Takeaways From the 2024 ACG DealMAX Conference

The state of play in PE middle-market dealmaking

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

Key takeaways

- DealMAX conference attendees were cautiously optimistic about a rebound in PE dealmaking despite a lackluster first quarter and a setback in the Federal Reserve's timeline for lowering interest rates. Underlying that optimism was robust attendance, which was up 6% from the prior year.[1]

- One of the conference panelists aptly described the current downturn as "the Great Exhaustion," which is not the same as the Great Recession of 2007 to 2009 and the government intervention that accompanied it, but more akin to the supply-demand contraction of 2000 to 2002, which eventually exhausted itself.

- Solving the PE exit dilemma is crucial to sparking a broader recovery in PE dealmaking. As sponsors explore ways to create liquidity in the face of an impending maturity wall, continuation funds offer a solution as a scalable offramp for PE-backed assets.

- AI is expected to impact M&A in largely three areas: internal operations, sourcing and dealmaking, and portfolio management.

1: "More Than 3,100 Middle-Market Professionals Converge at ACG's DealMAX," PR Newswire, ACG, May 6, 2024.

Conference overview

DealMAX (formerly InterGrowth) is an annual dealmaking conference for middle-market M&A organized by the Association for Corporate Growth (ACG). ACG is an M&A dealmaking community dedicated to middle-market growth and brings professionals together to provide resources to successfully navigate the industry landscape. The conference attracted more than 3,100 M&A professionals, including 840 PE professionals, 780 investment bankers, and 200 strategic acquirers and operating partners.[2] A record number of DealMAX attendees came together in Las Vegas from April 29 to May 1 to share ideas, connect with dealmakers, and engage with M&A service providers. The conference consisted of various session types, such as main-stage presentations and panels, pavilion discussions, and product demos. Sessions covered many topics, including dealmaking in a challenging environment, financing and exiting portfolio companies, and AI's impact on M&A processes. This analyst note covers the key themes and takeaways that emerged from the conference.

Current M&A landscape

High interest rates have been a significant dampener on dealmaking activity in the past two years. Investors have yet to fully recover from the fastest tightening cycle in over 40 years as the higher cost of leverage and lower valuations continue to drag down M&A activity. Leverage ratios have contracted meaningfully over the past year, and completed deals saw higher proportions of equity. But the sentiment that interest rates will largely stabilize this year was echoed throughout the conference, along with cautious optimism for improved M&A activity. Many speakers and attendees shared that they were busy prepping for deals and ready to bring their companies to market. Before, a lot of investors had been on the sidelines waiting out the market volatility, but many now consider the market to be in a steadier state. Although the buyer-seller gap persists, panelists said sellers are increasingly adjusting their expectations for valuations and becoming more accustomed to a challenged financing market.

Panelists spoke about the extended due diligence process as a pain point in M&A. Many agreed that due diligence has become longer and more intense. This trend is somewhat in contrast with the wave of transactions that rushed in during 2021, indicating that the market is finding a balance with the right pace of dealmaking. Investors are going deeper with due diligence to find an investment thesis early in a deal opportunity and develop value creation and exit strategies. Lenders are also asking tougher questions given the tightness in liquidity and reduced distributions through exits. It is also taking longer to approve loans or figure out the difficult capital structures that some deals may require.

Many pointed to the middle market's success in fundraising to explain why they expect M&A activity to improve in the second half of the year. According to PitchBook data, US PE middle-market fundraising (defined by PitchBook as between $100 million and $5 billion in fund value) marked its second-best year ever in 2023,

2: "More Than 3,100 Middle-Market Professionals Converge at ACG's DealMAX," PR Newswire, ACG, May 6, 2024.

with over $141.1 billion raised. Through the second quarter of 2023, middle-market PE funds held a record $508.8 billion in dry powder. Although PE deal activity remained sluggish in the first quarter of 2024, several panelists stressed that sponsors will have to deploy the massive amount of capital they have accumulated and that deal activity is bound to increase sooner or later.

