PitchBook

2022
ANNUAL

US
PE Breakdown

Sponsored by

STOUT

CBIZ Private Equity Advisory

GOLUB CAPITAL

APEX

PitchBook

Contents

Methodology change disclosure
We have changed our methodology for recording deal activity. This will apply to this and all future PE- and M&A-related reports. All announced deals will be included in our reporting of total deal activity in addition to completed deals, and announced dates will be used to reflect deal timing in favor of closing dates. We have made this change to reduce the lag time between when deals are negotiated and priced and when they close to provide a more accurate depiction of valuation trends and volume activity. Please note that this methodology change applies only to PE deals and M&A deals and not to venture-related deals, which will continue to use closing dates for recording purposes.

Sponsored by

PitchBook Data, Inc.

John Gabbert Founder, CEO

Nizar Tarhuni Senior Director, Institutional Research & Editorial

Dylan Cox, CFA Head of Private Markets Research

Institutional Research Group

Analysis

Tim Clarke
Senior Analyst, Private Equity
tim.clarke@pitchbook.com

Jinny Choi
Analyst, Private Equity
jinny.choi@pitchbook.com

Kyle Walters
Associate Analyst, Private Equity
kyle.walters@pitchbook.com

Rebecca Springer, Ph.D.
Senior Analyst, Healthcare
rebecca.springer@pitchbook.com

Andrew Akers, CFA
Senior Quantitative Research Analyst
andrew.akers@pitchbook.com

Data

Alyssa Williams
Data analyst

pbinstitutionalresearch@pitchbook.com

Publishing

Report designed by **Chloe Ladwig** and **Drew Sanders**

Published on January 12, 2023

Click here for PitchBook's report methodologies.

Sponsored by

EXECUTIVE SUMMARY

A year of transition

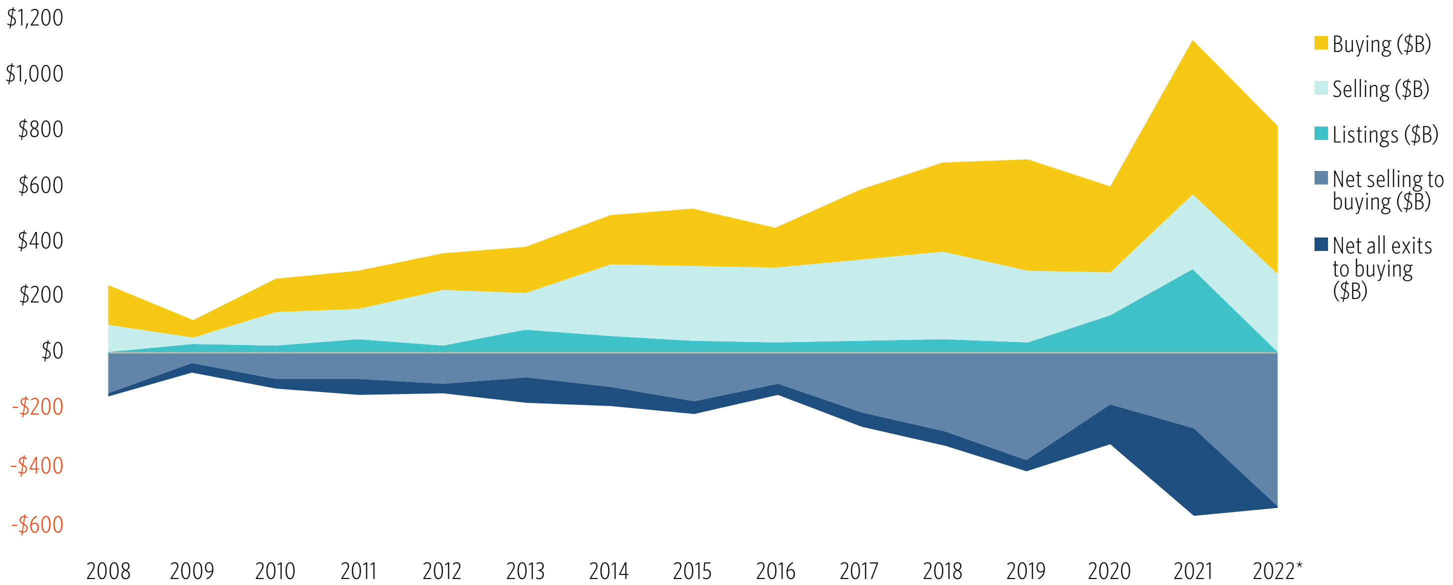
2022 is when nirvana ended for the PE world. That blissful state of declining interest rates and expanding valuations as far as the eye can see was shattered by the fastest tightening cycle in 40-plus years. PE borrowing rates are at twice the levels that they stood at the start of 2022 and are well into the double digits. The leveraged buyout (LBO) has a decidedly smaller "L," and PE firms are scrambling to find new ways to juice returns and retain PE's perennial claim to the top spot in asset class performance.

It took most of the year, but by August, deal activity finally succumbed to higher interest rates and lower multiples put in place by public investors and policymakers months earlier. US PE dealmaking declined 19.5% for the year but remains well above the quarterly pace that preceded the stimulus-driven melt-up of late 2020 and 2021. It is a downshift nonetheless, and PE managers have had to adjust to make deals happen and keep the LBO machine functioning. Deals got smaller, making them more digestible and easier to finance. Many came in the form of add-ons, which can deliver outsized revenue synergies to boot, and intensified as a result. Growth equity deals, which allow PE firms to apply active management despite fractional ownership, also saw an uptick. Buying smaller pieces of larger companies saw a resurgence, as well.

On the other end of the deal scales, robust activity continued in big take-privates, allowing mega-funds—funds with $5 billion-plus—to deploy dry powder more efficiently both in speed and price. The 24.9% swoon in the S&P 500 through early October allowed PE firms to buy up public companies at discounts to their recent high-water marks, while deal multiples for private companies refused to budge. And when the lending spigot began to run dry to finance these large LBOs, private equity turned to their own private debt funds and nontraded business development companies (BDCs). Bank lending was one area of the LBO market that shut down completely in 2022, but this new crop of private lenders and capital stood at the ready to partially replace it.

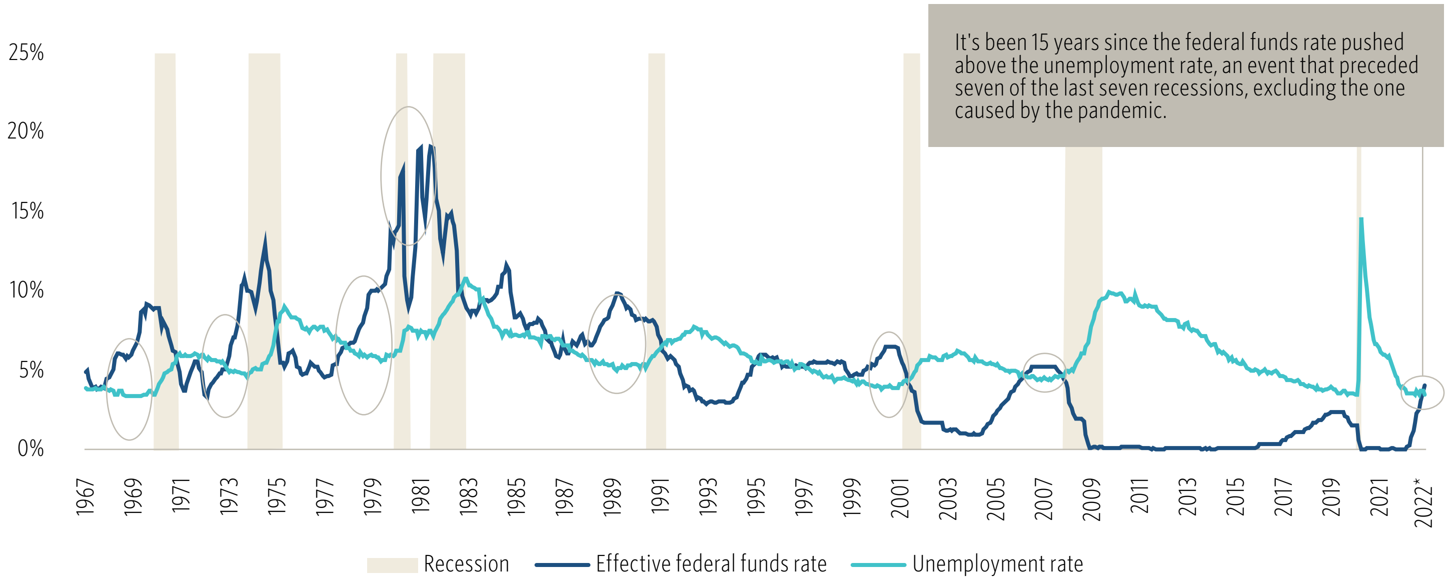
Exits are a different story. Activity was sliding all year and now sits well below pre-COVID-19 levels. After a wide-open exit

PE buying versus selling and the net exit gap



Source: PitchBook | **Geography:** US
*As of December 31, 2022

Federal funds rate and unemployment rate



Source: FRED | **Geography:** US
*As of December 1, 2022

window, which saw four years' worth of public listings push through in a single year, new listings have all but disappeared and M&A exits have halved. The dollar value of exits usually covers the amount of new funds raised from investors and new platform investments. However, that failed to happen in 2022 for the first time in 14 years. Inclusive of add-ons, the mismatch between selling and buying gapped to more than half a trillion dollars. This could be masked in a two-year span when public listings generated more than $400 billion in exit value, as occurred in 2020 to 2021, but now that gap is fully exposed. Here, again, the industry has devised other ways to soften the blow. Fundraising for secondaries has been on a tear as of late. These funds provide a liquidity option to LPs and even GPs. However, at $147.6 billion in cumulative dry powder, they don't come close to filling the net exit gap.

The knock-on effect that this increasingly lean distribution stream will have on future fundraising remains to be seen, but for the time being, activity has remained surprisingly robust. In the face of stiff denominator-effect headwinds, US PE fundraising posted another strong quarter and year and almost equaled 2021's record tally. Investors seem more enamored of the numerator for now, wagering that PE will weather the storm in public markets as promised. That view received support from what's trickled in so far from PE's largest sponsors, which point to flat Q3 performance. For PE to hang on to the 84.0% returns it has racked up since year-end 2019 is no small doing, given that US public equity is up a mere 25%, having surrendered half of its gains since that point in time.

Whether all of these adjustments that PE has made on the fly will hold up in a recession remains to be seen. Some of the industry's best returns were generated from recession-vintage funds. However, PE has a much larger existing portfolio heading into this recession than prior ones, and LBO-related debt ratios have been higher for longer than in prior cycles. While we think it's unlikely, a severe downturn and earnings contraction would place a significant strain on PE-backed companies' ability to service higher levels of debt expense. In the base case, we see PE completing its transition and having more liquidity options than ever before. Traditional sources will join nontraditional sources that PE has innovated in their absence. IPO deals will start flowing again, banks will start lending again, and PE will restock its enormous store of dry powder.

A WORD FROM STOUT

Dealmaking perseveres despite challenges

In the past few weeks, how has the tone shifted in talks about ongoing deals, and what do you find most surprising in these conversations?

Kevin: We always see a push for year-end closing around this time, and 2022 has been no different. However, more so than in years past, it feels like deals are falling into two categories: those pressing hard for a year-end close and those punting and re-engaging in 2023. Interest rate increases are definitely affecting dealmaking, but counterbalancing that is a strong appetite among strategics and financial groups to put money to work. In particular, rate hikes are affecting add-ons more significantly, as many groups will balk if the significant increase in financing expense requires a complete revamp of their existing credit facility. The financial groups that have relied most heavily on maximum leverage and financial engineering are certainly more challenged to put money to work in this environment.

Eric: From our ongoing dialogue with numerous PE firms, deal volume is consistent or slightly down from 2021's record-high levels. Our PE clients note that the quality of marketed opportunities is slightly lower, which typically results in longer transaction timelines and lower close rates. There's also been a shift to more targeted processes or strategic dealmaking. Bankers are being more selective in their outreach, and more time is being spent determining which groups are most qualified based on a thematic interest in the space or a relevant platform investment. This leads to more targeted buyer universes and more focused processes, with the most likely buyers putting forward more aggressive proposals.

There is also an increase in creative or structured equity transactions, even between sponsors. In such transactions, there's an opportunity for owners to achieve partial monetization without necessarily selling the entire company, as well as an opportunity for a new investor to gain exposure to an attractive business while keeping existing owners and lenders invested. GP-led single-asset continuation strategies continue to be in favor as PE firms are interested in backing their winners for longer. This market has slowed in the near term but remains a fundamentally attractive option for certain companies and their sponsors.

Kevin Mayer

Managing Director and Head of Industrials Investment Banking

Kevin has more than 25 years of investment banking and financial advisory experience serving public and private middle-market companies and PE firms operating primarily in industrial sectors. His industrial sector experience includes basic material areas such as building products, packaging, specialty materials, and chemicals, as well as niche manufacturing and distribution businesses.

Eric Welsch

Managing Director and Head of Financial Sponsors Investment Banking

Eric has 25 years of investment banking experience, having advised numerous companies and investment firms across the PE, consumer, and retail and technology sectors, among others. He has completed more than 150 diverse M&A, equity capital markets, and leveraged finance transactions on behalf of PE and corporate clients. At Stout, Eric's focus is on leading the firm's investment banking advisory and relationship activities with firms across the PE industry.

Scenario forecasting is hardly new, but now the stakes seem that much higher for both deals in progress and PE-backed portfolio companies facing more difficult economic conditions. Has the gamut of scenarios expanded?

Kevin: Investors are clearly being more discerning due to today's more uncertain environment. Downside scenarios are being further stress-tested, and due diligence is taking longer and therefore pushing timing out on deals. Overall, investors have been far more conservative in 2022 than they were in 2021, and that directly correlates to the more challenging market we've seen since the beginning of 2022. Some companies are just electing to hit the pause button and wait for greater clarity in the macroeconomic environment, while others with more resilient business models are finding it easier to stand out.

From a current portfolio management perspective, what are your clients bringing to you?

Kevin: For PE firms with differentiated companies that have performed well, the current choppy market with reduced deal volume is an opportunity to stand out. We expect highly attractive businesses with multiple growth vectors to receive as much interest as ever.

Eric: We are active with several sponsors seeking our help to grow their platforms through acquisition. Companies in most sectors have one or more PE-backed consolidator, and many of these companies and their owners are not slowing down consolidation plans despite fears of a recession. Some investors and their partner companies are viewing a potential recession as an attractive backdrop to continue building platforms through M&A.If you have conviction in your investment thesis, a softer market is an opportunity to be proactive and potentially average down your overall investment multiple, while also playing the long game as a strategic consolidator.

Debt markets are getting more interesting and dynamic for a variety of reasons. How is that playing into the transactions you're currently advising on?

Eric: Over the past five years, middle-market debt financing has continued to shift away from committed commercial bank and syndicated financing to unitranche and other private credit providers, which are often investing from private funds. While this market is less volatile than the large cap syndicated markets and more accepting of risk than the commercial banking market, it is more reliant on the ability of debt funds to raise capital.

We are seeing middle-market direct lenders and debt funds being more selective with investment opportunities and requiring higher economics (rate and fees) as well as lower leverage than they did in 2021. Regarding the transactions on which we are advising, we typically work with our clients in advance of launching a sale process to assess debt financing options available to potential buyers. It's important for the advisor to understand the available senior debt and junior capital financing options that will be available to sponsors in the leveraged buyout scenarios. Understanding this backdrop increases certainty and strategic insights, and also helps sponsor buyers allocate time when they know debt financing is available to them. We've also noticed that certain sponsor-backed platforms have become more selective about add-ons because of concerns about having to reprice their debt facilities. In these two types of situations, we often engage our Capital Markets team to provide our clients with debt market insights and to help deliver new lender relationships and/or more attractive terms.

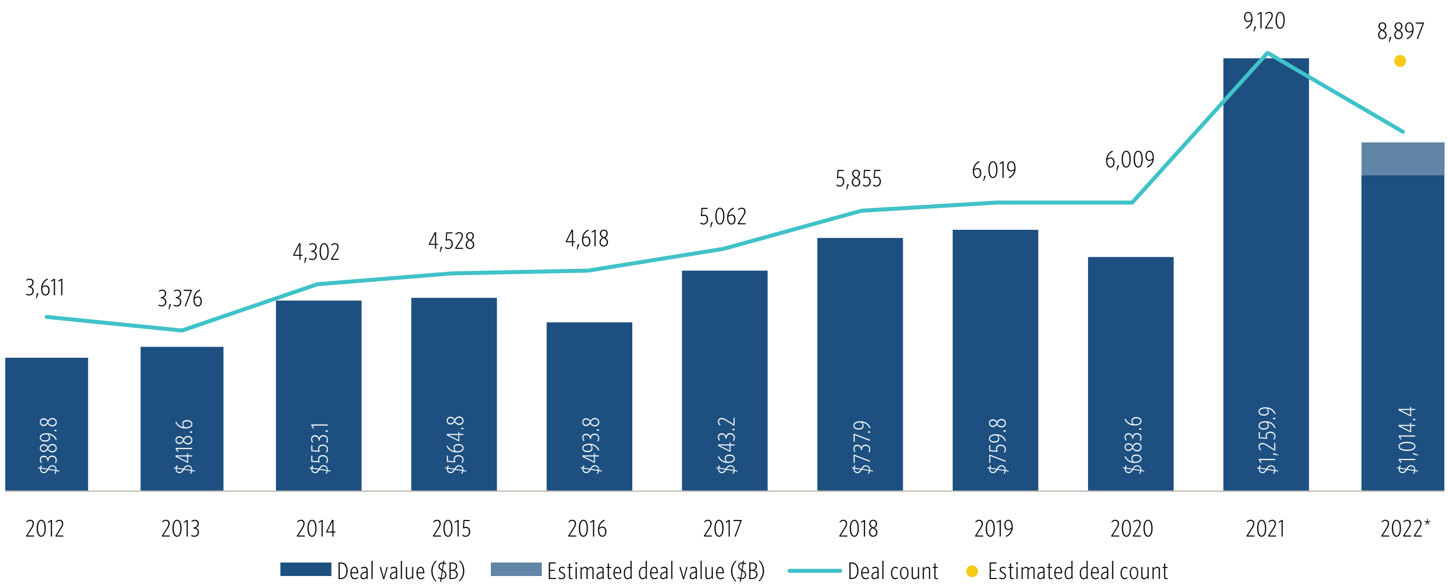
Which sectors stand to benefit the most among the companies you're working with?

Kevin: Not surprisingly, the sectors showing the most resilience in an uncertain environment are getting the most attention. Buyers are shying away from some sectors such as building product companies with more exposure to residential housing as well as certain areas within consumer. Within industrial, sectors such as industrial automation are seeing a boost in activity. As supply chains have been disrupted the past few years, there has been a reshoring of manufacturing activity. But that's happening in a tightened labor market. Therefore, businesses that are automating tasks both big and small are getting a lot of attention and bumps in valuation. Additionally, certain services-focused businesses within the industrial economy, including value-added distribution, are seeing strong activity, with investors homing in on predictability of revenue and more consistent earnings.

Eric: Stout is active in the market with several attractive healthcare mandates, and within the broader healthcare sector we've seen continued strong investor interest due to relatively little pullback in core business performance or outlook. Another area of strength and robust activity has been in environmental services- and infrastructure services-related businesses. We're working with several companies that are demonstrating strong year-over-year momentum with expectations for continued organic growth in the long term.

Deals

PE deal activity



Source: PitchBook | **Geography:** US
*As of December 31, 2022

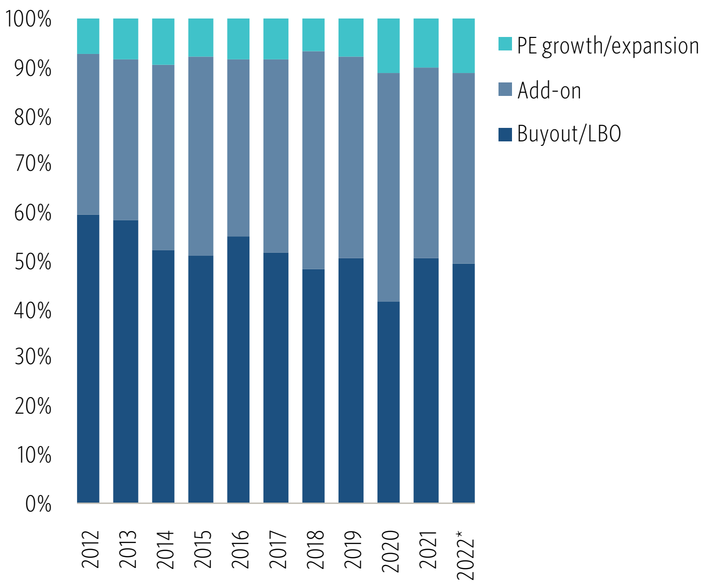
Overview

It took most of the year, but by August, deal activity finally succumbed to higher interest rates and lower multiples put in place by public investors and policymakers months earlier. In Q4, total US PE deal count and value declined by 23.4% and 41.8%, respectively, from the peak recorded one year earlier. These totals include all PE deal types including buyouts, growth equity investments, and add-ons. On the year, the decline was more subdued, down 2.4% in deal count and 19.5% in value. The final quarter of the year showed some signs of stabilization and was in line with Q3's slowdown, which saw dollar volumes ratchet down by 20.2%. If we assume that activity will level out from here, this translates to a quarterly pace of approximately $200 billion—or $800 billion annually. That is still 16.0% above pre-COVID-19 levels for the three years ended 2019.

