Here’s the Proof Private Market Valuations Aren’t Bogus

By John Stake
In 2022, one overriding refrain dominated discussions about private markets: “Valuations in private markets are bogus.” “Bogus” is serving here as a kinder, gentler placeholder for some of the actual words that were used. How, it was asked, can it be that public markets are down 20 percent and private markets are down around only 5 percent? Surely, private market valuations had fallen harder and just weren’t being reported as such.

Tempting as this narrative is, however, the facts don’t support it.

In fact, according to Hamilton Lane data, valuations are pretty accurate across most private market sectors.

In sum, private markets started 2022 generally priced at a discount compared to public sector equivalents. Private markets also had more exposure, relatively speaking, to better-performing sectors. Private companies held in private market portfolios had, on average, stronger operational performance than public market equivalents. To cap it off, prices at exit show that general partners (GPs) on the whole conservatively value their portfolio companies.

First, at the outset of 2022, private equity was less expensive compared to public equity, so it’s not a surprise that private valuations didn’t perfectly mirror the declines on the public side. Private markets already were valued in a conservative fashion compared to public markets.

Second, although it may have felt like the sky was falling in 2022, it is important to remember that not everything fell in value. About 15 percent of the component companies of the MSCI World Index were up more than 10 percent in 2022. Selection certainly mattered, and sector mattered a great deal (see figure 1). Overall, better-performing sectors had greater weightings in private portfolios and poorer-performing sectors had lesser weightings. Thus, the data show that some of the outperformance from private markets was the result of strong sector selection by GPs.

Thirdly, as shown in figure 2, private valuations held up as private companies notched better operational performance than public counterparts. Figure 3 shows that, in 2022, private companies subject to buyout deals outperformed companies on the MSCI World Index when it came to revenue growth and EBITDA (earnings before interest, taxes, depreciation, and amortization) growth. These private companies are unlikely to suffer to the same extent as their public counterparts due to stronger and more resilient fundamentals.
Our final data-backed reason that valuations in private markets held up in 2022 is the average price at which GPs exited deals (see figure 4). Looking at deals exited during the two years before the third quarter of 2022, the value of a company was on average 21.5 percent higher at exit compared with its value four quarters before. The average markup was 5.1 percent and 0.2 percent compared with valuations two quarters and one quarter before exit.

We can see that exits historically have tended to occur at prices higher than valuations. Furthermore, the data suggests this is true across market cycles.

This doesn’t mean private market valuations couldn’t course-correct in 2023; they may, as they did in 2001 and 2008, although initial data suggests a strong first quarter in 2023. It merely shows that previous valuations throughout 2022 were accurate and generally on the conservative side, and that it is a leap to suggest that valuations in private markets will continue to fall. An assertion along these lines is making an implicit assumption that public markets also will continue to drop.

The chance of the opposite occurring—namely, private valuations falling even if public markets rise—is incredibly slim. It’s only happened in one quarter in the past 30 years (see figure 3).

According to the data, the public-private lag that so many have been talking about, i.e., the period where those in private markets will lose money while public markets recover, is the exception and not the rule. Furthermore, figure 3 shows that when the MSCI World has been negative for a quarter, buyouts also have been negative only about 50 percent of the time. Private markets usually perform better; in fact, private markets outperformed 64 percent of the time across the 132 quarterly data points in figure 3.
CONCLUSION
The intrinsic differences between public and private equities, and the differences in the way public and private companies must be valued, mean this question about valuation always is going to be asked. The year 2022 provides a relevant case study only because the valuation gap had become extreme.

It may have looked like private valuations were proving sticky because GPs were lowballing the markdowns, but in truth, there were many overlapping reasons for private valuations to not track the fall in public markets, and GP valuation practices were, overall, conservative.

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ENDNOTE
1. See Hamilton Lane’s “2023 Market Overview,” https://hla.pe/454L3m.