Solving the exit dilemma

PE exit activity has plummeted to a decade low, and several session panelists spoke about the need to boost exit activity to increase liquidity to LPs. PitchBook's lead PE analyst, Tim Clarke, moderated a panel on how to solve the exit dilemma,[3] which is paramount to sparking a broader recovery in PE dealmaking. US PE exit activity remains stunted as sellers refuse lower valuations, which strains investor cash flows. The gap between buying activity and selling activity sat at a deficit of $353.8 billion at the end of Q1 2024, and the gap between the PE capital call rate and the PE distribution rate is currently around 20%. As PE firms waited longer to sell their assets, the median holding period of companies exited in 2023 hit a record high of 6.4 years while the median age of US companies currently held by PE firms stretched to 4.2 years.

This pent-up supply of PE-backed assets that need to sell hangs over the market, and a panelist shared that once M&A activity recovers, it will be almost overwhelming. The enormous backlog of companies that would sell combined with the pent-up demand from buyers with high levels of dry powder could result in a level of dealmaking that could be more than the industry can easily handle. The downsizing of headcount seen in the industry over the past two years could mean that there will not be enough well-trained personnel and service providers to handle the volume of M&A activity.

Panelists also discussed potential near-term signs of a recovery in exits. Panelists stated that seller sentiment has improved dramatically and that they expect more high-quality deals to close as debt continues to become more available. And as more high-quality deals pick up, this will provide market participants with more valuation data points and improve market sentiment. This will hopefully encourage more companies to come to sale, including lower-quality deals, which will help normalize the investor market.

In lieu of an immediate recovery in exit activity, a maturity wall will quickly approach in the form of finite-life funds, and sponsors will need to explore other ways to create liquidity. Continuation funds offer a solution as a scalable offramp for PE-backed assets. Continuation-fund-related exits have increased meaningfully since 2020, and Q1 2024 saw more activity than Q1 2023. There has been an increase in dry powder dedicated to secondaries opportunities, with many secondary buyers raising funds specifically targeting GP-led opportunities, demonstrating the growth expected in the continuation fund space. Panelists also mentioned that they are seeing increasing interest in sales of minority or large minority stakes in portfolio companies, as well as greater interest in M&A between portfolio companies in different funds to inject liquidity while continuing to own the asset.

3: Slides from the panel are included in the addendum of this note.

AI's impact on M&A

AI's impact on the M&A process was one of the most popular topics covered during the conference. Several sessions discussed how investors can adopt AI during due diligence, deal sourcing, risk assessment, post-merger management, and internal operations. Key takeaways include:

- There are largely three areas where AI can impact M&A: internal operations, sourcing and dealmaking, and portfolio management.
    - Internal operations: AI can help shift unstructured data into digestible data. Using AI to gather, organize, and format data can free up time for professionals to spend on more critical thinking, which can also benefit the development of junior financial professionals. AI can also be used to capture and share institutional knowledge in firms.
    - Sourcing and dealmaking: AI can expand the breadth of due diligence, going through more client satisfaction surveys and web scrapes than investment professionals can, for example. AI can also enrich data gathered on private companies.
    - Portfolio management: AI can improve efficiency and scale for portfolio companies. For example, bots can be used to simplify tasks in which a lot of people are spending a lot of time, and with more accuracy at a lower cost, which will drive value in portfolio companies. AI can be used to sift through customer history data, pricing patterns, and so on.
- A panelist emphasized that AI should be a way of doing business instead of a strategy pivot and development of a new business type. Financial professionals should approach AI with intellectual curiosity and try to find best practices to determine what works for them. The key is to keep exploring and start small instead of trying to get the business model right on the first try, because the industry will see several pivots in AI usage as it continues to figure out how AI can fit into clients' needs and how to monetize AI capabilities while the technology continues to develop.
- Most of the attendees of one session shared that they were in the early days of understanding AI or experimenting with ways to utilize the technology in their field. Those who were exploring AI use were mostly focused on improving internal operations and not yet integrating it into corporate diligence and portfolio monitoring.

