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2024 US Private Equity Outlook: Midyear Update

Checking in on our 2024 US PE predictions

PitchBook is a Morningstar company providing the most comprehensive, most accurate, and hard-to-find data for professionals doing business in the private markets.

2024 outlooks

p. 3 Continuation funds will hit critical mass with more than 100 new formations and related exit transactions.

p. 5 Tech-focused PE funds will outperform more diversified PE funds.

p. 7 Disappointing fund distributions will push buyout capital raised below trend.

p. 9 Holding periods of US PE-backed companies will hit new records as the exit environment remains weak.

p. 11 The mix of founder-owned company deals, now 56% of all US PE buyouts, will push even higher.

p. 13 PE healthcare services platform trades will not resume until the Fed begins cutting rates in earnest.

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Introduction

Every December, we share our views on how the year ahead might unfold for US PE. We offered six such outlooks in our 2024 US Private Equity Outlook, and it is time to take stock of those forecasts and see how they have fared versus expectations. We provide regular updates on these and other key PE trends throughout the year in our four quarterly reports, which include the US PE Breakdown, the US PE Middle Market Report, the Public PE and GP Deal Roundup, and the Global M&A Report, as well as our semiannual Global Private Debt Report.

The first half of 2024 rode the roller coaster of interest rate expectations. Hopes for as many as six interest rate cuts by US policymakers were soon dashed, and expectations have now been lowered to no more than two cuts. While public markets were able to shrug this off and gain an impressive 15.3%, PE is more interest rate sensitive given its reliance on debt to transact, and volumes and valuations have moved mostly sideways as a result.

Rate cuts from lenders, not the Fed, have been the big surprise in 2024.

That is not to say that PE borrows have not benefited from rate cuts in other forms. They have, and that has been the big surprise of 2024. While the Federal Reserve (the Fed) has kept base rates on hold, the spread being charged above those base rates on floating-rate loans made to PE borrowers has contracted significantly. Much of this can be attributed to a full reopening of the bank-led syndicated loan market and renewed competition with private credit lenders, placing downward pressure on spreads and rates. For B-minus borrowers, which describes many PE-backed companies, the spread on new-issue term B loans contracted by 23 basis points in Q2 2024, and by a total of 105 basis points in the last year, to the lowest spread in six years. This has spurred a massive amount of refinancing and repricing activity, allowing PE to replace expensive debt facilities with less costly ones and pushing out maturities along the way.

While the rate cuts administered by the leveraged loan and private credit markets provided welcome relief to existing holdings, they have yet to translate to higher deal activity. Until recently, PE had been holding back what appeared to be a budding recovery in global M&A dealmaking. PE share of M&A deal value plummeted to a worrisome 32.6% in Q1 2024, extending a one-year losing streak after eight straight years of steady gains, which peaked at 44.0% of all M&A value in 2022. This left many observers concerned that PE would perhaps not participate fully in the upside of an M&A rebound. In the latest quarter at least, PE appears to be joining in. In H1 2024, PE deal activity is tracking ahead of H1 2023 by approximately 12.0%. This has arrested the decline in PE share of dealmaking, which has stabilized at 36.8% of all M&A. The same goes for exits, which improved by approximately 15.0% in the first half of 2024 versus 2023, although it remains at half-strength versus the prior peak.

Our other outlook reports from December 2023 include US VC, European Private Capital, Healthcare, Consumer Technology, Allocator, Industrial Technology, and Enterprise Technology.

Meanwhile, fundraising continues to surprise on the upside. Total committed capital for PE funds that announced a final closing in H1 2024 equaled $155.0 billion, unchanged from 2023's near-record pace. We caution that fundraising is the ultimate lag indicator and reflects the fact that many large funds that have been fundraising for a long time are just wrapping up now. Ironically, we could see fundraising turn down while lead indicators such as deal and exit activity turn up concurrent with a second leg of rate cuts administered by the Fed.

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Outlook: Continuation funds will hit critical mass with more than 100 new formations and related exit transactions.

Rationale from December 2023

Relative to capital under management, US PE exits fell to unprecedented lows as 2023 came to a close. Total value equaled $285.8 billion, or 9.1% of beginning AUM. That was a record low, worse even than the 10.5% registered at the depths of the Global Financial Crisis (GFC) in 2009 when seemingly nothing transacted other than assets in distress.

As sponsors hold off on exiting holdings at less-than-optimal prices and returns, time is running out to wind down portfolios in an orderly fashion. The typical PE fund is finite life, with a 10- to 12-year term, and 38.6% of them have already passed the midway point at six years or older, or 2,406 funds out of 6,235 total.

With a maturity wall fast approaching for so many funds, we thought 2024 would mark the tipping point for GP-led secondaries, otherwise known as continuation funds. 74 were announced or completed in 2023—up from 56 the prior year. We projected that could reach 100 in 2024, especially with so much capital swelling on the sidelines from new funds focused on secondaries.

