INSIGHTS

SUPPORTED BY: Sourcescrub

AUGUST 2024



OVER THE LINE

DEAL DRIVERS IN TODAY'S PE LANDSCAPE

EXECUTIVE SUMMARY

Deal activity forecasts for the rest of the year remain tentative – with positive indicators such as narrowing valuation gaps and anticipated interest rate cuts, among others, being offset by intensifying geopolitical volatility and wider economic concerns.

As this tense reality persists, certain features characterise the private equity deal landscape of today.

Number one is the continued flight to quality. Our research finds that most deals fall through at the very early stages – during research and origination or due diligence. Only a few assets make it through multiple levels of scrutiny in a risk-off environment and – at least at the large-cap end of the market – these quality companies are coveted by multiple managers. What results is a highly priced and fiercely competitive deals landscape.

This is far from sustainable, particularly in light of the second defining feature of today's PE industry – vast pools of capital either unrealised or undeployed. Bridging solutions to generate liquidity in the short term have grown in popularity – as a way to return capital to LPs while waiting for more favourable exit opportunities – but the longer term play for GPs will have to be getting deals over the line.

The need of the hour is differentiation: whether in origination strategies through the use of tech and third-party partnerships; in segmentation of the market based on established investment themes; in the approach and proposition to sellers; or in the longer term value creation thesis.

This report digs deeper into all of the above themes, set against the backdrop of the wider conditions affecting the PE deal landscape.

AFTAB BOSE
HEAD OF PRIVATE MARKETS CONTENT

CONTENTS

KEY FINDINGS 3

SECTION 1 4
MARKET OUTLOOK

SECTION 2 12
STRATEGY SPOTLIGHT

METHODOLOGY

The data presented in this report is based on a survey of 130+ private markets fund managers. Data was collected over the course of Q3 2024 from senior leadership and C-suite respondents across North America, Europe, Asia Pacific and other key geographies. Survey analysis is complemented with qualitative interviews with PE leads at leading PE firms and allocator organisations, alongside knowledge and insight aggregated from a range of media, news and research resources.

KEY FINDINGS

1

Tentative optimism

Despite a slower-than-expected year so far, albeit with notable green shoots of recovery, 61% of managers expect deal activity to increase over the next two quarters. The biggest drivers here are intensifying LP demands for divestments and distributions, interest rate cuts, and a semblance of macro-economic stability. Still, over a third (34%) expect activity to remain the same over the next six months.

2

Pricing pain

The valuation gap between buyers and sellers remains the biggest blocker to a more vibrant deal environment, and with competition heating up for a select few quality assets at the upper end of the market – pricing will likely continue to be a pain point. Other top areas of concern include rising geo-political volatility, persistently high interest rates, and the potential of a recession/economic slowdown.