Restructuring wave

Heavy debt loans and high interest rates are putting pressure on portfolio companies, and a record number of PE-owned companies filed for bankruptcy in 2023. S&P Global Market Intelligence reported that bankruptcy filings by PE and VC portfolio companies jumped 174% from 38 filings in 2022 to a record of 104 in 2023.[4] One panel discussed the impending restructuring wave across sectors. Key takeaways from the panel include:

- Companies have largely avoided the need to restructure thanks to capital that was pumped in by investors and government funding after the start of the COVID-19 pandemic. With this source of delay largely gone in 2023, panelists expect restructuring to increase as companies grapple with a down market.

- PE and VC have been behind many of the bankruptcies in healthcare companies since 2019. Private Equity Stakeholder Project (PESP) reported that the aggressive use of debt and financial products has burdened healthcare companies and made them more vulnerable to changing market conditions, such as high interest rates and the rising cost of labor.[5] PESP expects PE-backed healthcare bankruptcies to continue in 2024.[6]

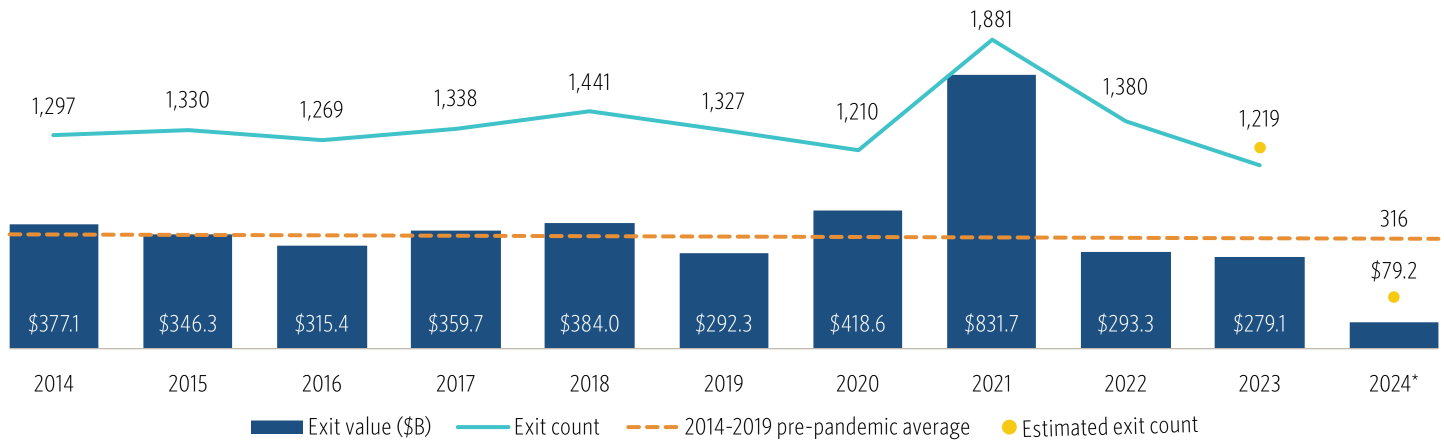
- Consumer-related sectors and real estate are other areas with increased stress. Consumers are tapped out with all-time-high debt and credit extension, which in turn puts stress on portfolio company profit margins. Retail, multifamily, and high office real estate assets have experienced lots of distress and bankruptcies in recent years.

4: "US Private Equity Portfolio Company Bankruptcies Spiked to Record High in 2023," S&P Global Market Intelligence, Dylan Thomas and Annie Sabater, January 11, 2024.
5: "Private Equity Healthcare Bankruptcies Are on the Rise," PESP, Eileen O'Grady, April 17, 2024.
6: Ibid.

