assets, and infrastructure investment firms. It has a global network of more than 1,500 Limited Partners across the US, Europe, and Asia.

In 2022, Capstone was acquired by New York based Mizuho Americas, expanding the Firm's broader investment banking and advisory capabilities for financial sponsors. Mizuho Americas is an integral part of Japan-based Mizuho Financial Group, Inc. (NYSE: MFG). To learn more about its capabilities, visit www.mizuhogroup.com/americas/banking/industry-coverage/financial-sponsors

For additional information about Capstone's experience and team, visit www.csplp.com.