Q2 2023

US PE Breakdown

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Methodology change update:

In connection with our previously communicated methodology change, we will discontinue estimating future restatements in deal value. Since adopting our new methodology of including announced deals in addition to completed deals, the restatement of deal value has diminished greatly and as such estimates based on historic activity are no longer warranted. This change will apply to deal value only. We will continue to estimate expected revisions in deal count, as that has remained fairly consistent with prior observed activity. This change will apply to this and all future PE- and M&A-related reports and harmonizes with the methodology already in use for VC-related reports.

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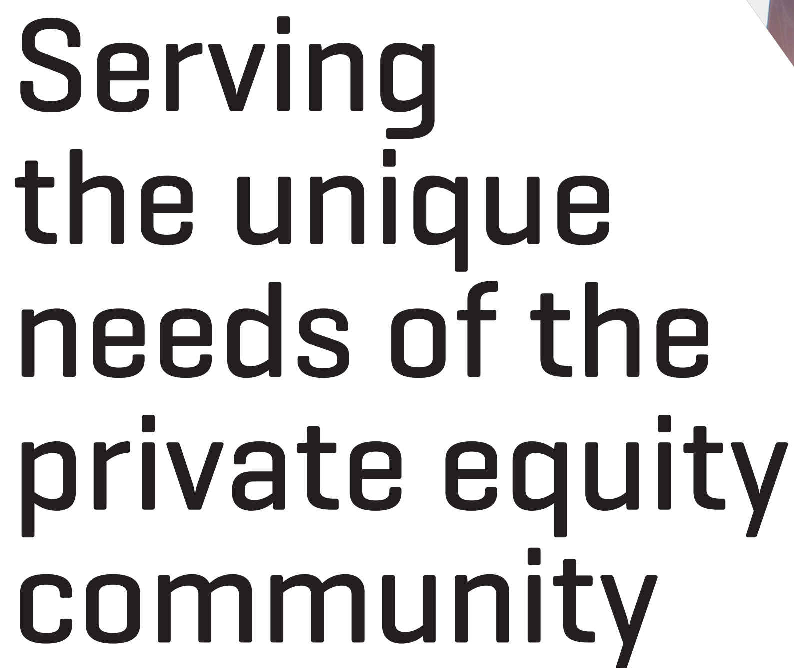

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EXECUTIVE SUMMARY

Halfway home

The first half of 2023 has played out in similar fashion to the back half of 2022 for US PE on many fronts. The industry continues to battle through a stubbornly high interest-rate environment that makes the cost of borrowing and servicing floating-rate debt prohibitively expensive for deals that would otherwise get done. Deployment remains down by 49.2% from the quarterly peak reached in Q4 2021, and realizations are down by 67.6% from the Q2 2021 peak. Fund performance, while still handily ahead of most asset classes and strategies on a 10-year basis, has fallen to the middle of the pack on a one-year horizon basis. As a result, fundraising continues to be more difficult and is tracking 15%-25% below 2022's first half, although other strategies such as venture and real assets have fallen more precipitously.

The seminal event so far this year, of course, was the Silicon Valley Bank failure and the mini-bank crisis that followed. PE escaped relatively unscathed, with four large take-privates announced in the two weeks surrounding that event. Indirectly, however, it created a more risk-averse environment among lenders and kept the lid on leverage ratios. The average share of debt to enterprise value on LBO deals has fallen to 43.3% so far in 2023, a lockstep change from 2022's average of 50.8% and the five-year average of 52.2%. Meanwhile the yield-to-maturity on new-issue leverage loan deals backing LBOs averaged 9.47% in Q2, little changed from nine months ago.

Also on the worry list is the continued anemic level of exit activity. The number of exits dropped by another 22.2% from Q1 and is now consistently below pre-COVID levels. Investments have outnumbered exits by three-to-one, even after excluding add-ons, and this imbalance needs to be cured to avoid a pile up further down the road when big funds face big maturity dates. There were some green shoots as the quarter closed with two large PE exits via M&A (Adenza for $10.5 billion and Apptio for $4.6 billion) and two via public listings (the $2.9 billion IPO of Savers Value Village and the $1.2 billion IPO of Kodiak Gas Services). The M&A exits were especially encouraging as they validate PE's furious "build-and-buy" playbook, which pushes platforms to reach critical mass quickly in order to attract much larger suitors, in this case Nasdaq and IBM. The multiples paid were also encouraging, to say the least, estimated at 20.2x TTM revenue for Adenza and 12.5x for Apptio.

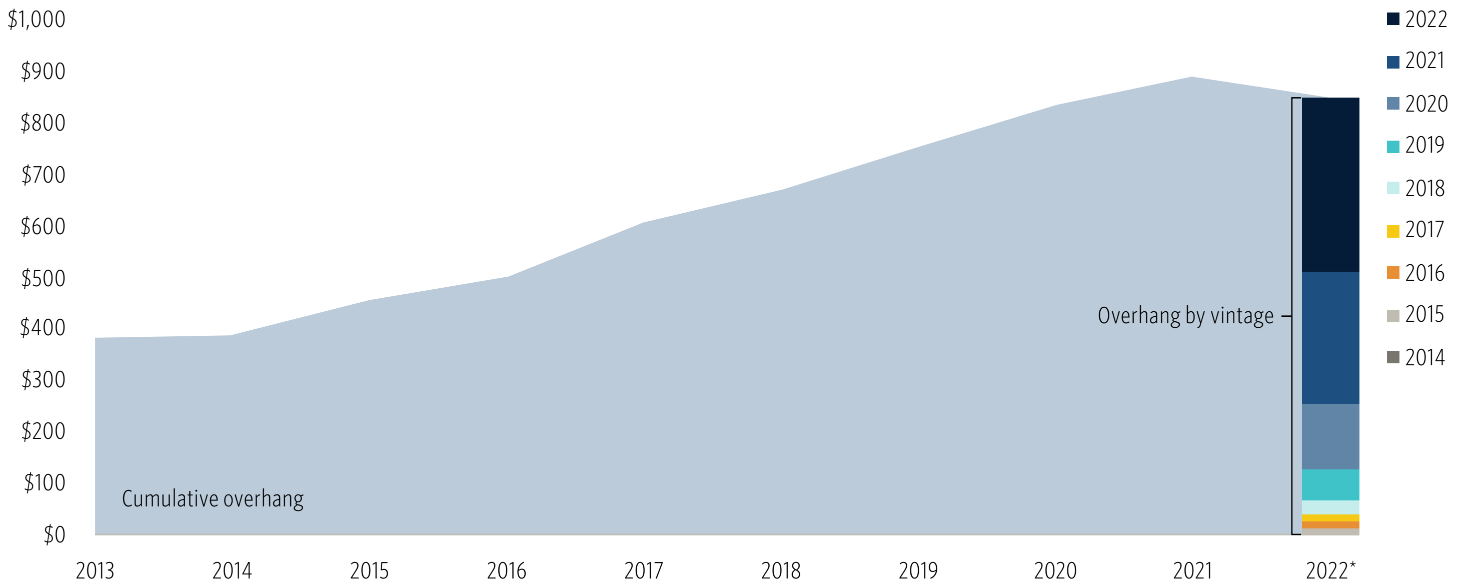
While many of 2022's trends carried into 2023, there are some notable differences. Public markets have rebounded: As of June 30, the S&P 500 was up by 17.6% on a one-year basis, in stark contrast to the 18.1% one-year negative return just six months prior. The negative denominator effect is not as pronounced, and allocators have some breathing room to allocate more to PE or stay the course. Another noteworthy change is that big banks have slowly waded back into the leveraged buyout (LBO) market. After taking an eight-month sabbatical on making any new commitments to large take-privates, a trickle of new leveraged loan deals was announced in February and picked up steam in March. Private credit funds continued to lend all along and were the main reason the LBO market and PE deal flow, in general, did not collapse coming out of the steepest rate hikes in more than 40 years. Instead, the industry has maintained pre-COVID-19 levels of deal activity, which used to be considered strong years before the 2020 to 2021 frenzy set the bar impossibly high.

We suspect the second half of 2023 will provide its own twists and turns and will render a verdict as to whether higher interest rates are here to stay or the industry's journey to a friendlier LBO backdrop is finally complete.

New issue spread and yield-to-maturity on debt-backing LBO deals

Source: PitchBook | LCD • **Geography:** US
**Note: As of June 27, 2023. Lack of observations in Q4 2022 to provide meaningful averages.*

US PE dry powder ($B) by vintage



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

A WORD FROM STOUT

The state of dealmaking in a down market

Ted Speyer

Managing Director - Investment Banking
Stout

As a Managing Director in the Financial Sponsors Group at Stout, Ted covers a robust network of premier middle-market private equity clients. Throughout his 12-plus years in investment banking, he has executed a broad range of M&A engagements and diverse capital markets transactions in the public equity, private equity, and leveraged finance markets.

Bartley O'Dwyer

Managing Director - Private Equity Business Development
Stout

As Head of Private Equity Business Development at Stout, Bartley is leading teams in cultivating extensive relationships across the private equity market and with senior executives in technology, consumer, industrials, healthcare, energy infrastructure, and financial services. He has over 20 years of experience working with private equity sponsors, venture capital firms, investment managers, hedge fund managers, family offices, credit investors, business development companies, and lenders.

1. Markets remain uneasy for a multitude of factors. Which factors are you watching most closely, and why?

Ted: It has been a difficult year for private equity dealmaking. The Fed rate cycle continues to dominate the macro landscape. Rising rates, inflation, and uncertainty have negatively impacted M&A conditions. Many industries have seen rapid shifts in valuation, portfolio company performance has slowed, and financing costs have increased. That said, the Fed has followed a reasonably predictable and well-communicated path, so there have been few surprises, and firms have adjusted expectations accordingly. Notably, while geopolitical events always impact markets, the war in Europe and the pandemic are no longer having a significant effect on the appetite for dealmaking

We started to see some green shoots of increased M&A market activity in late Q1, but they were mostly quashed by the liquidity crisis in US regional banks, which culminated in the failure of SVB and others. This summer has seen a similar mini spike in new launches, as some sellers try to get transactions done by year's end. Overall, most of our clients are seeing deal flow down 25% to 40% YoY, resulting in far fewer opportunities to deploy capital.

Today, we are mostly focused on the long process of buyers and sellers realigning on value. There is no real catalyst other than time to truly reignite deal activity. The exact timing remains difficult to predict. For much of the last year, we have been hearing the return of active market conditions is three to four months out. The pressure for private equity funds to deploy capital is intense and building, so we anticipate a significant spike in activity when markets return to something like what we saw in early 2021 after the pandemic-driven slowdown.

2. Sponsor M&A activity has been quiet this year, and competition for attractive assets remains significant. Where are you seeing pockets of activity?

Ted: Overall, sponsor-backed deal flow in the middle market is materially down as market volatility makes aligning buyer and seller valuation expectations more difficult. As a result, many sponsors are not even considering selling portfolio companies until 2024.

However, the drivers of activity in the lower middle market (particularly for founder/family-owned businesses) are less dependent on financing, cycle, and valuation than other areas. Stout has been very active with platform and add-on deals under $25 million of EBITDA backed by founders, and we continue to be busy pitching and executing in this space. Many sponsors have been playing down the market to take advantage of this flow, especially in situations wherein continued consolidation opportunities allow further deployment of capital.

Certain sectors are healthier than others. We see activity in services broadly, healthcare services (especially non-reimbursement risk plays), and less cyclical Industrials. Meanwhile, consumer/retail has been weaker overall, and growth tech has been challenging. However, our tech bankers are busy working on old-line industry tech enablement, which remains a huge opportunity.

3. How can sponsors play this market?

Ted: Firms are more actively considering minority and structured deals through their main funds or dedicated pools of capital. Sellers, particularly those attempting to fundraise in a tough environment, are also more open to these transactions, as they can provide a valuation mark for a current portfolio company and some return of capital. Continuation funds remain popular as a way to record a valuation mark while holding an asset longer through a cycle.

In this environment of limited supply, competition for quality assets that hit the market is fierce. We are seeing numerous attempts to preempt processes, and speed to close is a real advantage.

4. With deal flow down, how are investment professionals and operating teams spending their time?

Bartley: Many are taking this slowdown as an opportunity to get the house in order at portfolio companies across the obvious pillars of people, process, and technology. This includes downsizing and businesses not replacing headcount lost through the ordinary course of business attrition.

Additionally, the role of the operating partner has changed. Previously, the operating partner was a C-suite executive ready to parachute in, but more and more (even with middle-market and lower-middle-market sponsors), there is a greater emphasis on deep functional skills (go-to-market, finance, and supply chain, for example) and a direct remit to drive EBITDA. Firms that shifted to this model will likely fare better through this slowdown.

Sponsors with platforms that have been highly acquisitive over the past 24 months are slowing the add-on pace and are taking a deeper look at back-end integration and efficiencies, with a focus on driving more top-of-funnel demand and sales efficiencies so that they are poised for growth when the economy improves. Companies are also focusing on fixing processes within the cash conversion cycle, such as order-to-cash and procure-to-pay, as well as faster invoicing, collections, and cash management. Healthy portfolio companies are upgrading key parts of the application stack like enterprise resource planning (ERP) and enterprise performance management (EPM) solutions.

5. How are valuation processes and terms and conditions evolving in the current milieu? How do they vary on the sell side versus the buy side?

Ted: In the current environment of diminished deal flow, sponsors have been aggressive on deals for quality assets. We have seen more attempts to preempt sell-side processes in the past year, and the trend is continuing. Several clients have found it difficult to compete if they are not on a highly accelerated timetable.

This dynamic has several implications for launching sale processes. For example, as speed is paramount, we have seen more prevalent equity backstops and/or over-equitizing for sponsors, especially for the A/A+ assets.

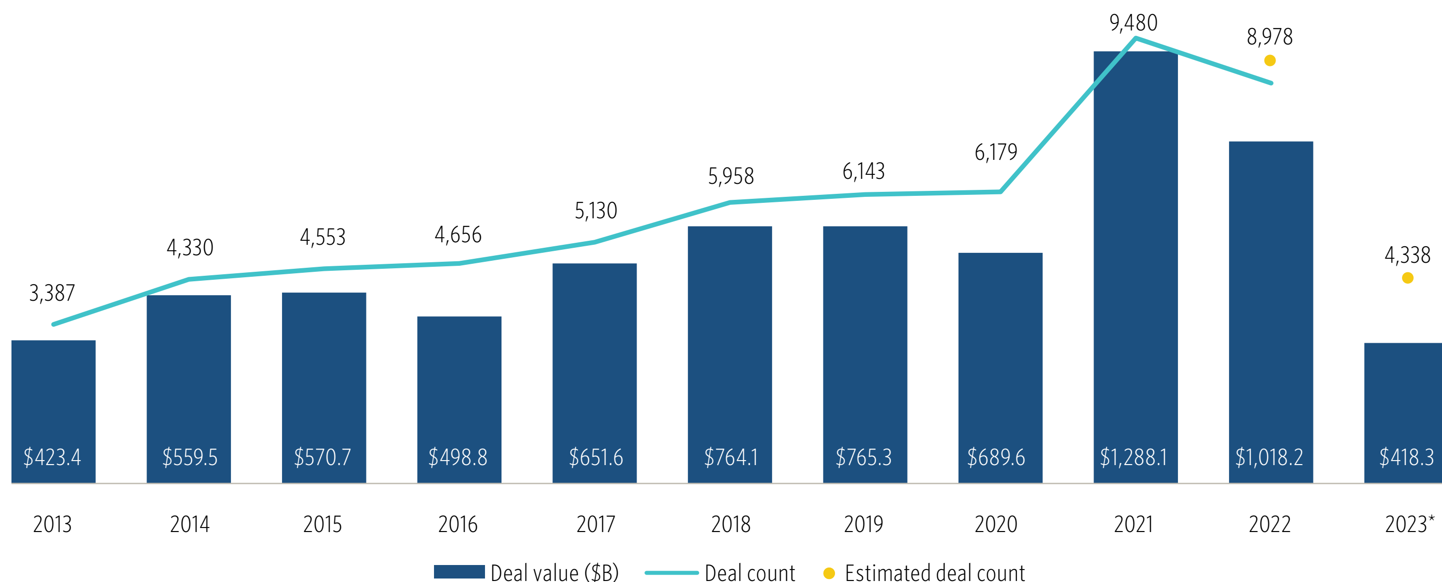
There has also been more caution around broad marketing launches. We have seen some sellers speaking to a small subset of buyers to see if a preemptive bid is possible, and then waiting for better market conditions if there isn't enough interest.

Getting an advance view on leverage before launching a process is increasingly important from the sell-side perspective. As available leverage levels have dropped and cost of debt has risen, valuation has come down modestly for assets that are more sponsor oriented. We have seen less of an impact in strategic-focused deals.