Addendum: Slides from PitchBook's sponsored panel "How to Solve the Exit Dilemma"

PE exit activity

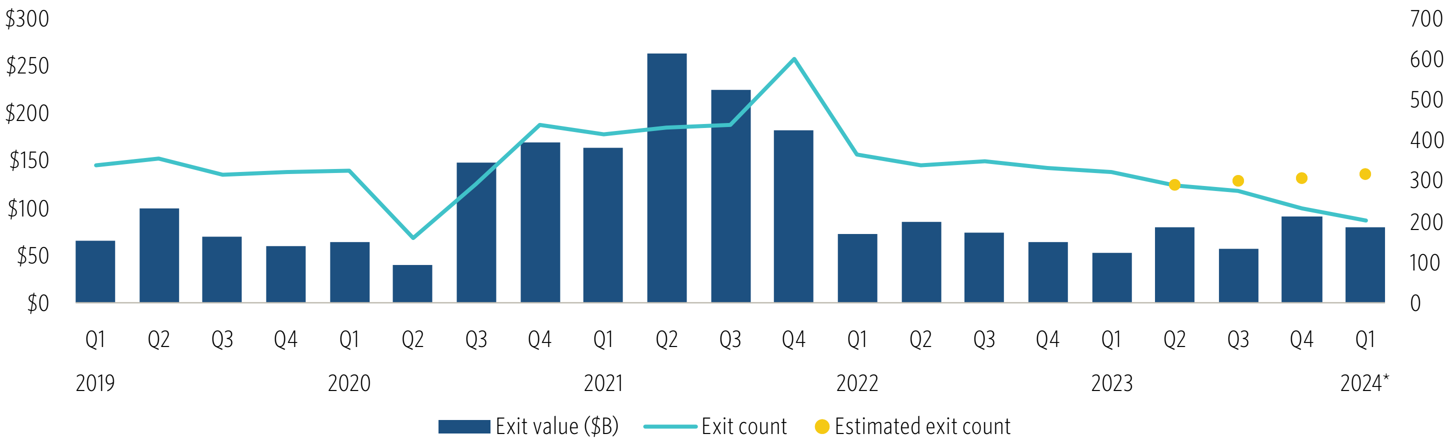
Exit value is at a decade low and below the "old normal"