3

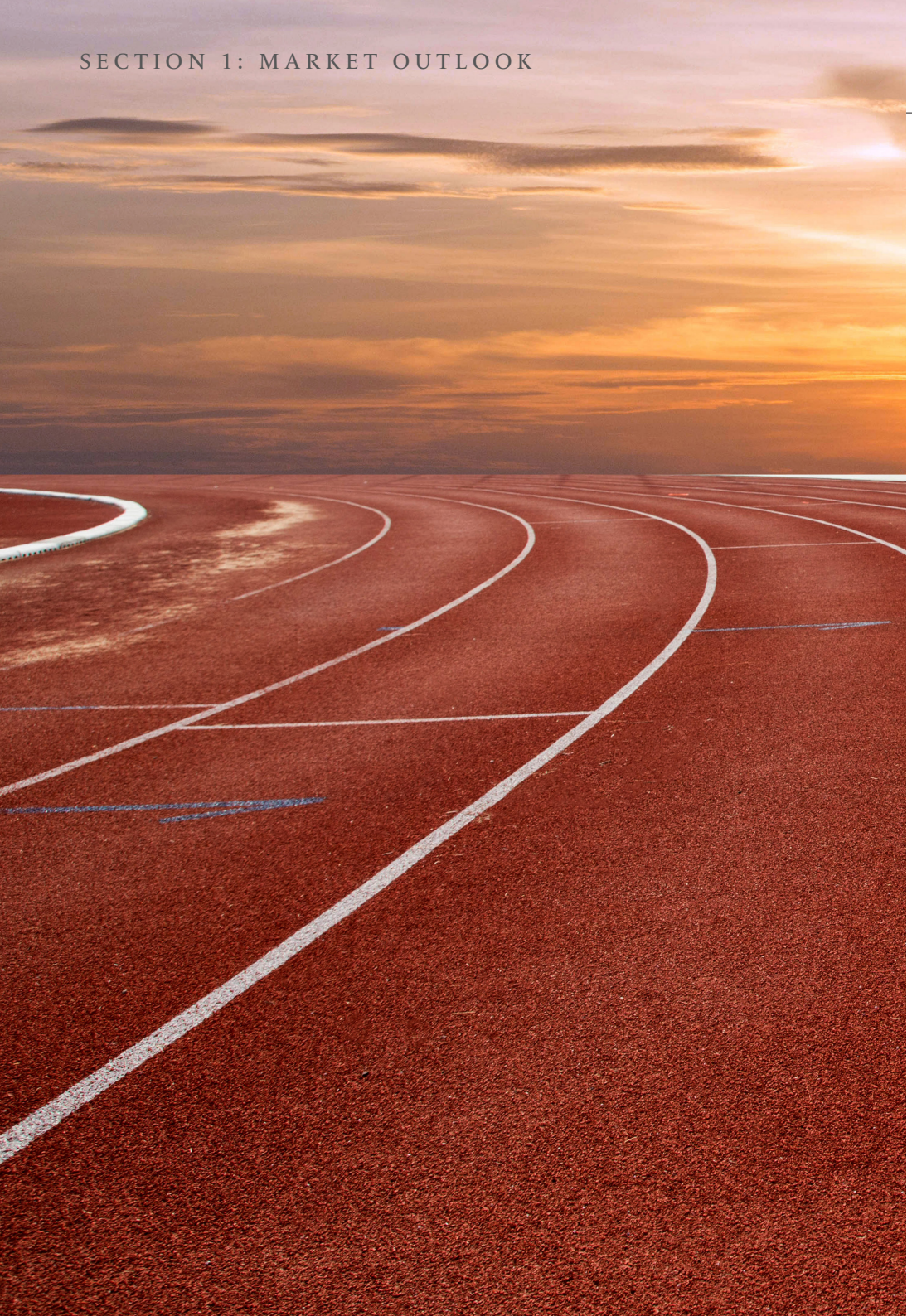
Strong undercurrents

The AI-fuelled rejuvenation of digital transformation across industries, alongside other considerations around cybersecurity, mean the tech sector will likely be the hotspot for deal activity over the next two quarters. Other era-defining trends, such as the energy transition and ageing demographics, put the energy and life sciences sectors in second and third place as deal hotspots, followed by consolidation in financial services.

4

Sourcing strategies

While pricing negotiations are the biggest pitfall in the transaction lifecycle, more than half (52%) of firms report most of their deals fall through earlier – either during research and origination or due diligence. Building third-party partnerships, marketing and business development, overall growth marketing and tech and data analytics are the most popular, and impactful, investments to boost origination efforts.



IN THE BALANCE

The world of PE has its say on the deal outlook for coming quarters, and the assets and sectors that will likely drive an uptick in activity

The deal logjam continues – what started out as a year of optimism has proved slower than expected for most involved in the world of private equity (PE). But expectations of an uptick remain persistently high. Indeed, they must, given Bain & Company's much-cited estimates that the global PE industry is holding $3.2tn in "un-exited" assets, amounting to 28,000 companies in portfolios worldwide.

Private Equity Wire's Q3 2024 survey of more than 130 managers revealed nearly two-thirds (61%) expect an increase in deal activity in the second half of the year (see Figure 1.1).

Michael Gahleitner, a Managing Partner and Co-Head of Industrial Tech at Triton, says: "If not in the next quarter, then certainly in the next six or nine months we can expect more activity. The industry is sitting on a mountain of dry powder, DPI is close to a ten-year low, and leverage is more readily available. In Europe, the risk premium on the base rate is about 150 basis points – that's lower than the average of the last two decades."

Survey data backs up this assessment. The top three drivers of a more active deal landscape this year according to the majority of managers are: demand for divestments/distributions, interest rate cuts and – closely related – more clarity on the macro-economic landscape (see Figure 1.2).

But where the macro-economic environment has found stability, the global geo-political backdrop is as volatile as ever – ranking as the second biggest blocker to deals for the remainder of the year (see Figure 1.3). Topping this list is the ongoing valuations gap, and the possibility of a higher-for-longer interest rate environment rounds off the top three – though recent indications from the Fed suggest a cut might be coming.

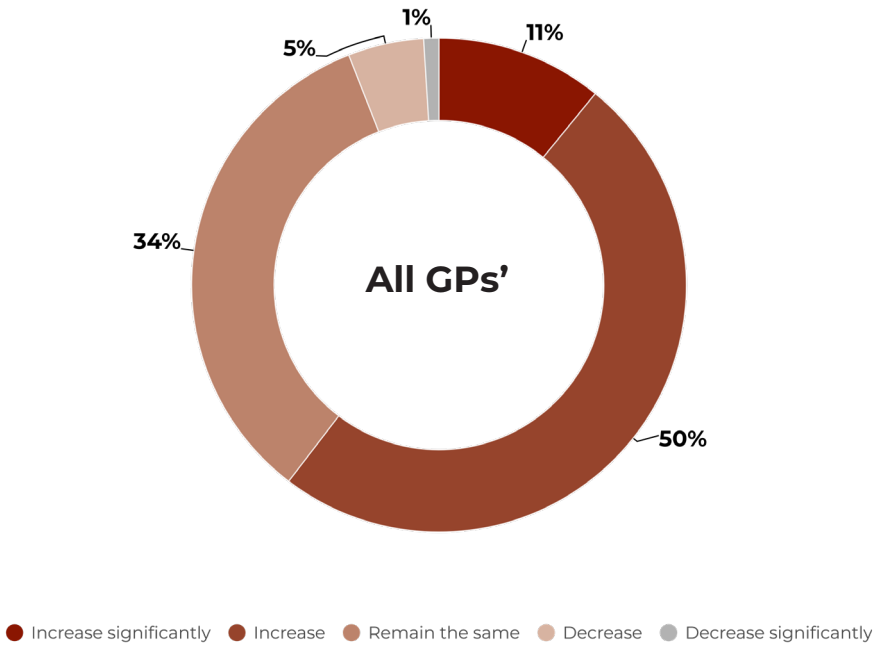
TENTATIVE TIMES

The result of these conflicting forces is what many describe as a cautiously optimistic deal environment. Scott Reed, Partner at Boston-based HighVista Strategies who co-leads the firm's lower mid-market PE strategy, says: "Expectations were nearly identical at this time last year – the widespread assessment was that H2 2023 would be the turning point, which never materialised.

"Since then, the same optimism has been carried over from one quarter to the next, and while there has been a degree of improvement in conditions, this has largely been at the margin and deal activity remains sluggish – both on the new deal front and on the exit side."