Lastly, we thought that the continuation fund process, while imperfect, offered the most scalable alternative to a traditional M&A and IPO process and could emerge as a new "third rail" for industry participants moving forward. LPs that need liquidity can cash out if they so choose, and GPs that need more time to work out of assets on a more profitable basis receive that as well.

49 continuation-fund-related exits were announced or completed in H1 2024, up by 48.5% over the prior year.

Midyear update: Outlook is tracking as expected.

In H1 2024, 49 exits were announced or completed in North America and Europe by way of a continuation fund process. This compares to 33 for the same period in 2023, a 48.5% increase, and is tracking in line with our expectation of 100 for the full year. The strategy was deployed by many sponsors, with many more watching closely to see how these processes fared as they are very much dependent on balancing the interests of new and old investors.

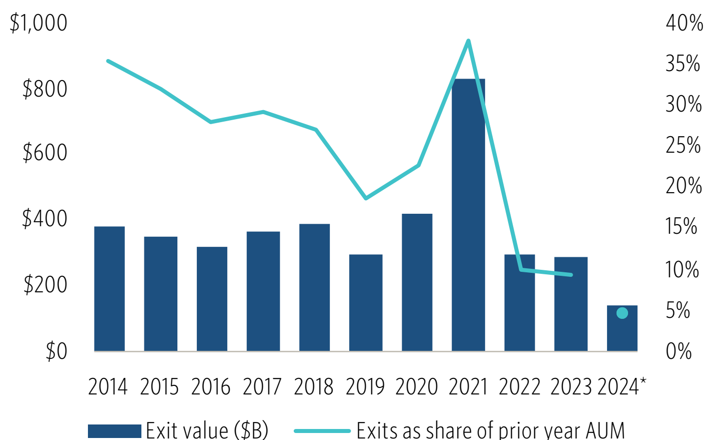
The largest completed process of H1 was KSL Capital Partners' $3.0 billion exit of Alterra Mountain to the KSL Capital Alterra Continuation Fund. Vista Equity is also thought to be considering a $2 billion process to monetize part of its stake in Cloud Services Group, the rebranded name for TIBCO after it acquired Citrix Systems in a $4 billion take-private in 2022.[1] By and large, however, continuation fund processes have been confined to the sub-$1 billion middle-market space. Paul Hastings LLP reports an average size of $592 million for the continuation vehicles it advised in the 12 months ended Q1 2024,[2] which is consistent with the $650 million median for the 13 transactions that PitchBook has tracked with a disclosed value this year.

1: "Side Letter: Vista's Continuation Fund," Private Equity International, PEI Staff, May 28, 2024.
2: "Paul Hastings Launches Third Edition of Its Continuation Vehicles Research Report," Paul Hastings LLP, April 25, 2024.

Looking ahead, the forces driving the recent acceleration in continuation funds remain in place. Traditional M&A and IPO exits recovered in H1 2024 but only modestly so. They remain well below historical averages relative to AUM and the 23,300 companies accumulated by PE funds in North America and Europe. Meanwhile, new money flowing to strategies that invest in LP- and GP-led secondaries, including continuation vehicles, continues to build. Total committed capital for funds closed in the trailing 12-month (TTM) period ending Q1 2024 topped $83.6 billion, a 48.3% gain over the prior year. In Q1 alone, an impressive $29.4 billion was raised by secondaries-focused funds. We would not be surprised to see the fundraising gap between primary and secondary PE strategies narrow significantly in H2 2024.

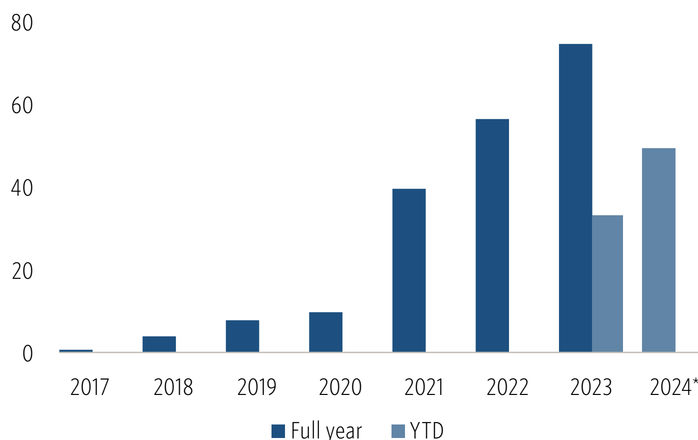
Lastly, to the extent that slow industry adoption has been an issue in the past, the continuation fund model received a major boost from the $18.3 billion sale of SRS Distribution to Home Depot in March 2024. It was the fourth-largest PE exit ever and locked in a sixfold gain for original investors. The fund owners completed a successful process just four months earlier that resulted in a partial stake being rolled into a new continuation vehicle, meaning that even LPs that elected to cash out retained participation in the subsequent sale. More success stories of this type will encourage more GPs and LPs to explore continuation funds as a strategic option.

PE exit value and share of AUM



Source: PitchBook • Geography: US • *As of June 30, 2024

Continuation-fund-related PE exit count



Source: PitchBook • Geography: North America and Europe • *As of June 30, 2024

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Outlook: Tech-focused PE funds will outperform more diversified PE funds.