That's a big "if," however. Looking through the numbers, the typical split between buyouts, add-ons, and growth equity has been 50/40/10 when measured by deal value, and that relationship held up more or less in 2022. Using deal count instead, a notable uptick can be seen in add-ons and growth equity relative to buyouts, as detailed below. We attribute this to deals growing smaller given the much more challenging environment in getting deals financed.

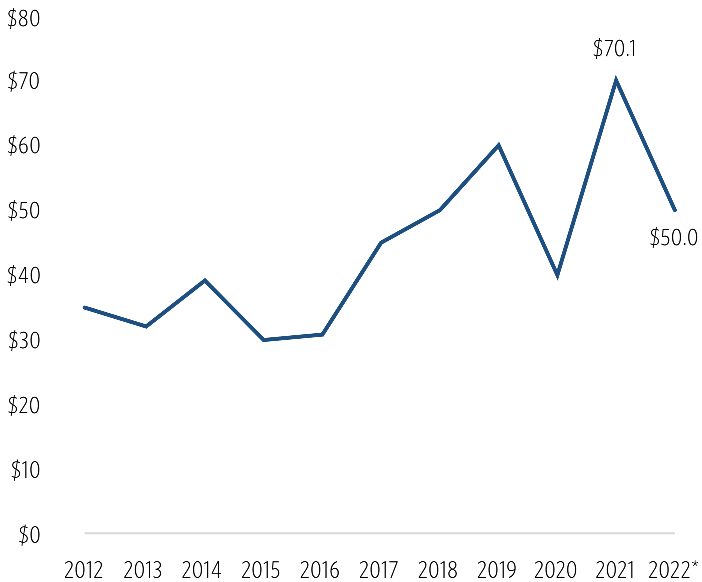
We saw this during the pandemic-related slowdown when the median deal size declined to $40.0 million in 2020, then rebounded sharply to $70.1 million in 2021, only to decline again to $50.0 million in 2022. Across deal types, PE growth equity is the smallest at a median of $28.0 million in 2022, followed by add-ons at $51.2 million. The number of deals in these two subtypes was slightly up versus the prior year, whereas core-buyout activity exclusive of add-ons—the so called "platform" deals—declined by 24.2%. However, because the median size of platform deals expanded to $301.0 million, these deals held firm at 49.5% of all deal value. We attribute this to increased public-to-private activity, a highly popular PE strategy in 2021 that got even bigger in 2022, resulting in larger—though fewer—platform deals.

Share of PE deal value by type



Source: PitchBook | **Geography:** US
*As of December 31, 2022

Median PE deal value ($M)



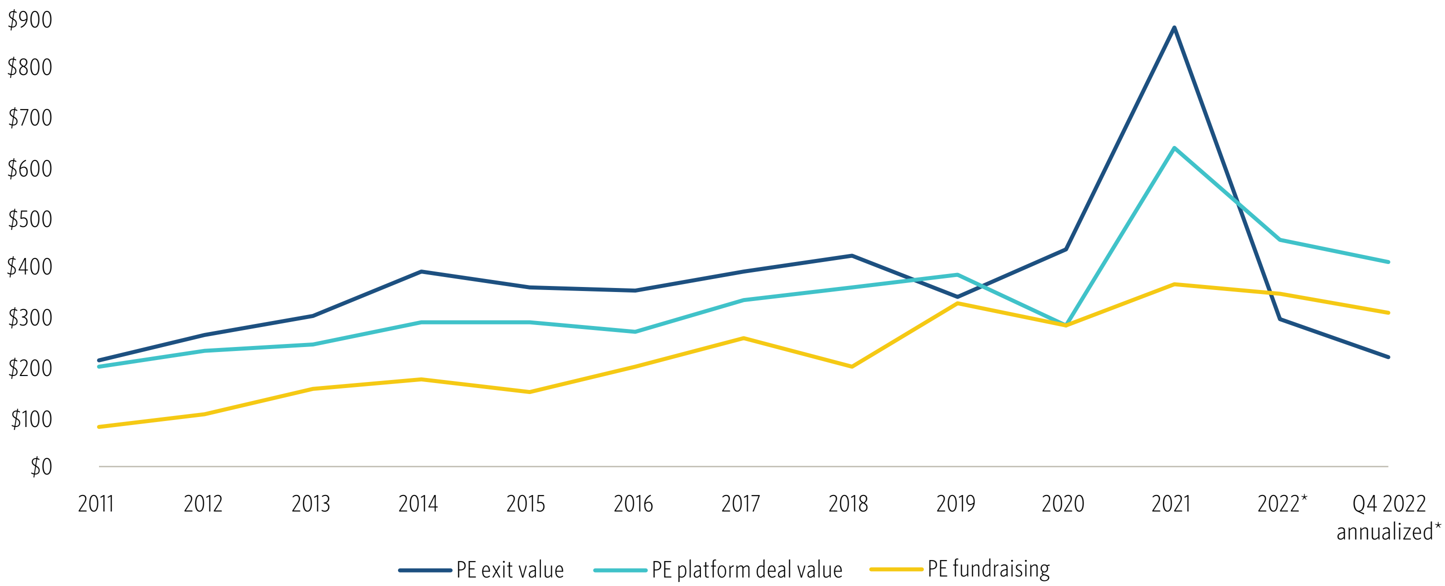
Source: PitchBook | **Geography:** US
*As of December 31, 2022

The problem with relying on this barbell approach of larger platform deals and smaller growth equity and add-on deals is twofold. For one, we see clear evidence of take-privates slowing and eventually migrating to the sub-$1 billion range, as laid out in our 2023 US Private Equity Outlook and Q3 2022 US PE Middle Market Report. The 46-day interruption in announced take-private deals between late October and December was virtually unprecedented. Typically, there are eight to nine announcements per month, and this sharp break signals a slowdown in the frequency of mega-deals—deals with $1 billion-plus—or as we believe, a downshift to a smaller garden variety of take-privates.

The other issue is that deal spending and fundraising have diverged sharply from exit activity, with platform deals remaining the main driver of that spending in dollar terms. Typically, deployment on platform deals has a symbiotic relationship with exit activity and fundraising. Exit proceeds eventually recycle into fundraising, which in turn recycles into capital to deploy. In 2021, there was $876.7 billion in exit value covering $637.8 billion in platform buyouts. In 2020, there was $432.3 billion in exit value covering $283.5 billion in platform buyouts. Going back to 2009, annual exit value has almost always exceeded platform deal deployment with an average coverage ratio of 1.19x. That same relationship to fundraising has been 2.0x (exit value to fundraising).

If one assumes that buy-side activity levels off here at $800 billion annually, that translates to $400 billion in platform deals, given the historic mix. However, with exit value now running at $200 billion annually closing out the year, deployment is likely to slow barring a sharp upturn in exit activity. This won't happen voluntarily—PE firms spend what they are given. Lean exit activity, should it continue, will eventually feed into fundraising, which shows no signs of slowing at $343.1 billion annually. Something needs to give. With exit value dropping to less than 50% of both platform buying and fundraising, we suspect it will be the latter.

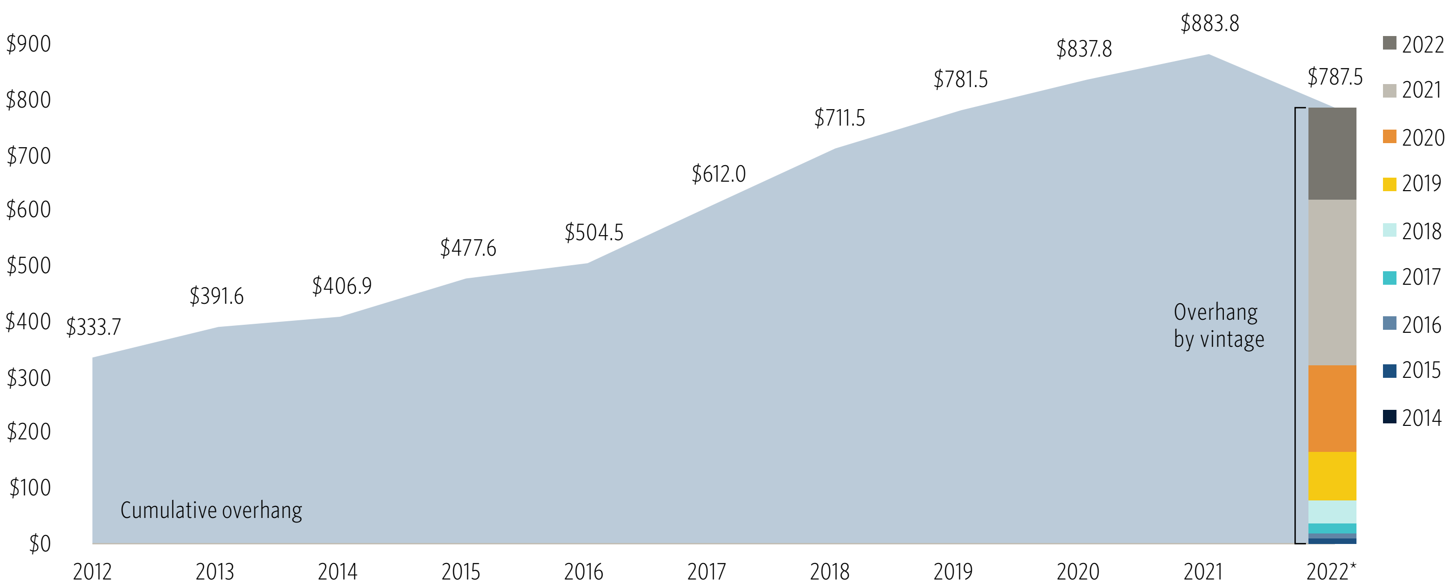
PE exit value, PE platform deal value, and PE fundraising ($B)



Source: PitchBook | **Geography:** US
*As of December 31, 2022

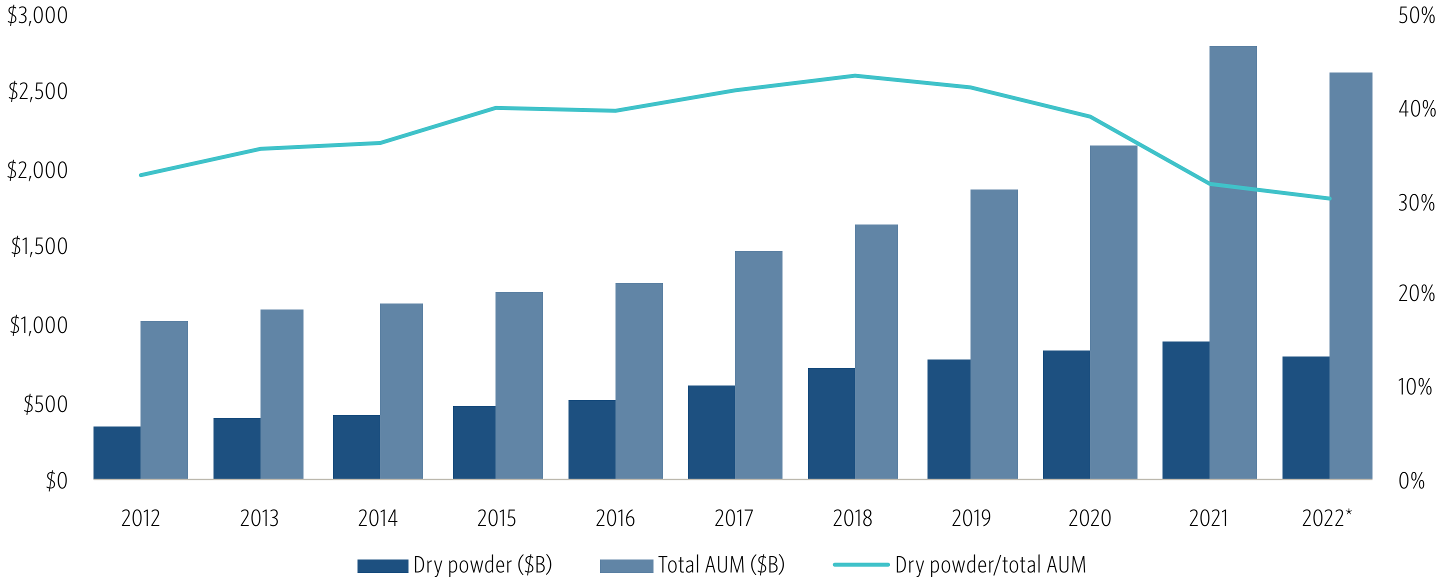
Counteracting this, of course, is the enormous amount of dry powder that PE has at its disposal. A majority of the world's $1.26 trillion in PE dry powder, or $787.5 billion, is held in US-domiciled funds, and all of it can be used for US deals depending on the appetite for cross-border investing. A good chunk of it already has. Dry powder shrank by 10.9% in 2022, the first down year since 2008, owing to record deployment in late 2021. It now stands at 30.2% of AUM, a new record low. That compares to 43.3% as recently as 2018. We expect some replenishment, given surprisingly strong fundraising in 2022, but it's another metric that argues for moderation in deployment going into the new year.

PE dry powder ($B) by vintage



Source: PitchBook | **Geography:** US
*As of September 30, 2022

PE dry powder relative to total AUM



Source: PitchBook | **Geography:** US
*As of September 30, 2022

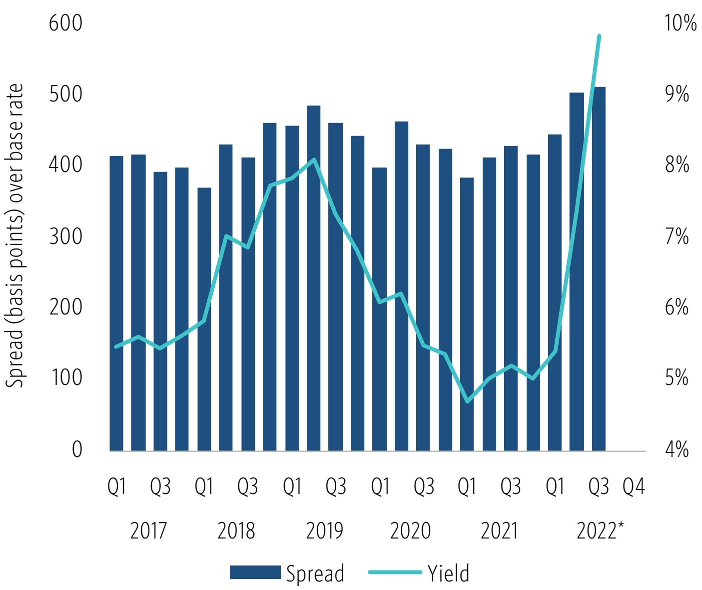
Take-privates

Taking public companies private has been a winning PE strategy. PE firms turned to this approach almost out of necessity as funds approached $30 billion at the extreme upper end. It allowed mega-funds to quickly deploy record amounts of dry powder. Better yet, PE buyers were able to buy public companies at attractive discounts. The 79 PE-led take-privates announced in 2022 were acquired at an average discount of 8.5% to the 52-week high of the target company's shares and averaged $3.7 billion in deal size. Unsurprisingly, this strategy has become highly popular among PE firms, leading to the strongest two-year run for take-privates in 15 years, with over $422.1 billion in deal value and 173 deals.

Until recently, the leveraged loan market underwritten by banks was the go-to source of funding for large LBOs above $1 billion and virtually all take-privates. The market was on a tear in 2021, setting a 14-year high for US loan volume backing LBO deals at $146.0 billion. However, the market came to a virtual standstill in H2 2022, with just $13.2 billion in US LBO-related volume, down 80.2% YoY.

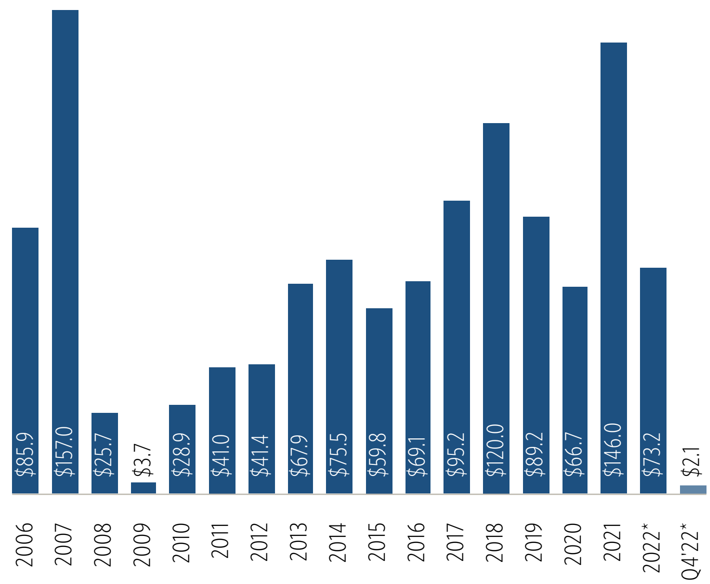
Stepping in to fill the void have been nonbank "direct" lenders comprised of private debt funds and nontraded BDCs. These vehicles spent the last two years amassing $155 billion in new capital, roughly equivalent to 2021's record year of LBO loans provided by banks. Many involve the same sponsors that are leading the charge on the equity side of the LBO capital structure. These funds have taken over as the new go-to providers of debt financing to LBOs both big and small. This can be best seen in the flow of new take-privates announced since June. There have been 28 such announcements in the US and Europe, and not one has been funded by banks. They are too busy offloading old loans—or the so-called "hung deals"—before making any new commitments.

Spread over base rate and yield on new issue LBO loans



Source: LCD | **Geography:** US
*As of December 15, 2022
Note: Q4 2022 observations were insufficient to provide meaningful averages.

New issue LBO loan value ($B)



Source: LCD | **Geography:** US
*As of December 31, 2022
Note: The final bar, Q4 2022, is annualized data.

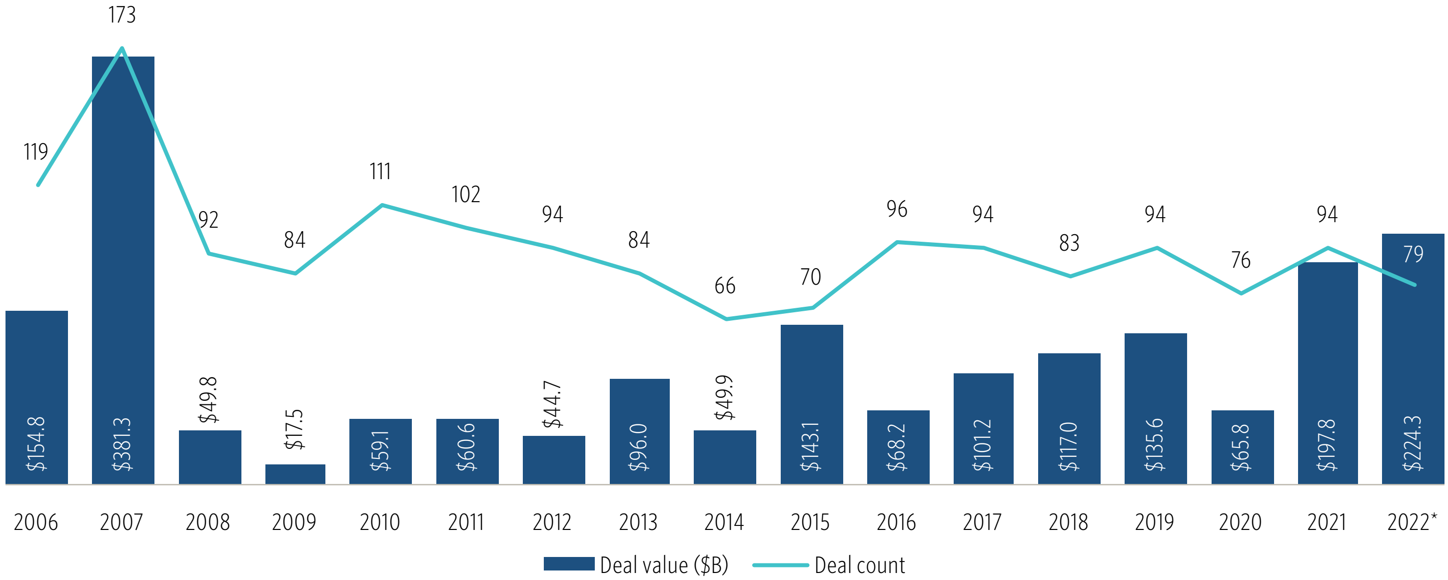
Take-privates came to a screeching halt in November. Instead of the typical eight to nine announcements, none occurred—an event that has happened only once going back 203 months. It appears that direct lenders may have had their fill of large LBO loans and that the $3 billion-plus take-private strategy may be winding down. As if on cue, two large take-privates were announced in mid-December: the $6.4 billion acquisition of Maxar by Advent and Thoma Bravo's $8.0 billion buyout of Coupa. For Thoma Bravo, it was their eighth take-private in as many months, far more than any other PE firm. Both deals were funded by direct lenders for $2.3 billion and $2.6 billion, respectively, or less than 50% of enterprise value. The debt component of PE buyouts has been trending downward since peaking at 61.5% in 2013, but now that trend seems to be gathering steam. Also notable is the number of lenders backing each loan—19 for Coupa and 10 for Maxar.