The biggest challenge remains the bid-ask spread on assets. Many, including Reed, suggest this gap has narrowed this year, which should combine with anticipated rate cuts in the US to grease the wheels to some extent. "At the same time, there's growing unease about the durability of the economy right now, which may offset the positive indicators and make it

Figure 1.1 Deal activity expectations for H2



Respondents were asked, 'In the next two quarters, you expect PE deal activity to:'

Source: Private Equity Wire GP Survey Q3 2024

KEY FINDINGS

Deal hotspots

Top four sectors that will see the most deal activity in the next two quarters

1  Tech, AI and cyber

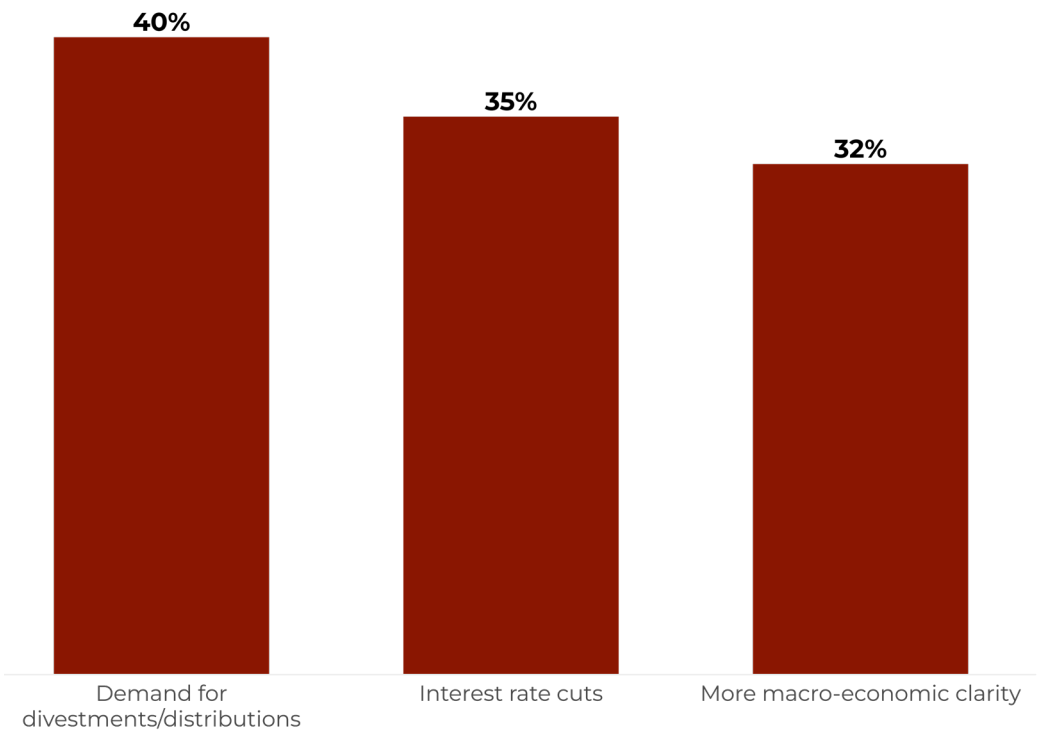
2  Energy transition towards renewables

3  Pharma, life sciences and biotech

4  Financial services consolidation

IN INSIGHTS

Figure 1.2 Drivers for a more active deal landscape



Respondents were asked, 'of the following, which factors are contributing most to higher deal activity?'*

*Respondents could pick multiple options

Source: Private Equity Wire GP Survey Q3 2024

harder for PE buyers to underwrite cashflow projections," says Reed.

He adds: "Even on the sell side, despite the need to boost the flow of distributions, anecdotally we've seen many PE firms hold out for another year with the hope of better conditions – rather than selling right now at a lower multiple than the purchase price."

Indeed, intel from the investor, manager and investment banker worlds all suggest that due diligence and overall transaction lifecycles are being drawn out, with several pitfalls along the way. Alan Gauld, Senior Investment Director at Patria Private Equity Trust says: "At the start of the year, we were hearing rumours that if all the transactions in the near-term investment banking pipeline were converted it would make 2024 the largest year in history for PE, bigger even than 2021."

QUALITY CHECK

The reality has been far removed. What has continued from 2023 and over the course of this year is a flight to quality assets – due diligence processes have stretched, and typically it is the highest quality prospects that have converted into deals.

Gauld says: "We've seen some PE-backed IPOs this year, but we've also seen a few cancellations, which is symptomatic of the current market. Volumes in the mid- and lower-mid-market have kept up a steady pace throughout but encouragingly we have seen a greater number of large cap deals in 2024

“

There’s growing unease about the durability of the economy right now, which may offset the positive indicators and make it harder for PE buyers to underwrite cashflow projections.