Rationale from December 2023

At the end of 2023, we identified an opportunity for US-based, technology-focused PE funds to resume their outperformance relative to diversified PE funds. Historical trends from Q1 2010 show that tech-focused PE funds have exceeded the performance of diversified PE funds, with an average excess return of 580 basis points and a median outperformance of 447 basis points, based on one-year rolling IRRs.

Recently however, tech-focused funds underperformed after an outsized reset in valuations amid volatile markets, elevated interest rates, recession risks, and IT spending uncertainty. Despite recent challenges, the core strengths of the tech and software sectors remain robust, with valuations more reasonable now. Analyzing 60 publicly traded software companies, we found their valuations below the five-year average, while EBITDA margins reached five-year highs in 2023. Thus, 2024 offers ample potential for technology-focused PE funds to shine.

Software companies with low churn and stable revenue streams often have capacity for higher leverage.

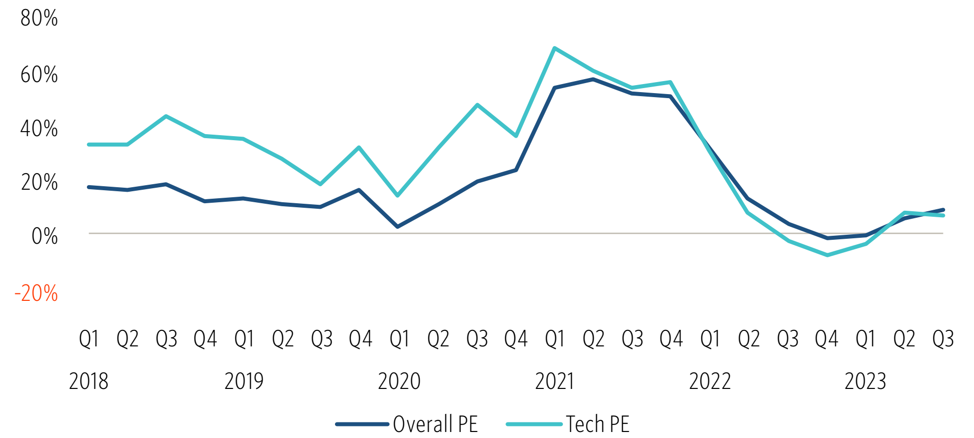
Midyear update: Outlook is tracking as expected.

Tech-focused PE funds have demonstrated a significant rebound in investment performance. After hitting a low point in Q4 2022, when IRRs were -6.8%, the latest data indicates a robust recovery, with a 7.2% IRR for Q3 2023. While these tech-focused funds briefly outperformed the diversified benchmark by 235 basis points in Q2 2023, they are now trailing by 240 basis points as of Q3 2023. We are monitoring this data for the final verdict by year-end.

Looking ahead to the second half of 2024, several strategies can drive returns in the current macroeconomic environment, particularly in the software sector, which constitutes over 57% of all deals in the tech PE space. In the context of new investments, public software company valuations have stabilized and are still trading below their historical mean. At present, there is a wide dispersion in valuations, with AI-focused companies trading significantly higher and smaller firms trading lower. This suggests there may be companies with turnaround potential, which could benefit from PE sponsorship through an LBO.

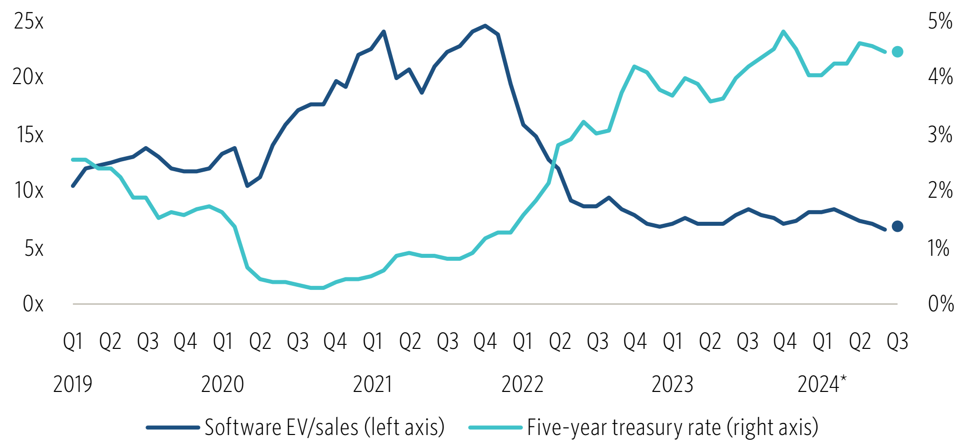
Operationally, in the last two years, there has been a noteworthy strategic shift in software companies' favored strategy, from a growth-at-all-costs mindset to a balanced focus on growth and profitability. This shift has helped overall sector margins, leading to better cash flow, which could ultimately support increased leverage. With credit spreads tightening, increased credit availability, and the potential for lower base interest rates by year-end, PE managers are likely starting to analyze the prospects for dividend recapitalizations and special dividends at portfolio companies. Software companies with low churn and stable revenue streams often have capacity for higher leverage, thus enhancing their appeal for dividend recaps and other value-creation strategies.