After such a prolonged pause, these two deals likely offer clues on future LBOs and take-privates. What's clear is that mega-buyouts are becoming less frequent and require many more parties. What's also evident is that the logic of buying heavily discounted public companies is as compelling as ever, especially given the lack of leverage to augment returns. We count 644 new listings from the last two years that now trade below $1 billion in market cap and an average discount of 76.5% below their initial listing price. We expect many of these companies will populate the ranks of take-privates going forward.

In early 2023, private debt funds will likely continue to dominate as lenders of first and last resort to the LBO market. Upward of $42.0 billion from hung deals is reported to be on bank balance sheets, and we estimate that another $22.0 billion in old commitments remains on deals still pending.[1] It is likely that banks will gradually return to underwriting new LBO loans late in 2023 as the backlog clears and the leveraged loan market becomes more liquid—but not before ceding significant share to direct lenders.

1: "Banks Stuck with $42 Billion Debt Seize Chance to Offload It," *Bloomberg*, Jill R. Shah and Claire Ruckin, November 29, 2022.

Public-to-private LBO activity



Source: PitchBook | **Geography:** North America & Europe
*As of December 31, 2022

Take-privates since June 2022 by loan type and price discount

Announced date (2022)	Company	Loan type	% discount 52-week high*
December 15	Trean Insurance	Nonbank	-35.1%
December 14	Maxar Technologies	Private debt	30.9%
December 12	Coupa	Private debt	-51.3%
October 27	UserTesting	Equity only	-53.1%
October 24	Weber	Private debt	-54.0%
October 24	AgroFresh Solutions	Nonbank	28.8%
October 12	KnowBe4	Private debt	-15.6%
October 11	ForgeRock	Equity only	-35.4%
September 28	Billtrust	Private debt	-13.7%
September 26	Semcon	Nonbank	-6.4%
September 4	ChannelAdvisor	Private debt	-21.5%
August 20	Computer Services	Nonbank	-4.9%
August 16	Ted Baker	Nonbank	-28.2%
August 8	Avalara	Private debt	-51.2%
August 4	Atlas Air Worldwide	Private debt	2.6%

Announced date (2022)	Company	Loan type	% discount 52-week high*
August 2	Ping Identity	Private debt	-5.8%
July 25	Bobst Group	Nonbank	-25.0%
July 21	Hanger	Private debt	-26.3%
July 12	Sharps Compliance	Private debt	-16.4%
July 10	Prima Industrie	Nonbank	-3.9%
July 10	Oncodesign Services	Nonbank	15.2%
June 28	Cary Group	Private debt	-21.2%
June 27	CareTech Holdings	Private debt	-12.5%
June 24	Zendesk	Private debt	-49.5%
June 23	Radius Health	Private debt	-56.5%
June 20	Euromoney I.I.	Private debt	5.5%
June 20	Momentum Software	Nonbank	-4.3%
June 13	The Go-Ahead Group	Nonbank	27.3%
Median			**-16.0%**

Source: PitchBook | **Geography:** North America & Europe
*As of December 31, 2022
Note: This table includes only deals of $100 million or more. "Nonbank" indicates deals using private debt, or all-equity structures, or those not broadly syndicated by banks.

A WORD FROM CBIZ PRIVATE EQUITY ADVISORY
2023 private equity outlook

What does CBIZ Private Equity Advisory think about the PE outlook for 2023 and beyond? Senior Managing Director Seth Goldblum answers industry questions with thoughtful advice that will help guide PE professionals through this new year, and it's not what you think.

Seth Goldblum

Senior Managing Director
CBIZ Private Equity Advisory
sgoldblum@cbiz.com

Seth is a Senior Managing Director for CBIZ Private Equity Advisory, leading the practice. He has almost 30 years of operational leadership, financial accounting experience, and transactional expertise, which includes business combinations, merger integration, and executive counsel. Seth specializes in generating profitable growth and facilitating solid long-term business alliances that help his clients achieve their optimum results.

What are the key macroeconomic trends across economies and markets that you are watching most closely?

We are watching two events closely: one, the ability of financial sponsors to close transactions, especially platform deals; and two, the economic health and welfare of the portfolio companies that our private equity clients own. Both events overlap and impact the other, as well as the industry as a whole.

Regarding deals this new year, we continue to monitor credit availability, pricing, and terms. While credit remains available, it has become much tighter, particularly for larger platform-type acquisitions. It is also more expensive, and that's a function of several things: the broader economic environment, lenders focusing on the credit quality and health of their existing portfolios, and overall concern about the uncertainty of 2023. As a result, lenders are pulling back and becoming more selective; consequently, lending standards have become more stringent, and pricing for debt is rising—making deals more expensive for sponsors to execute.

How is that reaction affecting opportunities this new year?

By the second half of 2023, we believe that platform transactions will be in full swing again. Here's why:

First, we have seen our client sponsors more focused on add-on deals; because they, along with portfolio company management, are informed of potential targets and are familiar with the businesses they want to acquire. Add-ons are an effective and efficient way to average down multiples paid, build synergies, and accelerate growth objectives. Generally, they also require less leverage; and financial sponsors often have more structuring flexibility to get deals closed. We expect significant add-on activity to continue through most of 2023.

We also predict that platform deal activity will pick up by the end of Q2 for several reasons. While multiples held for most of 2022, much of that hold was caused by a scarcity of quality assets available for sale. But by the end of last year, we observed valuations had begun to reset downward. We expect this softening to continue through the first half of 2023 as business owners contemplate whether to forgo a near-term exit—and potentially work through yet another difficult economic environment.

Additionally, toward the end of Q2, we anticipate pent-up demand for financial sponsors to do platform deals. For the private equity model to work within prescribed fund life cycles, there must be a flow of large—relative to the size of the fund—platform deals to be done. In fact, we have not seen a period in the last 20 years when platform deal activity has slowed for more than 12 months, and we do not expect that to happen in this cycle either.

Finally, our financial sponsors are incredibly resilient. Historically, we recognize that it might take a bit of time for sponsors to understand their existing portfolio risks and digest the current environment; but once they do, and it tends to happen quickly, they discover ways to successfully execute transactions. They will become more creative in finding approaches to perform platform deals and, most importantly, to deploy capital.

What other predictions, trends, and industry shifts do you project for 2023?

We forecast four trends and shifts that will impact 2023, and they bring good news for all of us:

The labor market for CFO talent is changing with more supply, as CFOs evaluate macroeconomic conditions and how that impacts their current situations. As a result, it may be easier to replace borderline talent, and at the very least, more financial talent will be willing to engage in discussions.

Run-rate earnings trends are likely to become more elusive in the near term as a "new normal" emerges. This, in conjunction with debt market dynamics—for example, cost of capital and tighter credit standards—will continue to help reset valuation expectations. We expect an increase in buyer-friendly structures via earnouts to bridge the risk and uncertainty gap.

Prospects for distressed, special situations, and tactical opportunities funds will increase due to their ability to apply more flexible structures than traditional buyout funds.

More resilient industry segments like healthcare and consumer staples, as well as defensible service businesses, are likely to be favored.

With regard to your overall practice, what are the top concerns your clients are bringing to you? Diving a little deeper, which areas of your practice have been busiest?

Our clients have two broad concerns. First, they want to get new transactions done at a reasonable cost. As a result, our Deal Advisory offerings have been in demand, helping to ensure that financial sponsors are doing the right deal and paying the right price for a deal they complete. Additionally, our clients want to make sure that once they own the business, the core financial and operational mechanisms are in place to ensure a solid start, while avoiding any pitfalls.

The second client concern is about being well-positioned to ride out any possible downturn. Clients are asking many questions: What is happening with inflation and interest rates? How are changes in the macroeconomic environment going to affect my portfolio? Are we entering a recession—or are we already in one? This is where our Performance Management and Improvement solutions have come into play.

We are helping our clients with early indicators for any potential business issues. It is the next level of operationally-oriented metrics and forecasting. They want to ensure they have leading indicators to inform decisions upfront and build strategic plans for all eventual contingencies. Our clients want to be more protective of their portfolios, so up-front work is essential.

Additionally, over the last 12 months, we have watched many of our sponsors instruct portfolio companies to pay down debt more rapidly to insulate from a potential recession. It can be a smart strategy to plan, but you also must have the cash to reinvest and create value. This is a choice that sponsors have to make. How defensive do they want to be out of fear, and how proactive do they want to be with their investments?

What do you think is an underrated development across the PE ecosystem that should be discussed more?

Over the last few years, new specialty- and industry-focused funds have been created. These sponsors want to differentiate themselves to sellers in an increasingly competitive market, show that they care about their space and growth, and prove that they can guide them to the next level. As the competition increases, we expect more specialty funds to be created. That said, fundraising is becoming more challenging and may continue as such, especially if public valuations stay on the lower end and throw LP holdings out of balance. This will continue the trend where LP fundraising dollars are being concentrated with fewer and larger players. Traditional midmarket players will have to work to stand out and may be less competitive in processes for larger, high-quality assets.

Another observation that many financial sponsors are not necessarily focused on right now is that there may be fewer accounting and finance resources available for deal support and portfolio company management in the coming years. The American Institute of Public Certified Accountants estimates that 75% of the CPA workforce met retirement age in 2020. Further, CPA exam candidates have drifted downward by 36% from 2010 to 2021. Many universities are also reporting fewer accounting degree candidates. To support this shift in accounting inventory, professional service partnerships will be crucial to respond to M&A opportunities and to have access and availability from top firms.

Growth equity

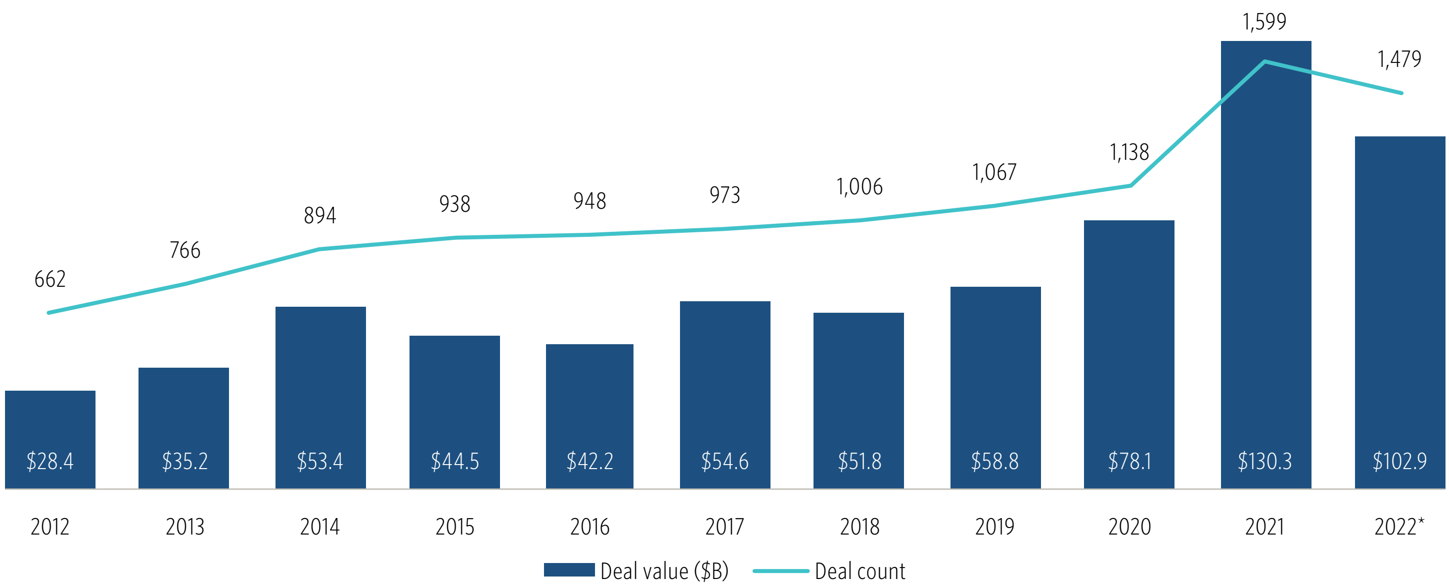
Growth equity has been able to parlay strong returns and fundraising from 2021 into strong deal activity in 2022. The strategy has bucked the overall downtrend in PE deal activity by delivering a higher number of deals in 2022. Its share of total deals now stands at 19.7%, up from 17.5% in 2021. The all-time high for this metric was 22.8% in 2009.

Deployment is easier for growth equity during periods of tight lending and credit conditions due to its limited dependency on debt. Growth equity deals typically involve no debt or very small amounts of debt. In this regard, growth equity is similar to late-stage venture investing, which acquires minority stakes in high-growth companies using all-equity structures. Unlike late-stage VC, growth equity features concentrated minority ownership shared with five or fewer other PE investors and more active involvement in the company's go-to-market strategy to ensure growth stays elevated and, in some cases, accelerated by intellectual property and resources contributed by the PE firm. That involvement is further bolstered by special provisions and redemption rights, which provide protection in the event of material changes in business plans and other operational milestones.

Many of the 2020 and 2021 vintage growth equity investments completed IPOs, leading to strong subsequent returns. With that window now closed, growth equity funds are focused on driving accelerated growth in their portfolio companies by contributing expertise and resources that their primarily founder-owned businesses lack—and that includes dealmaking. Of the 4,673 add-ons that US PE firms completed in 2022, 1,325, or 28.4%, were for growth equity-backed platform companies.

Among the more notable companies targeted for growth equity investment in 2022 was Fanatics, the leading merchandiser and e-commerce platform for US professional sports leagues. In March, the company received a $1.5 billion investment from BlackRock, Fidelity, MDS Capital, and the National Football League, valuing the company at $27 billion. In December, the company received another $700 million investment from Clearlake capital, Silver Lake, SoftBank, and LionTree, which valued the company at $31 billion. The company is believed to be a prime candidate for public listing when and if the IPO market reopens in 2023.

Growth equity PE deal activity



Source: PitchBook | **Geography:** US
*As of December 31, 2022

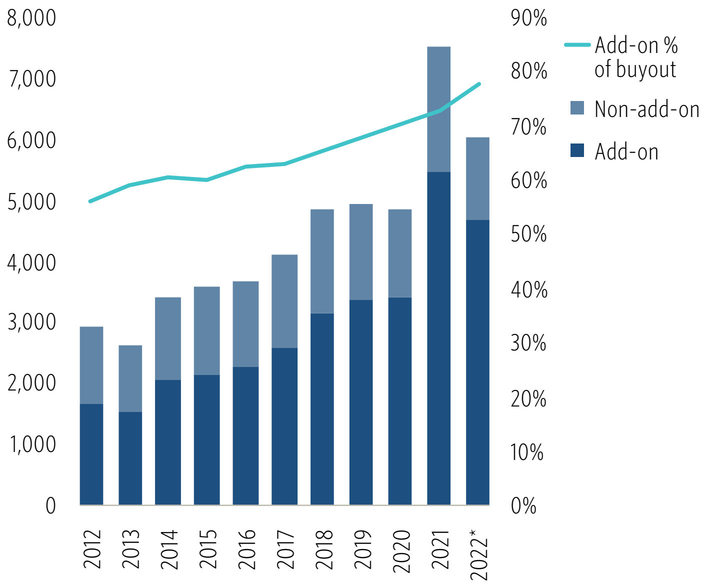
Add-ons

Add-ons are another means by which PE sponsors can continue to deploy capital while taking down deal size and biding time until lending markets are more accommodative for large platform buyouts. Add-ons can offer revenue and cost synergies that accelerate top- and bottom-line growth and add value for their platform acquirers as a result. Add-ons have always been easier to finance, given their smaller size and ability to rely on the credit of their larger acquirer. Whereas fixed-income markets are effectively closed to sponsors seeking loans on new LBO deals, they are still open for add-ons. A total of 14 PE-backed companies came to public debt markets in Q4 to receive loans backing add-ons that totaled $3.2 billion. One of those companies, Convergint, received a $145 million term loan to fund future add-ons. Convergint is a serial add-on acquirer, having completed 51 add-ons since becoming PE-backed in 2013, including 30 since 2017 under its present owner Ares.

Add-ons are at the core of the PE buy-and-build playbook, and they go up every year as a proportion of total buyouts. Historically, that increase is one or two percentage points, but in 2022, growth was off the charts. Add-ons as a share of total buyouts moved up nearly five full percentage points from 72.8% in 2021 to 77.7% in 2022.

Add-ons have been instrumental in keeping the PE flywheel in motion during this period of market stress and will remain integral in the future.

Add-ons as a share of all PE buyout activity



Source: PitchBook | **Geography:** US
*As of December 31, 2022

Carveouts

Buying smaller pieces of large companies and either restoring them to health or bolstering their growth prospects is a classic PE strategy. It harkens back to PE's early days when it functioned more as turnaround specialists—buying old corporate assets and flipping them for profit—before transitioning to the full-fledged growth investor that it is today. As a result of that transition, corporate carveouts as a share of total deals has been sliding for many years, declining to 6.2% in 2022 from 13.2% in 2009.

However, this strategy was deployed effectively and frequently in the aftermath of the global financial crisis (GFC) when, similar to today, the new issue market for loans backing leveraged buyouts closed, and when top-line growth became scarce. Unlike then, corporate balance sheets are strong, and companies are not being forced to sell assets for much-needed cash.

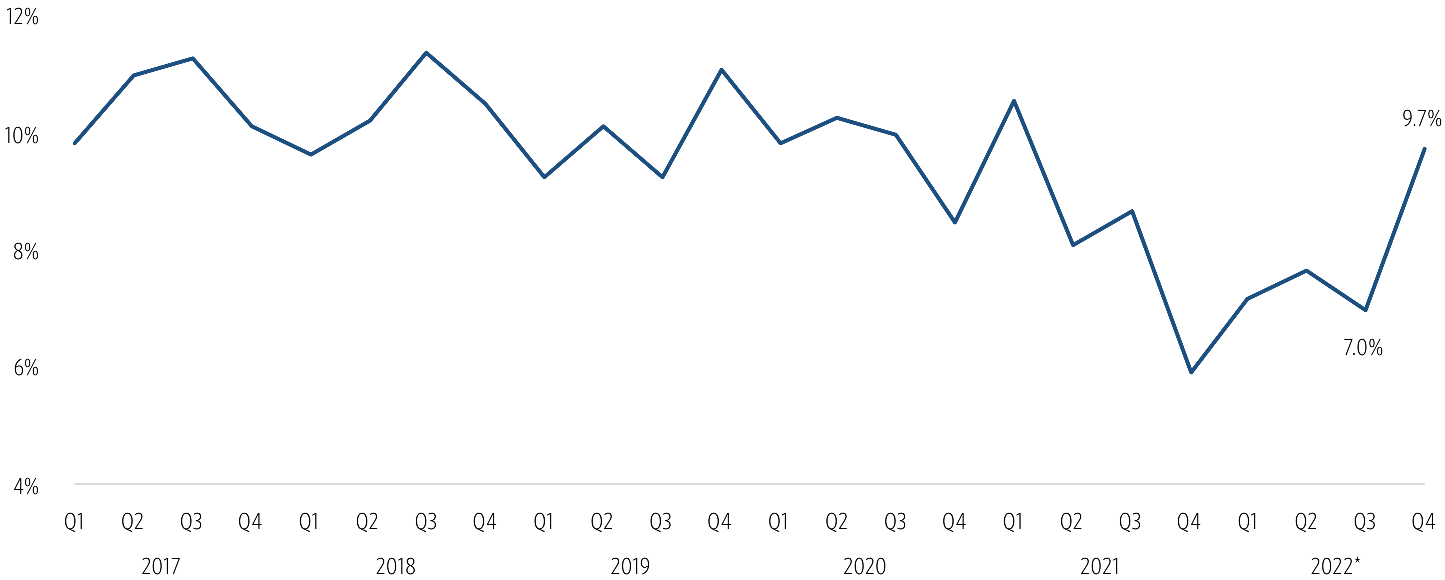
Still, we see evidence that this playbook has been dusted off. PE buying of corporate carveouts jumped from 5.1% of total buyouts in Q4 2021 to 7.7% in Q4 2022. We suspect that some of this can be traced to PE interest in the cheaper valuations of public companies and assets more broadly. Instead of buying public companies in their entirety, which is what the take-private strategy entails, a PE firm will buy a significant business unit of a public company or large private company using a carveout strategy. With it comes a more seasoned operating history that can be easier to bank and finance and a smaller deal size that is more digestible than a full-blown take-private.