Another continued trend is the increasing use of buy-side advisors with material fees in situations wherein banks bring real access and origination on deals. Most of our middle-market clients now recognize the importance of rewarding advisory partners for differentiated advice and idea flow.

Deals

PE deal activity



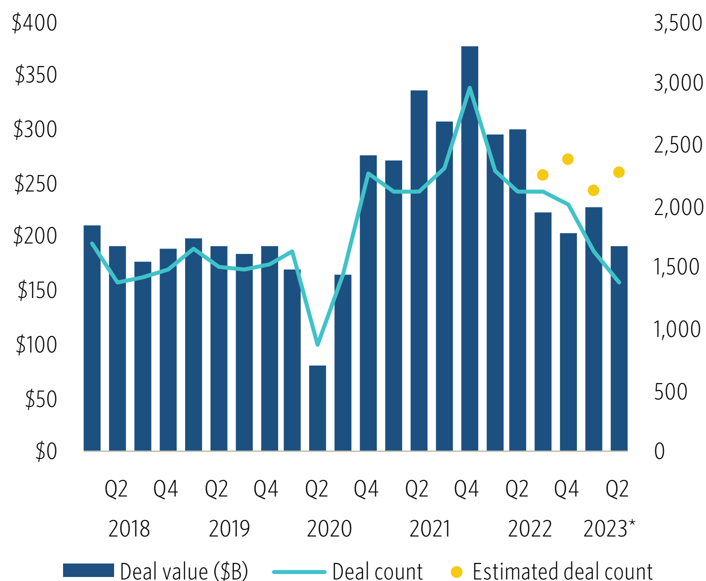
Source: PitchBook • **Geography:** US
*As of June 30, 2023

Overview

US PE dealmaking delivered another mixed quarter in Q2 with deal count slightly up and value declining by 15.8% from Q1. Dealmaking has declined in four of the last six quarters and has yet to stabilize. Since peaking in Q4 2021, quarterly volumes are now down 24.0% by deal count and 49.2% by deal value. Deal count is still solidly ahead of pre-COVID levels by 56.3% but only marginally so by dollar value.

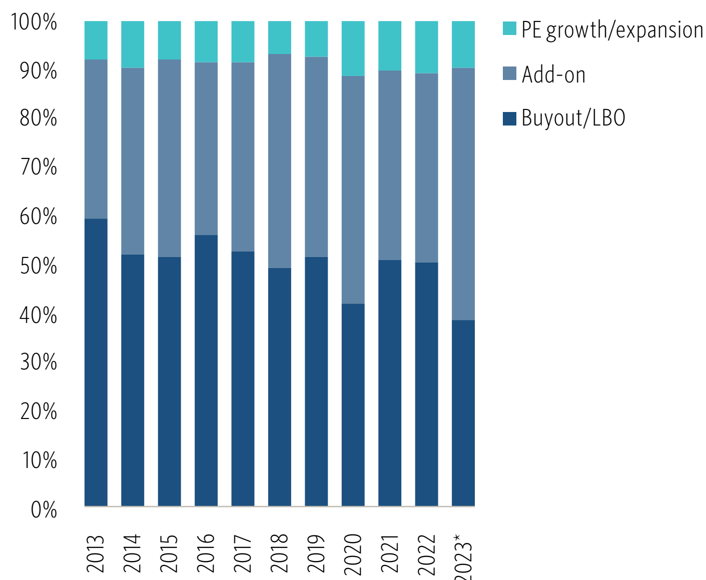
PE managers have had to adjust to make deals happen and keep the sputtering LBO machine from stalling. Deals have gotten smaller, making them more digestible and easier to finance. Many are add-ons, which have taken on outsized importance in the current environment for reasons described below, and now account for nearly eight out of every 10 buyouts. The leveraged loan market is still open for sponsor-backed companies wanting to do add-ons, and many have old facilities locked into place. Another source of credit for add-ons is net asset value (NAV) financing. Instead of using an individual company as collateral, these lenders use the NAV across a portfolio of companies held by a fund. This further

PE deal activity by quarter



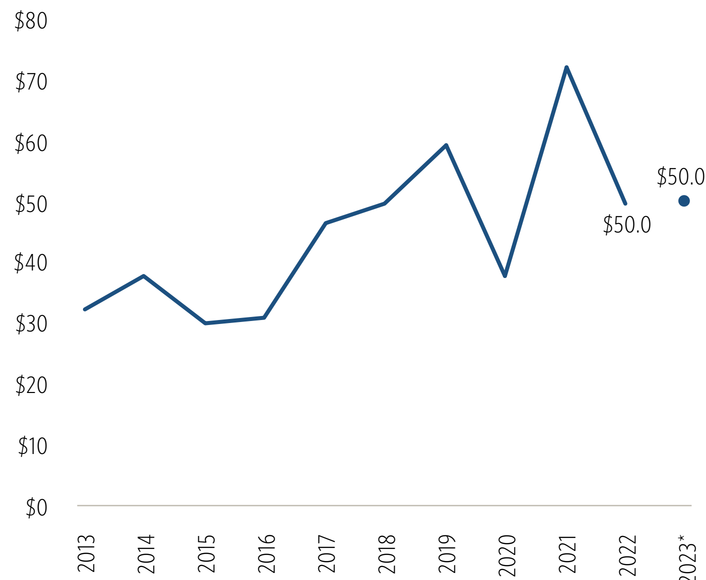
Source: PitchBook • **Geography:** US
*As of June 30, 2023

Share of PE deal value by type



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

Median PE deal value ($M)



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

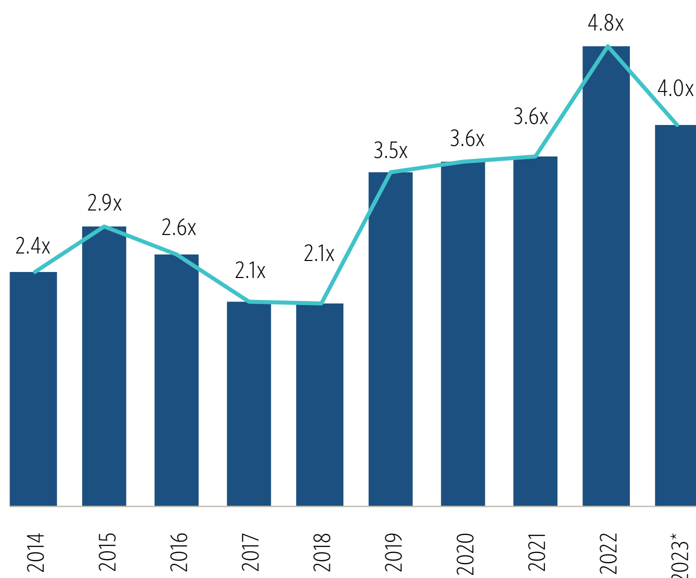
explains why add-on dealmaking is so frenzied, as it is seen by sponsors as a way to fix up portfolios in advance of selling these platform companies further down the road, and every bit of leverage counts. The NAV finance market is estimated to have grown by 50% in 2022.[1]

Growth equity deals, which are smaller deals and normally do not rely on debt, depend instead on a PE firm's ability to apply active management to augment company growth and boost returns via operational leverage in lieu of financial leverage. This continues to see increased deal activity. Corporate divestitures are another variation of the smaller deal theme. In recent months, buying smaller pieces of larger companies has seen a resurgence and is poised to push above a 10% share of all buyouts for the first time in more than a year. Lastly, even take-privates are smaller. Normally a bastion of large LBOs, more than half of all take-privates this year have been below $1 billion in size. As the target market for take-privates has broadened into the domain of middle markets, it has maintained the same brisk pace as the first half of last year when 43 take-privates were announced. This marks a re-acceleration from the second half of 2022 when it looked like take-privates had paused, only to be re-booted at the beginning of 2023. These are all examples of how PE has adapted to a rising rate environment: keeping deal sizes small or finding other sources of capital to fill gaps.

1: "Interviews," 17Capital, Robert de Caorainville and Greg Hardiman, March 22, 2023.

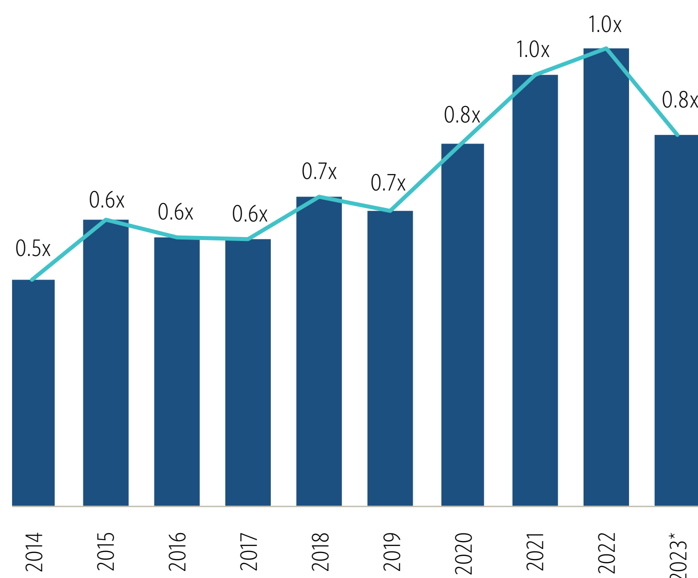
PitchBook

Median EV/revenue multiples on deals $2.5B+



Source: PitchBook • **Geography:** North America and Europe
*As of June 30, 2023

Median EV/revenue multiples on deals below $25M



Source: PitchBook • **Geography:** North America and Europe
*As of June 30, 2023

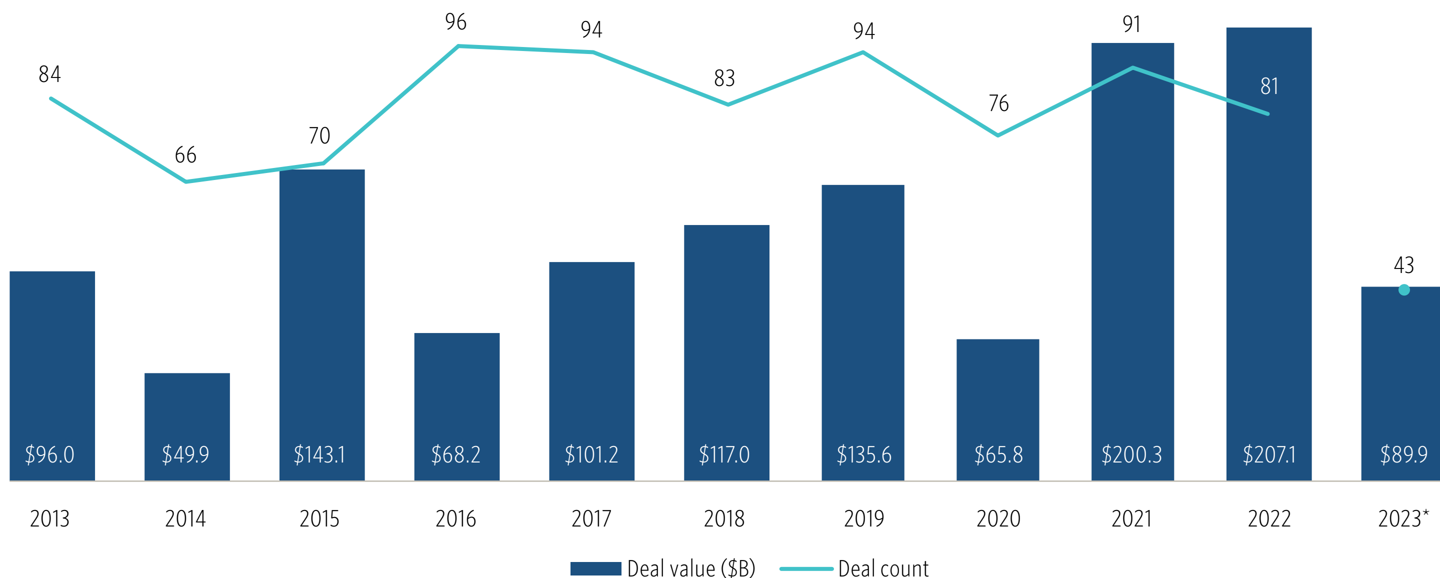
Valuations

Prices paid on PE buyouts are in full correction mode. Using enterprise value (EV) to EBITDA as a metric, multiples remained in a tight band of between 11.5x and 12.4x in the four years ending 2022 before collapsing by 18.5% this year. The median EV to EBITDA multiple now stands at 10.5x for the 12 months ended Q2 2023, down from 12.1x in 2022. EV to revenue multiples tell a similar story. After inching up to 2.2x in 2022, the median multiple has declined by a less-severe but still-significant 10%. EV to revenue is a broader yardstick of value as it captures a bigger sample size than EV to EBITDA, so it is less volatile. It also does a better job incorporating tech, which is littered with companies having little to no EBITDA but strong revenue growth. Likewise, revenue multiples are a better benchmark for financials where EBITDA is not necessarily relevant. The median EV to revenue multiple on PE buyouts now stands at 2.0x on a trailing 12-month basis, down from 2.2x at the beginning of the year. We pull in European multiples to further expand sample sizes as the US dataset is simply too thin and volatile due to low PE disclosure rates on private companies, especially on small to mid-sized companies. If one were to separate the two, it would show that prices paid by PE buyers for US companies skew higher by 25% to 30% owing to the concentration of large take-privates in the data. Combining the two better represents broader trends including the middle market. Both regional data sets are available for separate viewing in the Excel summary published with this report.

Drilling into the three distinct sectors toward which PE firms tend to gravitate —tech, healthcare, and financial—we see similar price weakness across the board with some variations. Financials are in full-scale retreat with revenue multiples below 2.0x from a median of 3.4x in 2022. Revenue multiples are holding up much better in healthcare and tech at 2.5x and 4.9x, respectively, but less so on an EBITDA basis where multiples have declined by 11.0% and 12.7%, respectively. We take that to mean PE buyers are still willing to pay up for revenues in these two secular growth industries—but only if they come with expanded EBITDA margins this year versus last year.

Drilling into size, just as we found in our Global M&A Report, which incorporates the corporate buyer in addition to the PE buyer, there is a clear relationship between purchase price multiples paid and size, with valuations stepping up to buy scale and stepping down for smaller companies and bolt-on deals. PE paid a median multiple of 4.0x revenue in megadeals of $2.5 billion or more in size, exactly twice the median multiple for all deals. While at first blush that may look like an enormous multiple and premium to pay, it was even higher last year at 4.8x and 117.2%, respectively, reflecting the fact that valuations have fallen harder in this segment of the PE deal market as leverage for large deals grew scarce. Looking at the other end of the size scale—companies and deals below $25 million in value—significant discounts emerge with a median revenue multiple at 0.8x, or 58.3% below the median multiple paid for deals of all sizes. Here too, multiples fell more steeply in the last year, down 20% from a median of 1.0x in 2022. Everything in the middle hewed closer to the 2.0x all-deals median and 10% average decline.

Take-private activity



Source: PitchBook • **Geography:** North America and Europe
*As of June 15, 2023

Take-privates

Taking public companies private continues to be a highly popular strategy for PE. A total of 43 take-privates have been announced or completed so far in 2023, identical to last year, which went on to record the highest take-private deal value in 15 years.

Deal sizes have contracted significantly due to the constrained lending environment for big LBOs. The median deal size of 2023's crop is $482.9 million, which compares with a median of $1.7 billion during the same span last year, dropping the combined value of take-private deals to $89.9 billion YTD versus $147.2 billion YTD in 2022. While down from H1 2022, this year's activity marks a re-acceleration from H2 2022 when take-privates slowed to just 32 deals and $44.8 billion in value.[2]

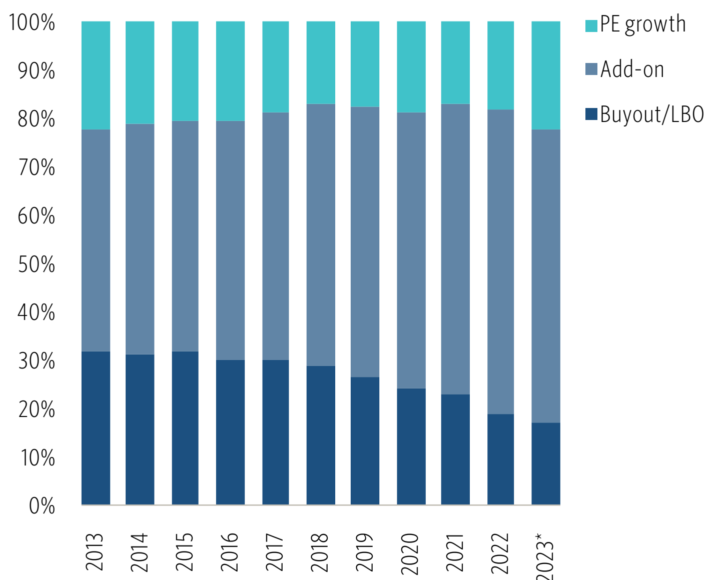
Of the 43 deals announced by PE firms this year, 23 were below $1 billion in size, up from 17 the prior year. This is consistent with our outlook expressed at the beginning of the year that take-privates would remain active but skew smaller. The $482.9 million median size of this year's deals was even smaller than we expected, and they came from an unexpected quarter. As it turns out, PE buyers went on a shopping spree in Europe where there is a long tail of sub-$1 billion public companies, and where the tender offer process allows for smaller stakes to gain full control. All but five of 2023's 23 sub-$1 billion take-private deals were European, a reversal from last year when the majority were North American.