Technology-focused PE and overall PE fund performance*



Source: PitchBook • Geography: US • *As of September 30, 2023

Software enterprise value (EV)/sales and five-year treasury rate by quarter



Source: PitchBook • Geography: US • *As of July 5, 2024

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Outlook: Disappointing fund distributions will push buyout capital raised below trend.

Rationale from December 2023

Exit activity plays an important role in the closed-end fund capital flywheel, as exits lead to distributions going back to LPs, which often recycle that money into new fund commitments. The slump in exit activity that began in 2022 has thrown a wrench in that flywheel. At the end of 2023, we called out how the lack of exit routes was leading to near-record-low aggregate distributions from buyout funds relative to net asset value (NAV). At that time, our estimate of the TTM distribution yield was 11.1% as of Q3 2023, well below the long-term average of 26.5% and the lowest figure since the GFC. Based on this data and a quantitative time series model that captures the relationship between distribution yields and future fundraising, we predicted that buyout fundraising would run about 30% below trend in 2024.[3]

Our model estimates that total capital raised will be 31.4% below trend in H2 2024.

Midyear update: Outlook is not tracking as expected.

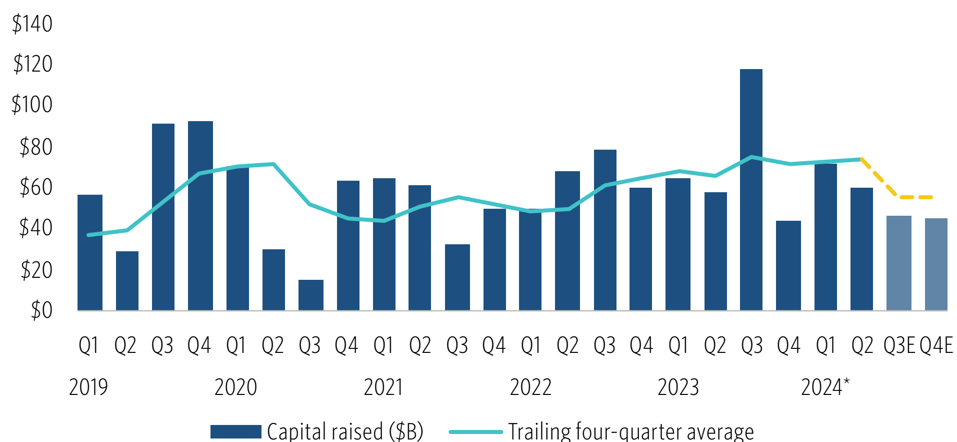
Despite negative sentiment for buyout fundraising for several reasons including the poor exit environment,[4] actual fundraising was more resilient than expected through the first half of 2024. Total capital raised was 2.9% above trend, and, due to lags in our data collection process, this figure is likely understated. However, the better-than-expected headline number does not mean that the fundraising environment is free of challenges for all managers. So far in 2024, megafunds—those with fund closes of greater than $5 billion—have dominated the market. Flagship megafund closings from Silver Lake, Vista Equity Partners, BDT Capital, TPG, and TJC totaled over $73 billion and accounted for more than 50% of all capital raised in H1 2024. For comparison, the five largest funds closed in 2022 and 2023 garnered around only one-third of the total capital raised.

With many of the largest players having already closed flagship funds and middle-market managers facing a more challenging environment, fundraising in 2024 has the potential to be front-loaded. However, several additional megafunds may be nearing a final close, which could contribute further to the top-heavy nature of the current fundraising market. Flagships funds from Blackstone and Platinum Equity Partners, which have already raised close to $30 billion combined, have been open for more than two years and could reach their final closes before the end of the year.

3: The trend is based on a linear time series model with automatic change point detection. It represents a baseline expectation after considering the noncyclical growth in fundraising over different points in time.
4: "Private Equity Faces Gloomy Fundraising Forecast for 2024," The Wall Street Journal, Chris Cumming, December 29, 2023.