At its core, carveout buyouts is more of a value strategy, and if widely adopted, PE sponsors would need to relearn how to become value managers. Large corporations are typically not divesting their prized assets with the rosiest of growth prospects. Usually, they are positioned as "noncore" to the primary business or industry that a company is operating in or seeking to pursue. Occasionally, they are divestitures that are forced as a result of antitrust decisions on proposed large mergers, and those can create interesting opportunities for PE sponsors while also attracting strong bids from strategic competitors and high regulatory scrutiny. Others can arise from new activist shareholders that force a breakup of a public company, and those can also create interesting opportunities.

The vast majority of carveout deals are add-ons. That share stood at 74.1% in 2022, roughly consistent with the mix of add-ons for buyouts overall. PE will often fold these carveout assets into platform companies to drive synergies in the same manner as full company add-ons, or they will combine the assets with other portfolio companies to create new platforms.

The largest carveout deal of 2022 was Emerson Electric's $14.0 billion divestiture of its climate technologies business. A 55% majority stake was acquired by Blackstone and other investors, while the balance of 45% was retained by Emerson. The new company has been structured as a joint venture until Blackstone can exit the company through a sale or IPO. The $14.0 billion enterprise value (EV) represents a 12.7x multiple of EBITDA and 2.8x of net sales. Of the $9.5 billion in upfront cash proceeds paid to Emerson, $5.5 billion was funded in debt that featured both bank and nonbank lender commitments. Blackstone's own credit fund will be participating alongside nine other private lenders in a $2.6 billion portion of that debt package.

Carveouts as a share of all PE buyouts by quarter



Source: PitchBook | **Geography:** US
*As of December 31, 2022

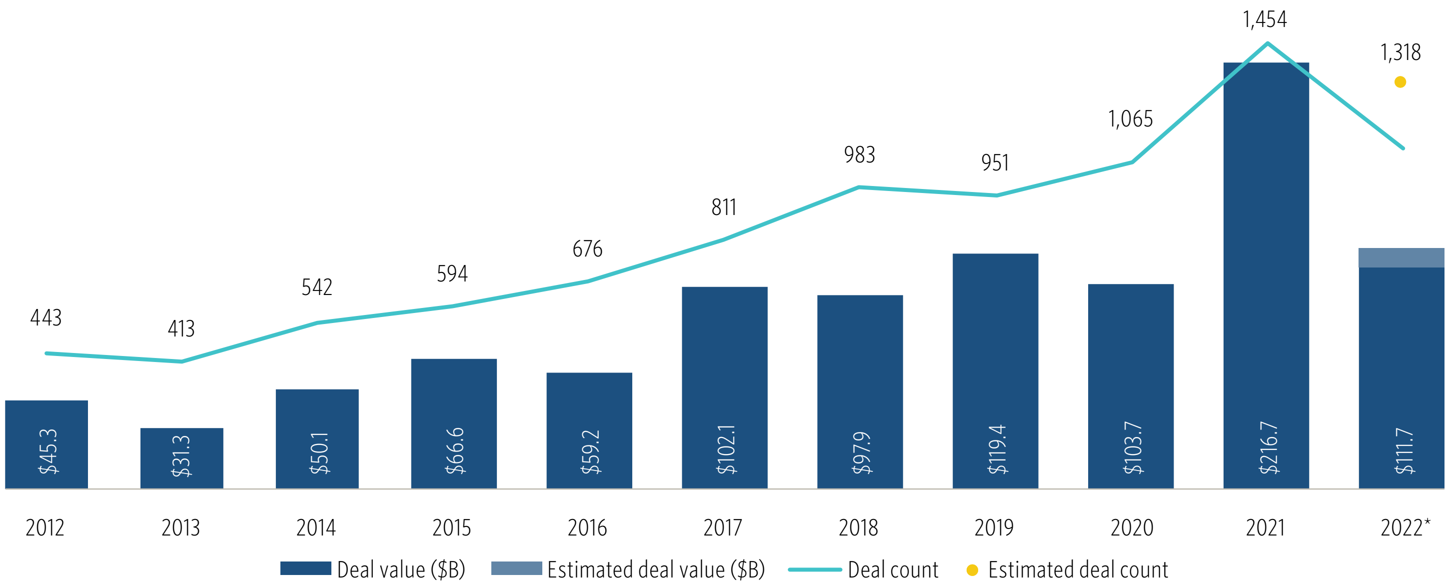
Healthcare

After a robust start to the year, healthcare deal activity quieted somewhat in Q4. Many investors and allocators are wondering whether the space will see increased activity in 2023 because of its recession-resistant qualities. Our historical data shows that healthcare deal activity relative to other sectors did not substantially increase during the GFC. This is partly because not all areas of healthcare are truly recession-proof. For instance, many digital health and wellness providers have built business models around employer contracts; a portion of these will see revenues shrink as CFOs rein in company benefit spending. Perhaps more importantly, healthcare deals are subject to cost of capital constraints like any other sector. And although 30% of LPs are looking to increase their healthcare PE allocations in 2023, it takes time for shifting LP priorities to trickle through to actual fund closes and capital deployment.[2]

That said, we believe that there is enough dry powder earmarked for healthcare to fuel healthy deal activity in 2023, especially in key high-demand categories. In healthcare services, we are bullish on behavioral health and skilled care. Deal activity slowed in these categories in the second half of 2022 as reimbursement uncertainty and increased staffing costs forced a valuation reset. But the base demand case in

2: "Liquidity Index: 2H 2022," Rede Partners, November 2022.

Healthcare PE deal activity



Source: PitchBook | **Geography:** US
*As of December 31, 2022

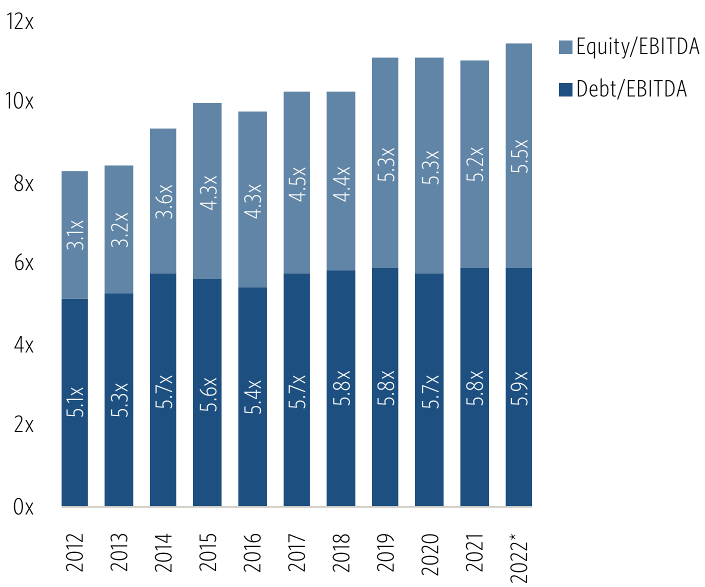
the space is so compelling that mean reversion would entail up and to the right activity. In particular, we believe that add-on activity and lower-middle-market platform creations will be robust as small agency and therapy center owners continue to face margin pressure. Valuations should reset firmly below 2021 levels, thus allowing PE-backed platforms to opportunistically take advantage of the sell-side pipeline. In December, we already began to see the signs of a return to home health activity with Revelstoke's The Care Team entering Indiana with 1st Care Home Health Services. In applied behavior analysis, MBF Healthcare Partners, which sold Acorn Health to the Ontario Teachers' Pension Plan in August, acquired Austin-based ABA Connect.

Many PE healthcare investors are also increasing their pharmaceutical industry exposure. The current therapeutics pipeline is promising and weighted toward specialty drugs. Pharmaceutical companies are well-capitalized and eager to speed up drug discovery, including by conducting clinical trials more efficiently and with more diverse populations. Clinical research site roll-ups are becoming an increasingly popular investment category as they combine the consolidation and multiple arbitrage theses of healthcare services with life sciences industry exposure. Additionally, contract research organizations (CROs), which are increasingly utilized by late-stage biotech companies and pharmaceutical giants to manage the complexities of biologic drug development, are increasingly seeking to vertically integrate and therefore provide a terminal exit opportunity for clinical research site groups.

In the fourth quarter alone, Grant Avenue Capital created Helios Clinical Research from 20 clinical trial sites across a range of specialties; LongueVue Capital and Abacus Finance Group jointly acquired two hepatology-focused groups, Summit Clinical Research and Pinnacle Clinical Research; and Martis Capital made a follow-on investment in Alcanza Clinical Research. The Summit and Alcanza platforms are noteworthy in relation to the theme of increasing the demographic and socioeconomic diversity of trial populations. Alcanza partners with community-based organizations to expand trial access, while Summit is an integrated research organization (IRO), meaning that clinical trial participation is embedded into day-to-day patient care. Recent months have also seen continued PE interest in pharma services—including outsourcing, consulting, and commercialization services—and pharma tools.

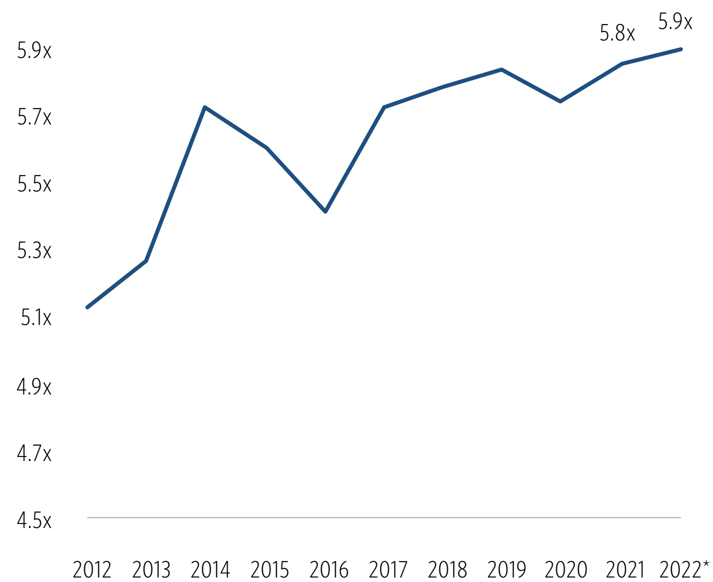
Deal valuation and debt metrics

Median PE EV/EBITDA multiples



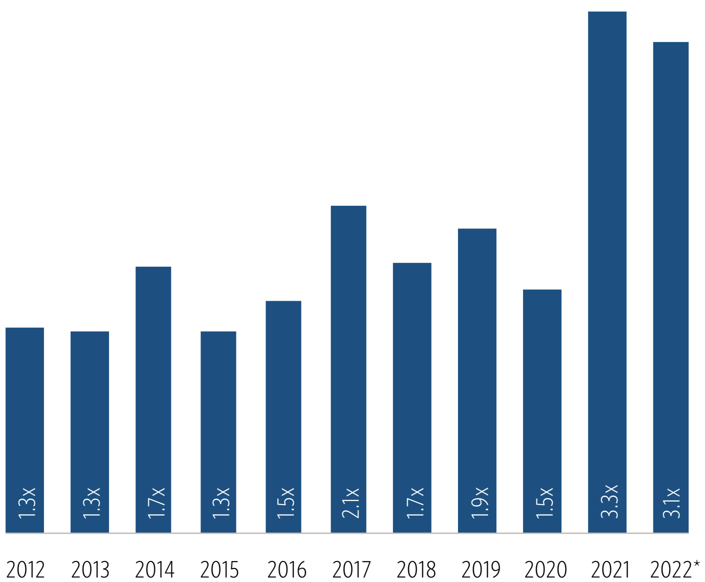
Source: LCD | **Geography:** US
*As of December 31, 2022

Median PE debt/EBITDA multiples



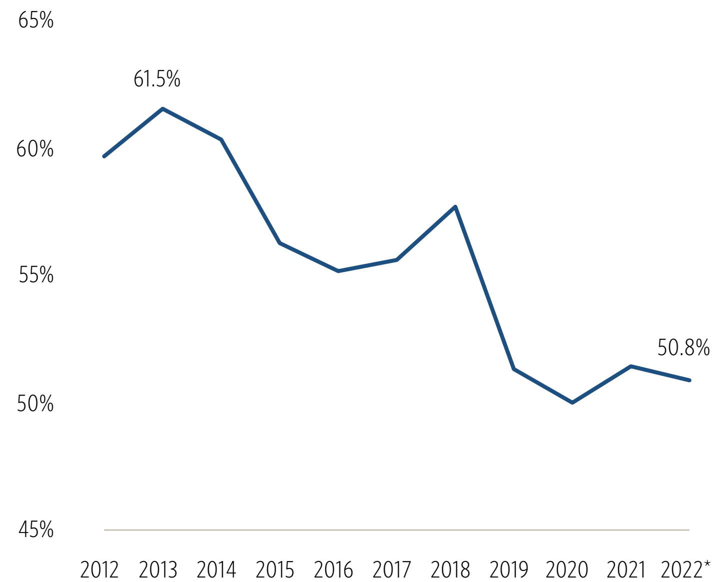
Source: LCD | **Geography:** US
*As of December 31, 2022

Median PE EV/revenue multiples



Source: PitchBook | **Geography:** US
*As of December 31, 2022

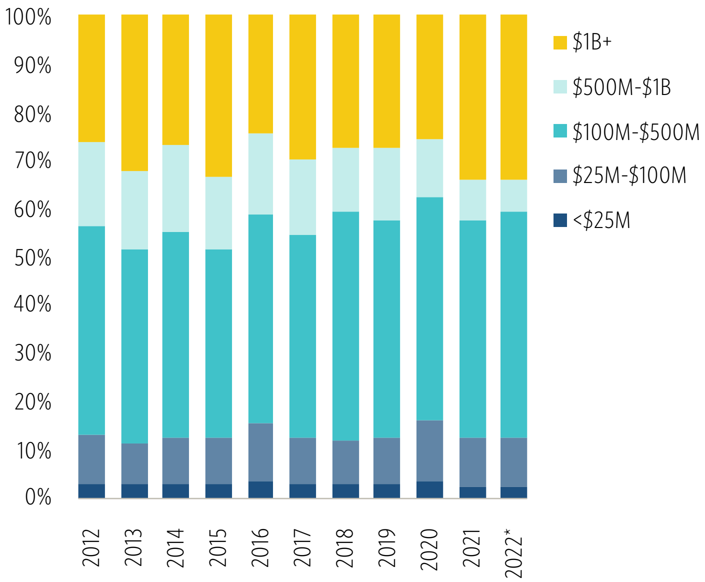
PE debt to enterprise value ratio (%)



Source: LCD | **Geography:** US
*As of December 31, 2022

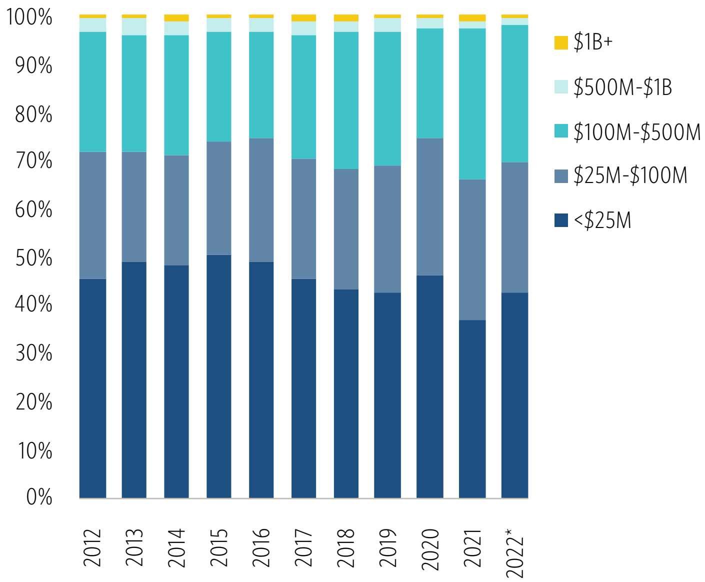
Deals by size and sector

Share of PE deal value by size bucket



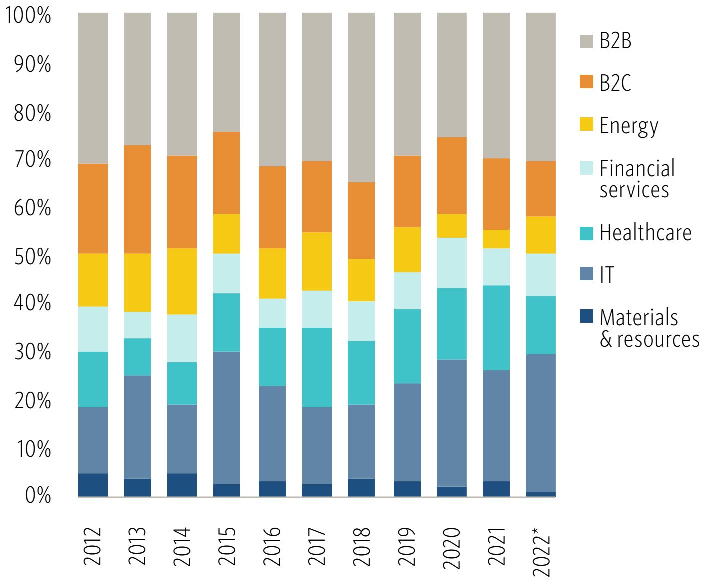
Source: PitchBook | **Geography:** US
*As of December 31, 2022

Share of PE deal count by size bucket



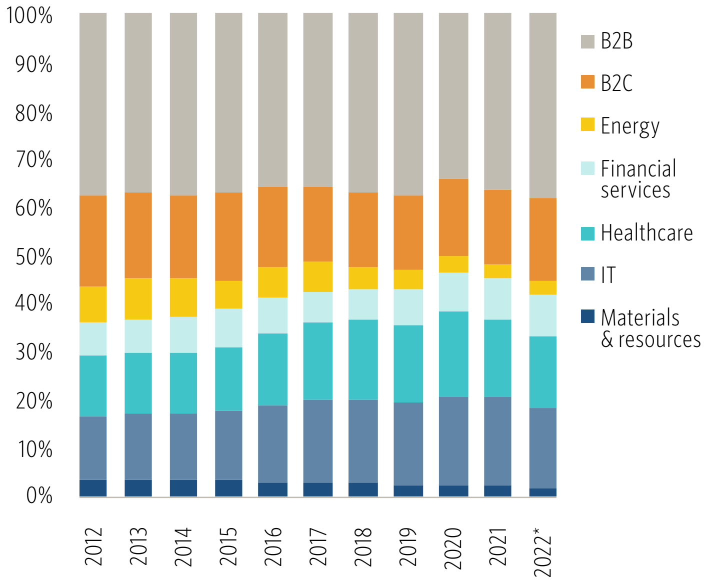
Source: PitchBook | **Geography:** US
*As of December 31, 2022

Share of PE deal value by sector



Source: PitchBook | **Geography:** US
*As of December 31, 2022

Share of PE deal count by sector

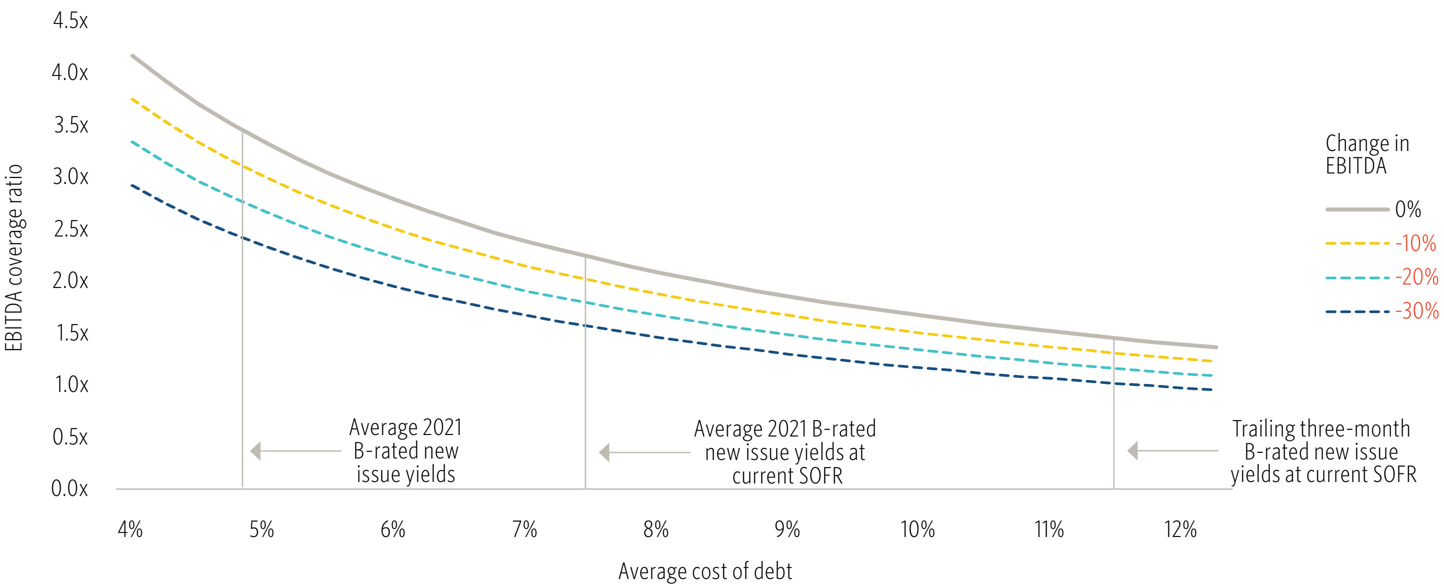


Source: PitchBook | **Geography:** US
*As of December 31, 2022

SPOTLIGHT

Quantitative Perspectives: When the Tide Goes Out

Interest coverage ratios by cost of debt and change in EBITDA



Source: PitchBook
*As of November 14, 2022
Note: Assumes a starting leverage ratio of 6x EBITDA. SOFR is 3.8%.