"Boomerang" stocks—companies that succumbed to the take-public wave of 2020 to 2021 only to be become private again—are playing out, but in a different manner than we envisioned. Just under half, or 17 take-privates total, featured newly listed companies from the class of 2020 to 2021. While we expected these to hail from the 664 US IPOs and de-SPACs that started the year at less than $1 billion in market cap and down 76.5% in price, only four were taken from that cohort; another nine disappeared into the hands of public buyers, and nine went bankrupt. Instead, PE buyers mostly took aim at larger-cap boomerangs offering less steep discounts but greater quality and scale, as illustrated by the take-privates of public newcomers Qualtrics and Cvent.

Having a sub-$1 billion market cap is a tough road to hoe in public markets. The trading float is not sufficient to attract market makers, and that carries over to research coverage as well. Before long they end up being orphaned stocks with very little Wall Street support, and as a result, getting caught in a value trap. We still believe it's only a matter of time before many of these once promising new listings are taken private again or just fold. Their ranks have remained relatively static since the beginning of the year and valuations have drifted even lower. Take-over targets with high EBITDA margins and low or negative net debt levels are the ones going first in the present take-private market, as it takes the pressure off sponsors to line up debt in a leveraged-starved environment.

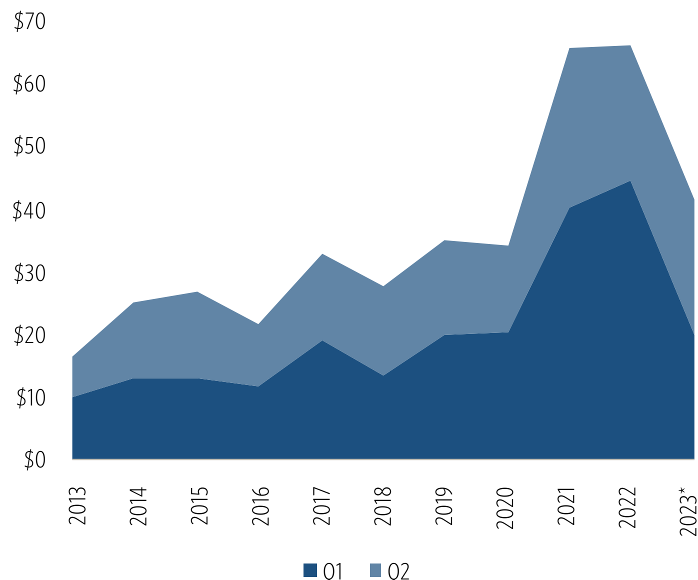
2: All values given are for North America and Europe

Share of PE deal count by type



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

H1 growth equity PE deal activity ($B)



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

Growth Equity

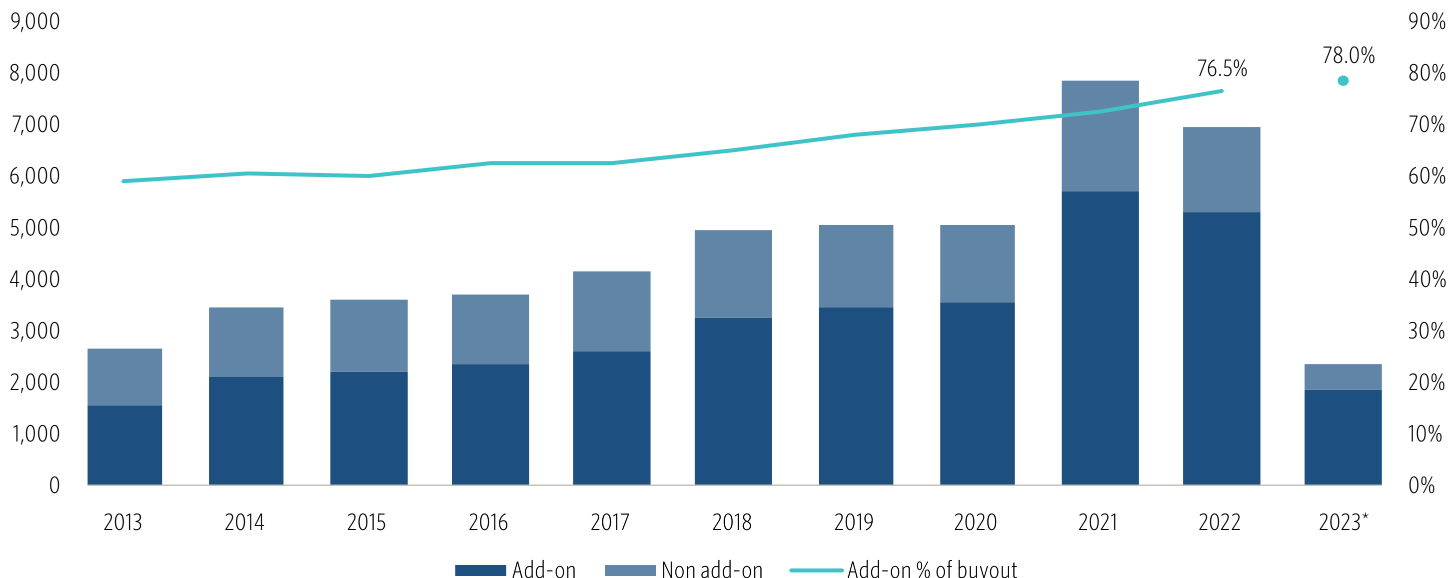
Growth equity is striding ahead on the deal front as it avoids the costly financing on which buyout strategies often rely. As a result, growth equity expanded its share of the total PE deal mix to 22.2% in H1 2023, up from 18.5% last year and within reach of the 10-year high watermark of 22.7% set in 2013. Additionally, growth equity is on pace for 2023 to be the first year in more than a decade where growth equity deals outnumber buyout deals.

Even if growth equity deal counts are down from the peaks of 2021-2022, the investment style exhibits resiliency. Its pace for deal volume in H1 2023 is tracking like 2019, with deal count up 9.3% YoY, while total deal value is up 19.5% YoY. This is a sharp contrast to the buyout category, where high rates are a headwind and activity is well below 2019 levels, with deal count down around 40% YoY, while deal value is down 24.0% YoY.

Growth equity aligns nicely with the current macro backdrop, as it involves minority investments with smaller check sizes and little or no debt financing. Additionally, with sellers anchoring their valuation expectations to the heydays of 2021-2022 and buyers expecting valuations marked-to-market for 2023, minority investments present an easier path to common ground on valuation, especially relative to a control buyout transaction. The value creation opportunity from incorporating the expertise of a PE firm can shift both parties to focus on the future upside after implementing best practices from industry mavens. PE firms are adept at scaling go-to-market, prioritizing growth investments, optimizing supply chains, and executing acquisitions (if advantageous). Pursuing this joint value-creation approach can increase competitive advantage as well as the likelihood of achieving financial goals for both parties.

Looking at the leaderboard, two of the largest growth equity deals of Q2 2023 were in the clean energy space. The largest was Chicago-based Invenergy, a developer and operator of sustainable energy generation and storage projects globally. In June the company received a $1 billion investment from Blackstone, bringing its total raised to $5.0 billion. The second largest was New York-based CleanCapital, which raised $500.0 million from Manulife Investment Management in May 2023. CleanCapital specializes in monitoring, identifying, and managing clean energy projects. This brings its total raised to $1.24 billion, and the company is believed to be a prime candidate for an IPO when the new equity issuance window eventually re-opens.

Add-ons as a share of all PE buyout activity



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

Add-ons

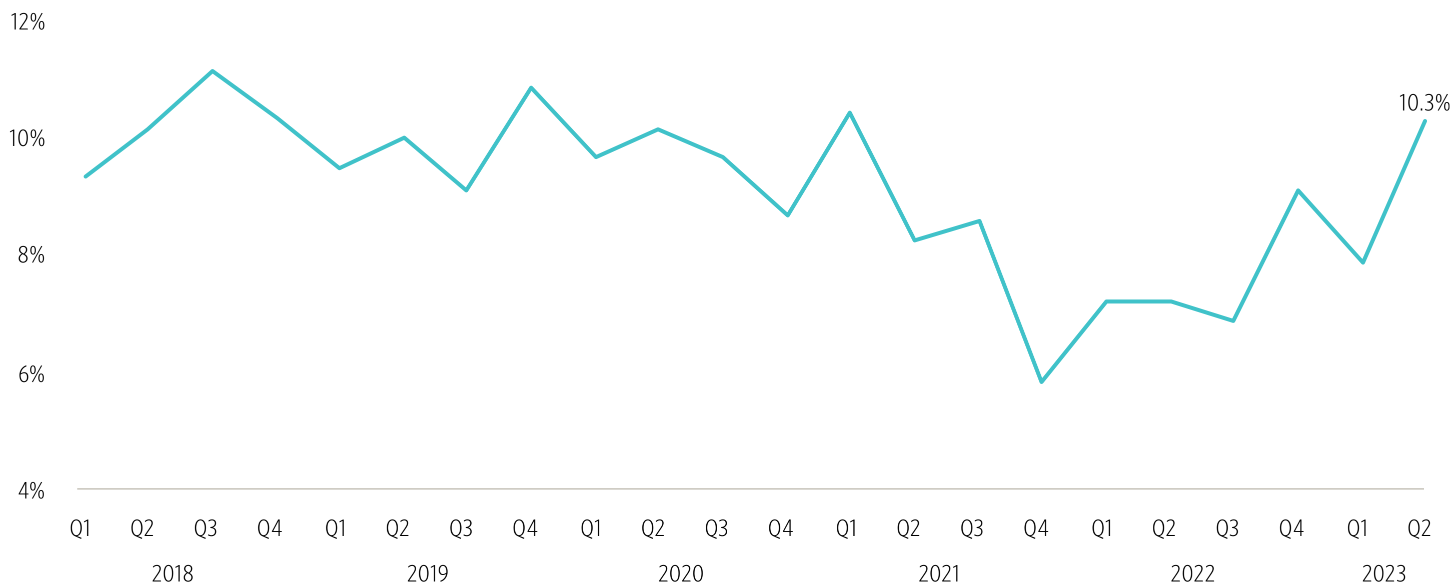
Add-ons are at the core of the PE buy-and-build playbook, and their share of all PE buyouts has risen steadily every year. Historically, that increase is one or two percentage points, but in 2022 and so far in 2023, growth has been off the charts. Add-ons as a share of all buyouts expanded by nearly four full percentage points in 2022 from 72.5% in 2021 to 76.5% before adding another point-and-a-half in the first six months of 2023 to stand at 78.0% currently.

Add-ons have been instrumental in keeping the PE flywheel spinning during this period of tight credit and market dislocation. They allow PE sponsors to continue deploying capital while taking down deal size and biding time until lending markets can support larger platform buyouts. A well-executed add-on can provide revenue and cost synergy that accelerates the top and bottom line for the acquiring platform company and creates value for the PE owner and potential buyer down the road. Add-ons have always been easier to finance, given their smaller size and ability to rely on the existing credit lines of their larger platform acquirer.

These credit facilities are locked into place shortly after a platform is created from a PE-backed LBO. That platform company will then tap the bank-led leveraged loan market, or increasingly, the private credit lending market, for a debt facility to back future M&A activity.

Since 2018, $326.8 billion in leveraged loan deals have been closed for M&A purposes by 479 unique PE-backed issuers. As these tend to be term loans with seven-year maturities, most of these facilities have yet to mature. Moreover, to the extent these older facilities have more advantageous base rates or other terms than what is available presently from M&A lenders, they become a valued source of inexpensive funding, which allows these PE platforms to continue intense dealmaking, albeit in smaller chunks that add-ons are known for. A good recent example of this is Hub International, a platform company owned by Helman & Friedman that is a leading consolidator of the highly fragmented 200,000-strong insurance agency business. The company tapped the leveraged loan market for $850.0 million in October of 2022 and has since completed 24 add-ons of insurance agencies and other related businesses, including 16 in Q2 of 2023 alone.

Carveouts/divestitures as a share of buyouts by quarter



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

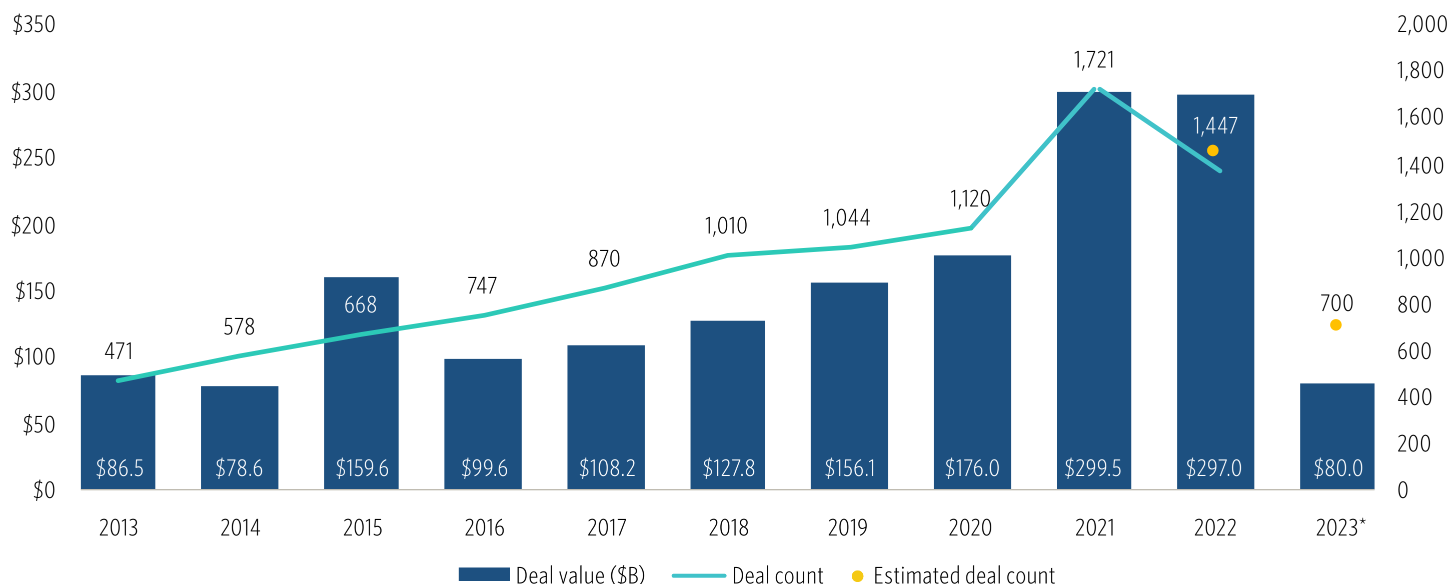
Carveouts and divestitures

In a market downturn, GPs are finding increasing deal opportunities in corporate carveouts and divestitures. Many companies are choosing to spin out noncore or nonperforming assets after reevaluating their businesses to better strengthen their balance sheets. At the same time, sponsors are readily available to pick up those deals thanks to their ample supply of dry powder. Carveouts can be more attractive for GPs during periods of rising interest rates and limited access to loans for leveraged buyouts because they allow GPs to acquire developed businesses at more digestible prices and with more seasoned operating histories that can be easier to bank and finance. Sponsors can use carveout strategies to either restore assets to health or bolster their growth prospects, often combining them with other portfolio companies to create synergies as a platform company. In Q2 2023, carveouts made up 7.8% of all US PE deals, the highest share in recent quarters. Of just buyout deals, carveouts made up 10.3% YTD, and accounted for 7.0% of all US PE activity, which is a slight uptick from 6.6% in 2021 and 6.2% in 2022, which were record lows for carveout activity due to the bull market. YTD carveout share of US PE is still below the last 10-year average. But as the slowed economic environment persists, carveout activity is likely to increase further as more corporates spin off assets and sponsors acquire them in a classic PE strategy of acquiring distressed assets for cheap and strengthening their growth.