Scott Reed,
Partner, HighVista Strategies

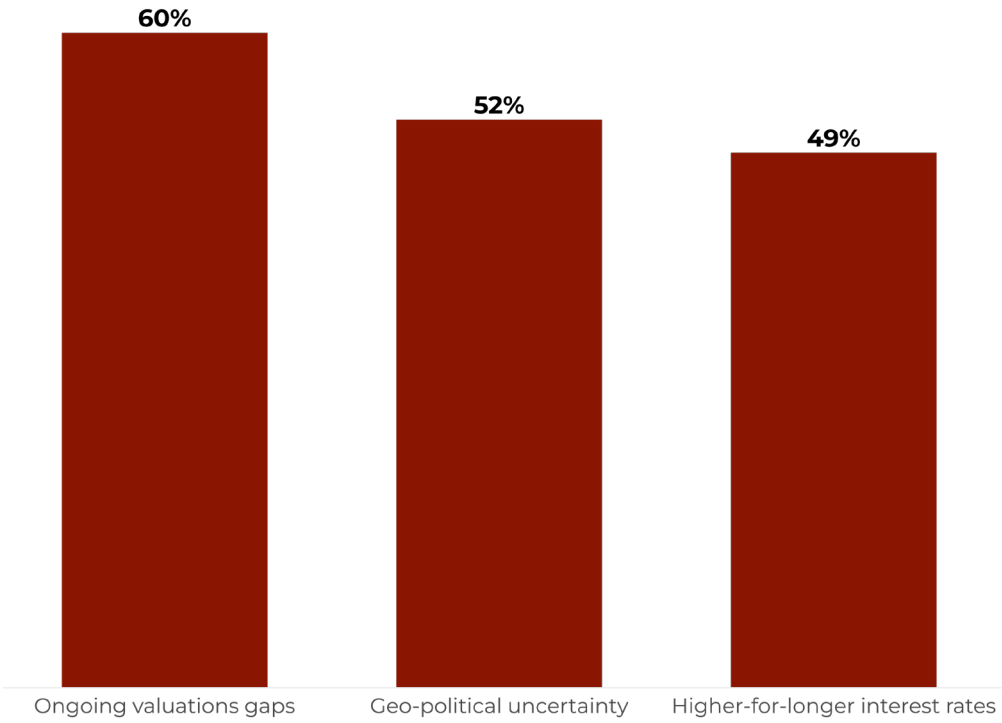
compared to the prior year. However, the lower quality, tier two or three assets have been slower to trade – much of the market has recently been competing for high-quality, market-leading businesses.

“This has meant that pricing for those high-quality assets has remained relatively high, which somewhat caps the potential upside. There will come a point when that dynamic changes and we’ll start to see a few more value-oriented deals. As interest rates begin to fall, firms will likely gain more confidence and seek pockets of opportunity across the entire market, rather than targeting top companies in the economy’s most resilient niches.”

It is true that investors have flocked to certain sectors amid recent economic turbulence – particularly those with positive underlying indicators. This will continue to be the case. According to our survey, the top three sectors expected to drive deal activity over the next two quarters are: technology (including cybersecurity and AI), the energy transition towards renewables, and pharma and life sciences. In a close fourth is the consolidation of the financial services sector.

“Areas such as business-to-business, mission critical software, healthcare technology and insurance brokerage have all been PE hotspots recently, and other business-to-business services are also achieving relatively high multiples,” says Gauld. Transaction numbers will likely climb higher as PE firms begin to look beyond just the top of the pile in each of these segments.

Figure 1.3 Main blockers to deal activity

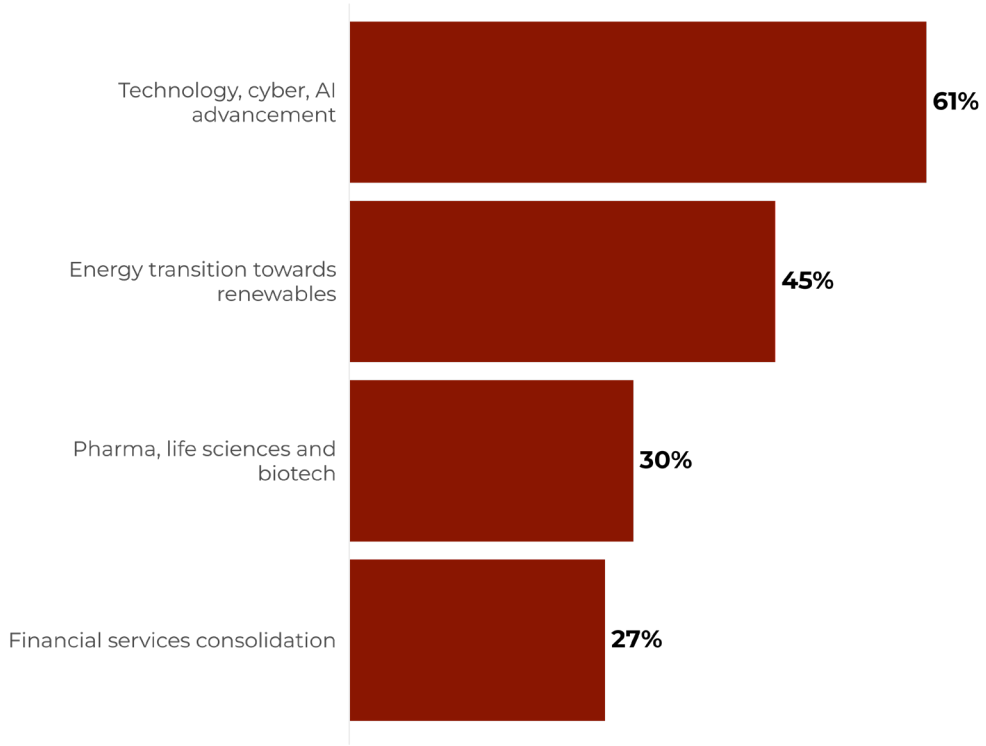


Respondents were asked, ‘Of the following, which factors will continue to hinder deal activity?’*

*Respondents could pick multiple options

Source: Private Equity Wire GP Survey Q3 2024

Figure 1.4 Sectors ripe for deal activity



Respondents were asked, 'Which of the following sectors/trends could represent a deal hotspot in the next two quarters?'*

*Respondents could pick multiple options

Source: Private Equity Wire GP Survey Q3 2024

One thing that will help this along is the gradual elimination of spurious factors affecting business risk fundamentals and cashflow projections. As explained by Gahleitner: "We had a lot of dislocation during the pandemic, mainly because it was difficult to track the historical financials of a company and compare the performance – pre- and post-Covid.

"During due diligence, it was difficult for PE firms to determine what was really driving movement in the profit and loss statements, and form a full picture of what they were purchasing. That's largely behind us."

