

The Risk-Adjusted Performance of US Buyouts

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Abstract:

This paper assesses the risk-adjusted performance of US buyouts. It provides evidence for a significant outperformance of this asset class compared to a mimicking portfolio of equally risky levered investments in the S&P 500 Index. It draws on a unique and proprietary set of data on 199 US buyout fund investments between 1984 and 2004. For each of them we determine a public market equivalent that matches it with respect to its timing and its systematic risk. The regression of the buyout internal rates of return on the internal rates of return of the mimicking portfolio yields, after a correction for selection bias in our data, a positive and statistically significant alpha. Our sensitivity analyses highlight the importance of a comprehensive risk-adjustment that considers operating risk *and* leverage risk for an accurate assessment of buyout performance. The analyses further confirm the notion that buyout investors choose industries with low operating risks, make use of financial leverage when advantageously, and transfer an important portion of the transaction risks to the lenders.

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