While carveout deals can be smaller transactions, they can also be megadeals ($1 billion or greater) as corporations spin out well-established businesses during strategic restructuring. The largest carveout deal in Q2 was Baxter International's divestment of its BioPharma Solutions business, which is being acquired by Advent International and Warburg Pincus for $4.25 billion. Baxter, a medical device manufacturer, had been dealing with supply chain shortages and rising costs of raw materials and labor the last few years and sought to restructure its businesses to better align with the company's manufacturing footprint. Through the acquisition, the two PE firms will use their extensive experience investing in healthcare companies to accelerate BPS' growth as a standalone end-to-end CDMO (contract development and manufacturing organization). Thanks to this deal, healthcare made up the greatest share of carveout deal value YTD at 23.5%. Another sizable carveout was BPEA EQT's announced acquisition of Endeavor Group's IMG Academy for $1.25 billion in April. IMG Academy, a global sports education institution, plans to expand across markets in Asia and broaden its educational offering with the support of its new PE partner.[4]

3: "Baxter to Divest Biopharma Business for $4.25 Billion," Reuters, May 9, 2023.
4: "Endeavor Enters Agreement to Sell IMG Academy to BPEA EQT, in Partnership With Nord Anglia Education, for $1.25 Billion," Businesswire, April 25, 2023.

Technology PE deal activity



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

Technology

Technology sector deals slowed in Q2 2023 following a busy Q1 that saw six software take-privates announced totaling more than $23.5 billion. Taken together, this makes for a decent H1 2023 with 700 PE deals in the tech space equating to $80.0 billion in total value. While this is well below the heydays of 2021-2022, it is consistent with H1 levels seen before the pandemic, such as in 2018-2019. Buyouts continue to be the preferred approach here, accounting for 76.0% of deals and similar to last year's 76.7%, with the balance comprising growth equity and a handful of platform creation deals.

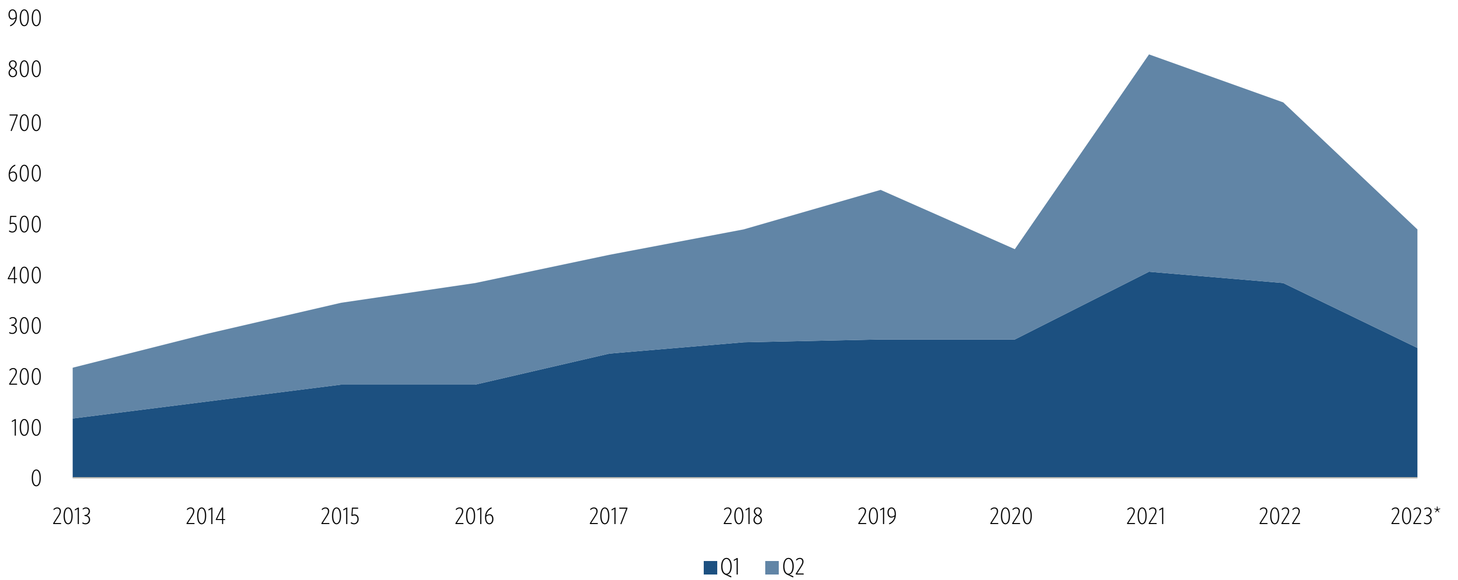
We see encouraging signs for continued strength in tech PE deals this year. Notably, banks are ramping up lending for LBO transactions after a pause in H2 2022 (see 2023 US Private Equity Outlook: H1 Follow-Up), PE firms hold ample dry powder, and valuation levels have reset from recent highs. LPs and specialized PE firms have an affinity for investing in the tech software vertical because the business model lends itself well to the transformation from unprofitable growth at all costs to a state of modest growth with robust profitability. Successful execution of this strategy often results in outsized returns.

The software model is advantageous because companies sell on a recurring model, often software-as-a-service (SaaS), a recurring license model, or a perpetual license coupled with a maintenance and support agreement. This means the business isn't at the mercy of its next sale for its profitability and viability because the recurring base gives stability during a recession. With B2B software, the customer generally derives significant economic advantage from the product through higher productivity and efficiency, meaning churn is often low.

Software companies in their early stages are often chasing 50+% YoY growth rates with high spending on marketing and sales, which often results in a large cash burn and an unprofitable business. When growth inevitably resets to a more sustainable single-digit pace, the management team may have the instinct to try investing in a new hit product, make a large acquisition, or hesitate to lower sales spending, blaming an exogenous factor for the slowdown. These situations often result in a sharp valuation reversal and create opportunities for PE buyers to step in to help these unprofitable software companies ditch the growth-at-all-cost strategy and transition to a new stable growth and high-profit model.

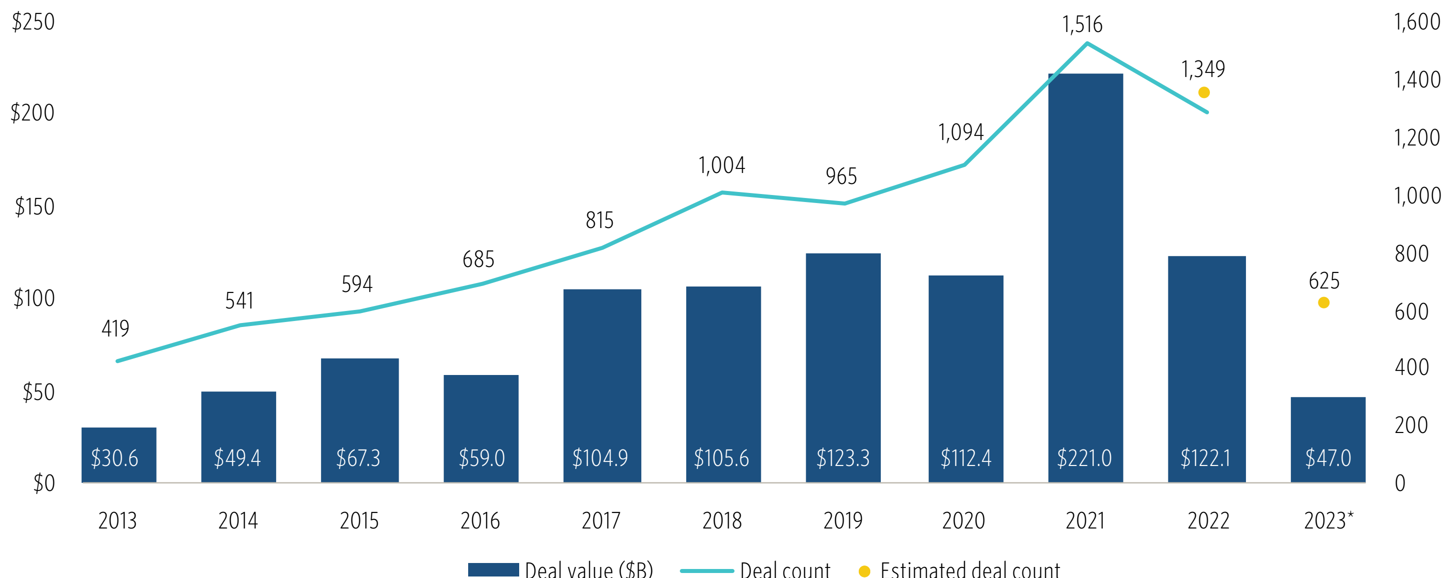
Notable technology deals announced in the IT space this quarter include two large software deals, Scopely, and Absolute Software. Scopely, based in Culver City, CA, offers a mobile-first digital entertainment platform that enables game design and development, live services, marketing, and analytics. On April 5, 2023, it agreed to be acquired in a $4.9 billion LBO by Savvy Gaming Group and Saudi Arabia's Public Investment Fund. Absolute Software, based in Vancouver, BC, offers a cloud-based endpoint visibility and control platform that provides management of and security for computing devices. The majority of its customers are based in the US, and key verticals include education, healthcare, government, and professional services. It agreed to be taken private in an $870.0 million LBO transaction by Crosspoint Capital Partners on May 11, 2023.

H1 technology PE deal count



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

Healthcare PE deal activity



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

Healthcare

Healthcare PE deal activity continues to lag other sectors, defying the common narrative of the industry's counter cyclicality. As of the end of Q2, 14.4% of US PE deals YTD have been in healthcare, down 1.8 percentage points from the five-year average. With a few noteworthy exceptions, sponsor-to-sponsor platform trades have been all but nonexistent so far in 2023. Buyer-seller price mismatches remain a key sticking point to some extent regarding multiples but more importantly regarding pro forma EBITDA adjustments.

Instead, GPs are deploying capital into small (one- or two-state) platform creations, carveouts, and take-privates. Advent International's announced a $4.25 billion carveout of Baxter's Biopharma Solutions business in May follows a wave of PE investment into pharma services as medtech giants rationalize their business lines. And Gurnet Point Capital and Novo Holdings, the investment arm of Novo Nordisk, together agreed to take struggling antibiotics manufacturer Paratek Pharmaceuticals private. In addition, many sponsors of mature platforms are bringing in new minority investors to either validate valuations, restructure, or fuel additional growth while the sponsor waits for a better exit opportunity.

According to a Coller Capital survey, 87% of LPs see healthcare as an attractive sector for investment over the next two years,[5] but healthcare specialist GPs will not be well positioned to take advantage of this sentiment if they cannot realize their current portfolios.

In 2022, the primary story in healthcare was cost inflation—principally labor, but also materials for some contract manufacturing platforms. We are finally seeing signs that the labor situation in healthcare services is stabilizing, albeit incrementally. This is a result both of efficiency gains at the company level—staffing has been the central preoccupation of most healthcare services operators over the past year and a half—and of reduced turnover in the labor pool. It is no coincidence that healthcare IT has seen steady PE investor interest over recent quarters. Some healthcare specialist firms that previously focused on healthcare services—and have seen first-hand the need for greater clinical efficiency and improved revenue cycles—have increasingly turned their attention to payer and provider software that addresses these challenges. For example, New Mountain Capital bought Apixio, an AI platform for value-based care, from Centene for $300.0 million in June.

5: "Global Private Equity Barometer," Coller Research Institute, 2023, accessed July 5, 2023.

If 2022 was the year of staffing pressures for healthcare platforms, 2023 is the year of debt burden. KKR's Envision Healthcare, which filed for Chapter 11 bankruptcy in May, and Blackstone's Team Health Holdings, which is exploring options to repay more than $1 billion in debt due next year, are the most extreme examples. The physician staffing companies fell prey to cuts in out-of-network reimbursement, first by payers directly, then via the No Surprises Act, as well as a protracted legal battle with UnitedHealth. Under heavy debt loads, the companies were both downgraded to CCC+ by S&P Global Ratings in the second half of 2022. Healthcare-focused sponsors have broadly moved away from businesses built on out-of-network reimbursement—including clinical staffing groups—for this reason. We have heard that many other healthcare platforms have seen growth slow significantly because debt service, combined with margin erosion, is eating into free cash flow. With the Federal Reserve expected to raise rates another 50 basis points, this pain will continue, and conservatively-leveraged platforms may have an opportunity to take additional market share as a result.

A WORD FROM WEST MONROE

Market downturn is driving evolved value-creation playbook for PE-backed SaaS companies

Continued macroeconomic headwinds have significantly impacted the software sector, with many software companies facing slower growth for the first time in several years and struggling to meet their earnings targets. This is causing companies to carefully manage expenses and private equity firms with dry powder to focus on improving EBITDA margins early in their hold periods.

At a high level, what are some key themes that you think are evolving in the PE environment over the first half of 2023?

Chris Stafford: This has been a very different year compared to the past decade. A fundamental slowdown in deal volume has impacted M&A and transaction opportunities for software companies. At the same time, they are also facing significant revenue challenges and rising costs. This is putting tremendous pressure on software management teams—pressure not seen in a decade—to properly focus on their bottom lines and ruthlessly prioritize their research & development (R&D) and M&A investments. A lot of value is placed on having the right leaders in the right functions who can make timely and often difficult decisions.

Dhaval Moogimane: It remains uncertain how long these market conditions will last, with some optimism for a rebound in H2 and early 2024. There is still significant dry powder that investors need to deploy, and the assets coming to market are still competitive. A more opportunistic theme that's getting significant attention is generative AI: The primary focus has been on software company leaders considering strategic uses for it within their products and to support operational efficiency. Furthermore, PE firms are discussing how to best apply it across the portfolio and advise their companies on embedding it in the most effective manner.

From the buy-side perspective, grappling with deal structuring—plus murky growth prospects for many sectors—is daunting enough. What other challenges are your clients seeing?

Chris Stafford: Challenges with revenue growth have made it difficult to pin down valuations and are making it more difficult to get buyers aligned with sellers. In some cases, diligence is uncovering slower revenue growth projections, lower pipeline volume, or greater retention risk than originally thought, which usually leads to valuation adjustments and can lead to buyers walking away from a deal. When growth projections are lower, these fluctuations are critical.

Developing a precise value-creation plan is another big factor. Investors are more focused than ever on executing operating-margin improvement initiatives very early in the hold period, partly driven by more tempered revenue growth projections. This requires additional scrutiny and intelligent, one-time investments to make the business more efficient and digitally enabled.

Dhaval Moogimane: Higher interest rates and the increasing cost of capital are forcing private equity firms to increase their upfront focus on value-creation plans across the full profit & loss (P&L)—from sales & marketing and revenue operations (RevOps) effectiveness, to R&D, cost of goods sold (COGS), and general & administrative (G&A) efficiency.

Dhaval Moogimane

Senior Partner, High-tech and Software

Dhaval Moogimane, a senior partner in our High-Tech and Software practice, excels in driving growth for software, technology, and IT services companies. With a focus on emerging trends, he collaborates with clients to develop and expand new products, solutions, and services. Dhaval maximizes value through M&A transactions, fosters customer retention, and enables profitable growth via digital transformation.

Chris Stafford

Partner, Mergers & Acquisitions

Chris Stafford is a partner in West Monroe's Mergers & Acquisitions practice, specializing in pre-close technology and operational transaction advisory, as well as post-close integration and separation leadership. A trusted advisor to many private equity firms and management teams, Chris has led more than 300 M&A transactions over the last decade.

Are publicly held companies currently a buying opportunity? What factors are at play? Are value-creation playbooks highly applicable?

Chris Stafford: Private equity investors have seen a significant buying opportunity for public companies, as many are not managed toward strong EBITDA margins. Value-creation playbooks are being realized and put to the test. Strong playbooks are being used in valuable and effective ways, but investors and companies without a clear or actionable approach are playing catch-up.

Dhaval Moogimane: An additional factor at play: Many private equity investors will try to get creative on their financing. In instances where valuations have come down, stock prices are fine, but price tags are still large. How can buyers finance these in an effective way? In some cases, we're seeing all-cash deals now with plans to finance later.

How are software management teams and private equity firms trading off between revenue growth and margins?

Chris Stafford: Software companies—and the sector as a whole—are in a pivotal moment. They simply must become more efficient. How do software-as-a-service (SaaS) companies optimize margins without sacrificing growth? It begins with proper portfolio management and making data-driven decisions regarding product/R&D investment. What does data indicate will drive growth across the customer base? For products at scale, how do you make them more efficient? For new products, how do you design them to have strong gross margins at scale? Oftentimes, we see poorly managed product roadmap priorities as a root cause of a variety of inefficiencies across the P&L.

Dhaval Moogimane: Fundamentally, good management teams and investors aren't trading off between revenue growth and profit margins; they are focused on both and are determining which specific investments can help to drive growth and optimize costs simultaneously. Companies with an increased focus on profitability are getting valued at higher multiples, but the Rule of 40 still holds in software.

What are the best options for software companies to reduce costs and improve profitability without sacrificing growth? How can software companies continue to increase their efficiency?