From the macro-economic backdrop to granular transaction details, there appear to be positive indicators for a more lively deal market – the question remains of how long it will take for investor sentiment to truly loosen, for the valuations gap to close, for manager risk appetite to build up and, eventually, for the PE floodgates to finally burst open.

KEY TAKEAWAY

Opinions are mixed on how deal activity will develop in the next two quarters, but a more competitive and potentially stable environment may drive managers to explore a riskier class of assets.

“

What has continued from 2023 and over the course of this year is a flight to quality assets

Pulse check

Big Four advisory firm EY reported Q2 2024 to be PE’s “strongest quarter in two years” in a July report.

The cumulative Q2 2024 deal value, at $196bn, was nearly a 100% jump on the $100bn in Q1 2024 – though deal volumes remained relatively muted when compared to the end of last year, and far below the 2021 peaks.

The spike in value over volume reiterates the ‘flight to quality’ thesis – a number of high profile assets are changing hands for very high prices in a competitive environment. A spike in volumes would more accurately represent a wider warming of the market.

In terms of expectations for the next six months: The number of firms expecting a 10-25% spike in deal activity has nearly doubled over the past six months (from 23% in Q4 2023 to 43% in Q2 2024) – mirroring the optimism revealed in PEW’s Q3 2024 survey.

Interestingly, the number of distressed opportunities appears to have decreased significantly since the start of the year, while a slight drop is also notable in expectations from the secondaries space. Expectations of a spike in the growth equity or late stage VC stage, meanwhile, have doubled since early 2024.

LAYERS OF DIFFERENTIATION

As we wait for deal floodgates to open, PE firms give us a deeper understanding of how they have been positioning themselves in a competitive market

A core problem that many have set out to solve in the past two years has been to generate liquidity in the absence of exits. According to Scott Reed of HighVista Strategies, what has resulted is a wave of creativity in either deploying or distributing funds.

He says: "We've seen partial sales to buyers, preferred structures, dividend recap activity and a host of other solutions to bridge the gap and start the distribution machine revving up – a welcome move for LPs, who can start deploying capital elsewhere. These solutions effectively add an extra step in between, buying time till the transaction mill starts turning again and firms can generate more fulsome liquidity over the next six to 12 months."

Still, the ideal solution for firms is simply to get transactions over the line – a task that is rife with pitfalls. Asked about the stage of the transaction at which most deals tend to fall through, most firms (34%) predictably reported valuation negotiations to be the biggest pitfall (see Figure 2.1). This was followed by due diligence (29%) and research and origination (23%).

NAVIGATING COMPETITION

The numbers portray a clear narrative. A higher degree of selectivity is leading firms to reject most prospects at the early stages – that is during origination or due diligence. And when a select few assets make it through the funnel, differences over pricing throw a spanner in the works.

With many firms facing similar challenges, at least at the upper end of the market, the result is a flurry of competition for a handful of coveted assets – a scenario that is far from sustainable as the risk-off environment persists.

What firms need is differentiation – either in their origination strategy, so as not to stumble upon the same assets as the mainstream, or in their