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

PE exit activity by quarter

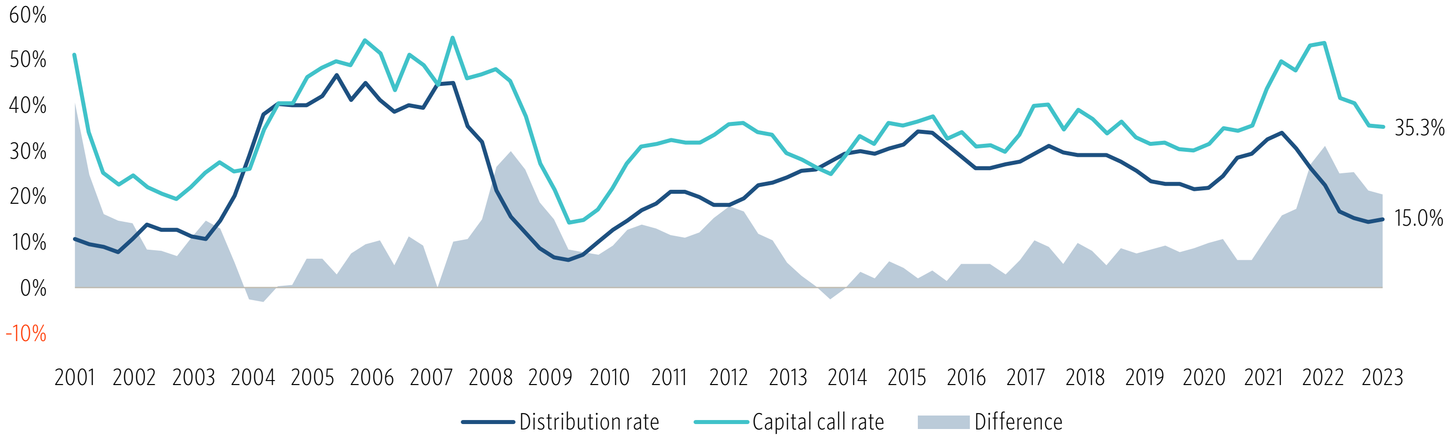
Q1 2024 was better but below Q4 2023



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

PE capital call versus distribution rates*

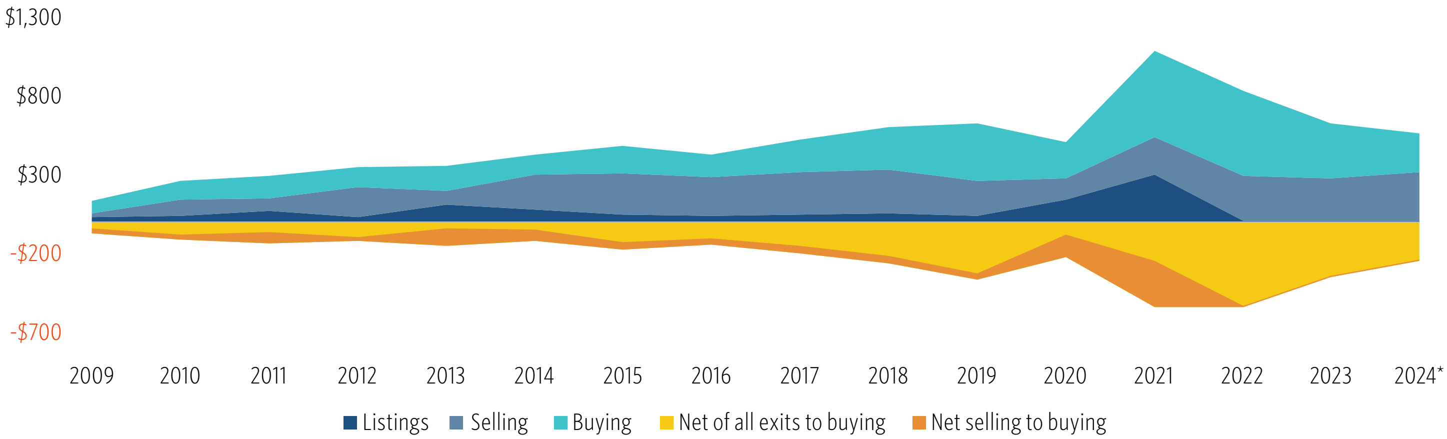
This is putting pressure on investor cash flows



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

PE buying to selling and the net exit gap ($B)

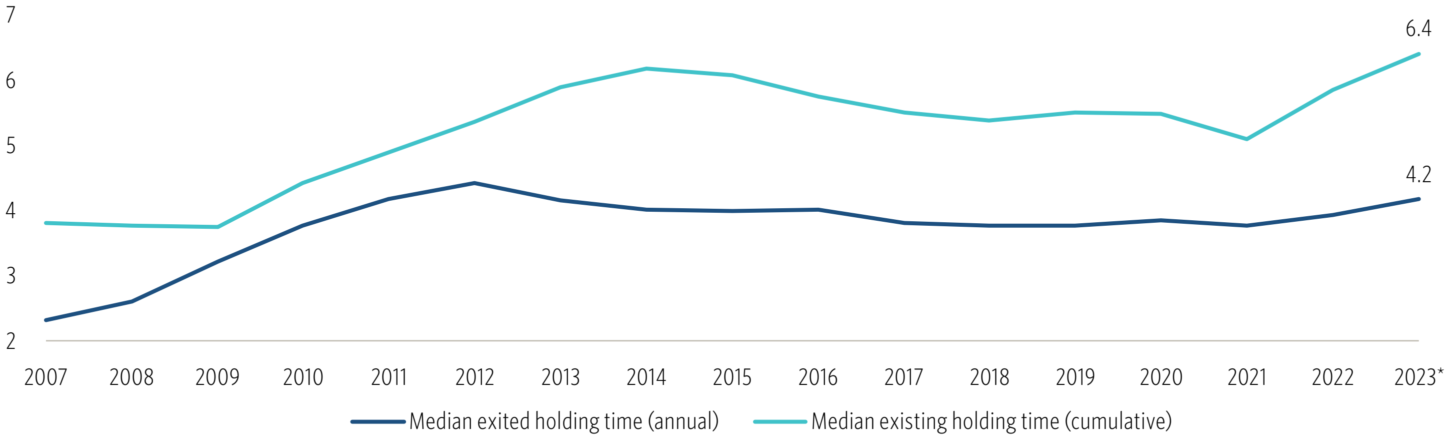
Deployment has also slowed, narrowing the gap to exit