Chris Stafford: Every SaaS company is built on complex technology, and many are built on older technology that is no longer efficient. Part of becoming more efficient is sometimes taking a hard look at the core tech stack, which is a big lever in the R&D and COGS cost base. In the past, updating the tech stack in ways that reduced operating expenses over time was a "nice-to-have," but now, it is becoming a "must-do" in many situations.

Dhaval Moogimane: Many companies are rethinking their nearshore and offshore options for R&D, support, and services. We're also seeing a lot of interest in increasing efficiency and streamlining processes with automation. Companies are also harnessing more data—and using it in more impactful ways—for everything from predicting cross-sell and up-sell opportunities to reducing churn. AI will play a large role in this.

What are the top value drivers you are seeing within software companies today in relation to creating value through operational efficiency and innovation?

Chris Stafford: First is R&D efficiency: How product management and engineering operate day to day, how they generate revenue and improve customer experience (CX), and also the overall R&D cost base. As Dhaval mentioned, offshore and nearshore engineering is continuing to become a default operating norm for most SaaS companies.

A second significant lever is cloud operations. For many SaaS companies, usage costs are not optimized, architectural designs are not conducive to efficient cloud consumption, and companies struggle to quickly reduce their cloud operating expenses and improve gross margin.

A third key driver is automation and AI. The surface is just getting scratched with generative AI and automation, but I think we'll see a lot of use cases for operational efficiency and innovation over the next several years.

Dhaval Moogimane: There is also innovation around the customer experience. What is the company's unique offering, and how could it be enhanced to drive increased usage and adoption? Plus, plugging more into customer sentiment to ensure ongoing satisfaction and retention is more critical than ever to drive net and gross retention.

West Monroe supports more than 600 private equity transactions every year, performing buy-side operational, technology, and market diligence and driving value creation efforts with management teams. This experience, combined with our multidisciplinary approach—which looks at each situation through the lenses of industry, operational, and technology expertise—helps dealmakers plan for and manage the complexities of mergers, acquisitions, and divestitures.

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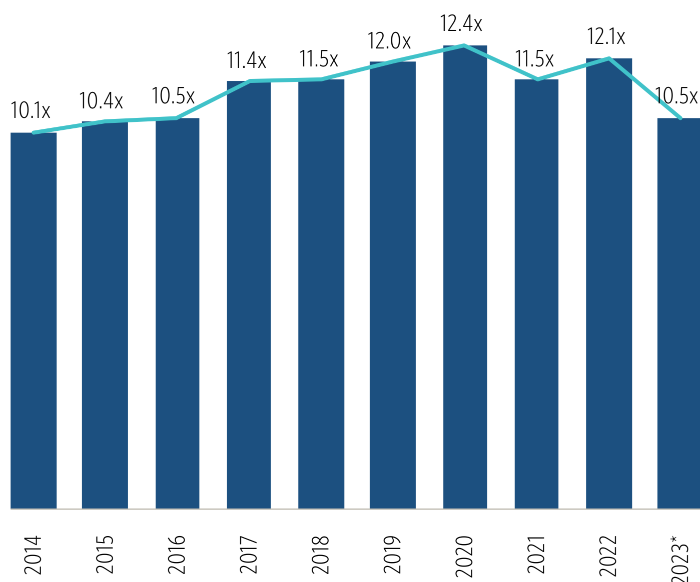
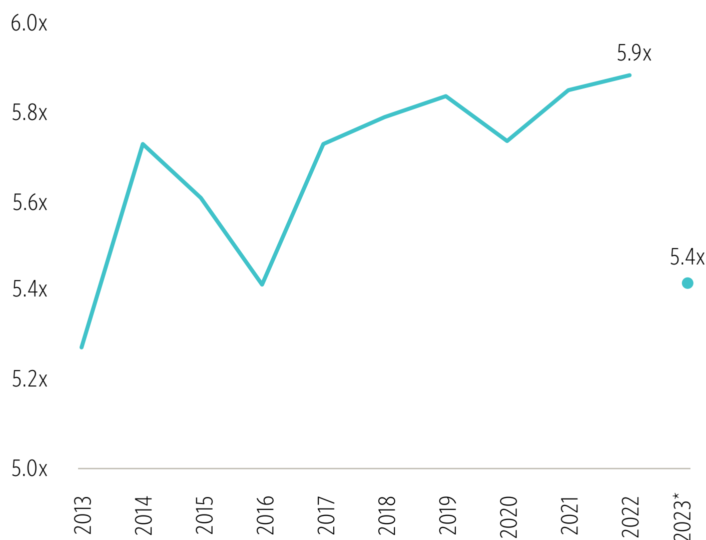
Deal valuation and debt metrics

Median PE EV/EBITDA multiples



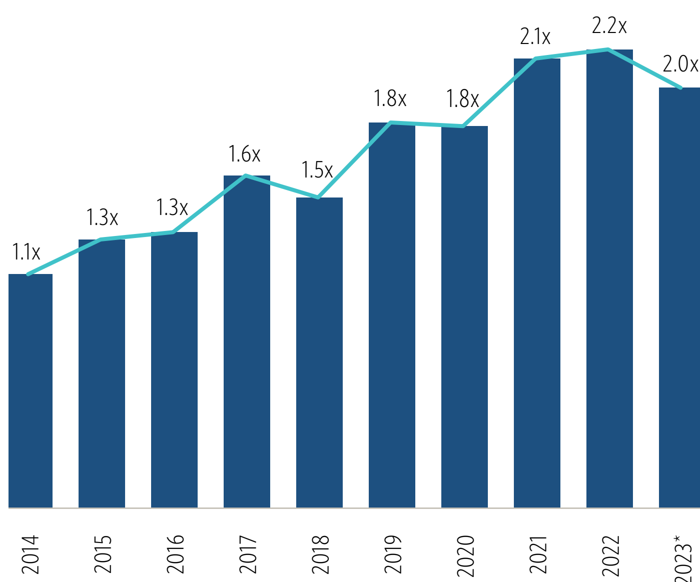
Source: PitchBook • **Geography:** North America and Europe
*As of June 30, 2023

Average PE debt/EBITDA multiples



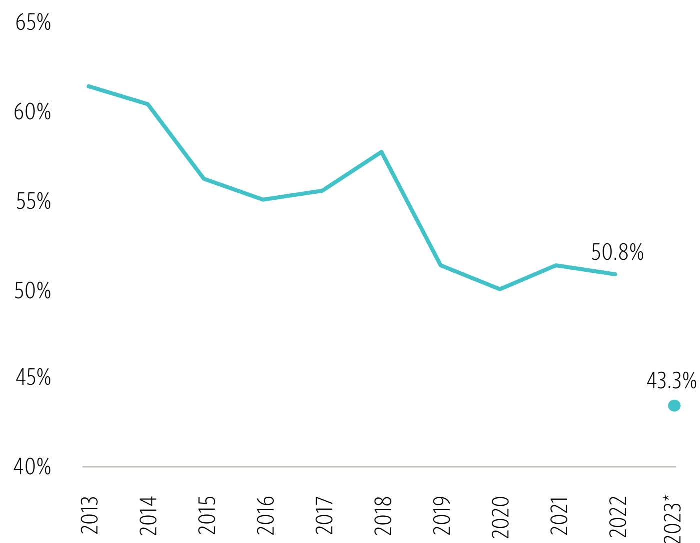
Source: PitchBook | LCD • **Geography:** US
*As of May 31, 2023

Median PE EV/revenue multiples



Source: PitchBook • **Geography:** North America and Europe
*As of June 30, 2023

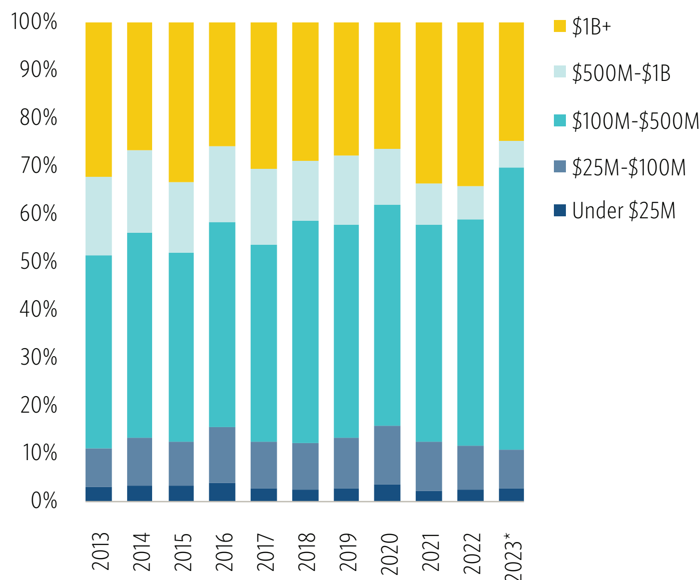
Share of PE LBO debt to EV



Source: PitchBook | LCD • **Geography:** US
*As of June 30, 2023

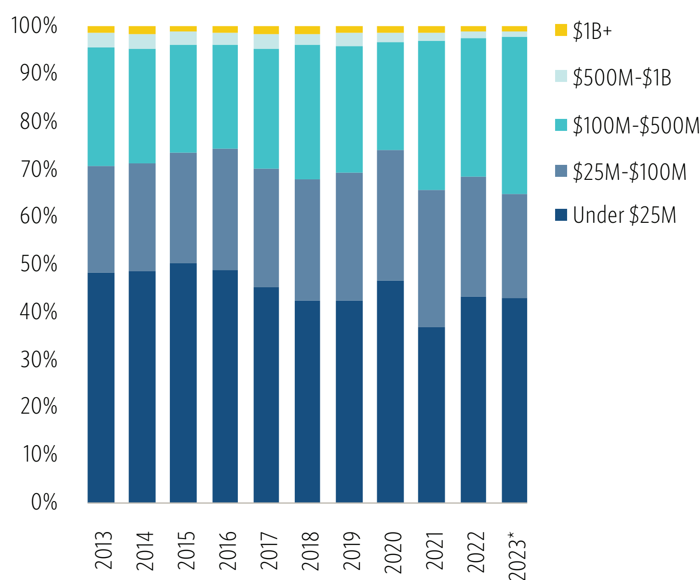
Deals by size and sector

Share of PE deal value by size



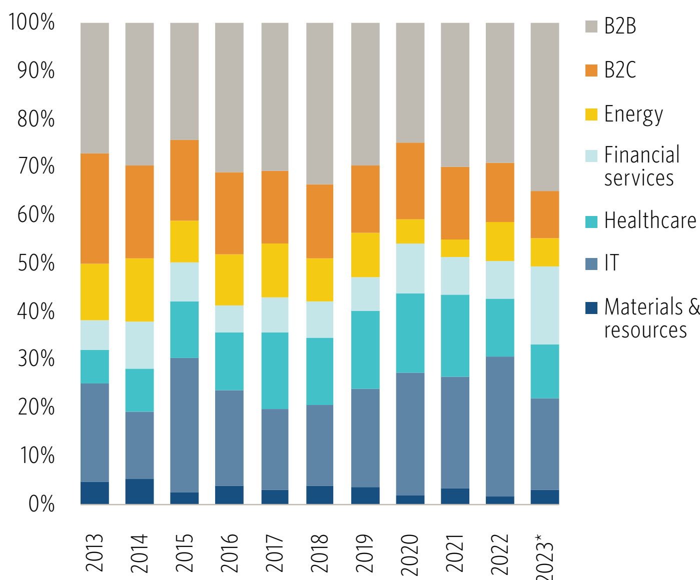
Source: PitchBook • **Geography:** US
*As of June 30, 2023

Share of PE deal count by size



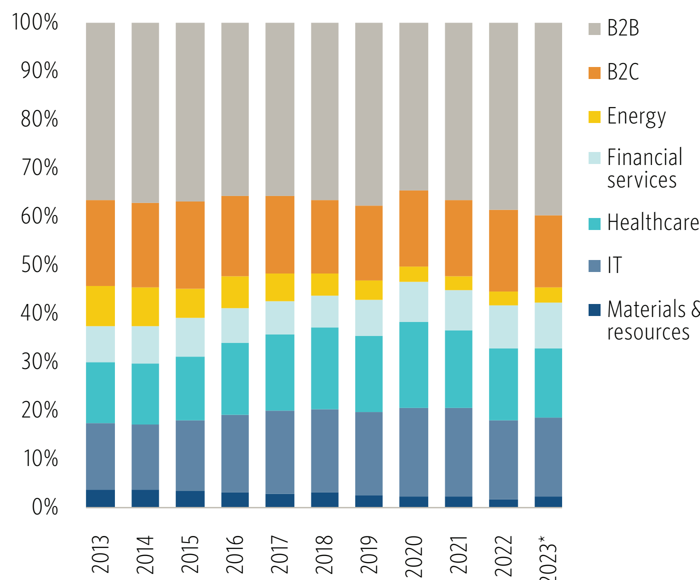
Source: PitchBook • **Geography:** US
*As of June 30, 2023

Share of PE deal value by sector



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

Share of PE deal count by sector



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

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SPOTLIGHT

PE Exit Timelines and the Impending Maturity Wall

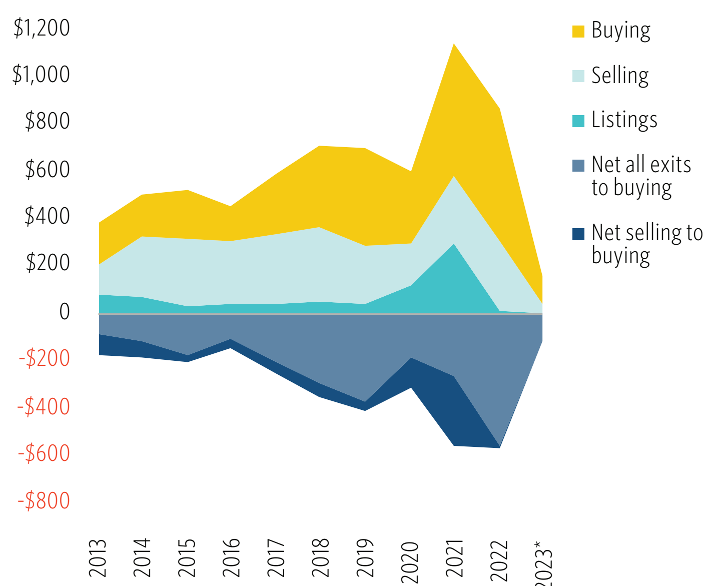
Note: This spotlight is excerpted from our analyst note, PE Exit Timelines and the Impending Maturity Wall. Please see the full report for additional analysis on PE fund timelines and maturities.

Key takeaways

Private markets have been enjoying an extended period of bullish economic conditions, setting new records in investment activity. After a blip during the pandemic, US PE activity flourished in the second half of 2020, thanks to cheap and abundant access to capital and investor interest in alternative assets. US PE set new records in 2021, as deal value soared by 86.6% to reach $1.3 trillion and deal count jumped by 53.1% to 9,286 deals.

While the bull market seemingly knew no bounds, markets tumbled shortly after as rising inflation and resulting interest rate hikes disrupted a golden period for PE. Deal activity fell from its peak but exits have dropped even more precipitously and have been suffering ever since. Quarterly exit value was flat to down for seven consecutive quarters starting in Q3 2021 and declined significantly throughout 2022, as sponsors continue to struggle against unfavorable valuation adjustments, an effectively closed IPO market, and an uncertain economic outlook. By the end of Q1 2023, quarterly exit value was down 75.1% from the peak in Q2 2021. Quarterly exit activity is now well below the pre-COVID (2017 to 2019) median with no signs of bottoming, which indicates to us that a new normal is firmly in place. Even if we assume a rebound to the pre-COVID norm, the industry is running out of time to complete an orderly disposition of portfolio holdings within the time frames initially allotted to its funds.

A typical buyout fund has a lifespan of approximately 10 years, with many PE funds starting to exit their successful assets earlier, around the five- or even three-year mark. On the other hand, buyout firms can extend their funds' lifespans for two one-year periods as needed to create more value for their assets. The current weakness in exit activity is creating a gap between the two flows of capital: While deal activity soldiers on, exit pacing has slowed as GPs hold onto their portfolio companies longer to allow for valuations to recover to their liking or grow revenues and EBITDA to compensate for lower multiples.



Source: PitchBook • **Geography:** US
*As of March 31, 2023

The significantly fatigued exit market means an impending "maturity wall" looms in the PE industry for deals made five to seven years ago that are beginning to reach their natural exit timelines. With exit activity expected to remain stunted in the near future as investors continue to face macroeconomic headwinds, GPs will need to address the oncoming maturity wall of their existing investments. The investments made during the bullish deal environment of the last 10 years are now confronted with an economic downturn and will need to adjust to a much different exit environment.