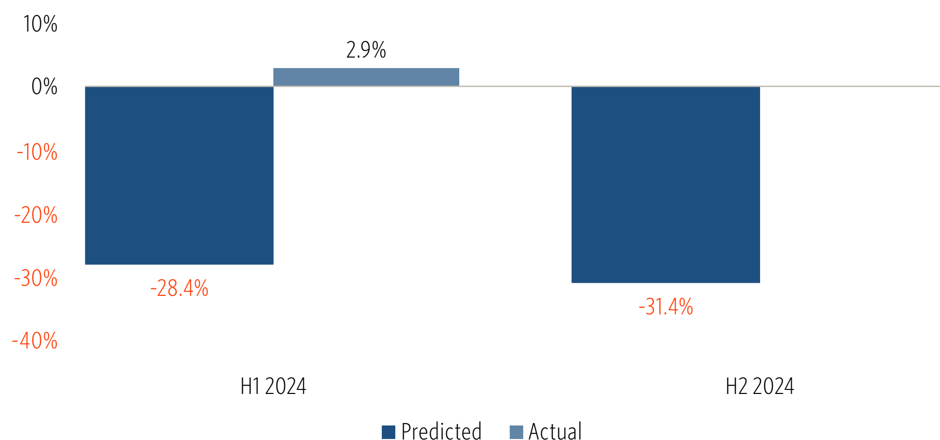
Looking beyond the largest managers and at the environment more broadly, the headwinds to raising buyout capital remain strong. In particular, the cost of capital remains high, and the exit market has shown few signs of rebounding from the ongoing slump of the past two years-plus. Alongside this slump in exit activity, buyout fund distributions continue to fall despite GPs' best efforts to create alternative liquidity solutions, such as NAV loans and secondary transactions. Our latest estimate of the TTM distribution yield as of Q1 2024 was just 8.5%, which is near the low point reached in 2009. Given the lack of recovery in distributions, our fundraising outlook for the second half of the year has not materially changed over the last six months. Our model estimates that total capital raised will be 31.4% below trend in H2 2024. Considering the strong first half of the year, this would put annual fundraising around 16% below trend. Although this would prove our original outlook directionally correct, the actual amount of capital raised would be much better than initially expected.

Quarterly PE buyout capital raised ($B) with H2 2024 forecast



Source: PitchBook • Geography: US • *As of June 27, 2024
Note: Data is seasonally adjusted and winsorized at the 99th percentile to mitigate the impact of outliers on the model fitting. The predictions were made in December 2023.

Predicted versus actual PE buyout capital raised relative to trend



Source: PitchBook • Geography: US • *As of June 27, 2024
Note: The trend is based on a linear time series model with automatic change point detection. The predictions were made in December 2023.

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Outlook: Holding periods of US PE-backed companies will hit new records as the exit environment remains weak.

Rationale from December 2023

Exit activity has plummeted since early 2022, as sponsors struggle against prolonged inflation and unfavorable valuation adjustments. In Q3 2023, exit value hit its lowest quarterly level since the GFC—outside of one quarter during the height of the pandemic—and is now down 83.7% from its peak in Q2 2021. Exits slowed on all fronts, with the IPO market effectively closed and the M&A market choked off by higher borrowing costs. With interest rates expected to stay elevated for the foreseeable future, we expect PE firms to continue to postpone selling and extend portfolio company holding periods in the process. Currently, the median holding period of US PE investments exited in 2023 reached 6.4 years, crossing the six-year mark for the first time since 2015. This shows that even the winning assets in PE funds are being sold more slowly in the current environment.

We also expect the holding period of existing PE-backed funds that have yet to be exited to hit new records. Portfolio companies likely will remain in their funds for longer to allow for valuations to recover to the PE investors' liking or for revenues and EBITDA to grow to compensate for lower multiples. Companies currently in our US PE inventory have been held by their respective firms for a median of 4.2 years, which is the highest level since 2012. The median holding period of existing PE companies is on an upward trend, and we expect it to reach an all-time high median of 4.4 years by the end of 2024 as exits continue to get postponed.

The median holding period of completed or announced exits has contracted meaningfully, dropping to 5.8 years.

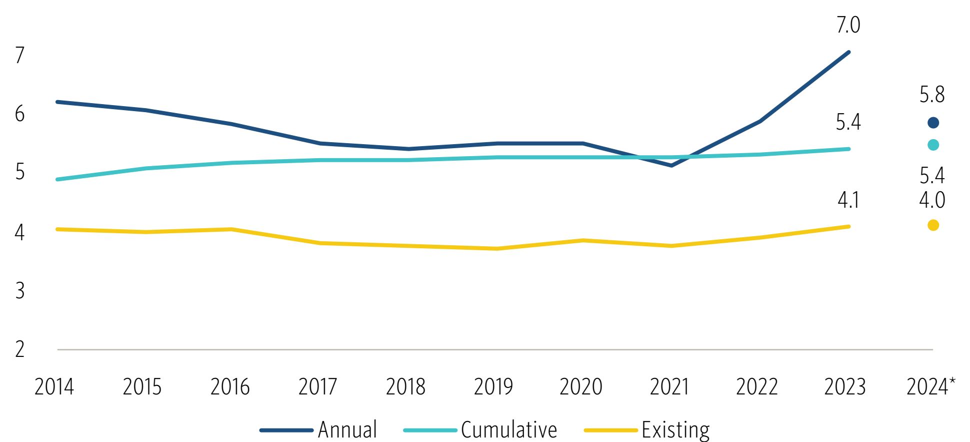
Midyear update: Outlook is not tracking as expected.