Note: This spotlight is abridged from our Q4 2022 Quantitative Perspectives: When the Tide Goes Out. Please see the full report for additional analysis on the deteriorating macroeconomic outlook and market environment and how this might impact PE.

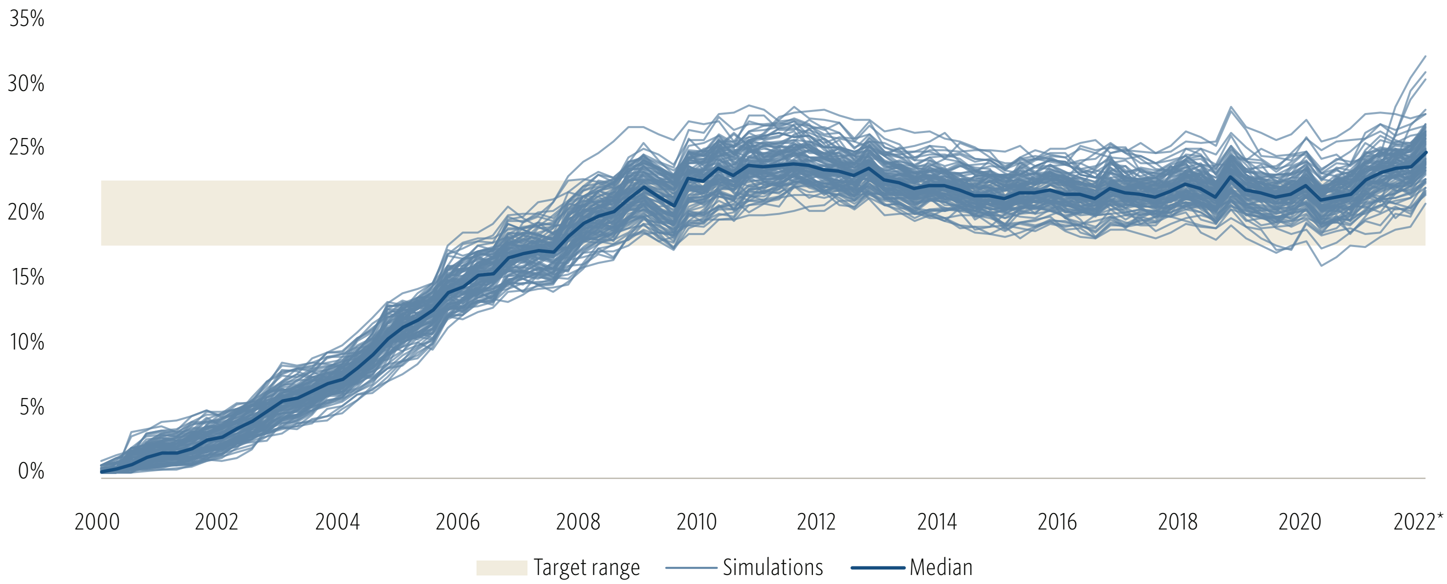
The economic outlook

A deteriorating macroeconomic outlook and market environment, highlighted by slowing growth, a sharp increase in short-term interest rates, and tightening credit and liquidity conditions, will likely lead to a challenging period ahead for investors. The window for an economic soft landing following the current monetary tightening cycle has narrowed further as high inflation has been more stubborn than many expected, leading the Federal Reserve (the Fed) to be more aggressive with rate hikes relative to expectations earlier in 2022. Our quantitative recession model has predicted the probability of a recession occurring during the next 18 months at over 75% using data available as of the end of November. While inflation has started to slow—and is likely to continue to do so over the next year as lagged consumer price index (CPI) measures catch up to market prices—its path back to the 2% target remains highly uncertain, as does the Fed's willingness to accept anything significantly above that target. A resilient and tight labor market has fueled wage growth well above 5% that has showed little signs of slowing, which is a major headwind to a sustainable low inflationary regime. Relative to past economic downturns, above-target inflation will force the Fed to be more conservative this time with respect to supporting weak growth and financial markets.

Credit and liquidity concerns

Credit has rapidly become scarce as lending standards have tightened, especially for riskier borrowers. These tighter credit conditions, along with rising benchmark interest rates, have effectively shut off the leveraged loan market, which has been the primary source of buyout debt in recent years. Trailing six-month leveraged loan issuance for buyouts registered just $22.3 billion through October, the lowest level since mid-2020. Not only will tighter credit conditions and rising interest rates dampen the dealmaking environment, but they will also create liquidity challenges for some buyout-backed companies. A hypothetical buyout deal with the average leverage ratio of 6x EBITDA and the average current new issue financing yield of near 12% would have an interest coverage ratio of just 1.4x. A further rise in debt costs, combined with the possibility of a decline in earnings if a recession does occur, would raise bankruptcy risks across the market. On the other hand, many companies took advantage of the recent period of easy credit and near-zero interest rates to refinance debt, which pushed out the wall of maturity to 2025 and beyond. This mitigates the risk of widespread bankruptcies in the short term as most companies will not need to roll over their debt in adverse conditions.

Simulated PE allocation of a 60/40 portfolio with a 20% target to PE



Source: PitchBook | **Geography:** US
*As of March 31, 2022

Portfolio impacts

Institutional investors and other allocators to closed-end PE funds face their own set of challenges in the current environment. A sharp rise in bond yields and falling public market valuations have resulted in a significant decline in traditional stock-bond portfolios. While this has been a painful experience for many, it has also shifted return expectations across asset classes higher. For example, the implied expected return of a 60/40 portfolio has risen from 4.0% to 7.3% in the past 18 months, its most attractive level in more than 10 years. Just as extremely low interest rates and tight risk premiums in public equities pushed investors out on the risk curve to meet return requirements, the reverse, if sustained, will bring them back in. Meanwhile, US PE funds have marked down valuations only modestly through Q2 2022 after several quarters of record returns. The sharp drawdown in public market assets and lagged private market fund reporting have caused relative allocations to private markets in multi-asset portfolios to surge. To gauge the severity of this effect, we simulated a simple multi-asset portfolio targeting 40% public equity (Russell 3000), 20% PE buyout, and 40% fixed income (Bloomberg US Agg). In each simulation run, four random buyout funds are added at the end of every year with a commitment size of 30% of total portfolio value during a seven-year ramp period and 18% thereafter. The simulation results, shown in the above chart, suggest that LPs are extremely overallocated to PE at the end of Q3 2022, with the median portfolio a net 6.5% overweight. This will likely contribute to a difficult fundraising environment in the coming quarters.

A WORD FROM APEX GROUP

Future-proofing PE firms amid uncertainty

Investor requests for greater data and transparency are driving PE firms to work with service providers to become recession proof.

Elaine Chim

Global Head of Closed Products

Elaine has over 19 years of experience in the financial services industry and joined Apex Group in 2018 as part of the Deutsche Bank AFS acquisition. Elaine heads the delivery of Private Equity, Private Debt, and Real Assets product development globally.

Is private equity fundraising going to get harder with talk of a potential recession?

High inflation and rising interest rates have impacted all asset classes, which is causing institutional investors to become more selective when it comes to allocating capital to private markets. This has led to longer fundraising cycles and an uptick in secondary market transactions as investors look to reshuffle their risk exposure.

In an increasing interest rate environment, private debt remains an attractive asset class, and we expect to see a substantial increase in allocation here in 2023 since private debt instruments are usually attached to shorter-term benchmarks, which are well-protected against interest rate hikes. In times of stress, we have seen the private debt market perform well. We would expect bank lending to diminish and public markets to become increasingly restrictive during a potential recession.

Our private equity clients will also continue to participate in the growing trend of opening up access to private markets for retail investors, as they seek new sources and pools of capital. This "democratization" is expected to continue further in 2023, driving greater demand for transparency and better information from investors. To support this, private markets are making more fund processes digital, including onboarding, transaction capturing, and reporting, to name a few. The ability to deploy technology solutions to remove the friction of traditional manual processes will be a key differentiator in the year ahead.

We expect midsized managers to be impacted most by these developments, and do not expect the larger managers with extensive track records of raising capital to have any issues.

As a firm, Apex Group is committed to assisting the capital fundraising process and working with midsized managers in North America and beyond in 2023 to enable them to connect better with investors and perform well during these uncertain times.

We have invested in a digital solution to support fundraising, called Profilir, which caters to both startups looking for first phase funding, and established growth companies seeking growth capital or partnerships—it connects LPs and GPs during the capital-raising process. We also acquired a company called Context365, which provides technology and events to connect alternative asset class investors with managers.

Where are you seeing an increased data demand from PE firms?

Our company has been dealing with an increasing volume of data-driven requests amongst private equity firms, not just in North America, but globally across our client base.

Private equity funds involve investments in dozens of companies in an environment that is constantly changing. As transactions are becoming increasingly more complex, delivering the right level of disclosure to investors and regulatory authorities is also necessary, so that investors can make better-informed decisions and regulators can uncover any potential fraud.

The Securities and Exchange Commission (SEC) has the power to bring enforcement actions against private equity firms for violations of the SEC regulations, but is currently limited by the level of opacity that is commonplace in the private equity industry.

In February 2022, the SEC revealed plans that will require private fund advisors to provide quarterly statements detailing select information regarding fund fees, expenses, and performance. It remains to be seen whether these rules will increase transparency, competition, and efficiency in the $18 trillion private equity market, but accurate data monitoring and reporting is key.

The increasing sophistication of LPs and their demand for greater transparency, particularly around performance and investment-level data, have also increased the disclosure burden on many private equity managers.

Private equity managers need to have access to custom-built and real-time data to deliver the level of transparency required for institutional investors. Quarterly static data is no longer the norm. We are increasingly being asked to provide access to dashboards built with custom reporting requirements in mind, drill-down features, and access to real-time data.

Another increasingly crucial area is data analytics; the ability to collate and aggregate all the fund data and provide managers and investors with the ability to slice/dice their own data is critical now for private equity firms. This includes all manner of data, as there is so much out there for them to deal with and analyze now to obtain a true picture—including industry data, environmental, social, and governance key indicators, and financial information.

How does outsourcing technology and reporting help PE firms to meet increased data and transparency needs from investors?

The benefits of outsourcing technology and reporting are usually to solve problems for functions that are high-volume and resource intensive—for example, things that are manually done, repetitive, and with a degree of risk if not done correctly, like data.

As an administrator, we must rely on technology to capture, consolidate, and analyze the mass of data to satisfy the reporting requirements of the manager and/or LPs.

The principal drivers for working with a service provider are trust, transparency, guidance, strategy, value for money, and unlocking scale. In addition to delivering services and providing increasing sophistication of their client's investor base, private equity firms must have access to the best-in-class technology.

A lot of private equity managers are coming to Apex Group when it has become obvious that they've hit a point where they either need to invest in technology, or to find a partner to outsource to because we will have the technology and infrastructure to do it faster, cheaper, and more accurately.

By using the best technology available, private equity managers can stay competitive and ahead of the curve when it comes to meeting the data and transparency needs for investors. Ultimately, technology empowers fund administrators to do more for clients and at a lower cost—to work more efficiently and with greater transparency to satisfy the increasing sophistication of the limited partners.

How can PE firms ensure they have the right data strategy for 2023 and beyond?

The data challenges in private equity firms are wide-ranging, but some recurring themes are emerging as we start to enter 2023.

Based on conversations with our clients, the top challenges are focussed on efficiency, integrity, and completeness around data consumption, data management, data validation, data aggregation, data integration, data reporting, and analytics.

To overcome these challenges, North American private equity firms need to have a firm-wide data strategy in place, which they can then roll-out with their private equity managers, and sometimes it's tricky to know just where to start.

Firstly, there are numerous technology options out there. Secondly, new technologies are being rolled out all the time, so it's hard to keep pace with innovation. Lastly, you need to invest time, energy, and dollars into implementing digital transformation strategies that might not be easy to come by, so it's crucial to put your firm on the right path to success from the start by working with the right service provider who understands the nuances for the private equity industry and has a strong track record.

How important is the collection and measurement of data to driving progress?

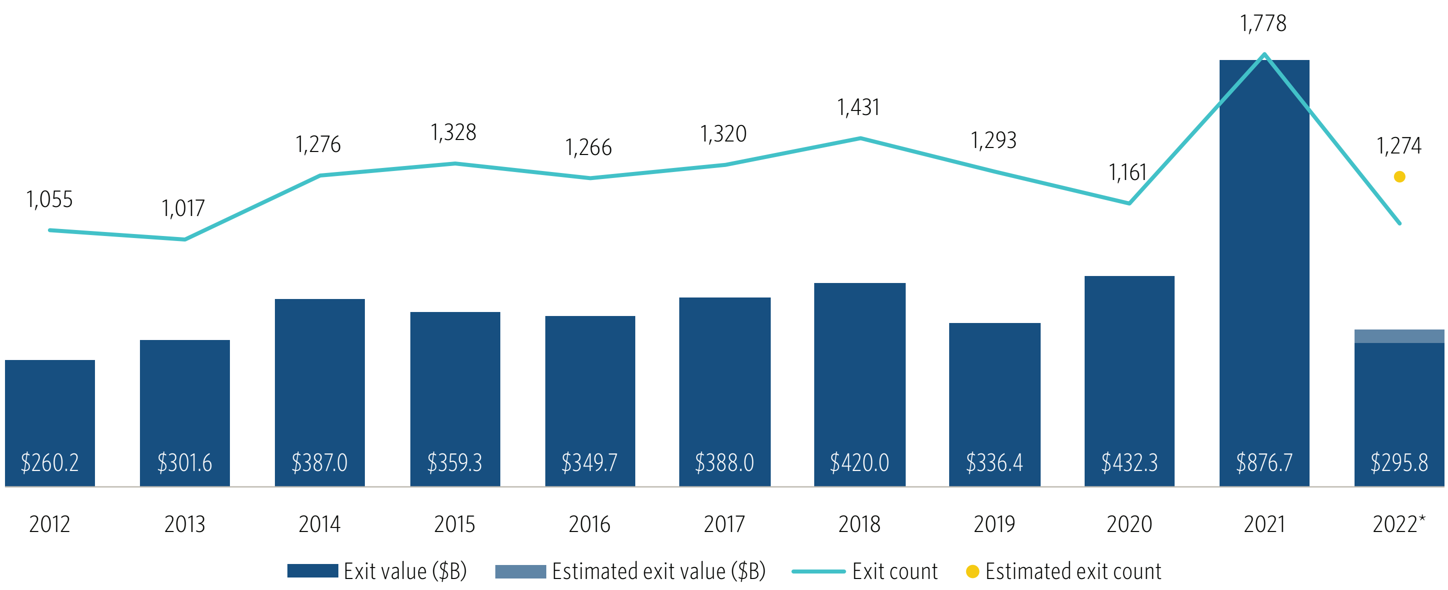
It is critical for private equity firms to collect the right data and provide greater insight across all funds and asset classes to drive real progress—they can't afford to stand still. This leads to better decision-making and, ultimately, value creation for investors.

Forward-thinking private equity managers will leverage service providers like Apex Group to access the latest technologies and tools without adding any headcount to their businesses in North America.

In addition, by partnering with us, they don't have to deal with vendor management and decide which technology is most suitable for them, because that's where we excel. We are skilled at finding the most optimal solutions for our clients, which includes putting the best operating model in place for their private equity firm and the right technology too—so that they can remain future-proof during uncertain times.

Exits

PE exit activity



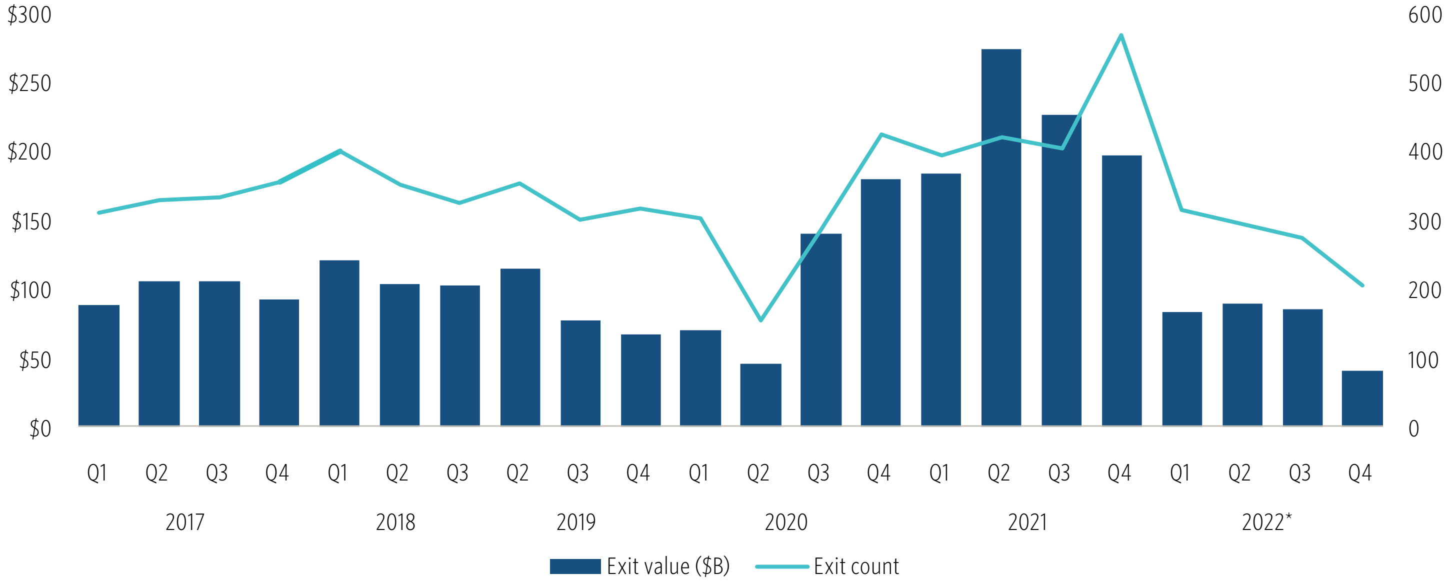
Source: PitchBook | **Geography:** US
*As of December 31, 2022

Overview

US PE exit activity dropped sharply compared with the record-breaking number of exits closed and their total value seen in 2021. In 2022, PE firms exited 1,274 US companies for a cumulative value of $295.8 billion, which was a decline of 28.3% and 66.3%, respectively, from levels seen the year prior. Despite the drastic decline from the fervent exit activity seen in 2021, exits were still healthy relative to historic levels and show a reversion back to long-term PE exit trends. Exits slowed as potential sellers chose to hold portfolio companies amid intense headwinds driven by prolonged inflation, geopolitical conflict, and subsequent market volatility. The exit-to-investment ratio decreased to 0.39x, the lowest figure seen since the GFC. The greatest hit to exit activity came from the disappearance of public listings as a viable option for GPs. Public listings, which drove the impressive exit activity seen in 2021, dropped as PE firms held on to their portfolio companies instead of testing the public markets during times of steep stock market decline and valuation adjustments. Public listings accounted for only 2.5% of exit value in 2022, whereas it had been a whopping one-third of exit value in 2020 and 2021 as bullish markets gave way to a flurry of private companies listing on the public market with elevated valuations. With IPOs out of the picture, exits held on through sales to other sponsors and corporates, which have remained broadly in line with historic levels.