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

Median PE company holding times (years)

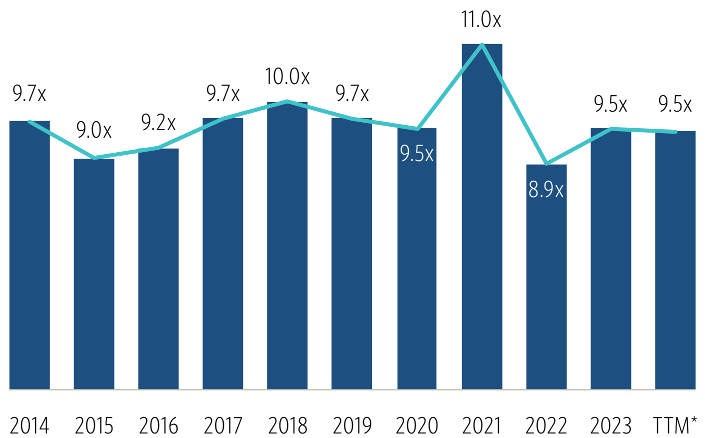
PE companies are growing for longer...



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

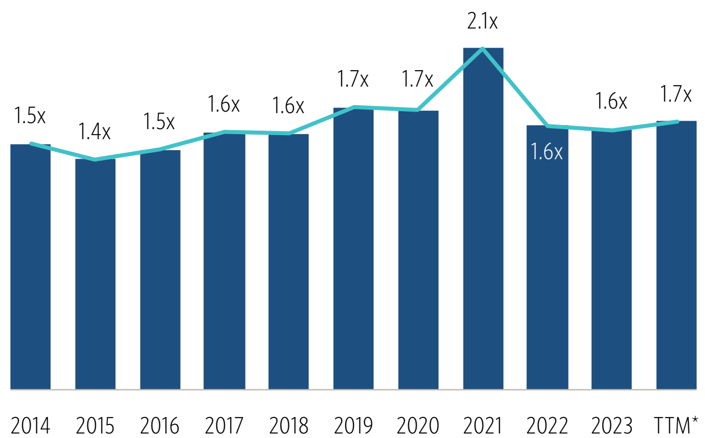
...to compensate for lower valuations, which are now holding firm