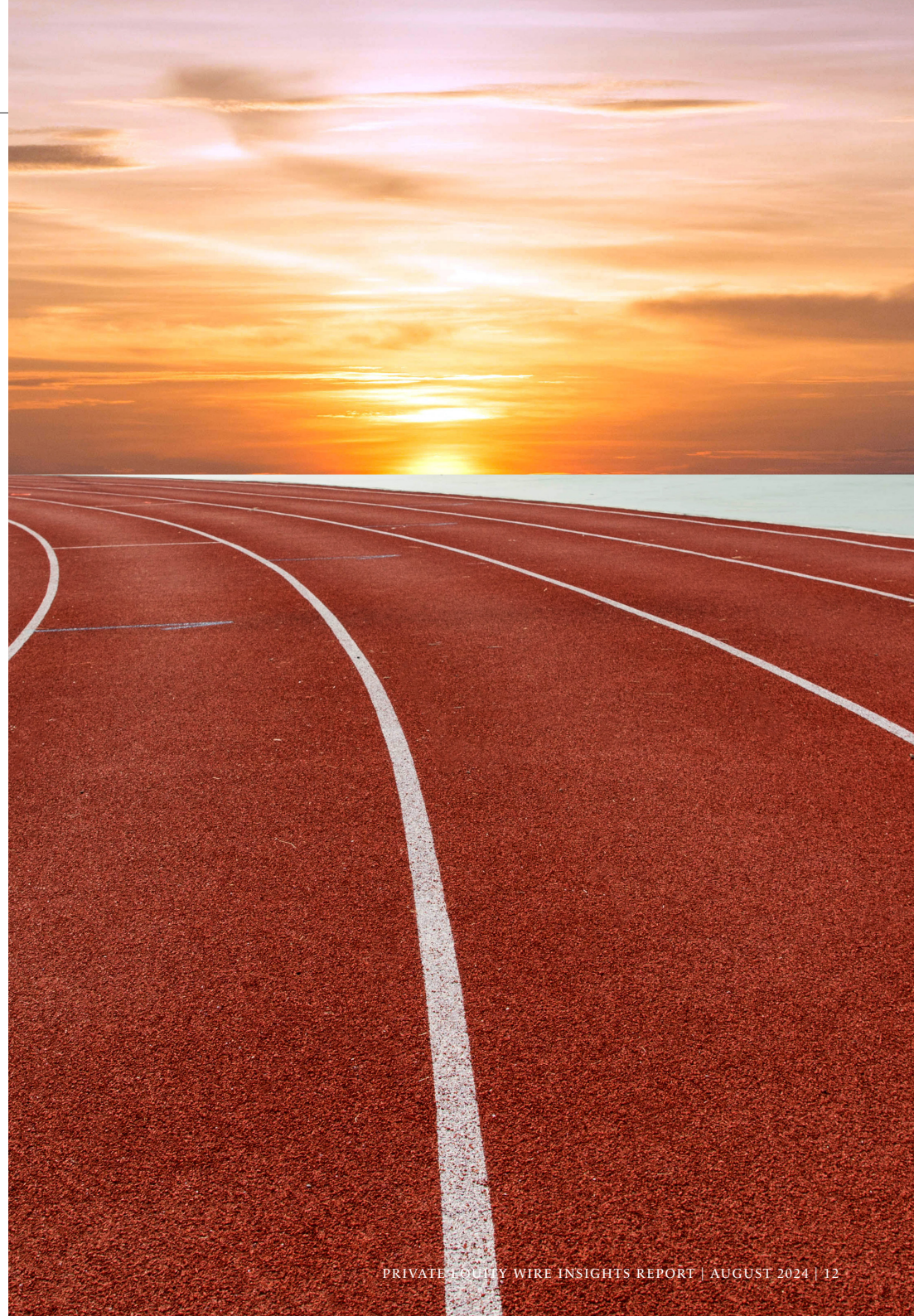
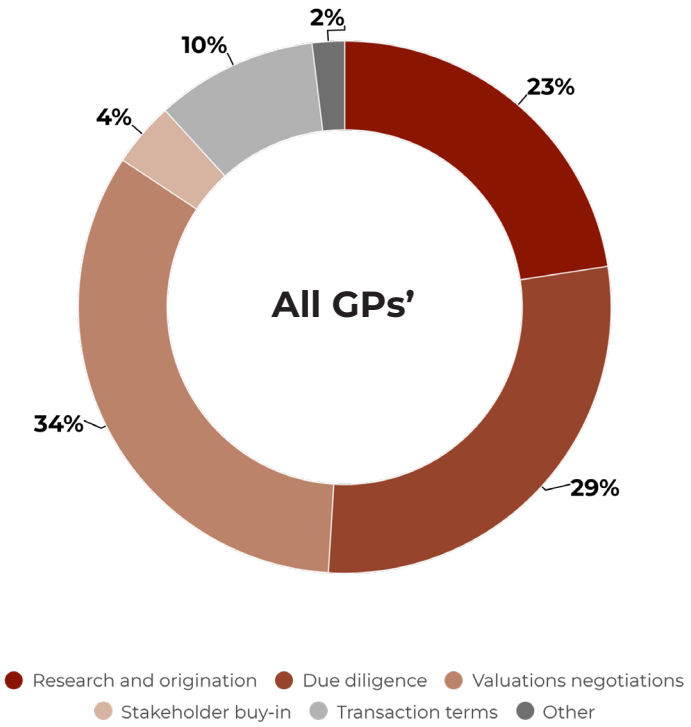


Figure 2.1 Most challenging stages of the transaction lifecycle



Respondents were asked, 'At which stage of the transaction lifecycle do the majority of your deals fall through?'

Source: Private Equity Wire GP Survey Q3 2024

approach to negotiations that can set them apart from fellow suitors.

Many are investing in the former capability. The majority of firms in our survey have adapted their sourcing efforts in some way or the other to maximise deal flow in the current environment (see Figure 2.2). The top three: third-party partnerships; marketing and business development; and growth monitoring. In a very close fourth place is the use of technology and data analytics. We followed up and asked firms what were the most effective of these strategies – yielding the same top three, respectively.

Interestingly, the use of tech and data analytics was second on the list when it comes to the largest firms – those with more than $10bn in AUM – and also ranked as the most impactful investment for this bracket of firms, alongside third-party partnerships (see Figure 2.3). But the value gained from tech differs greatly from one firm to the next, depending on how it's leveraged (see boxout).

KEY DIFFERENTIATORS

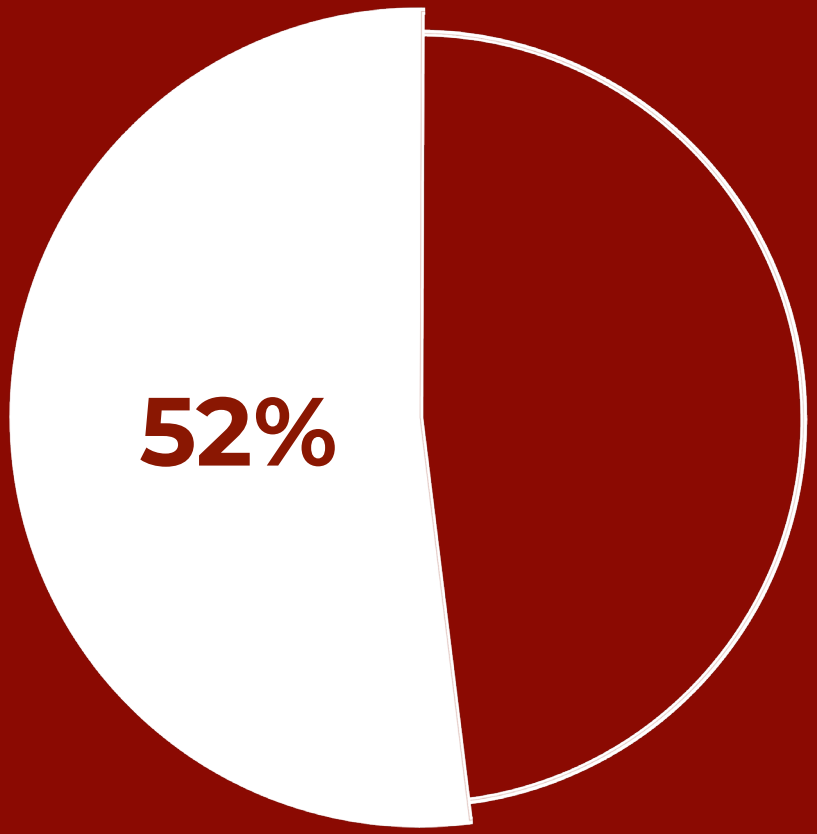
In reality, firms tend to use a mix of all of the above strategies, and a variety of others, to give themselves a competitive edge. Triton has been among the more active firms in the European market, making six divestments in 2024 and announcing the acquisition of Dutch Business Services company V&N Group.