Although exit activity was stunted in 2022, with many PE firms choosing to wait out market volatility rather than be forced sellers in an unattractive market environment, GPs continued to find ways to opportunistically exit portfolio companies. The median size of exits in 2022 was $325.0 million, which is greater than pre-pandemic values, thus demonstrating that GPs have still been able to successfully close sizable exits despite a challenging exit landscape. One reason for this is the ample supply of dry powder still on hand for PE sponsors. With $787.5 billion of dry powder for US PE firms as of Q3, sponsors are likely to find plenty of acquisition targets from other sponsor-backed companies as they look to deploy capital. This source of liquidity will be a key support factor going into 2023 for PE-backed exits. The median size of corporate acquisition exits was also higher than pre-2021 values, and sales to corporates saw a slight down-tick in 2022, from $300.8 million to $289.8 million. Although corporations are likely to be less acquisitive in turbulent markets, compelling valuations can prompt them to take up sponsor-backed companies from PE sellers.

PE exit activity by quarter



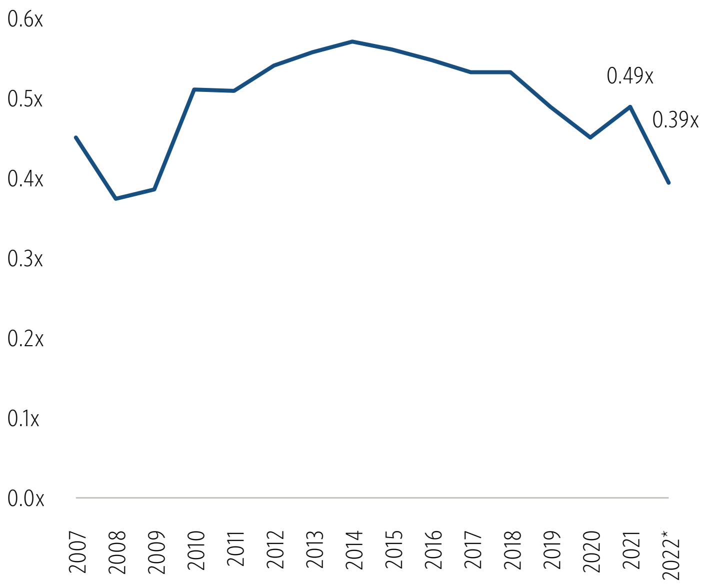
Source: PitchBook | **Geography:** US
*As of December 31, 2022

Sponsor-to-sponsor exits

During 2022, GPs exited 547 companies to other sponsors for a total of $134.0 billion. Sponsor-to-sponsor exits made up 45.3% of US PE exit value, which is a sizable uptick from the 10-year average of 38.8%. When comparing sponsor-to-sponsor exits with exits to corporates, the split favored the former in 2022, which is a reversal of trends seen throughout the last 10 years. Sponsor-to-sponsor exits have steadily increased over time as a share of exit activity, and we anticipate seeing them make up a record portion of US PE exit value in 2023. The number of PE managers has steadily expanded over the years, while the number of corporate buyers has remained relatively fixed, and sponsors could more readily pursue deals with their supply of dry powder than corporate buyers that are likely to focus on protecting their balance sheets amid recessionary fears.

Sponsor-to-sponsor exits were steady across most sectors, with YoY declines roughly in line with the overall contraction in exit activity. Sizable exits in the healthcare sector buoyed sponsor-to-sponsor exits in 2022, although it is important to note that many of the deals closed this past year were negotiated before the turn in the market environment. The $17.0 billion sale of Athenahealth by Veritas Capital and Evergreen Coast Capital to Hellman & Friedman (H&F), Bain Capital, and GIC marks the largest sponsor-to-sponsor exit during the year, even though it had been announced the year before. Other notable exits include the $8.0 billion sale

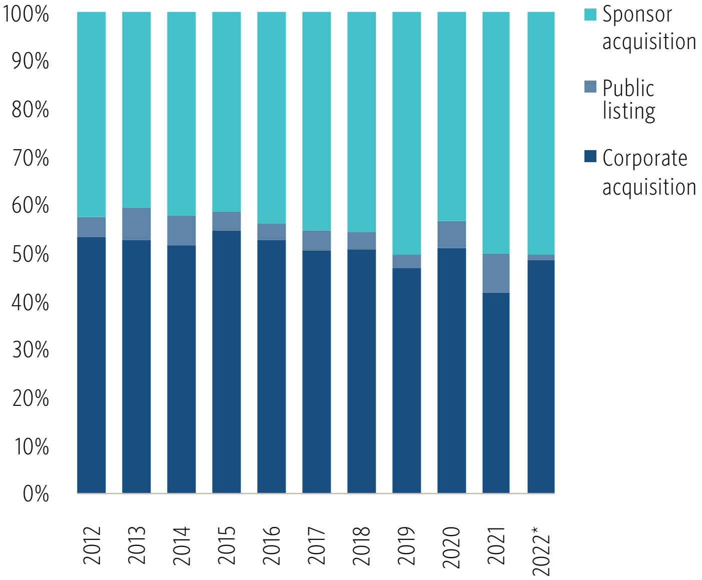
PE exit/investment ratio



Source: PitchBook | **Geography:** US
*As of December 31, 2022

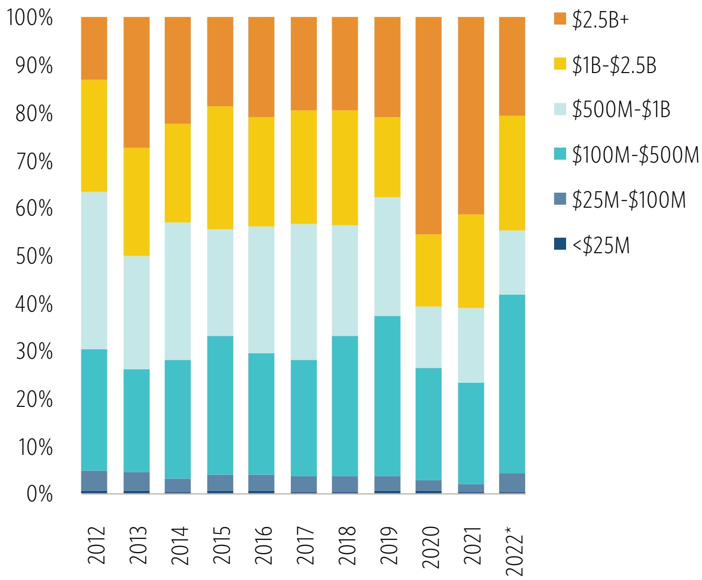
of Information Resources (IRI) to NPD Group, a platform company owned by H&F. The sale, which was announced in April and completed in August, brings together two technology, analytics, and data companies to create a data visualization platform for total retail purchasing and consumption trends.

Share of PE exit count by type



Source: PitchBook | **Geography:** US
*As of December 31, 2022

Share of PE exit value by size bucket



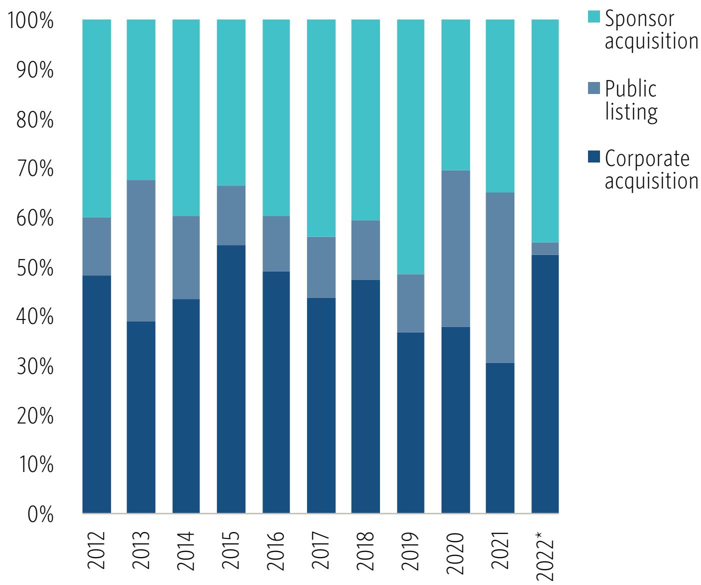
Source: PitchBook | **Geography:** US
*As of December 31, 2022

Exits to corporates

2022 witnessed PE exits to strategics register sequential declines throughout the year, falling in line with the overall contraction in the exit markets. In a typical quarter, corporate buyers snap up 150 to 200 companies from PE sellers. That activity was seen only in Q1 2022 while markets were still riding the highs of 2021. Since Q1, exit activity was halved in the three quarters that followed. An oversold stock market and unforgiving investment sentiment meant that strategics had far less margin for error than they did in 2021. In 2022, PE firms exited 523 companies to strategic buyers at an aggregate value of $154.4 billion, the lowest deal count total since 2011 and the lowest value figure since before the pandemic. Several of the largest corporate acquisitions in 2022 took place in the energy sector, as PE firms were able to capitalize on higher energy prices and offload assets that were in high demand. These deals were announced in H1 2022 while energy prices soared, making these portfolio companies even more desirable. In February, Warburg Pincus and Sallyport Investments sold Navitas Midstream Partners to Enterprise Products Partners for $3.3 billion. In July, Riverstone Holdings and Goldman Sachs Asset Management (GSAM) sold Lucid Energy Group to Targa Resources for $3.6 billion. Both of these acquisitions allow for these respective corporates to increase the size and scale of their operations.

Corporations will not hesitate to buy PE-backed companies with a strong strategic logic and fit; however, they could be passing on prices that PE sellers are demanding. Corporate acquisitions are usually driven by high levels of balance sheet cash and C-suite bullish sentiment, both of which took a hit in 2022 as higher interest costs consumed cash flow and the risk of a recession grew. Significant deterioration in these factors could further shrink M&A appetites and further dampen PE exits to corporations. While not at the same clip and amid economic concerns, PE firms were still able to capitalize by exiting investments to companies seeking strategic acquisitions to position themselves for continued growth.

Share of PE exit value by type



Source: PitchBook | **Geography:** US
*As of December 31, 2022

Continuation vehicles and GP-led secondaries

Continuation funds are created to acquire one or more portfolio companies of a fund that is nearing the end of its lifespan and roll them into its own investment. Rather than using continuation funds as vehicles for distressed assets, which has been the case in the past, GPs now use continuation funds if at the end of a fund they deem that one or more investments have further upside and want to hold on longer. These vehicles continue to proliferate and have become a go-to tool for GPs in certain situations, especially as the exit market has soured. These funds, which can encompass one or more portfolio companies, now offer a compelling option beyond a public listing or a sale to a strategic or competitor, which became more difficult under 2022 market conditions. As markets have shifted, these continuation funds have become a strategy that PE firms can employ to prevent unfavorable exits for companies they deem as stable performing assets or assets that have further value that can be added.

Some GP-led transactions are even beginning to happen earlier in a fund's lifecycle as certain investments perform exceptionally well. The deal to roll them out of a flagship fund is seen as a portfolio management tool to avoid overconcentration and allows for further growth capital to be injected. Continuation funds are just one type of GP-led secondaries, joining the likes of fund restructurings, GP-led tender offers, portfolio strip sales, and staples transactions. However, continuation funds are the most common for GP-led secondaries. This trend of continuation vehicles is expected to only gain more traction as market conditions worsen, valuations remain low, and GPs look for new ways to offer their investors liquidity in a weaker exit environment. Continuation vehicles can also benefit LPs—should they choose to retain their stake in the company when it is rolled into a new vehicle—by providing GPs with the ability to better time exits as they hold on to their investments for longer to wait out volatility. GPs can also roll over their carry into the new vehicle to ensure that the GP is aligned with the fund LPs.

These funds are not perfect, however, and they offer several contentious points for LPs. First is the option to invest more, which LPs in the current market are inclined to turn down as many LPs are already overallocated to PE. Second is the option of rolling over the existing stake into the new vehicle, which would continue to lock up the LPs' capital, just in the next fund. Last is to fully or partially cash out of their stake, which most did in 2022 as they sought liquidity in an already illiquid market. This is a major decision for LPs and is one that requires them to peform extra due diligence and value one or more companies, which is typically the GP's job. This decision from LPs is often expected to be derived quickly, despite many major LPs already being understaffed.

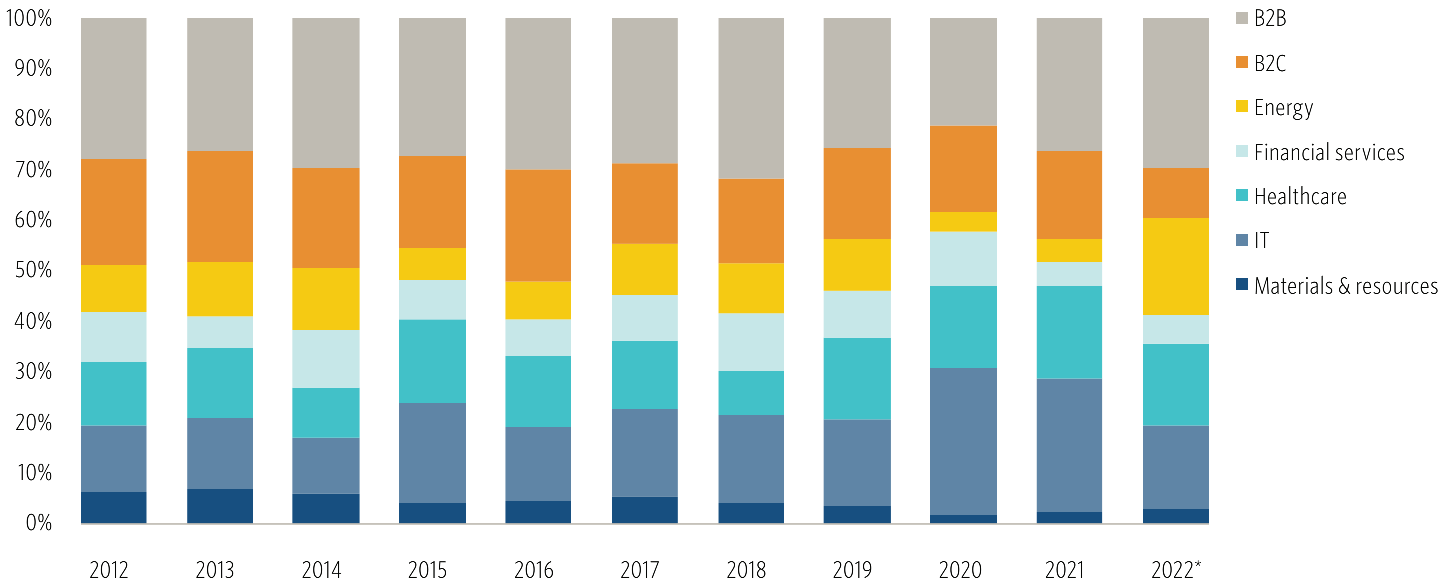
B2B

The B2B sector comprises a broad mix of primarily nontech businesses. It encompasses everything from manufacturing to professional services, such as accounting and consulting firms, to transportation and infrastructure. The common denominator is a heavy reliance on human services, and they cater to business customers. The B2B sector showed more resilience than other sectors in 2022 as it saw 423 exits completed for a total value of $87.5 billion. Part of the sector's resilience is due to PE firms still riding the wave of positive sentiment following the Infrastructure Jobs Act of 2021 and the Inflation Reduction Act of 2022, which has kept exit activity stronger than most.

The sector has always been active, even in a tougher exit environment. B2B took the reins back from technology—which held the number-one spot during the pandemic—in 2022 as the primary contributor to exit value realized in the year. Since then, the rotation has run heavily in favor of B2B as tech valuations tumbled during 2022 and PE firms resisted selling into that weakness. In a more difficult macroeconomic environment, investors look toward B2B as the industry offers ways to improve efficiency, given its high labor intensity. More recently, the sector's large workforce has become an attractive quality for investors seeking exposure to human capital as a competitive advantage amid the growing worker shortfall. Companies that have been able to build greater supply chain resilience and pass off costs to consumers have endured the current macro challenges better than others, making them more attractive to investors and corporations and leading to exits in the space.

Sponsor-to-sponsor exits for the B2B industry were quite common in 2022 as new PE ownership and structures attempted to accelerate value creation and reinvigorate growth. In April, CVC Capital Partners acquired Radwell International, a distributor of new and surplus industrial automation components, from Greenbriar Equity Group for

Share of PE exit value by sector



Source: PitchBook | **Geography:** US
*As of December 31, 2022

$1.3 billion; both will remain shareholders in the company. CVC looks to continue Radwell's growth domestically, internationally, and through strategic acquisitions.[3] In November, Carlyle finalized its sale of portfolio company Sequa, the parent company of Chromalloy and supplier of advanced repairs for jet engine parts, to Veritas Capital for $1.9 billion. The biggest B2B exit of the year was sponsor-to-sponsor based. IRI and The NFD Group, a portfolio company of H&F, have completed their merger to create a global technology, analytics, and data provider that values the combined entity at more than $8 billion. H&F acquired IRI as an add-on to NFD to produce a blended company that better serves customers, responds to trends, and leverages more powerful insights to drive growth.[4]

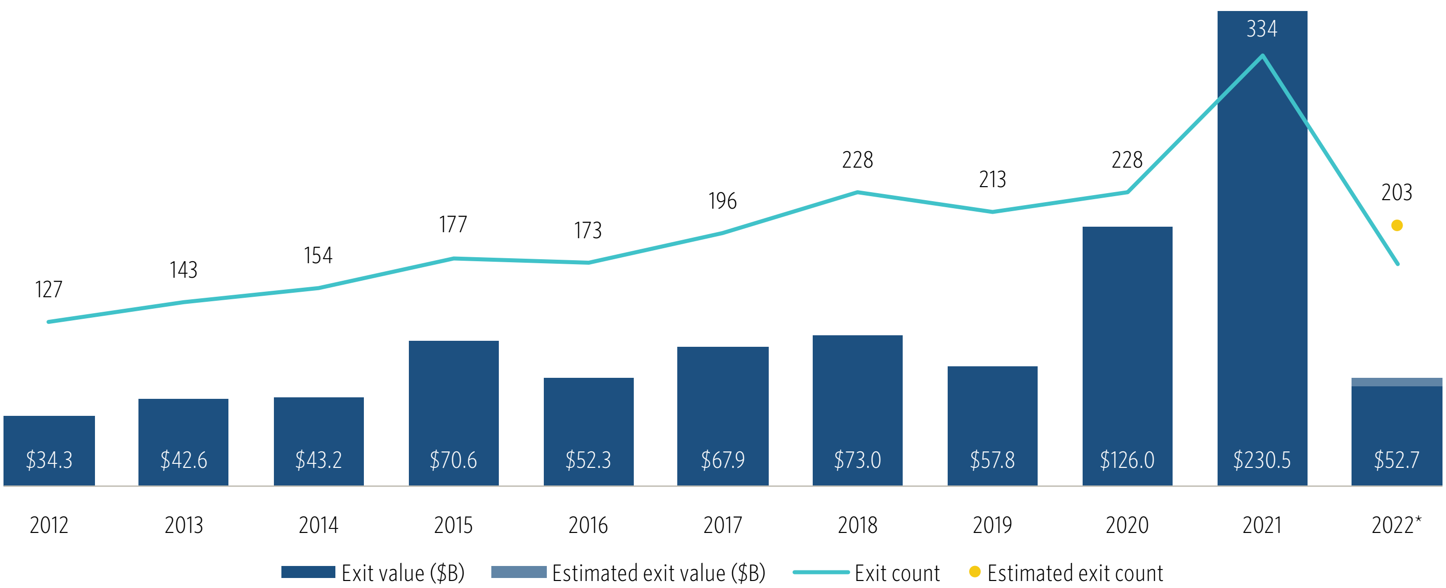
Information technology

Information technology (IT) saw sizable step-downs in exit activity in 2022 when compared with the historic pace seen in 2021. 172 IT exits took place in 2022 at an aggregate exit value of $48.2 billion—a sharp reversal in the exit value that was witnessed both before and during the pandemic. Plummeting public tech stocks have impacted valuations for PE-backed companies. Big Tech stocks crumbled in 2022 amid high inflations and multiple interest rate hikes, and the Nasdaq 100 is down 32.9% YTD. As tech continues to find itself in a bear market along with most of the broader market, PE firms have held on to portfolio companies in an effort to wait for some of the volatility to dissipate or avoid exiting companies at lower valuations than they may have garnered earlier in 2022. With public listings coming to a screeching stop, corporations and sponsors alike have continued to pick up PE-backed companies in tech, as private investors sought opportunistic investment at more attractive prices.

