STEPSTONE
inside private markets

When Is MOCC a Better Indicator of Performance Than IRR?

The internal rate of return (IRR) is often the conventional measure of performance in private markets. However, as many CFAs will attest, there are instances when other measures may be more appropriate. In this short paper, we will explore one such alternative, the multiple on committed capital (MOCC), which has become our private debt team's preferred performance measure.

MOCC

MOCC compares a portfolio's earnings (in dollar terms) with the investor's commitment amount. Two key factors drive it:

- **Investment level income**—Since income is only earned on dollars invested, increasing the amount of money at work and maintaining that level can help maximize income.
- **Deployment speed**—The faster the better. Rapid deployment allows investors to maximize their capital at work (and income) in a shorter period of time.

We have found MOCC is most useful in the following circumstances:

- When evaluating asset classes that have lower return targets;
- When commitments need to be backed by liquid assets (lest investors incur a capital charge); or
- When an LP is either ramping up or making changes to their strategic asset allocations.

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IRR

IRR estimates the profitability of investments. It is driven by the timing and size of cash flows and can be helpful when comparing GPs. IRR is best used to evaluate direct investments, mature client portfolios, and asset classes with higher target returns, like private equity. IRR is not as thorough as MOCC in assessing the actual monetary gains of an investment because it does not account for uncalled capital, thereby hiding the opportunity cost of suboptimal deployment levels. Further, subscription lines and leverage can distort IRR.

COMPARING THE TWO

The amount of money generated during a holding period determines how an investment performs. While MOCC is more concrete than public market equivalents, it is not a widely adopted measure. MOCC is useful because it is not influenced by the holding period: earnings are simply summed up. Therefore, two investments generating $10 million will show the same MOCC irrespective of their investment period. In addition, because investors must reserve their commitment amount to serve any capital calls they might receive, uncalled capital represents a large opportunity cost for investors. IRR does not consider this opportunity cost, which can result in less confident decision making.

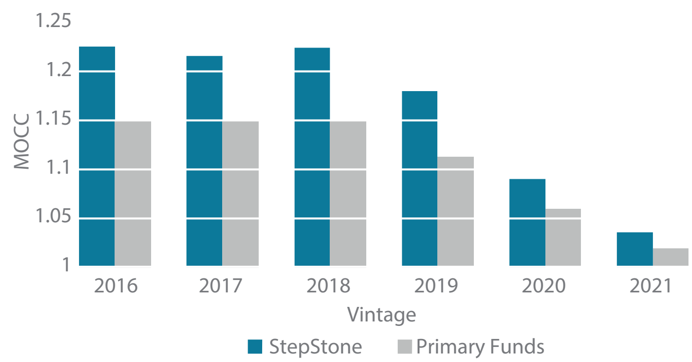
Figure 1 illustrates these potential two advantages.

FIGURE 1 | MOCC AND IRR COMPARISON MODEL

	BASE	EXAMPLE #1	EXAMPLE #2
LP Commitment (M)	$100	$100	$100
Invested amount (M)	$10	$10	$100
Interest (%)	6%	10%	3%
$-earned (M)	$0.6	$0.5	$3.0
Holding Period (Years)	1.0	0.5	1.0
IRR (%)	6%	10%	3%
MOCC	1.006	1.005	1.03

For Illustrative Purposes Only.

FIGURE 2 | MOCC COMPARISON BY VINTAGE



Source: StepStone Group as of April 2022 and Preqin 2022.

MOCC IN ACTION

Debates over performance measures may seem like an academic exercise. In our experience, picking the right measure and structuring your investment portfolio in a way that optimizes it can yield tangible benefits to investors.

To demonstrate, we compared the MOCC of our platform, which seeks to optimize that measure, with that of comparable primary funds that have tended to be more reliant upon IRR and other metrics.

For this analysis, a group of leading GPs provided information on 64 funds.[1] Using these data, we calculated the deployment speed of each of the underlying funds as a percentage of total commitments. Additionally, we calculated the MOCC using cashflow and NAV data from the funds. The fund data is based on the latest available information that the GPs provided. Though the comparable funds may include leverage, an allocation to more junior positions, or both, our portfolio has so far been favorable in terms of deployment speed, investment income level, and MOCC.

As seen in **Figure 2**, which compares the MOCC of our portfolio, with that of these 64 comparable funds, choosing the right performance measure can have real results. Here, MOCC is calculated after 14 quarters (3.5 years) to allow for a seasoned portfolio.