According to Partner Michael Gahleitner, there are four key differentiators in Triton's approach: "One is technology, but I wouldn't class that as

KEY FINDINGS

High scrutiny

Share of managers reporting most of their deals fall through during research and origination or due diligence



INSIGHTS

a key differentiator – I would assume most of the sophisticated PE firms in the mid and upper market now apply AI, machine learning and data analytics to build their pipeline. The second is relationships, which is crucial. We've worked a lot with industry experts and people with vast networks that can be leveraged for more information.

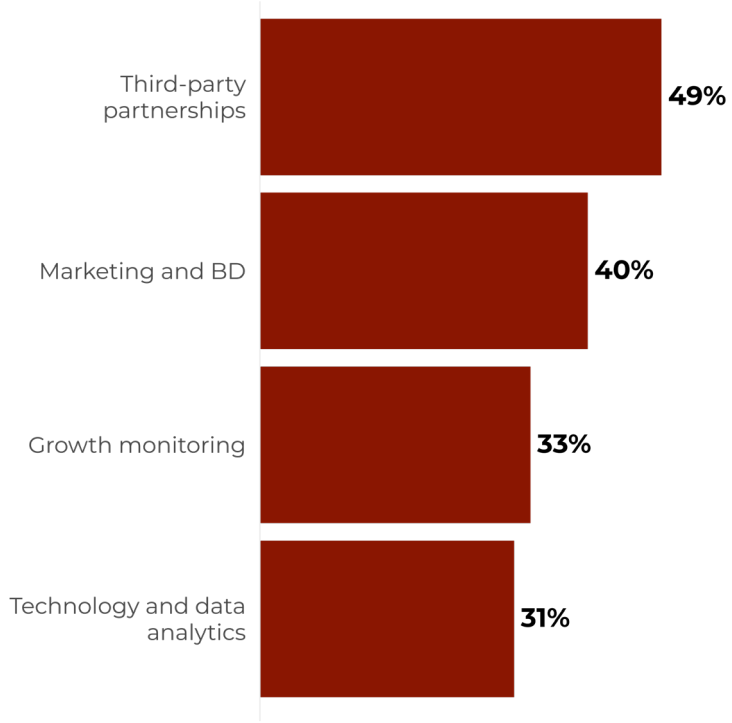
"The third is reputation. Our pipeline is quite non-typical – we look for companies that are under their full potential and transact mainly with corporates and families, and in many cases the deal negotiations are prolonged, bilateral, customised interactions that are viewed more as a partnership than an acquisition. Reputation and trust is critical in this space, and we've been able to cultivate these over time.

"And finally, we have focus. For example, industrials is such a broad space. We have to pick our battles and be disciplined about the sub-sectors, segments and pockets of the market in which we operate – based on whether they fit within the themes we support."

Another firm that has been in the news for transactions recently is Waterland Private Equity – notably its recent acquisition of Lebara Group. The firm's UK lead, Partner Wendy McMillan, also highlights the need for focus.

"We've oriented our investments around four key themes – sustainability, digitalisation and outsourcing, ageing populations, and leisure and wellbeing. This gives us a framework within which to identify the types of business and founder that might have an interest in partnering with us.

Figure 2.2 Sourcing strategies to maximise deal flow



Respondents were asked, 'How are you adapting your sourcing efforts to maximise deal flow in the current environment?'*

*Respondents could pick multiple options

Source: Private Equity Wire GP Survey Q3 2024

“

…we strongly believe in margin expansion to improve the performance of a company – to make it more resilient, healthier and more robust. These factors remain under our control.

Michael Gahleitner,
Managing Partner and Co-Head of Industrial Tech, Triton



JOSH GIGLIO

VP of Product, **Sourcescrub**

SOURCING SOPHISTICATION

As green shoots emerge in the world of PE dealmaking, Sourcescrub's VP of Product, Josh Giglio, discusses the evolving role of data solutions in origination.

Macro and geopolitical uncertainty, combined with the valuation mismatch and a number of other factors led to a high degree of deal selectivity in recent years.

"Figures from H1 2024 reveal an uptick in deal activity compared to last year, but there is substantial capital out there chasing a competitive number of deals," says Sourcescrub's Josh Giglio, pointing at the demand-supply gap for high-quality and, significantly, resilient assets.

"Five years ago, sourcing was a key problem – to separate the 'hopes and dreams' businesses from those with fundamentally positive indicators. And while this remains a challenge, the sheer volume of data and solutions available to firms has progressed significantly – levelling the playing field to an extent."

Scope and search

Indeed, a fifth of firms surveyed by PEW now use tech and data analytics to enhance their sourcing strategies, and 14% say this has been their most impactful investment to this end. These platforms can be instrumental in growing pipeline and reaching targets before competitors do.

So where is the room for improvement? Giglio outlines three key areas: One is the foundational layer of data on the investable universe – its volume and quality. "It's important to strike the balance between having a comprehensive dataset in a solution, while also keeping it manageable."

The second relates to integration and intercommunicability of data solutions. "Firms use such a plethora of tools – they have a source of truth for companies, a portfolio of upcoming transactions, a system to operationalise the pipeline, an outreach tool, and many others. No one solution has been able to solve the integration problem, but it's important the data across these tools is intercommunicable."