An exit logjam continues to plague the PE industry, as GPs hold out for better market conditions instead of being forced sellers. US PE exit activity slid for two consecutive quarters in 2024 so far despite growing pressure from LPs to distribute capital by way of realizations. Persistent buyer-seller valuation gaps have been the main culprit behind the muted exit activity. Recently, however, there have been some encouraging signs: Exit value in the first half of 2024 is tracking ahead of the same period in H1 2023 after being mired in a decade low for all of 2022 and 2023, and exits via continuation funds are steadily gaining speed. PE sponsors appear to have gained more breathing room on the financing front as well, which will likely bolster more sponsor-to-sponsor exits.

Since the US PE Outlook was published last December, PitchBook has captured over 200 more lagging PE exits that occurred in 2023. As a result, the median hold time of companies exited in 2023 has since been pushed up to a new record of 7.0 years. For YTD 2024, the median holding period of completed or announced exits has contracted meaningfully, dropping to 5.8 years. This is in line with the previous five-year average, and it demonstrates that GPs have successfully alleviated some of the mounting pressure from a backlog of exits. The cumulative median hold time remains steady at 5.4 years. The two measures of a stalling exit environment have improved somewhat since the end of 2023 as GPs adjust to slowly improving valuation gaps and bring their higher-quality—and perhaps younger—assets to the market while holding on to the rest. GPs turning to continuation funds as a strategy could also ameliorate hold times.

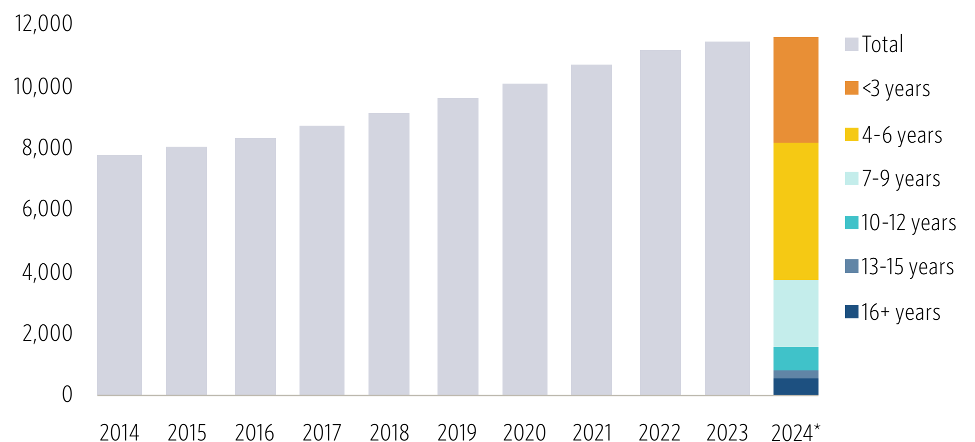
Hold times on unexited portfolio companies have also contracted, albeit slightly. As of June 30, 2024, the 11,567 companies in our US PE inventory have been held by their respective firms for a median of 4.0 years, which is just below the December 2023 figure of 4.1 years. The PE inventory has grown as platform deal activity continues to outpace exits, and this mismatch is helping lower the median age of currently held PE companies. The impact of a slower exit pace can be seen more clearly by comparing to the five-year average of 3.8 years. A rebound in PE deal activity paired with a modest improvement in exits could continue to push down the median age of PE companies, but if GPs market their younger assets for sale first, the median age could tip toward the older companies that remain in the PE inventory.

Median PE buyout hold time (years)



Source: PitchBook • Geography: US • *As of June 15, 2024

PE-backed company count by investment year and investment age



Source: PitchBook • Geography: US • *As of June 30, 2024

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Outlook: The mix of founder-owned company deals, now 56% of all US PE buyouts, will push even higher.

Rationale from December 2023

Nonbacked companies—meaning companies that have yet to accept institutional money—have historically represented the largest portion of US PE deal activity, accounting for an average of 55.6% of the total number of deals over the past decade. For the most part, these represent businesses that are still in the hands of the employees or families who founded them. Since the beginning of 2021, there has been an upswing in the share of all PE deals represented by these nonbacked companies. From a starting point of 48.5% in Q2 2021, this percentage has now risen to 53.0% of deals as of November 2023.[5] However, this falls short of the Q1 2020 peak, when nonbacked companies reached 65.3% of all private equity buyouts, capping a nine-year upward trend.

PE investors are currently placing a greater emphasis on operational improvements rather than relying solely on financial leverage to generate returns. When acquiring a founder-owned business, there has been no outside capital previously injected, so PE owners can start with a clean slate, free of any baggage or conflicting cultures from prior owners. Acquirers of founder-owned businesses are entering these companies on the ground floor in terms of value-creation opportunities, such as scaling the business and improving cost efficiency. We anticipate that GPs will continue to turn toward nonbacked companies to operate their value-add strategies in this manner. Founder-owned businesses also tend to offer cheaper purchase price multiples—a welcome offset to higher borrowing costs.

Nonbacked companies provide ample opportunity for PE firms to create value, making them attractive deal targets.

Midyear update: Outlook is tracking as expected.