In our estimation, two factors drive this outperformance.

[1] StepStone Group as of March 2022 and GP data as of the latest available. The GPs we contacted are already on our private debt platform. The opinions expressed herein reflect the current opinions of Stepstone as of the date appearing in this material only. There can be no assurance that views and opinions expressed in this document will come to pass.

» **Deployment**—Our private debt platform generally offers investors faster deployment than comparable primary funds due to its diversification across GPs, sectors and strategies as well as its ability to rotate commitments between managers. On average, StepStone can deploy 35% more capital in the first three years versus a comparable primary fund.

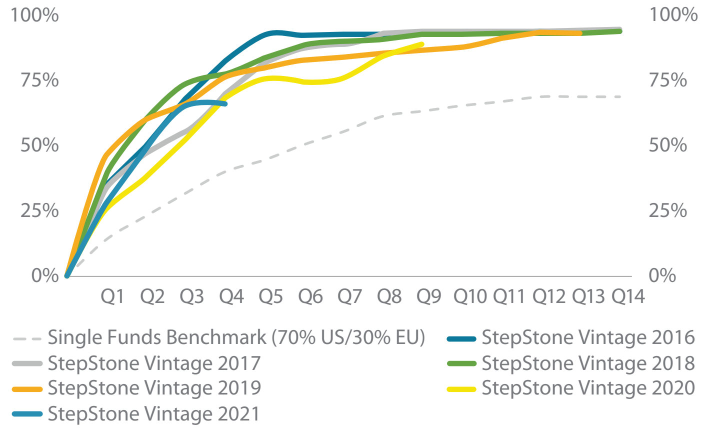
» **Investment-level Income**—Compared with primary funds, StepStone's private debt platform can allow investors to sustain their investment level by reinvesting repayments into new transactions (i.e., an Evergreen structure). As a result, investors generally avoid the typical ramp up / ramp down process of primary funds, which negatively affects the average investment level over multiple vintages.

Our portfolios consistently outperformed comparable primary funds on an MOCC basis.[2] **Figures 3, 4** and **5** underscore the importance of faster deployment and sustained investment levels. Specifically, Figure 3 shows that StepStone has exhibited faster deployment consistently across vintages. The importance of deployment pace becomes clear when looking at Figures 4 and 5, which show the deployment pace and subsequent impact on returns versus comparable primary funds.

Conclusion

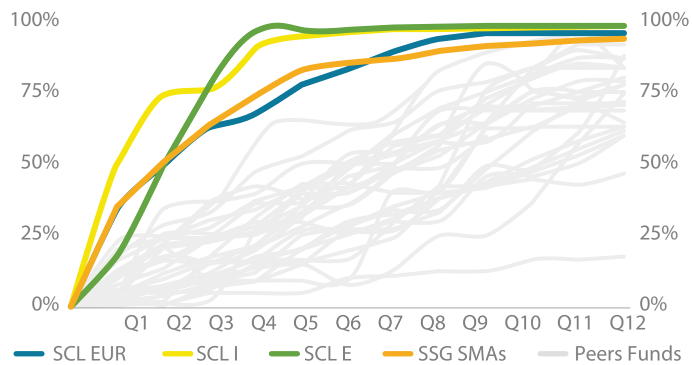
It is now evident why our private debt team favors MOCC over IRR to measure investment performance. MOCC displays how much capital was really returned on the commitment provided to the GP because it is not influenced by holding period nor does it overlook uncalled capital. We believe our outperformance versus comparable primary funds is a result of faster deployment and sustained investment levels—both of which we seek to maximize in pursuit of higher MOCC.

FIGURE 3 | DEPLOYMENT SPEED BY VINTAGE



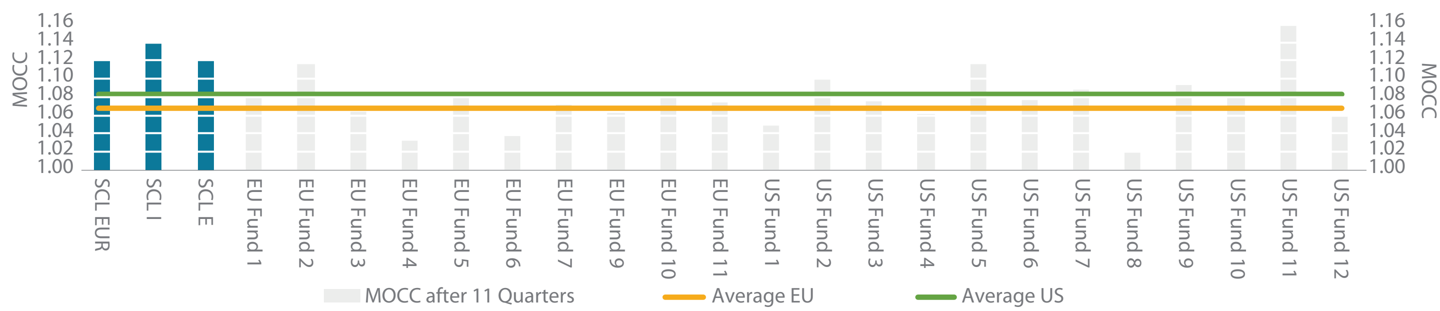
Source: StepStone Group as of April 2022 and Preqin 2022.