Maturity wall approaching for legacy PE funds

A way to discern the approaching maturity wall is to examine the capital raised by funds that are reaching the end of their 12-year term. Funds that closed in 2016 will hit their term in 2028, and the capital raised in 2016 that has yet to be distributed back to investors through exits will be the amount hitting the maturity wall, assuming no change in value. The chart above shows the set of funds and the value of capital raised between 2016 and 2022 with a 12-year shift—and the estimated remaining held amount at each juncture assuming a liquidation rate. In a hypothetical case in which nothing gets liquidated from this set of funds, the chart shows the maximum amount of capital that would hit the maturity wall at the 12-year mark, which equals the capital that had been initially raised by US PE funds. However, a portion of these funds has already had exits. Using a more realistic assumption, the chart presents the expected amount of the remaining capital that will hit the maturity wall at the end of the 12-year fund life using the incremental pace of exits seen through 2022, and then a slower 2022 exit rate thereafter for the remainder of the fund life cycle. This rough estimate, which combines the exit pace we have already seen and an adjusted exit pace, shows a reasonable expectation of how funds will wind down and the amount that will be liquidated, and shows how it will not be enough. Using this estimate, around 20% to 26% of the capital initially invested by funds is expected to hit the maturity wall. The cumulative held amount grows from $41.0 billion to $363.0 billion in the seven years beginning in 2028 as more fund vintages reach the maturity wall. PE investors would be faced with an enormous pileup of deals still held if the slowed exit activity were to continue.

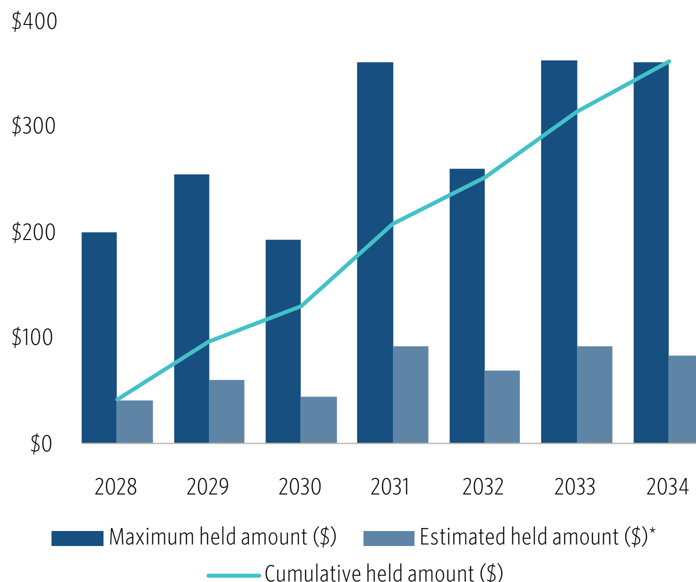
Conclusion

The economic outlook has changed for PE: Exit activity has fallen 75% from peak to trough on a quarterly basis and shows no immediate signs of recovery to its previous heydays. Sponsors will need to adjust to this newly challenged exit environment, as the inventory of investments that are nearing their exit timelines either can't be sold or are being held for longer than expected because of their currently lower valuations. Even when we assume exit activity will revert to pre-COVID levels, PE firms are not out of the woods. A simple forecast using pre-COVID exit levels shows that investments entering their typical exit timelines will be slower to liquidate than previous investments.

Further extrapolation shows that the stunted exit pacing likely to pervade the PE industry's foreseeable future will push holding periods beyond the exit time frame that both GPs and LPs have been accustomed to. While the assets purchased five years or more ago are slightly ahead of the game, thanks to the impressive boost in exits seen in 2021, the industry now faces a growing maturity wall as exits have slowed to a crawl and funds draw closer to their end dates.

GPs, therefore, will need to find solutions to a rising liquidity concern, and it is likely more sponsors will turn to secondary sales, continuation funds, or NAV lending to placate capital needs to avoid becoming forced sellers in an unattractive exit market. The PE industry will have to innovate and do so quickly.

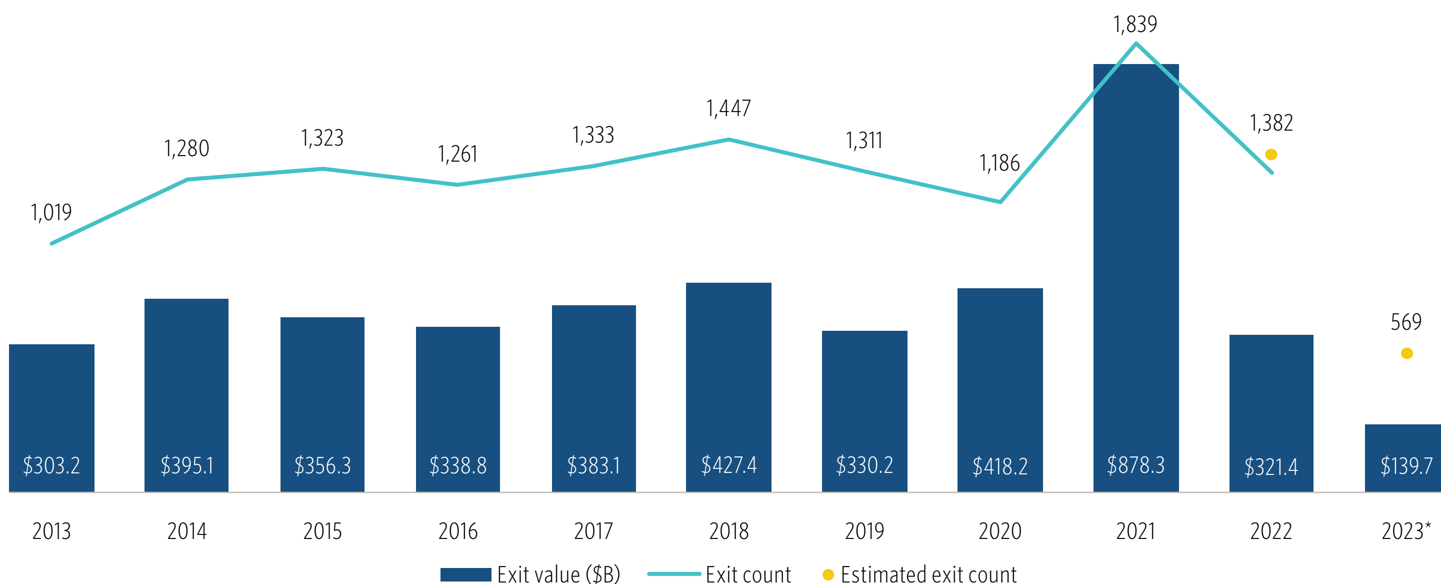
Capital funds closed with 12-year shift



Source: PitchBook • **Geography:** US
**Note: Estimation using the observed exit rate for the six years ending 2022, and the TTM 2022 exit rate for all years thereafter.*

Exits

US PE exit activity



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

Overview

US PE exit activity lightly bounced back in Q2, a welcomed break from the three consecutive quarters of decline the industry experienced. 289 PE-backed companies exited with a cumulative exit value of $87.3 billion during Q2, increasing by 3.7% and 66.9% QoQ, respectively. Exit value experienced the first quarter of growth in the trailing 12 months (TTM). But this incremental jump in exit activity is not yet meaningful to the fatigued PE exit market, as both exit value and count remain below the pre-COVID-19 averages (2017-2019), and the quarter's exit value was boosted by a few mega-sized transactions. The exit-to-investment ratio dropped further to 0.32x by the end of Q2 2023 compared to 0.48x in 2021. Furthermore, YTD exit activity is less than half of that seen in 2022, projecting another year of stunted exits.

US PE exit activity by quarter

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

The current weakness in exit activity means that a "maturity wall" is fast approaching for the PE funds nearing the end of their term life to distribute their capital back to investors through exits. Because the new normal of slow exit activity is expected to continue in the near term, PE investors would be faced with an enormous pileup of deals that are either unable to sell or are being held for longer than expected because of lower valuations. Even when we assume exit activity to revert to pre-COVID-19 levels, which is not likely in the currently depressed market conditions, PE firms are expected to fall behind on their

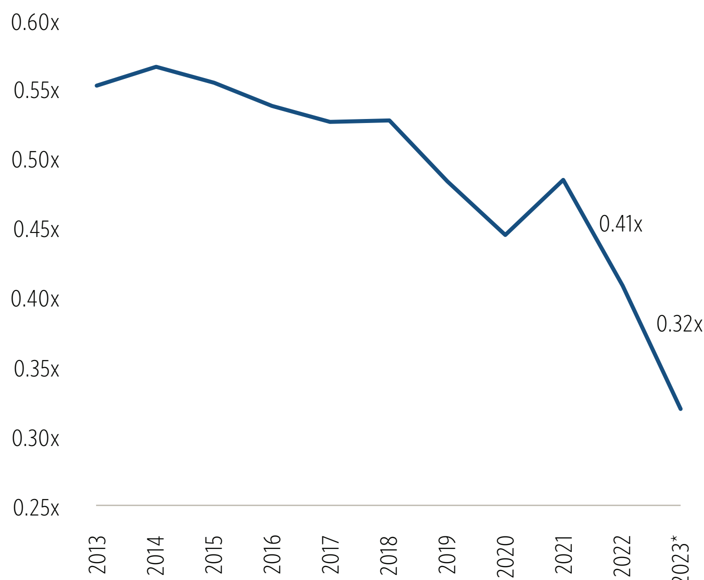
exit timelines. A simple forecast using pre-COVID-19 exit levels shows that investments that are entering their typical exit frames will be slower to liquidate than previous investments.[6] Further extrapolation shows that the stunted exit pacing that is likely to pervade the PE industry's foreseeable future will push holding periods beyond the exit time frame to which both GPs and LPs have been accustomed. The pressure is building for GPs to find solutions to a rising liquidity concern and to do so quickly.

Exits through public listings remained quiet for PE in Q2, although recent developments suggest there may be a long-awaited recovery of IPOs soon. Cava's successful IPO in June is a positive sign for those that had been reluctant to exit their investments at the risk of an unfavorable debut. EQT also bet on returning investor appetite for new offerings by listing Kodiak Gas Services, a natural gas compression services firm, during the last week of the quarter. EQT sought to raise $328.0 million at a $1.54 billion market cap but raised $256.0 million as stocks opened below range,[7] signaling a still-weak IPO market. On the same day, Ares Management also listed Savers Value Village, a thrift-store operator, on the New York Stock Exchange. The company received a warmer reception, fetching nearly $4 billion in market cap, which was above its target of $300.0 million at a $2.8 billion market cap. Ares will retain an 88% stake in Savers Value Village after the IPO.[8] While the IPO window seems to have cracked open a little, continued interest rate and valuation volatility is likely to keep PE investors cautious about potential exit routes.

Exits to corporates

Exits to corporates gained steam in Q2, accounting for a record 64.8% of total PE exit value. YTD, they are also tracking for the greatest share of PE exits annually at 61.9%. 85 companies exited in Q2 for an aggregate of $56.6 billion, showing an uptick in exit value but a third consecutive decline in quarterly exit count. In fact, exits to corporates marked the lowest count on an absolute basis amid anemic exit volume in the broad PE industry. Corporates with the ability and appetite to pursue acquisitions are pursuing larger deals, as demonstrated by fewer exits resulting in higher exit volume and the increase in median exit size for exits to corporates. PE firms in the energy sector in particular saw sizable exits to corporates as industry actors continued to consolidate and the push towards energy transition drove investment activity. In May, ONEOK announced it would acquire PE-backed Magellan Midstream Partners for $18.8 billion. The merger would combine ONEOK's mainly natural gas liquids and natural gas business with Magellan's refined products and crude oil transportation business to form one of the biggest oil and gas infrastructure companies in North America and will enhance the company's presence in sustainable fuel and hydrogen corridors for further opportunities in energy transition.[9]

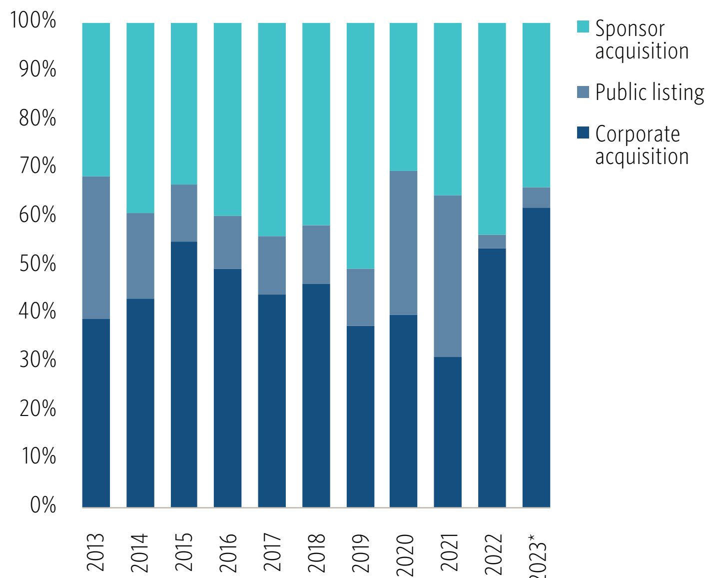
PE exit/investment ratio



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

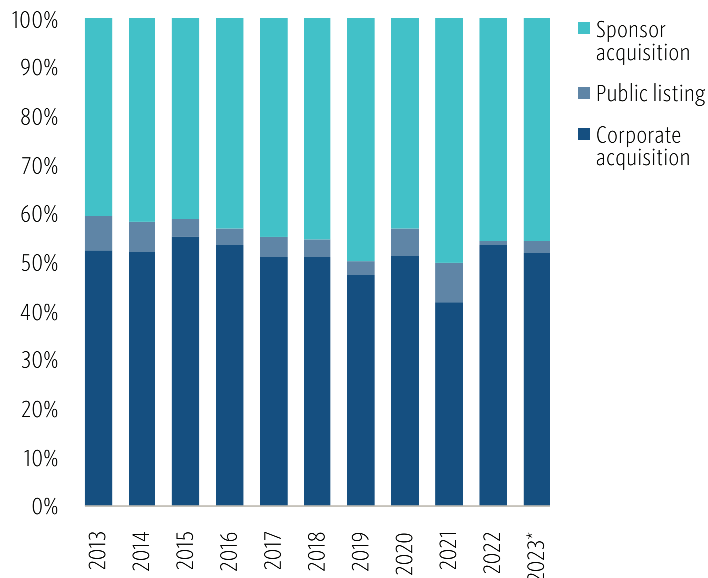
6: For more analysis, please refer to the Q2 2023 PitchBook Analyst Note: PE Exit Timelines and the Impending Maturity Wall. https://files.pitchbook.com/website/files/pdf/Q2_2023_PitchBook_Analyst_Note_PE_Exit_Timelines_and_the_Impending_Maturity_Wall.pdf
7: "The IPO Buzz: Kodiak Gas Services (KGS) Prices IPO at $16—Below Range," IPOScoop.com, Jan Paschal, June 28, 2023.
8: "Private Equity-Backed Savers Value Village Targets $2.7 Billion Valuation in US IPO," Reuters, Chibuike Oguh, June 21, 2023.
9: "US Midstream ONEOK to Acquire Magellan Midstream Partners in $18.8 Bil Deal," S&P Global, Rong wei Neo and Jeff Mower, May 15, 2023.

Share of PE exit value by type



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

Share of PE exit count by type



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

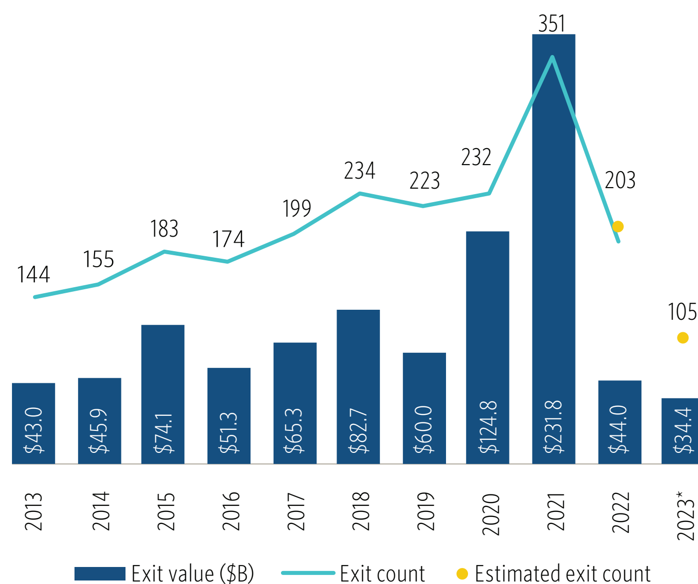
Sponsor-to-sponsor exits

On the other hand, sponsor-to-sponsor exit activity declined sharply because of compounding challenges: PE firms remained generally cautious in their dealmaking, which reduced transactions between sponsors, and disruptions in the lending market limited GPs' ability to absorb sizable deals and further slowed sponsor-to-sponsor exit activity. At the same time, those GPs that could finance larger deals have been increasingly focused on take-private opportunities as reduced valuations in the public market made for attractive acquisition targets. With $26.2 billion in quarterly value, sponsor-to-sponsor exits accounted for just 30.0% of Q2 exit value, declining from 40.5% in Q1. The number of exits to other sponsors fell in line with the broader market, with sponsor-to-sponsor exit count still accounting for a little less than half of Q2's total exits. Median size of sponsor-to-sponsor exits fell to $349.2 billion YTD compared to the $529.5 billion peak in 2021, reflecting the lower valuations at which sellers are able to exit their holdings.