The dealmaking environment has started to show signs of stabilizing, with nonbacked companies continuing to represent the majority of US PE deal activity. Despite signs of improvement in dealmaking, the seller universe remains limited as sponsors are selling their best assets and waiting on the rest for a better exit environment. Moreover, bid-ask spreads between PE firms have limited sponsor-to-sponsor deal activity. That leaves only a few other sellers, and of those that remain, nonbacked companies looking to sell for various reasons sit on top. As PE dealmaking continues to find its footing, nonbacked businesses will likely play a key role in helping the asset class return to pre-pandemic deal flow levels.

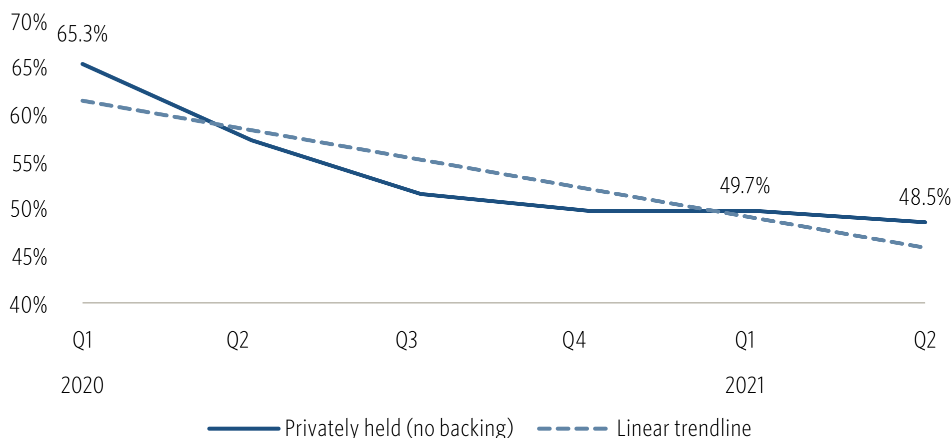
Sponsors continue to employ more of a value-oriented dealmaking approach, and as a result, nonbacked businesses continue to account for the majority of PE deal activity in the US. Through the end of Q2 2024, nonbacked companies accounted for 56.4% of US PE deal activity, with the first and second quarters of 2024 seeing sequential increases. Nonbacked deals have seen their percentage of deal flow bounce back from the Q2 2021 bottom of 48.5% of deals in the US. Nonbacked companies provide ample opportunity for PE firms to create value, such as

5: These figures are restated from original data to reflect late reporting deals.

implementing operational improvements rather than relying on financial leverage to generate returns, as seen in recent years, making them attractive deal targets for sponsors.

Borrowing costs remain elevated and will likely stay that way for the remainder of 2024. As a result, PE firms continue to look further down market at companies with lower, more favorable purchase prices to compensate for the lack of leverage. When looking further down market, the number-one seller that sponsors have found is nonbacked companies, also known as founder-owned businesses, that have never accepted outside capital. Additionally, US PE firms continue to sit on elevated levels of dry powder, which currently totals $965.0 billion and needs to be put to work in a limited universe of sellers. As a result, we expect nonbacked businesses to continue to take up a growing percentage of all US PE deal activity.

Deals with nonbacked companies as targets as a share of all PE buyouts by quarter*



Source: PitchBook • Geography: US • *As of June 15, 2024

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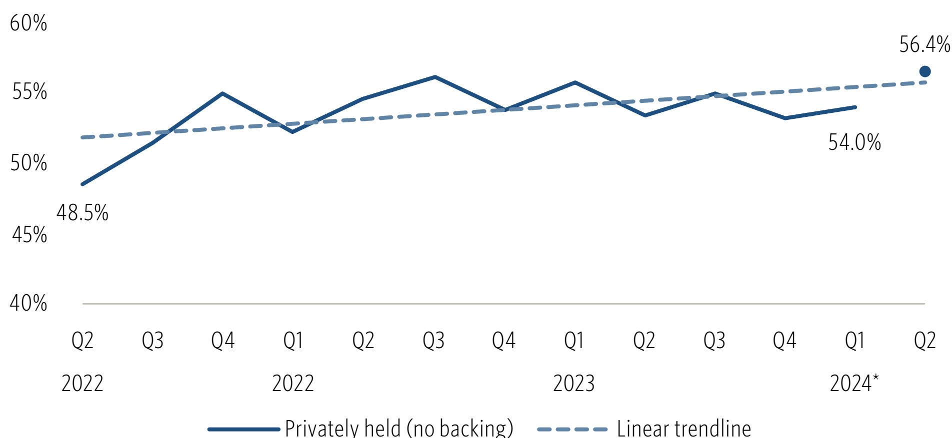

Source: PitchBook • Geography: US • *As of June 15, 2024

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Outlook: PE healthcare services platform trades will not resume until the Fed begins cutting rates in earnest.

Rationale from December 2023

We recorded just 66 platform buyouts in 2023, one-third less than 2020, the next-lowest year since the start of our curated healthcare services data in 2017. Most of the platform deals recorded in 2023 were acquisitions of small providers without existing institutional backing. Very few platforms have been sold from one sponsor to another, the traditional exit route in healthcare services. This means that sponsors are returning very little capital to their LPs, and some platforms are in dire need of recapitalization.