M&A EV/EBITDA multiples



Source: PitchBook • Geography: North America and Europe • *As of March 31, 2024

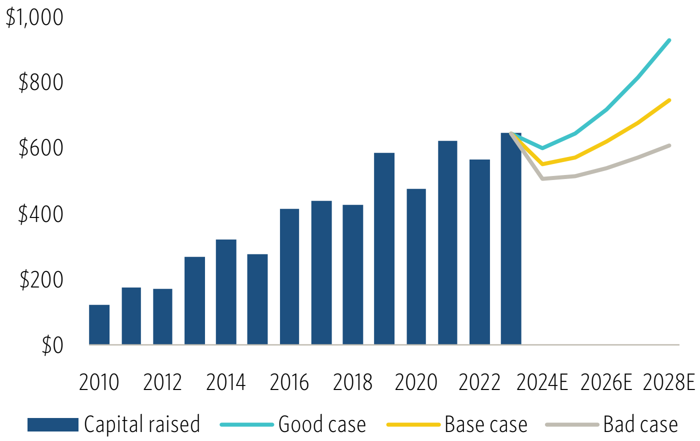
M&A EV/revenue multiples



Source: PitchBook • Geography: North America and Europe • *As of March 31, 2024

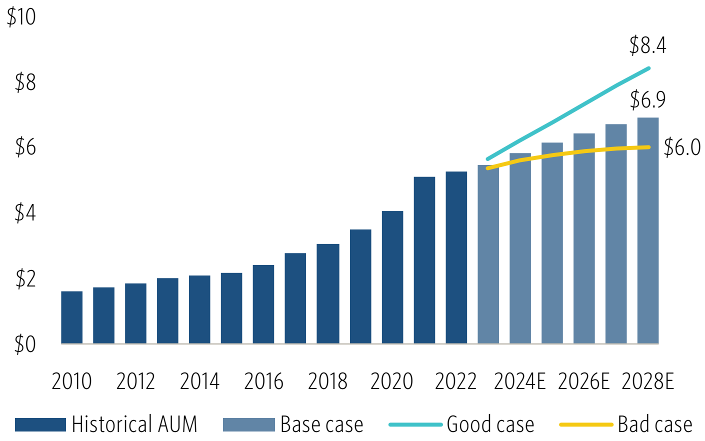
This has yet to impact fundraising or AUM growth

PE fundraising activity ($B) forecast*



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

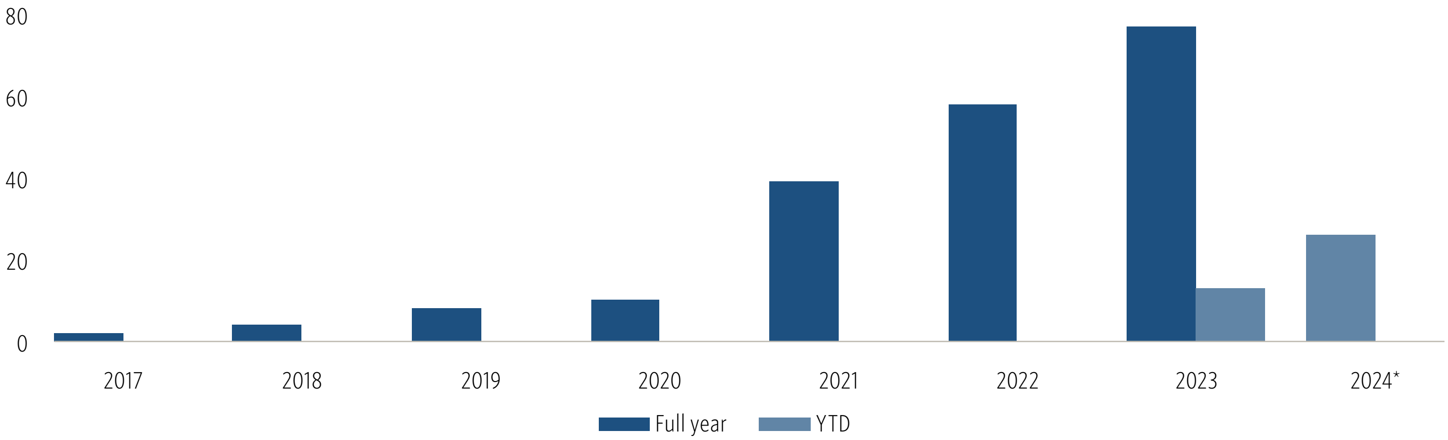
PE AUM ($T) forecast*



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

PE exit count related to continuation funds

Continuation funds are gaining favor as a "third rail"



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