Despite the downtick in 2022, the tech exit count remained in line with historical trends as it continued its climb. IT exits accounted for 16.3% of overall PE exit value in 2022. This percentage is down from the mid- to high twenties seen in each of the past two years and percentages in the high teens predating the pandemic. Continuing its exit activity dominance in 2022, software had the five largest exits in the space. Software has been the leading subsector of the IT industry for several years now and helped buoy tech exit counts this past year. Secular growth trends remain in IT, helping companies that offered long-term growth opportunities to exit. For example, Thoma Bravo sold cloud securities services firm Barracuda Networks to KKR for $4.0 billion. KKR plans to further expand Barracuda's offering and push the company into key security markets to capture business in a growing market.

3: "CVC and Greenbriar Announce Recapitalisation of Radwell International," CVC, April 4, 2022.
4: "IRI and NPD Complete Merger, Creating a Leading Global Technology, Analytics and Data Provider," NPD, August 1, 2022.

Information technology exit activity



Source: PitchBook | **Geography:** US
*As of December 31, 2022

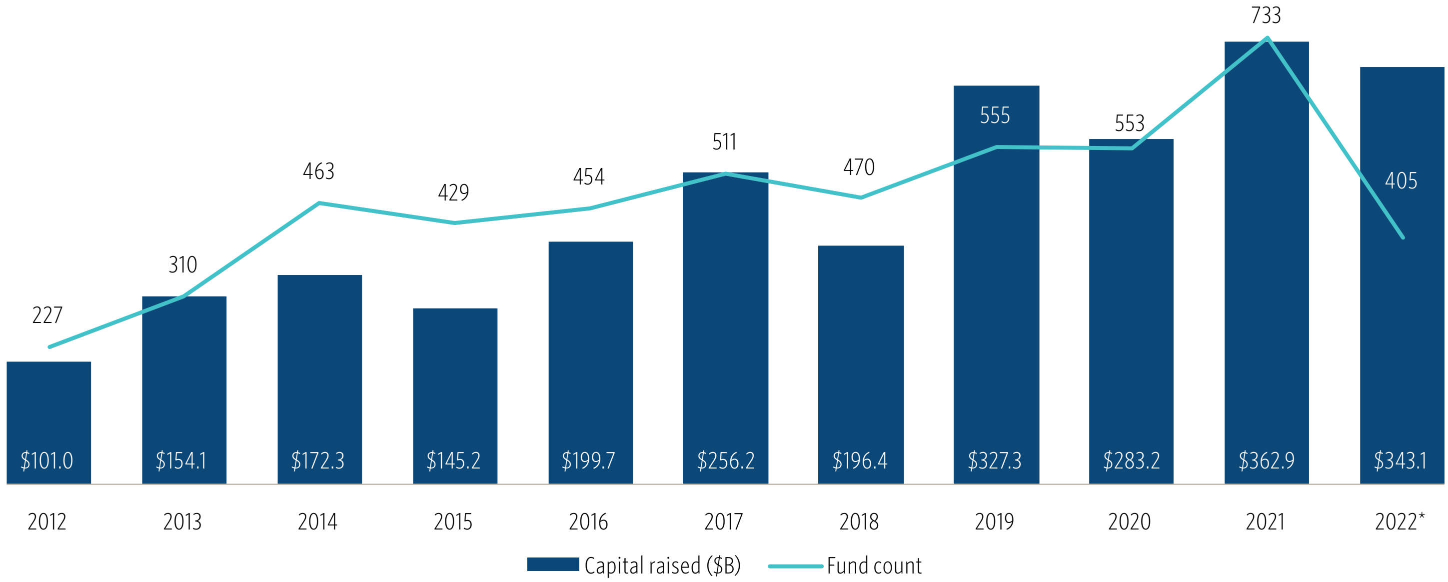
Corporate acquisitions also contributed to tech exits as reliance on data, analytics, and software spurred exit opportunities for PE firms investing in tech companies focused on increasing and advancing digitalization within business operations. In August, Clearlake Capital Group sold Brightly Software to Siemens Smart Infrastructure (SI) for $1.9 billion. The acquisition of Brightly Software will allow SI to elevate performance levels with seamless data exchanges, enhance efficiency for customers, and permit better data-driven decisions.[5] In October, Thoma Bravo completed its sale of Frontline Education to Roper Technologies for $3.7 billion. Frontline's cloud-based software provides a connected platform of administrative solutions that are purpose-built for K-12 education, including human capital management, business operations management, student management, and analytics that will help firms increase productivity and improve overall performance.[6] The acquisition allows Roper to add on to its technology businesses, which will enhance the company's cash flow compounding.

5: "Siemens Acquires Brightly Software To Accelerate Growth in Digital Building Operations," Siemens, June 27, 2022.
6: "Roper Technologies To Acquire Frontline Education," *GlobeNewsWire*, August 30, 2022.

Sponsored by STOUT, CBIZ Private Equity Advisory, GOLUB CAPITAL, APEX

Fundraising and performance

PE fundraising activity



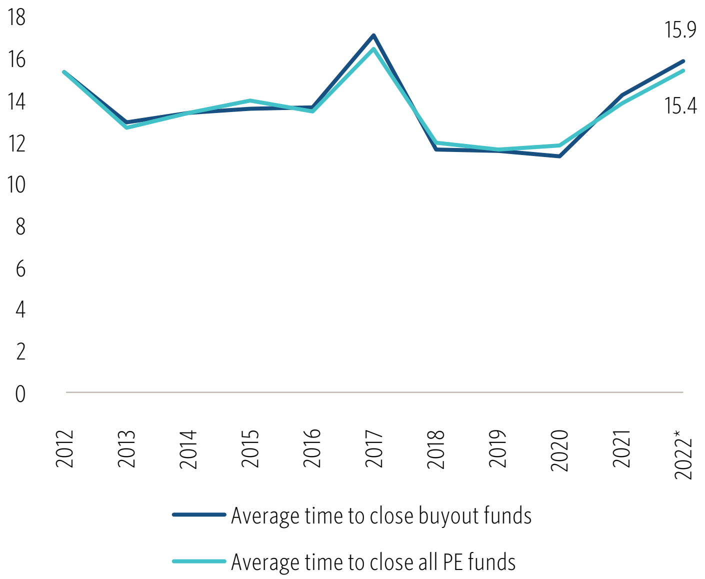
Source: PitchBook | **Geography:** US
*As of December 31, 2022

Overview

2022's fundraising environment was far more challenging for GPs than it was in 2021—and 2023 may be just as tough. Market sentiment completely shifted in 2022 for the buyout and growth equity funds coming to market. A majority of institutional LPs have allocated all of their capital for the year as of the end of Q3. With the denominator effect in full swing, many LPs have seen their allocations to private markets—and more specifically to PE—become overweight, with many LPs facing tough decisions regarding their allocations to the space in 2023. For more on the denominator effect, read our 2022 Allocator Solutions: Taking the "Demons" Out of the "Denominator Effect." Future fundraising can also be negatively affected, as this phenomenon has been cited by investment committees across the country. As long as the current gap between public and private equities persists in a down market, fundraising from traditional LPs will be hampered.

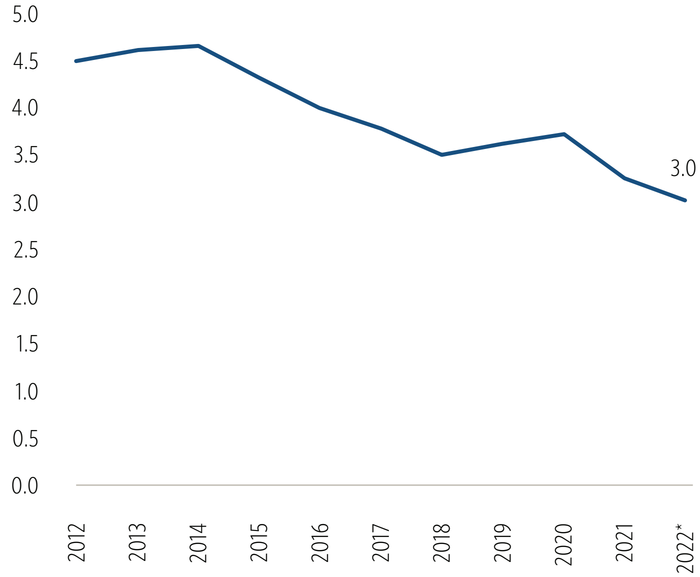
The entire PE ecosystem seems to be taking a step back after firing on all cylinders in 2021. Most funds on average are being raised in 15.4 months, up from the 13.8-month average seen in 2021—showing that the challenging fundraising backdrop is already pushing back the fundraising timeline. On the other hand, the average time between funds continues to lower as it reached three years in 2022, down from 3.2 years in 2021. The typical five-year investment cycle has turned into a three-year cycle, with even less time for some of the technology specialists. This, combined with LPs being overallocated to the asset class, has created the perfect storm for the fundraising environment, wherein there is an abundance of funds looking to raise capital from a limited number of LPs that can supply it. In the back half of 2022, LPs became more comfortable pushing back on GPs, as most are sharing the same pain of rapid re-ups with limited capital.

Average time (months) to close for PE funds



Source: PitchBook | **Geography:** US
*As of December 31, 2022

Average time (years) between PE funds

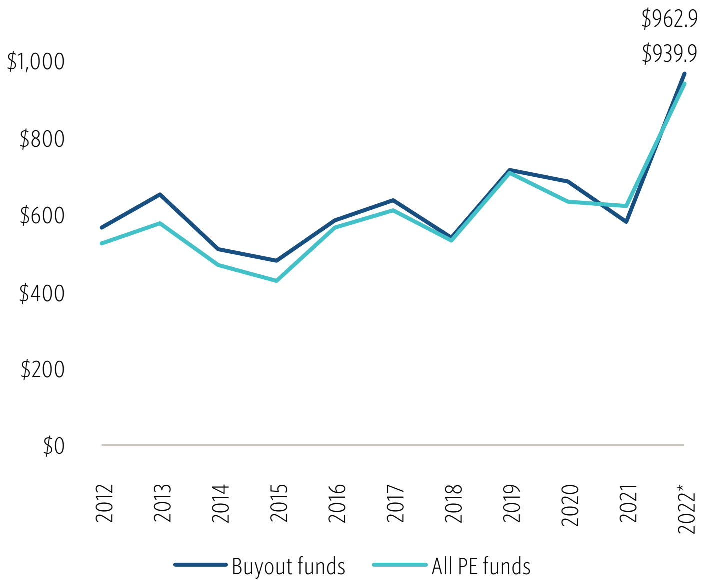


Source: PitchBook | **Geography:** US
*As of December 31, 2022

While the denominator effect continues to play out, large LPs are reconsidering allocation percentages to the asset class as they look to rebalance their portfolio for the coming year. It's a mixed bag of decisions, with some LPs keeping allocation percentages the same, while others plan to lower their allocation—citing market headwinds and the denominator effect—and some have decided to increase allocation percentages as previous performance and confidence in the industry has left them bullish. For example, CalPERS, under new leadership, has decided to raise the pension fund's private equity assets from 8% to 13%, and in September, the investment board of Iowa's Public Employees' Retirement System increased the pension's PE allocation from 13% to 17%. Meanwhile, in a December board of trustees meeting at the Alaska Permanent Fund Corporation, which oversees over $70 billion in AUM, Chief Information Officer Marcus Frampton suggested the fund decrease its PE allocation target by 4% over the course of the next three fiscal years—as discussed in our article, "Will Public Pensions Stick to Their PE Targets in 2023?" Outlooks on the industry vary, but PE will remain a key investment area for LPs.

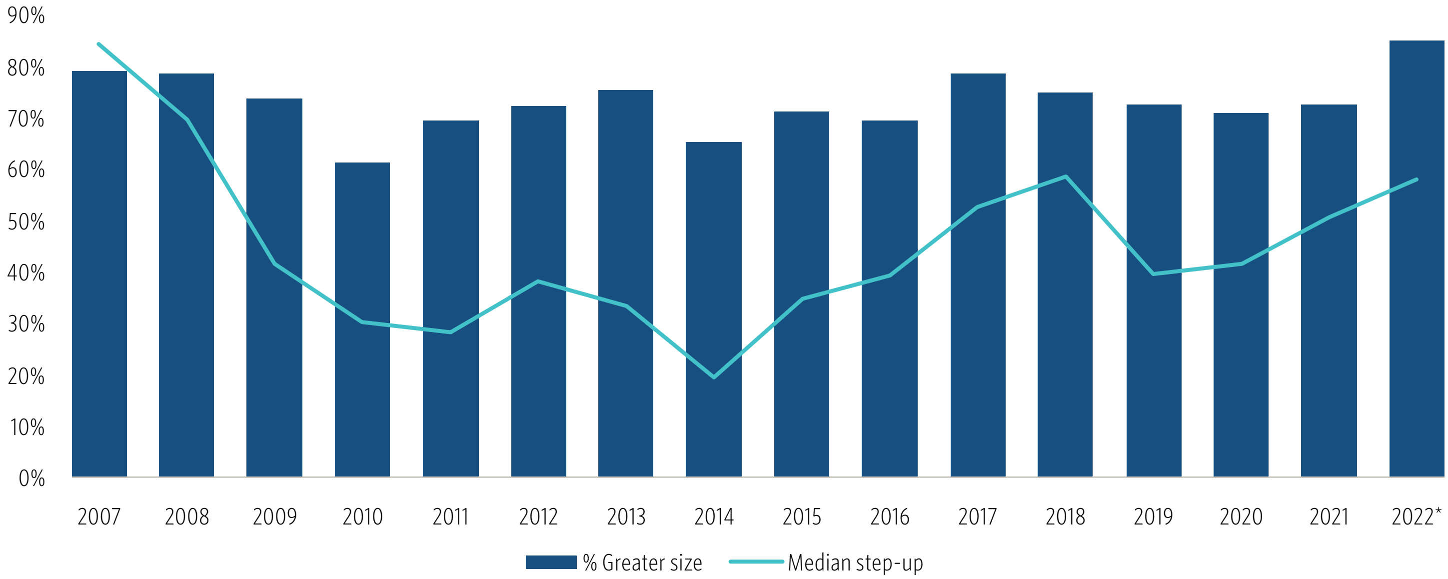
Going forward, deployment and fundraising cycles will likely revert to their historical norms as the current pace is unsustainable for LPs and GPs alike. Anecdotal conversations with LPs indicate that they are seeing slower deployment and think that fundraising will return to a more manageable cadence. Due to the variety of challenges being faced in the fundraising environment, the process is being drawn out. 2022 saw sponsors returning to their investor bases at a blazing pace, seeking re-ups larger than there was capacity for. As a result, many firms that looked to initially close in 2022 have pushed their final closing dates into 2023, hoping to get a piece of LPs' 2023 allocation pool. In other cases, managers have been asked to delay fund launches until 2023 for the same reasons.

Average PE capital raised ($M) by fund type



Source: PitchBook | **Geography:** US
*As of December 31, 2022

Median step-up from previous PE fund in fund family



Source: PitchBook | **Geography:** US
*As of December 31, 2022

PE tie-ups and strategy expansion

Many of the largest managers continue to build out their offerings, attempting to be a one-stop shop for the largest LPs. The top dozen or so firms now offer myriad strategies. This seems to benefit both the managers and institutional allocators. These managers get to maintain growth, providing attractive returns to shareholders and offering upward mobility to retain top talent. For LPs, they can consolidate significant proportions of capital with only a handful of relationships. This comes as many of the largest pension plans, foundations, and other entities report being understaffed and technologically behind for their size. This makes performing due diligence on a multitude of managers nearly impossible. More managers are adopting a similar playbook, though this trend is not new. This playbook of expanding offerings can be seen in the venture debt space, which has grown exponentially and drawn in some of the biggest players in the alternative investments space. In recent years, large firms such as Bain Capital, Vista Equity Partners, and BlackRock began offering services in venture debt. The most recent entrant in the space is Blackstone, which announced a $2 billion allocation to technology debt deals over the next few years. KKR has also considered entering the space by either purchasing an existing venture lender or building its own effort.

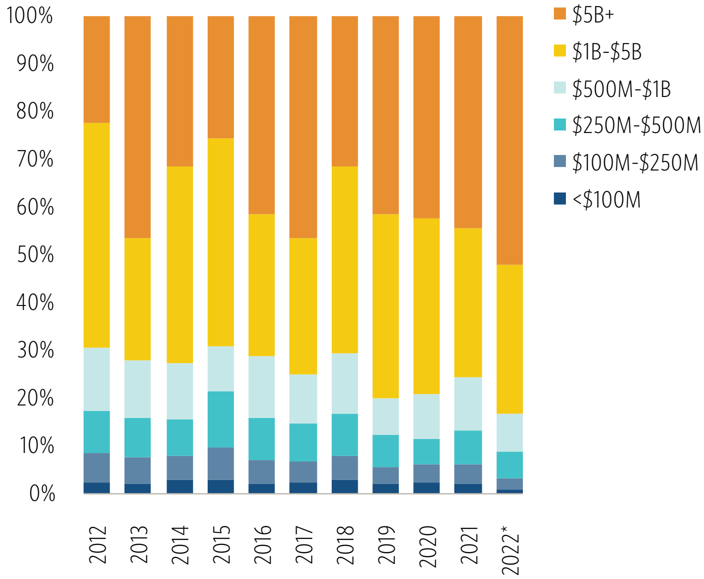
M&A in the alternatives fund manager space saw sporadic activity in 2022 as firms continued inorganically seeking ways to expand their strategy offerings. This includes tie-ups between traditional asset managers and alternative managers as the former attempt to accelerate fee growth. Several firms made forays into the private credit space as it continues to garner attention and the syndicated loan market remains closed. General Atlantic acquired Iron Park Capital and rebranded to General Atlantic Credit, which will expand and enhance the firm's ability to provide capital solutions to high-quality companies at multiple stages of corporate and economic lifecycles.[7] Similarly, Nuveen acquired Arcmont Asset Management, a leading European private debt manager. The acquisition allows for Nuveen to broaden its capabilities and accelerate growth in Europe and complement its North America private debt specialist Churchill Asset Management.[8] Apollo also made moves in the credit space when in Q3 it announced it would buy most of Credit Suisse's securitized products group (SPG) to complement its credit strategies. Strategy expansion into private credit is expected to continue in 2023 as demand for the product continues.

M&A is likely to play a significant role in the decision to build or buy for the largest players. Additionally, as more firms, including CVC Capital Partners and General Atlantic, weigh

7: "General Atlantic Announces Acquisition of Iron Park Capital and Formation of General Atlantic Credit," General Atlantic, October 26, 2022.
8: "Nuveen To Acquire Arcmont Asset Management, a Leading European Private Debt Manager," Nuveen, October 27, 2022.

their options to go public, M&A activity is likely to rise. Public alternatives managers will do almost anything to be seen as a growth stock rather than a value play, meaning they must constantly launch new strategies, bring in new people, and increase AUM. Being public also affords them a new currency with which to finance M&A and retain talent: public stock. For example, Sweden-based public PE firm EQT AB acquired PE firm Baring Private Equity Asia in a move that gave EQT almost €18 billion, equivalent to $19.8 billion in additional AUM, for a total of more than €90 billion. This acquisition allows EQT to grow AUM while becoming a major operator in Asia—a market that investors are very bullish about—to complement its operations in Europe and the US.[9] Although many firms will still attempt to build out new strategies over the coming years, M&A is likely to continue playing a significant role in markets going forward as more firms go public.

Share of PE capital raised by size bucket



Source: PitchBook | **Geography:** US
*As of December 31, 2022

Mega-funds

Despite a more challenging fundraising year, mega-funds continued to shine by bringing in just over half of total capital raised in 2022—totaling $178.5 billion, or 52.0% of total fundraising dollars across only 13 vehicles. Other fund managers, such as middle-market, emerging, and first-time, were squeezed in 2022 as there was only so much LP capital to go around in such a congested market, and as LPs chose to allocate to more established and pedigreed managers. While these $5 billion-plus funds often count on the largest pensions, endowments, and foundations for the bulk of their capital, many allocators maxed out their ability to write nine- to ten-figure checks earlier in 2022. With so many gargantuan vehicles in the market and a much slower exit environment reducing capital flow back to LPs, it has already become more difficult for GPs to find LPs willing to commit these large amounts of capital with ease, or close mega-funds, or raise funds as smoothly or quickly as they did even just one year prior. With limited capital from traditional LPs, even some mega-funds have elected to push out their fund closings into 2023. In mid-December, Carlyle announced it would miss its original deadline of March 2023 to complete fundraising for its eighth flagship buyout fund and requested an extension from its investors to August 2023. The fund has raised $17 billion as of year-end 2022, short of its $22 billion target, as market headwinds and the denominator effect limit the LP pool. Apollo also stated that it would take longer to raise its latest buyout fund.

During the initial months of the pandemic, many LPs took a defensive stance in their portfolios and looked to re-up with existing relationships rather than perform due diligence on new investment managers. With many LPs understaffed, they were further incentivized to invest with more established managers. The largest managers were additionally advantaged in the following economic recovery when the unprecedented deal activity allowed them to deploy capital and return to market faster, often with larger funds. This has carried from 2021 into 2022, with LPs erring on the side of caution and choosing to re-up with existing relationships, oftentimes with managers of mega-funds. For example, Thoma Bravo amassed $24.3 billion for its latest flagship fund in December 2022—a large step-up even for a mega-fund—after closing its prior flagship fund on $17.8 billion in October 2020. However, even the mega-funds are expected to have a more challenging fundraising road in 2023, with restricted allocations coinciding with larger and larger funds.