Technology

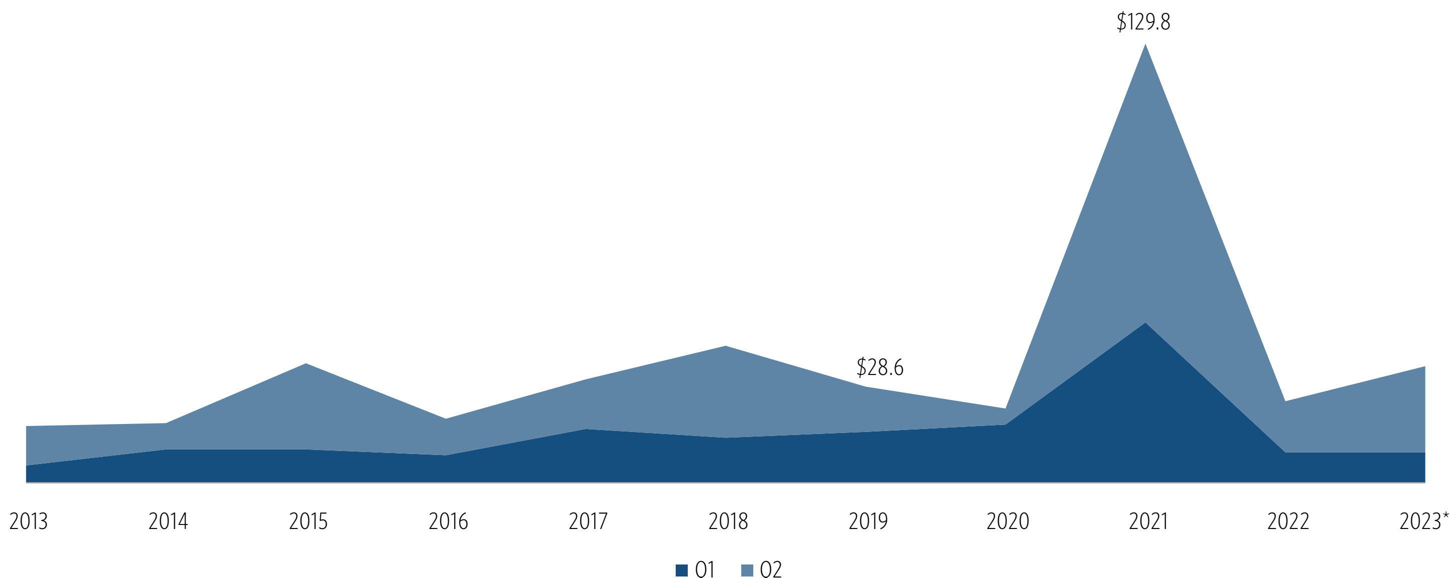
Technology exits accelerated in Q2 to $25.6 billion, up from $8.8 billion in Q1, a welcome sign for LPs and GPs alike as it demonstrates that buyers and sellers are converging on pricing and marking expectations to market amid higher rates.

Information technology exit activity



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

H1 IT PE exit value

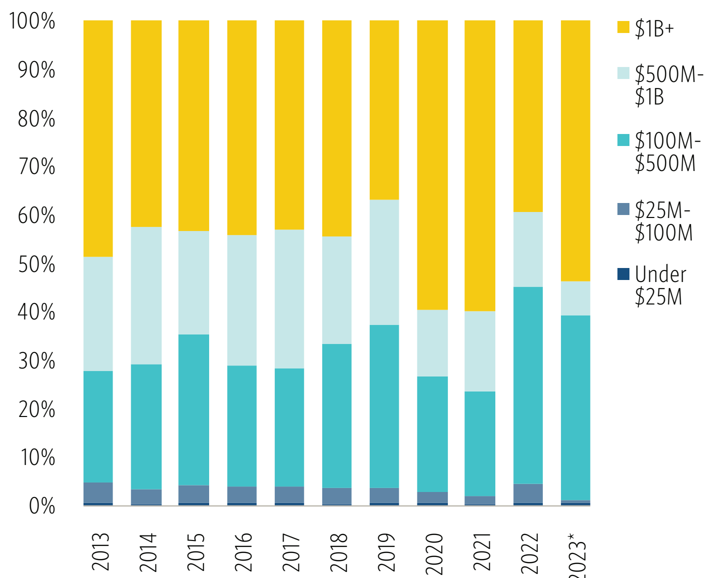


Source: PitchBook • **Geography:** US
*As of June 30, 2023

This brings H1 2023 tech exits to a total of $34.4 billion. While this H1 pace is below levels seen prior to the pandemic—and way off the peak of H1 2021 at $129.8 billion—we are optimistic that H2 2023 can beat the H1 watermark.

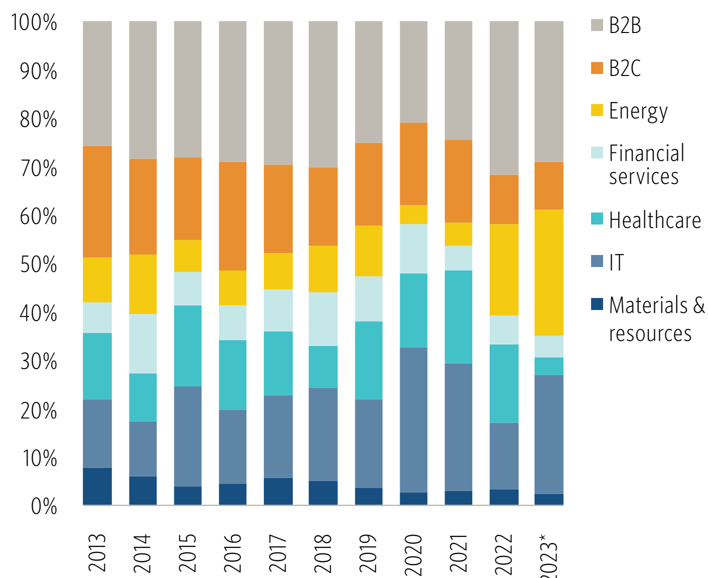
Software is leading the segment to better exit volumes, as mega deals are back on, bolstered by corporate buyers with strong balance sheets and ready access to capital. Two headline software exits were announced in June. Thoma Bravo will sell portfolio company Adenza, a provider of risk management and regulatory software to the financial services industry, to Nasdaq for $10.5 billion. Nasdaq seeks to increase its serviceable addressable market by $10.0 billion and expand its software solutions portfolio. The deal will be financed in part by a $5.9 billion debt offering, and Thoma Bravo's consideration will include a 14.9% stake in Nasdaq. Additionally, Vista Equity Partners announced it will sell Apptio to IBM for $4.6 billion in an all-cash deal as IBM seeks to increase its portfolio of hybrid cloud and automation tools. Notably, IBM has long-term debt at attractive rates and a strong balance sheet, making it uniquely positioned to capitalize on these market conditions.

Share of PE exit value by size



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

Share of PE exit value by sector



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

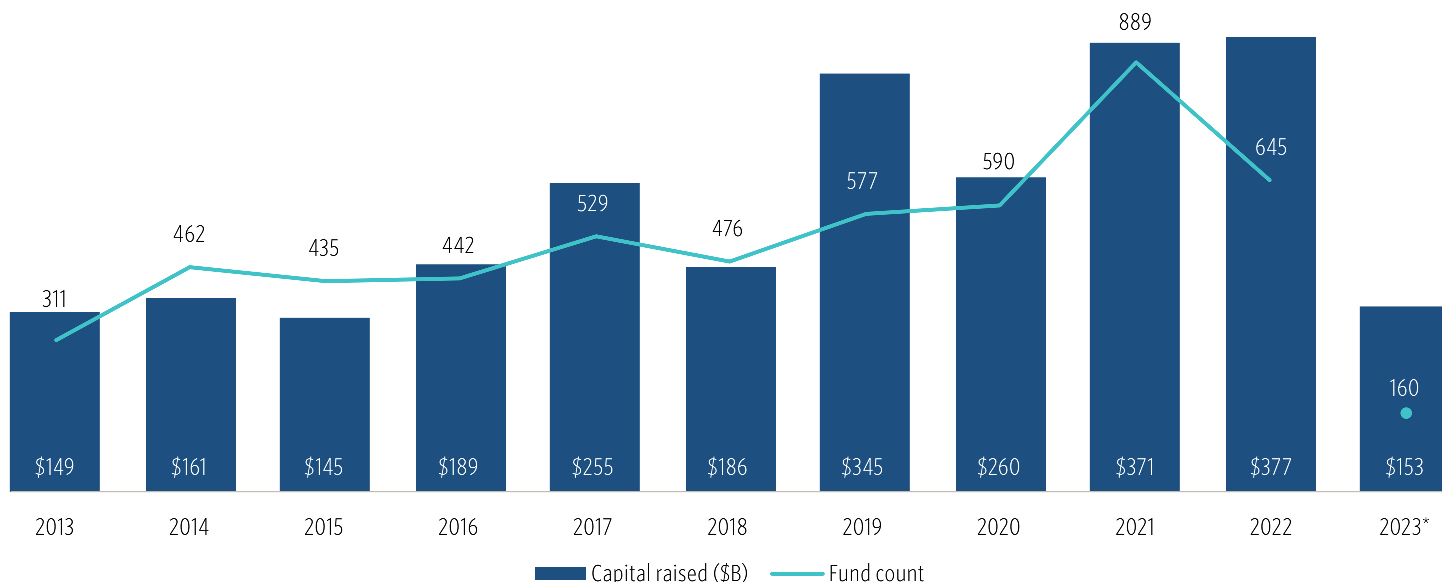
B2B

B2B exit activity faltered with 70 exits for an aggregate value of $17.6 billion, declining 24.2% QoQ in exit value. Although the sector's exit count and value are well below its quarterly averages of the last five years, the decline is in line with that of the broader PE exit landscape. In fact, B2B is performing well so far relative to other sectors; the sector's YTD share of total PE exit value is slightly above the average seen in the last five years. B2B captures a broad mix of primarily nontech and service-oriented businesses, and the exits that occurred in Q2 spanned various subsectors. For example, the largest exit during the quarter was Warburg Pincus' announced $2.05 billion sale of Wencor Group, a commercial and military aircraft aftermarket company, to HEICO, an aerospace and defense supplier. The transaction will be HEICO's largest-ever purchase and will provide complementary product sets and create synergies for its existing aircraft parts services business.[10] In industrials & manufacturing, Industrial Growth Partners sold ASPEQ Heating Group to SPX for $418.0 million in May. ASPEQ, which provides electrical heating solutions, will become part of SPX's HVAC Heating platform along with Marley Engineered Products.[11] Exits in B2B are expected to keep steady as potential buyers look for opportunities to increase capabilities, close strategic gaps, and scale their businesses.

10: "Heico Plans Wencor Acquisition," Aviation Week, Lindsay Bjerregaard, May 15, 2023.
11: "Exciting News! ASPEQ Has Joined SPX Technologies to Create Industry Leader in Commercial and Industrial Electric Heat," ASPEQ Heating Group, June 5, 2023.

Fundraising and performance

PE fundraising activity



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

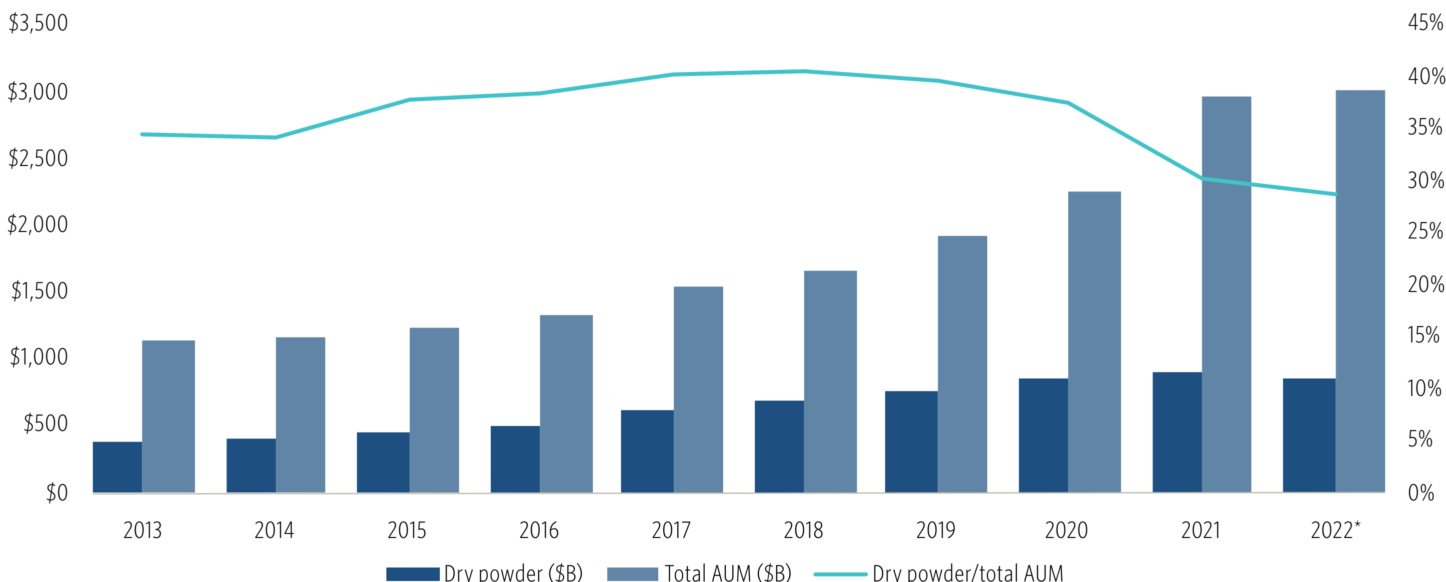
Overview

PE fundraising activity in H1 2023 is 15-25% slower than last year's pace based on the number of funds closed and final amounts of those closed funds. This slowdown was widely expected given that 2022 turned into another banner year with a record $377.0 billion raised for US based PE funds. The big surprise so far this year has been the turnaround in middle market PE fundraising. Middle market funds, which we define as between $100 million and $5 billion in size, have accounted for 57.4% of all PE fund value closed in 2023, up from a 15-year low of 47.4% last year and its best level since before the global pandemic. Numerically, the middle market's share of all PE fund closings has reached 60.5% so far in 2023, a record high. Granted we are only hallway into the year, but the reversal of fortune in fundraising by smaller buyout funds has been dramatic, nonetheless.

The strength in the sub-$5 billion fund segment masks the fact that a number of traditional players in the middle markets space are raising much larger funds to go after the middle market opportunity. These include TA Associates which raised $16.5 billion for its fifteenth buyout and growth equity fund; Genstar Capital which closed its eleventh flagship fund for $12.6 billion, and GTCR which closed on $11.5 billion for its fourteenth flagship fund.

Looking at fundraising by PE strategy, buyout funds dropped to 74.5% of the overall mix, slightly below 2022's 77.7%. This came at the benefit of growth equity funds, which increased to 25.4% of the mix, up from 22.2% last year. As LPs seek exposure to unique opportunities, specialist funds were popular in H1 2023 and reached a 19.4% share of total, up from 15.2% last year.

PE dry powder relative to AUM



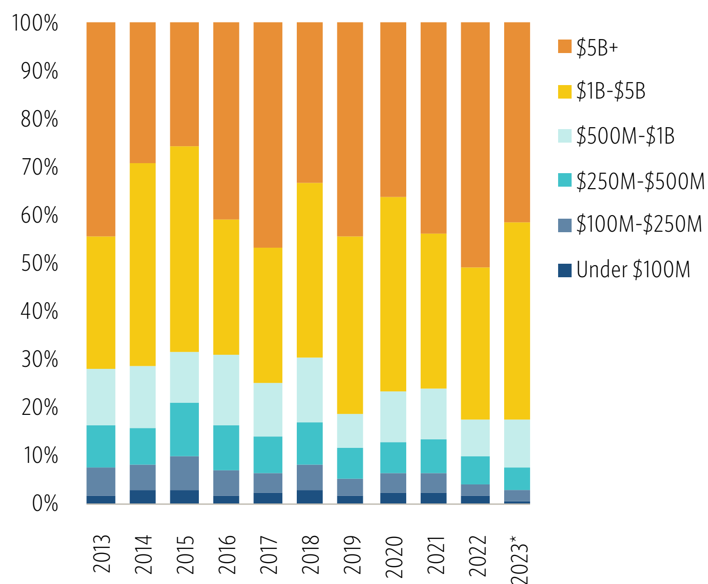
Source: PitchBook • **Geography:** US
*As of December 31, 2022

Megafunds

The first half of 2023 saw five megafunds (funds of $5 billion or more) close, down from seven in the first half of 2022. Over the past two years, megafunds have accounted for 47.2% of total fundraising. That share has dropped to 41.7% through the first half of 2023, but that downtrend is likely to reverse in the second half, as numerous large funds that have been kept open by mega sponsors are poised to close. Blackstone, Apollo, Carlyle, TPG, CDR Vista and Warburg all have flagship funds in the market that have been fundraising for a year or more and have collected close to $100 billion in investor capital. All but two of these seven flagship funds are likely to reach their targets, which total $146 billion in aggregate, and three have been open since 2021.