FIGURE 4 | DEPLOYMENT OF STEPSTONE PRODUCTS



Source: StepStone Group as of March 2022 and GP data as of the latest available.

FIGURE 5 | MOCC COMPARISON—STEPSTONE PRODUCTS VS PRIMARY FUNDS



[2] **Past performance is not necessarily indicative of future results and there can be no assurance that the investments will achieve comparable results or avoid substantial losses. Source: StepStone Group as of March 2022 and GP data as of the latest available. For illustrative purposes only while returns and portfolio structures of individual investor may vary.**

StepStone Group (Nasdaq: STEP) is a global private markets investment firm focused on providing customized investment solutions and advisory and data services to our clients. StepStone's clients include some of the world's largest public and private defined benefit and defined contribution pension funds, sovereign wealth funds and insurance companies, as well as prominent endowments, foundations, family offices and private wealth clients, which include high-net-worth and mass affluent individuals. StepStone partners with its clients to develop and build private markets portfolios designed to meet their specific objectives across the private equity, infrastructure, private debt and real estate asset classes.

Global Offices

BALTIMORE
100 Painters Mill Road, Suite 700
Owings Mills, MD 21117

BEIJING
Kerry Centre
South Tower, 16th Floor
1 Guang Hua Road, Chaoyang District
Beijing, China 100020

CHARLOTTE
128 S. Tryon Street, Suite 880
Charlotte, NC 28202

CLEVELAND
127 Public Square, Suite 5050
Cleveland, OH 44114

DUBLIN
Newmount House
22-24 Lower Mount Street
Dublin 2, Ireland

FRANKFURT
Opernplatz 14
60313 Frankfurt am Main
Germany

HONG KONG
Level 15
Nexxus Building
41 Connaught Road Central
Central, Hong Kong

LA JOLLA
4225 Executive Square, Suite 1600
La Jolla, CA 92037

LONDON
2 St James's Market
London SW1Y 4AH

LUXEMBOURG
33 Bd Prince Henri
L 1724 Luxembourg

MEXICO CITY
Insurgentes Sur 826, 9th FL
Colonia del Valle
Ciudad de México, 03100, MX

MIAMI
270 S. Ocean Boulevard
Manalapan, FL 33462

NEW YORK
450 Lexington Avenue, 31st Floor
New York, NY 10017

PALO ALTO
228 Hamilton Avenue, 3rd Floor
Palo Alto, CA 94301

PERTH
Level 24, Allendale Square
77 St George's Terrace
Perth WA 6000, Australia

ROME
Via Crescenzio, 14
00193 Rome, Italy

SAN FRANCISCO
Two Embarcadero Center, Suite 480
San Francisco, CA 94111

SANTIAGO
Tenderini 85, Oficina 31
Santiago, Chile

SÃO PAULO
Av. Brigadeiro Faria Lima 3355, 8th Floor
Itaim Bibi, São Paulo, Brazil 04538-133

SEOUL
Three IFC Level 43
10 Gukjegeumyung-ro
Youngdeungpo-gu, Seoul 07326 Korea

SYDNEY
Level 40, Gateway Building
1 Macquarie Place
Sydney NSW 2000, Australia

TOKYO
Level 1 Yusen Building
2-3-2 Marunouchi
Chiyoda-ku, Tokyo 100-0005, Japan

TORONTO
77 King Street West TD North Tower
Suite 2120, P.O. Box 44
Toronto, ON, Canada M5K 1J3

ZURICH
Klausstrasse 4
CH-8008 Zurich, Switzerland

Carbon Neutral Company
Pathzero

For more information regarding StepStone's research, please contact us at research@stepstonegroup.com.

www.stepstonegroup.com