Additionally, LPs are currently looking to consolidate relationships as allocations remain tight for the foreseeable future. Although some LPs look to emerging managers and specialists to diversify, many are being forced to prioritize certain relationships over others, and the victor is typically the larger funds with proven track records and established relationships spanning sometimes multiple decades. As market conditions remain bleak, we expect mega-funds to continue their fundraising dominance like they did in 2022, though the fundraising timeline might be longer than during previous fundraising cycles. In 2022, Advent

9: "EQT Buys Baring Asia Unit in $7.5 Billion Private-Equity Merger," *Wall Street Journal*, Ben Dummett, March 16, 2022.

International led the pack with a $25 billion buyout fund, followed by Thoma Bravo's $24.3 billion fund. Multiple mega-funds are lined up for 2023 closes, including Blackstone's latest corporate PE fund, which has raised $14 billion as of the end of Q3, with the expectation that it will be at least as large as its $25 billion predecessor. Overall, the club of mega-funds continued to grow despite the more challenging year, keeping them in line with the historical average from the last half-dozen years.

New sources of capital and liquidity

The shortfall of exits and related distributions was an additional element that made fundraising more challenging in 2022. Most capital received by LPs from distributions is typically recycled into future commitments. With a dearth of capital flowing back in from legacy PE investments, LPs looked to sell other assets in their portfolios to meet future commitments. This led many institutional allocators to explore the private secondaries market to shed older LP interests or reduce excess allocations to certain GPs. According to Lazard's *Secondary Market First Half Review 2022*, LPs sold approximately 90% of the time in continuation fund transactions in the first half of 2022.[10] This was driven by record deployment and slower exit activity, causing a liquidity squeeze. Secondary transactions reached new highs in 2022, hitting $57 billion in total volume in the first two quarters and surpassing the previous record of $48 billion from the first half of 2021. As more liquidity is needed for both LPs and GPs, the secondaries market offers a solution for liquidity needs and is expecting to grow tremendously alongside increased liquidity demand in 2023.

As secondary transactions have increased, the use of continuation funds has followed suit in this market environment. Rather than using continuation funds as vehicles for distressed assets, they are now being used as a mechanism to extract further value from well-performing investments that have yet to reach their full potential or relieve the pressure to sell a stable performing asset that at least some partners would be happier to hold for a longer term.[11] Continuation funds roll an asset or assets into a newer fund, and in the process, offer LPs the chance to liquidate their share in that investment—an option that LPs are taking a vast majority of the time, as they desire liquidity in this market.

The fundraising environment became very crowded in 2022, with many GPs relying on the same endowments and pension funds. As record levels of capital were deployed in 2021, this led to a mass number of GPs returning to LPs while looking to raise another fund, oftentimes at a sizable step-up from their prior fund. As LPs are capital constrained, this has forced the industry to consider other sources of capital, such as retail investors, sovereign wealth funds, and family offices. Sovereign wealth funds represent a big opportunity for firms seeking new sources of capital. Strong commodity and energy prices have produced record profits for certain sovereign wealth funds, and many are looking to commit more capital to US PE managers in particular, given the strength of the dollar and its effect in padding returns for non-US LPs. The hunt is on for individual investors and family offices—and their capital. It is viewed across the industry that this market is vast and largely untapped, with individual investors currently accounting for a low-single-digit percentage of the total money raised by private capital funds, but many believe this will grow significantly in the next decade. Family offices, too, have boomed in number worldwide over the past couple of decades, partly due to surging fortunes across industries such as tech, finance, and real estate.[12] As fortunes have risen, so, too, has the desire to boost PE bets after notching several years of double-digit returns. This bodes well for PE firms looking to raise capital as family offices provide a source of capital outside of the traditional LP universe.

ESG and DEI

Environmental, social & governance (ESG) and diversity, equity & inclusion (DEI) have never been more important for a manager looking to raise a fund. LPs are more conscious of ESG and DEI, and many expect GPs and their portfolio companies to follow suit. There is growing evidence that when investors embed ESG considerations into their strategies, they achieve superior valuations and a host of positive outcomes. As employees, consumers, and communities raise their voices in support of ESG initiatives, companies that lead on these issues will establish clear differentiation.[13] However, the main challenge for both institutional investors and PE firms is the lack of standardized metrics, which makes the reporting process unwieldy and labor-intensive for PE firms. Meanwhile, investors are left to wade through a mix of data from multiple PE firms that is difficult to compare and

10: "Sponsor-Led Secondary Market Report H1'22," Lazard Private Capital Advisory, August 2022.
11: "Continuation Funds: A Growing Trend," JD Supra, Mia Bacic, Elizabeth Dylke and Jonathan McCullough, May 27, 2022.
12: "Family Offices With $182 Billion Eye More Big Gains on PE Bets," *Bloomberg*, Benjamin Stupples and Amanda Albright, November 16, 2022.
13: "ESG in Private Equity," Bain & Company, n.d., accessed January 4, 2023.

therefore is sometimes unable to be used in the allocation decision-making process. Standardizing these diversity metrics will take time; however, LPs are clearly increasingly considering PE investing teams' ESG and DEI metrics in capital allocation decisions.

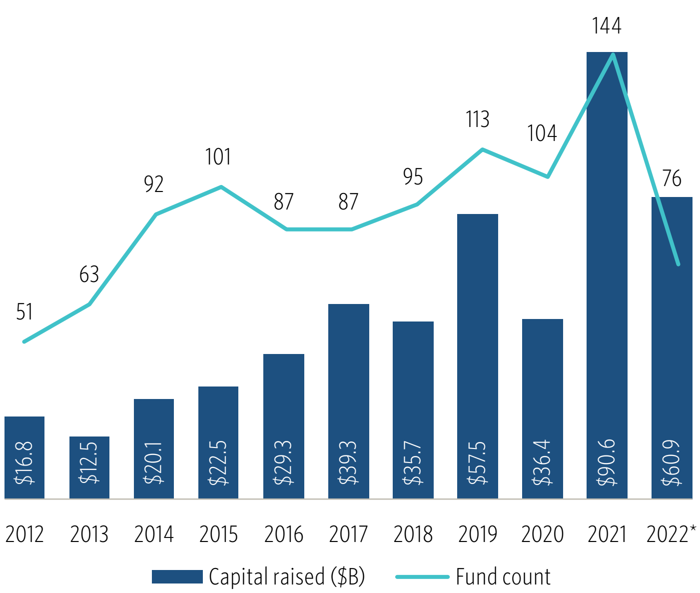
LPs are embedding ESG considerations throughout the investment decision-making process—driven by evolving stakeholder expectations, regulatory developments, and recognition that ESG factors provide an important lens for both value creation and risk mitigation—and are increasingly looking to GPs for more transparency on ESG-related disclosures.[14] Many LPs and GPs have developed policies to formalize the ways in which ESG considerations are incorporated into their investment processes. In an effort to quantify ESG integration and use the data to drive returns, several firms have developed proprietary impact measure frameworks. According to Bain, 70% of LPs surveyed have investment policies that include an ESG approach, with one of the primary motivations being the belief that ESG factors are additive to performance.[15] One of the most common ways in which LPs incorporate ESG considerations in investment decision-making is through a pre-investment due diligence questionnaire. By asking GPs to share their approaches to ESG integration, a growing number of LPs are signaling the importance of sustainable investing to their organizations and selecting fund managers that align with their sustainability commitments.

Institutional investors are increasingly asking for and receiving more diversity data from PE firms seeking to raise funds. Moreover, once a PE firm begins to provide diversity data as part of fundraising, the firm is likely to continue providing diversity data for subsequent funds' capital raises. According to a McKinsey & Co. survey, institutional investors tended to allocate more capital to diverse GPs. When deciding between two firms with identical historic performance, investors would allocate on average twice as much capital to the deal team with more gender diversity and 2.6x as much to the team with more ethnic and racial diversity.[16] The data also showed that investors have the same mindset when building new relationships—they would allocate an average of 1.3x as much capital to new funds with more gender diversity than to funds they previously backed that have less diversity on deal teams. More than half of sponsors are now reporting internal diversity metrics to potential LPs when raising funds.[17]

Growth equity

Growth equity fundraising returned to the pre-pandemic historical trajectory after seeing record inflows in 2021. This fundraising remains in line with the historical trajectory of the strategy due to a strong Q1. Fundraising in Q1 made up 62.0% of all growth equity fundraising dollars in 2022 as the highs from 2021 carried into the first quarter thanks in large part to the $20.0 billion growth fund closed by Insight Partners. However, appetites have shifted away from high-growth strategies after a record-breaking year in 2021. In 2022, growth equity saw 76 funds raise a total of $60.9 billion. While company prospects at the growth stage are far more predictable than early-stage VC investing, the potential for losses is not insignificant, especially as companies that paid for low-quality growth in the past have become more apparent in hindsight as market conditions have shifted. Growth equity companies are also much closer to an exit than early-stage VC companies, forcing them to face market headwinds that have trickled into the space. These growth equity firms are also valued by looking

Growth equity fundraising activity



Source: PitchBook | **Geography:** US
*As of December 31, 2022

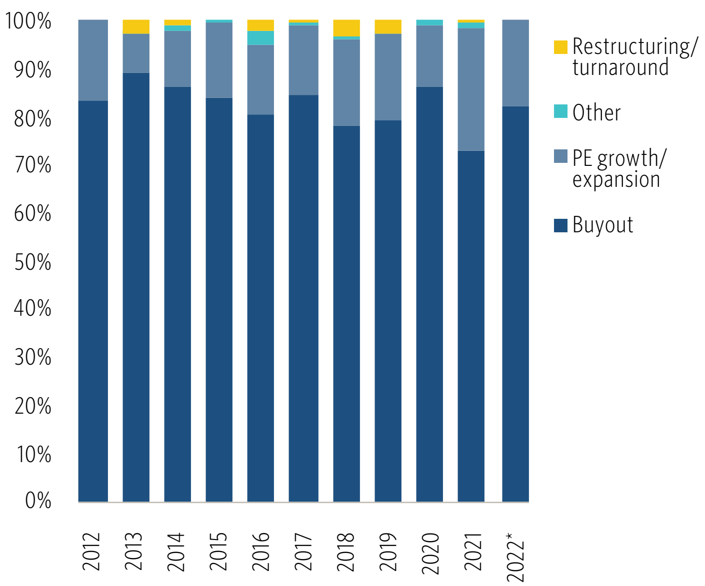
14: "ESG in Private Capital," RBC Capital Markets, Lindsay Patrick and Ram Amarnath, May 31, 2022.
15: "Limited Partners and Private Equity Firms Embrace ESG," Bain & Company, Marc Lino, et al., 2022.
16: "The State of Diversity in Global Private Markets: 2022," McKinsey & Co., Pontus Averstad, et al., November 1, 2022.
17: "Side Letter: KKR's New Friends; PE's Diversity Double-down; Kentucky's ESG Debate," Private Equity International, November 2, 2022.

at their public comparables, which for the most part have been hammered in the public markets in 2022, thereby lowering the valuation of these growth companies.

Industry insiders suggest deals being negotiated today are likely to be at a much lower multiple than 12 months ago. Late-stage growth companies, which had massive hiring plans to hit aggressive financial projections, have had to switch up their plans, announcing layoffs. These adjustments should help these late-stage growth companies more quickly achieve profitability and lessen their burn rates, thus extending the time until their next funding rounds. However, we expect the next 12 to 18 months to prove difficult in the growth equity space as price discovery is delayed with companies slimming down and delaying new rounds for as long as possible.

Established players in the space continued to dominate the fundraising totals. The 13 largest growth equity funds raised in 2022 made up 81.1% of total growth equity fundraising value, led by firms such as Insight Partners and its $20.0 billion fund, GSAM via Petershill's $5.0 billion fund, KKR's $3.8 billion fund, and Sixth Street Partners' $3.6 billion fund. Many well-known private capital firms are making their presence felt in the growth equity space by launching offerings. Growth equity is a natural strategy expansion opportunity for many buyout firms. The capital is often more flexible than control-only buyout funds, and the funds allow for healthy AUM growth, while the GPs can stick to their more established strategies—oftentimes traditional buyout.

Share of PE capital raised by type



Source: PitchBook | **Geography:** US
*As of December 31, 2022

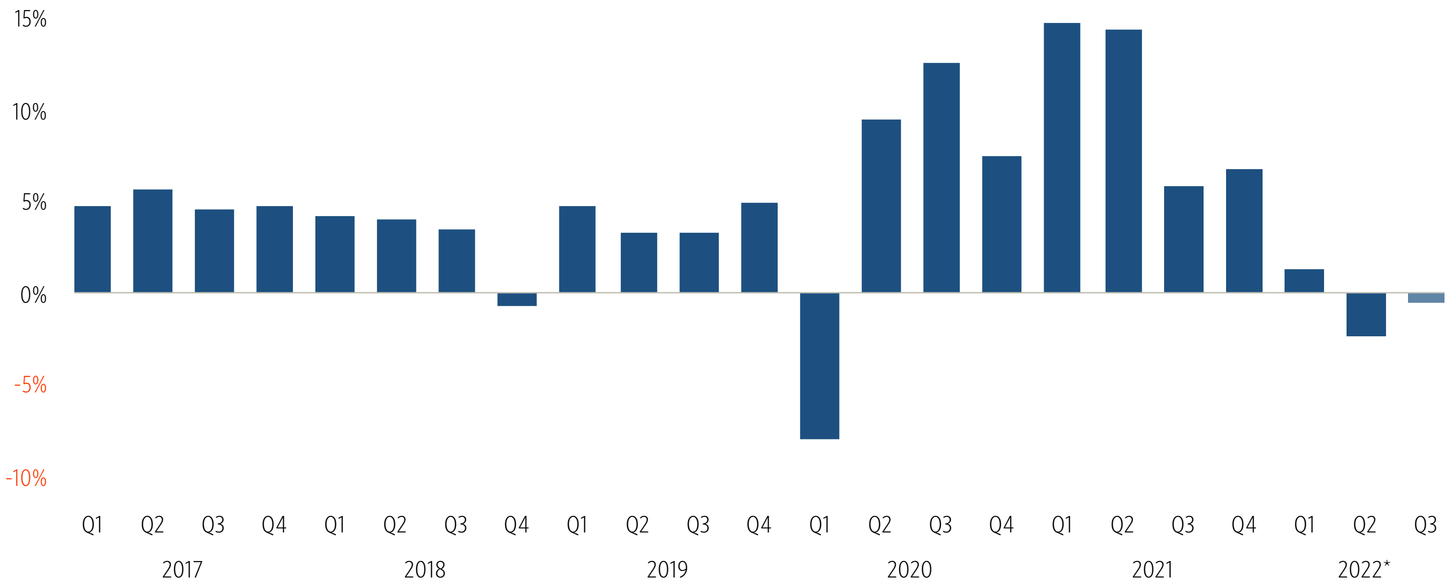
Performance

PE fund performance in 2022 has registered muted returns with some markdowns thrown into the mix. PE fund returns remained relatively flat in 2022, while public market indexes, such as the S&P 500 and Dow Jones, were down 19.4% and 8.8% in 2022, respectively. The returns data from five of the largest public PE managers and from our benchmark across the size spectrum illustrates this point. The broad-based returns prove how the market headwinds have affected firms of all sizes. Preliminary estimates for Q3 2022 for PE funds globally show returns of -0.6% following the -2.4% returns seen in Q2 2022, which were both sharp drop-offs from the quarterly figures seen in the last three years—except for Q1 2020 due to the pandemic, which was a one-off. Muted-to-negative PE fund returns are not expected to be a one-off like during the pandemic; instead, they are expected to remain muted for the coming quarters.

Both realized and unrealized return figures dragged overall performance figures up in 2021. And prior to 2022, PE witnessed several historic quarters for fund performance, driven by accommodative fiscal and monetary policies. Large GPs especially benefited from the high valuations in public markets by marking their portfolio companies to market or by exiting them through public listings. As markets have shifted, this is no longer the case. Beginning in 2022, investors faced a much different macro environment. The Fed imposed aggressive interest rate hikes to curb surging inflation, while Russia's invasion of Ukraine roiled financial markets. With private market returns lagging by a few quarters, we expect to see changes in PE performance continue to take place in the coming quarters.

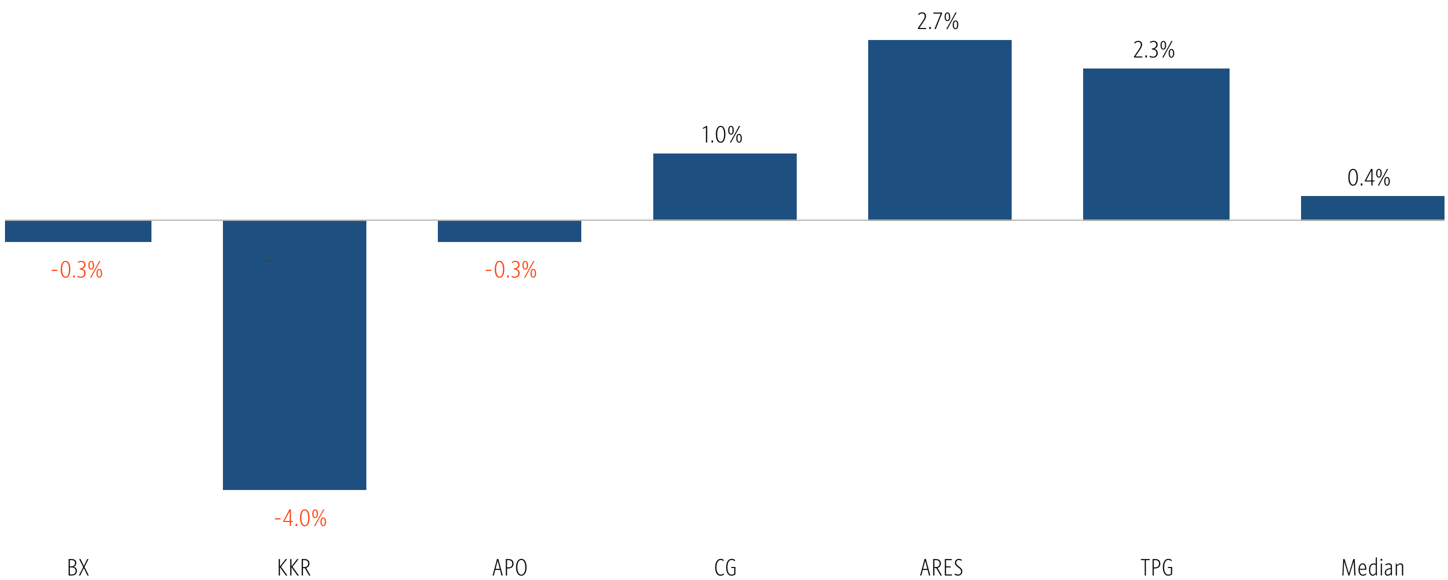
PE performance has faced many pressures in 2022. With the current economic environment, labor has become harder to find and retain. While salaries continue to increase, overhead costs are also rising, which in turn can start to shrink the bottom line, even if top-line revenue keeps growing. Some firms have portfolio companies that are better protected than others from these headwinds, but none are immune. 2022 has also seen public markets take a tumble, which no longer allows for these firms to aggressively mark up portfolio companies or tap the public markets as a lucrative exit opportunity. PE firms will be forced to re-examine and write down the value of their investments on the back of lower public valuations, higher costs of capital, and a deteriorating growth outlook due to weak consumer and business sentiment. While negative return figures for the coming quarters are not predicted, returns are expected to be relatively flat.

PE funds quarterly IRR



Source: PitchBook | **Geography:** US
*As of September 30, 2022
Note: Q3 2022 represents preliminary estimate.

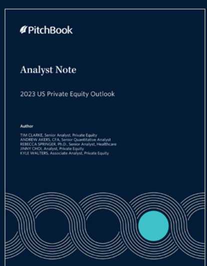
Q3 2022 gross returns for PE funds managed by public firms*



Source: Public filings | **Geography:** Global
*As of September 30, 2022

Additional research

Private equity



Analyst Note: 2023 US Private Equity Outlook

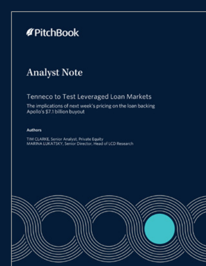
Download the report here

Q3 2022 US PE Middle Market Report

Download the report here

Q3 2022 Global Private Market Fundraising Report

Download the report here



Analyst Note: Tenneco to Test Leveraged Loan Markets

Download the report here

More research available at pitchbook.com/news/reports