And the final piece of the puzzle, Giglio says, is the relevance, or "orientation" of data. Many solutions are positioned as large repositories that can be queried – like a search engine. The advancement of LLMs last year only accentuated this tendency, but the answers aren't always accurate or relevant. A better tool would create a user journey for firms, leading them to the specific types of data that are most of interest.
In a competitive investment landscape where speed and reliability are of the absolute essence for dealmaking, the ability to trust the quality of data, access and enhance it in a streamlined way, and manipulate it based on unique preferences are all critical functionalities.

New arenas

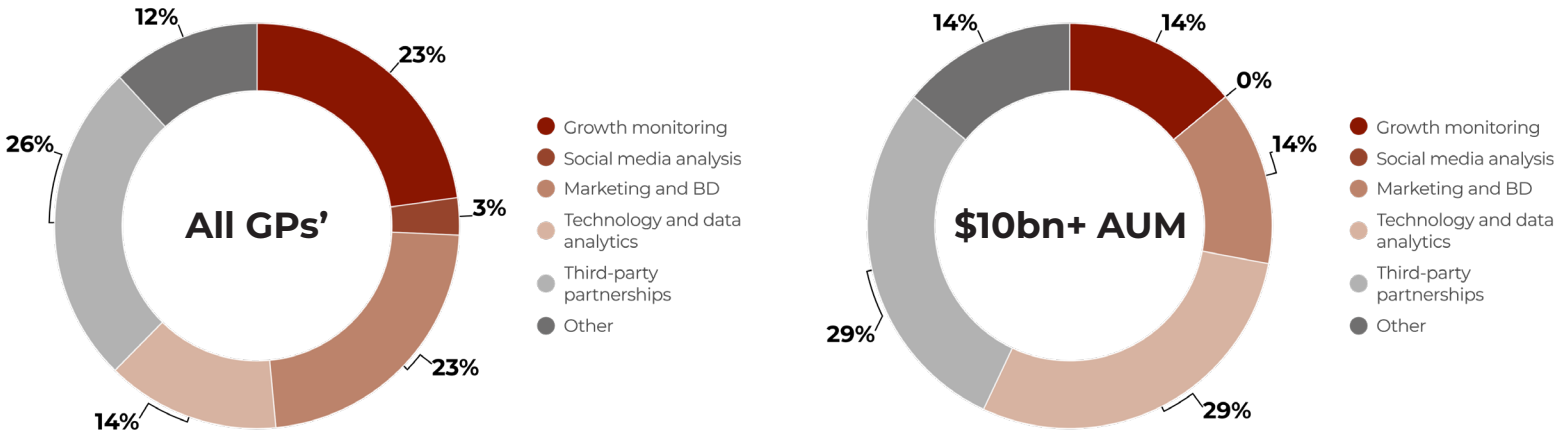
The iteration and evolution of data solutions in itself has created new challenges for firms, Giglio says. "Most managers can now unearth quality assets – the focus is on how to find the best angle into a deal, and strategically chart out a path to exit.

"The entire cycle includes a lens on: outreach strategies, the right communication to illustrate your sector and sub-sector expertise, in-person events and conferences that can facilitate meetings with
the right kind of companies, and subsequently information on making a successful exit – the holy grail for any asset manager."

"As the competitive landscape evolves, so too will the role of data solutions in driving this level of sophistication," he concludes.

"A better tool would create a user journey for firms, leading them to the specific types of data that are most of interest

Figure 2.3 Most impactful strategies for deal sourcing



Respondents were asked, ' Which of these investments have made the biggest impact?'

Source: Private Equity Wire GP Survey Q3 2024

"Many of the deals we do come from direct reachouts to business owners, to find a way in which we can collaboratively build a journey that includes a buy-and-build proposition. We certainly use technology to aid our sourcing efforts, but there's no substitute for the human engagement that allows both sides to determine if a partnership would be suitable".

VALUE FIRST

A critical consideration highlighted by both Triton and Waterland is the focus on a value creation plan at the point of contact. McMillan says: "Right from the beginning, it's possible to bring sellers onto the same page by thinking about the value of a business in all environments – with extra diligence on whether the price is fair or not."

Gahleitner describes Triton as an "all-weather investor", highlighting its "intention to make money, no matter the environment". He says: "What this requires is for us to buy a company and underwrite a value creation thesis that is largely under our control. The PE industry in recent years has digressed from this thesis, but we strongly believe in margin expansion to improve the performance of a company – to make it more resilient, healthier and more robust. These factors remain under our control."

In a mature PE market, where financial engineering and multiple expansion have taken centre stage over many years, Gahleitner positions this as a USP – one that appeals to sellers and investors alike.

KEY TAKEAWAY

Technology is levelling the playing field, and firms are differentiating based on investment themes, sector segmentation and their approach to value creation

PRIVATE EQUITY WIRE

CONTRIBUTORS:

Aftab Bose
Head of Private Markets Content
aftab.bose@globalfundmedia.com

Johnathan Glenn
Head of Design
johnathan.glenn@globalfundmedia.com

FOR SPONSORSHIP & COMMERCIAL ENQUIRIES:

sales@globalfundmedia.com

Published by: Global Fund Media, Fox Court, 14 Gray's Inn Rd, London, WC1X 8HN

© Copyright 2024 Global Fund Media Ltd. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior permission of the publisher.

Investment Warning: The information provided in this publication should not form the sole basis of any investment decision. No investment decision should be made in relation to any of the information provided other than on the advice of a professional financial advisor. Past performance is no guarantee of future results. The value and income derived from investments can go down as well as up.

Sourcescrub