The key question, then, is when platform trades will resume. Anecdotally, bankers are sitting on growing pipelines of potential sales, but almost no one is willing to pull the trigger. Buyers, too, have capital to deploy, as evidenced by the fundraising trends discussed above. A substantial rate-cutting cycle will likely be the impetus for the resumption of platform trades. Valuations have already come down a few turns (if not more) in most healthcare services categories, and sellers need to believe that they are exiting into the best market they can reasonably hope for. This is especially true for platforms that last traded at high prices in 2019 to 2021. Valuation, in turn, is dependent on the buyer's deal math. In a high-rate environment, deal math for a traditional physician practice management company (PPM) roll-up has become far less attractive, with more cash required up front, less headway available to finance add-ons with debt, and the real prospect of further multiple compression. Ironically, the tantalizing prospect of a soft landing—and concordant rate cuts—on the horizon makes sponsors less likely to exit now. Put another way, we believe most sponsors will prefer at this point to elongate their holding periods rather than accept subpar returns, at least in 2024.

Midyear update: Outlook is tracking with some variations.

Platform deal activity remained low in the first half of 2024, with just nine deals recorded through the end of Q1.

Platform deal activity remained low in the first half of 2024, with just nine deals recorded through the end of Q1.

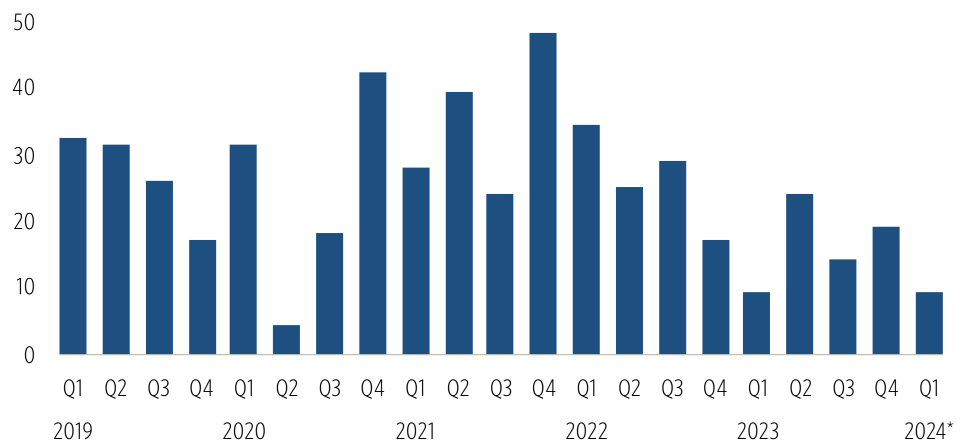
The same valuation impediments we highlighted in our outlook persist, although leveraged loan pricing has eased since 2023 in both the broadly syndicated loan market and, in turn, private credit markets. Troubled capital structures have generally been repaired in a wave of refinancings and repricings. Several dynamics have emerged or grown since December 2023 that net out to an expected slight increase—but far less than a full resurgence—in sponsor-to-sponsor platform trades.

On the positive side of the scale, managers continue to be under intense pressure from LPs to return capital, even at a below-target IRR if need be. Another key stakeholder group not always acknowledged in deal flow discussions—physician-partners with rollover equity—is also clamoring for the "second bite" realizations they were promised. Additionally, in just the past month or so, we have begun to hear a few managers express that they are under pressure to deploy capital rather than simply to return it. This is a new dynamic, and probably a somewhat healthcare-specific one, since a strong crop of specialists closed large fundraises in 2023, and a few more are preparing for or are in early fundraising motion with ambitiously targeted funds. Finally, one of the "risks" to our prediction we identified in the December 2023 note—that the Fed continues to signal "higher for longer," thus dimming prospects of imminent rate cuts and forcing some sellers to bite the bullet and come to market—is beginning to come true.

On the negative side, regulatory headwinds for PE healthcare services investing have grown to gale force over the past six months. Most healthcare sponsors we have spoken with recently, including historically healthcare services-focused managers, are prioritizing healthcare IT and pharma services theses. As the top end of the market pivots away from investing in direct patient care, there is growing anxiety around exit prospects for mature, midsized to large PPMs.

All in all, we now hold a slightly more positive outlook for sponsor-to-sponsor deal flow than we had at the end of 2023. The applied behavioral analysis space offers an encouraging example. There, platform multiples, which reached the high 20s in 2018 to 2021, subsided to a still-healthy mid-high-teens level for a pair of platform trades in Q2 2024. We expect to continue to see a few high-quality assets trade at respectable multiples in the second half of the year, though this will not come close to clearing the significant exit backlog. We will consider the healthcare services market fully "reopened" when platforms that suffered broken processes in 2023 return to market en masse—likely at depressed prices—but we expect that will not occur until at least 2025.

Platform buyout count by quarter



Source: PitchBook • Geography: US and Canada • *As of March 31, 2024

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