While megafunds are still raising capital, it is flowing in at a slower pace than in the past two years. This has led to some large sponsors to temper expectations.. On its first-quarter earnings call Blackstone announced that its ninth flagship buyout fund will likely be smaller than the $25.0 billion predecessor fund. Similarly, TPG announced on its Q1 earnings call that it is reducing the size of its flagship funds as the original targets were set under different market conditions. The same was echoed by Carlyle, which reduced its outlook for buyout fundraising while stating that it did not expect the current vintage of corporate buyout funds to be the same size as its predecessors.

Share of PE capital raised by size



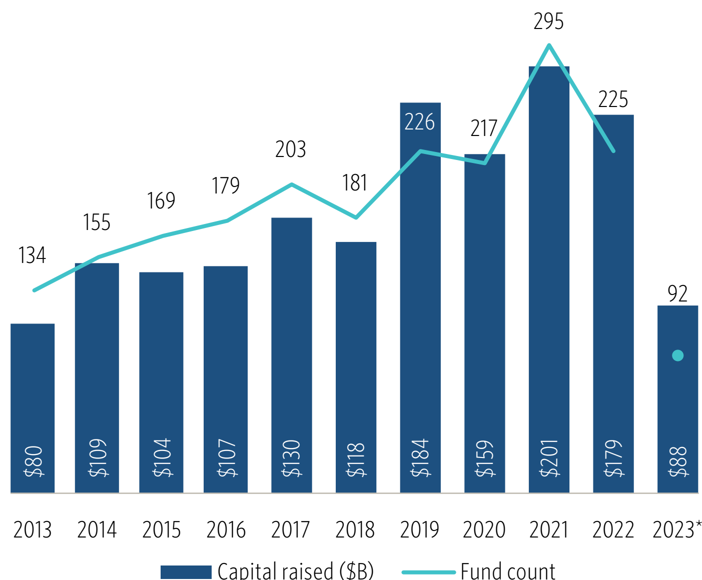
Source: PitchBook • **Geography:** US
*As of June 30, 2023

Notable open funds

Investor name	Fund name	Fund type	Fund size ($M)
Silver Lake	Silver Lake Partners VII	Buyout	$19,158
Apollo Global Management	Apollo Investment Fund X	Buyout	$16,000
Blackstone	Blackstone Capital Partners IX	Buyout	$15,547
Warburg Pincus	Warburg Pincus Global Growth XIV	PE growth-expansion	$15,364
The Carlyle Group	Carlyle Partners VIII	Buyout	$14,405
Clayton, Dubilier & Rice	Clayton, Dubilier & Rice Fund XII	Buyout	$13,704
BDT & Company	BDT Capital Partners Fund 4	Buyout	$10,382
TPG	TPG Partners IX	Buyout	$9,265
Audax Group	Audax Private Equity Fund VII	Buyout	$5,004
L Catterton	L Catterton X	Buyout	$4,346

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

Middle-market fundraising activity



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

Middle-market funds

Middle-market funds are in the midst of a strong run. They are outpacing their megafund counterparts in both fundraising and performance. Middle-market funds are vehicles that raise between $100 million and $5 billion. Through the first half of the year, 92 middle market funds have closed with an aggregate value of $87.9 billion, putting it on track for its best fundraising year since the peak in 2019. Big fund fatigue has clearly set in, and investors are gravitating toward smaller funds doing smaller deals that are easier to close and finance in the current macro backdrop. Deal valuations are also cheaper in this size range, making it easier to compensate for the lack of leverage and higher borrowing costs. Lastly, these funds are known to target non-backed companies. As highlighted in our recent analyst note, non-backed companies tend to have less flexibility to wait out an economic downturn, creating an opportunity for funds that can acquire them at attractive values and closer to a turn in the business cycle. Due to these factors, the fundraising environment favors middle-market funds for the foreseeable future.

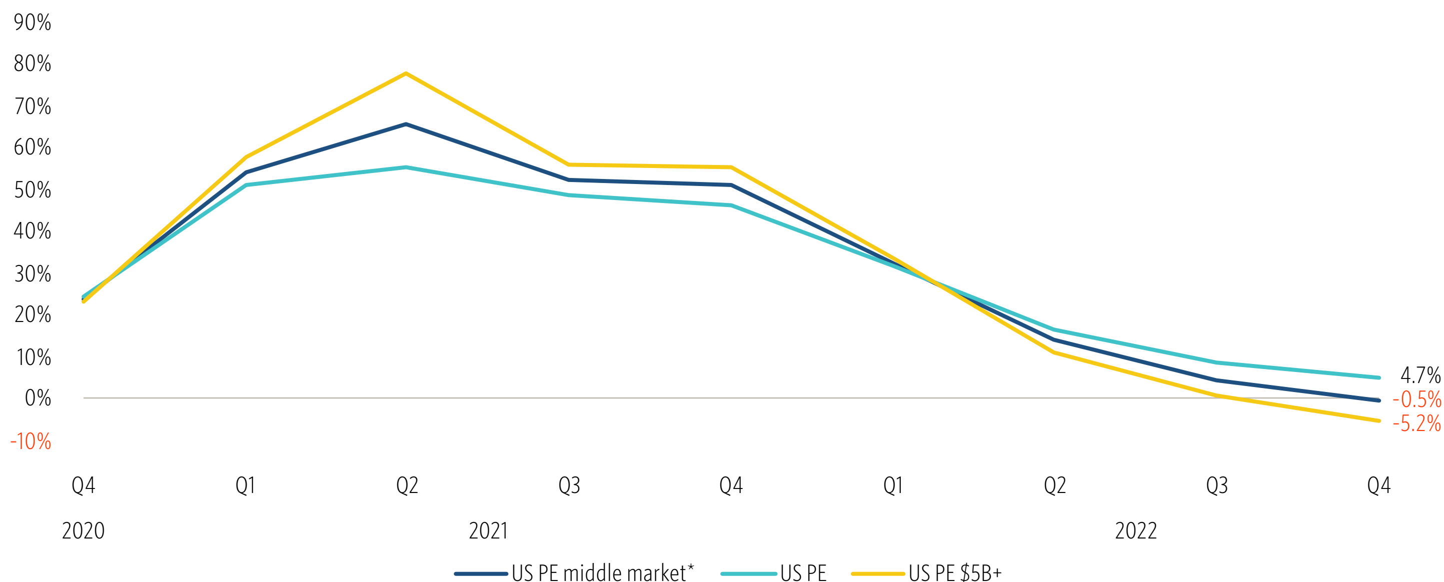
New sources of fundraising

Traditional LPs in North America remain constrained in their PE allocations, prompting GPs to explore other regions such as the Middle East and Asia have fewer headwinds. These LPs continue to commit capital and are attracted to PE as an asset class to diversify away from US public markets and local markets that are tied to other non-correlated assets such as energy. Increasingly, GPs are also seeing these major LPs from these regions seek out co-investment opportunities on specific investments, allowing GPs to tap another funding source when financing is tight. For example, French PE firm Ardian is raising its latest secondary fund, and the Abu Dhabi Investment Authority (ADIA) has agreed to invest $6.0 billion in the fund and provide co-investments in its deals.[12] Fellow Abu Dhabi sovereign wealth fund Mubadala and Singapore's GIC are also active in the co-investment space. In June, Denver-based KSL Partners and GIC made a joint £4.0 billion bid for UK holiday resort company Center Parcs in the sovereign wealth funds' latest co-investment endeavor. ADIA itself participated in three of the largest LBOs so far this year including the $4.6 billion take-private of Cvent, the $8.1 billion take-private of Univar, and the $5.5 billion take-private of Dechra Pharmaceuticals.

The under-penetrated market of retail investors has become a new avenue for fundraising. More vehicles are being launched with each passing quarter. These take a variety of forms including non-traded BDCs, trusts, interval funds and private placements, Most of these vehicles are tied to other asset classes such as real estate or private credit, but they are slowly creeping into corporate buyout strategies. For the time being they are limited to secondary strategies such as Ares' private market fund series

12: "Ardian Raises $20bn to Buy Stakes in Buyout Funds," Financial Times, Will Louch, June 25, 2023.

US PE rolling one-year performance by size



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

or private equity substitution strategies such as Apollo's AAA series, but over time they will pervade PE fundraising just as they have in other more income-oriented private market strategies.

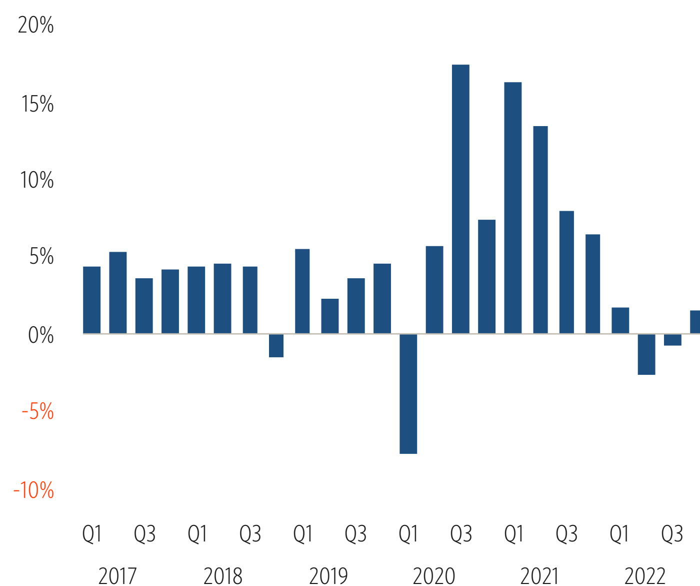
Asset gathering through acquisition

Large PE managers continue to seek ways to expand their product set, with private credit attracting significant demand. In May, TPG announced the $2.7 billion acquisition of private credit and real estate manager Angelo Gordon. This will bring $73.0 billion in AUM to TPG, including $55.0 billion in private credit strategies. This will fill a gap left after its separation from Sixth Street Partners in 2020. In March, First Sentier Investors announced it will acquire a majority stake in European credit lender AlbaCore Capital Group for $763.4 million. The acquisition of AlbaCore enables First Sentier to offer new asset classes and structures to clients, as well as unlock new channels, regions, and products to meet growing investor demand in the private credit sector.[13]

Performance

Final data collected by PitchBook points to a return of 1.5% for US PE funds in Q4 2022, following two negative quarters. For the year, US PE funds recorded an average return of -0.5%. This is in stark contrast to 2021's average return of 50.8%, but nowhere near as bad as the 18.3% decline in the S&P 500.

PE funds IRR by quarter

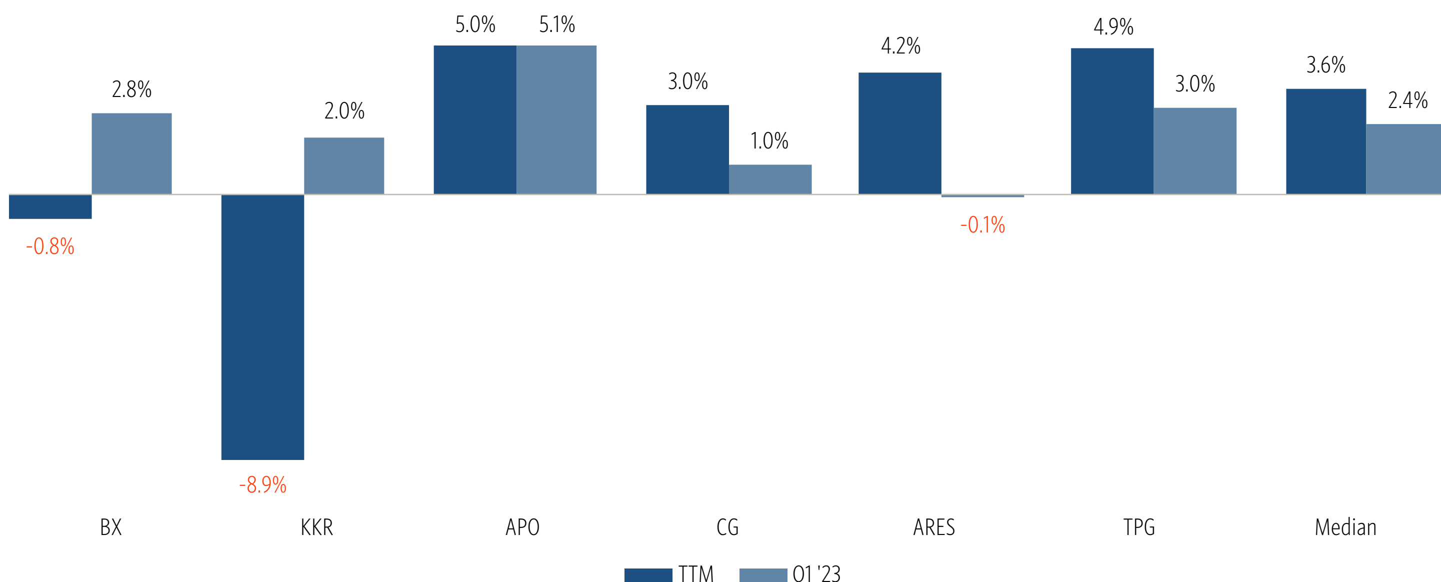


Source: PitchBook • **Geography:** US
*As of December 31, 2022

For the third quarter in a row, smaller PE funds have outperformed larger funds. The rolling one-year IRR on middle market funds stood at 4.7% in Q4 2022 versus a decline of -5.2% on megafunds, or 989 basis points of outperformance.

13: "First Sentier Investors announces strategic partnership with AlbaCore Capital Group," Cision PR Newswire, March 20, 2023.

Gross PE returns/appreciation by manager



Source: Company reports • **Geography:** Global
*As of March 31, 2023

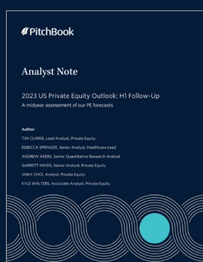
That's the largest gap in favor of middle markets since 2016. Investors were early to recognize the better set-up for smaller buyout funds in the current macro backdrop, resulting in better fundraising for middle market funds so far this year, and the outperformance of the last three quarters has only reinforced that view.

As expected, PE funds slowly marked down portfolio valuations in the second half of 2022. The markdowns were small, however, compared to the extreme valuation markups that preceded it. In the nine quarters ending Q2 2022, fund NAVs increased by an average of 7.9% per quarter and accounted for the vast majority of reported performance with very little coming from cash distributions. Historically, this figure has averaged just 2.5%. Even with a flat 2022, US buyout funds gained 81.4% in the three years ending 2022 versus a return of 25.6% on the S&P 500 index.

Looking forward into 2023, we use PE returns reported by the big six publicly traded PE managers as a lead indicator for the rest of the industry which tends to report on a six-month lag. Not including fees, the median Q1 return reported by these managers improved to 2.4%, while lagging the S&P 500 return of 7.5%. Given the large cumulative performance gap that remained at the end of 2022, we expect further underperformance from PE funds relative to public equities, and as a result, another year of flattish absolute returns. That said, the rally in public markets is a welcome change; it allows PE managers to mark down portfolios less severely given that comparable valuations have improved.

Additional research

Private equity



2023 US Private Equity Outlook: H1 Follow-Up

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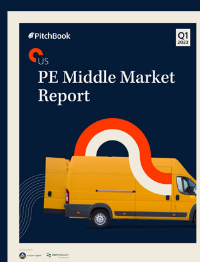

Q1 2023 US PE Middle Market Report

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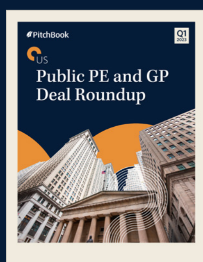

Q1 US Public PE and GP Deal Round Up

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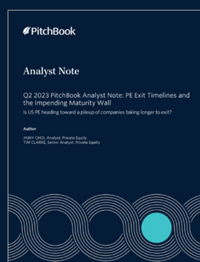

PE Exit Timelines and the Impending Maturity Wall

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