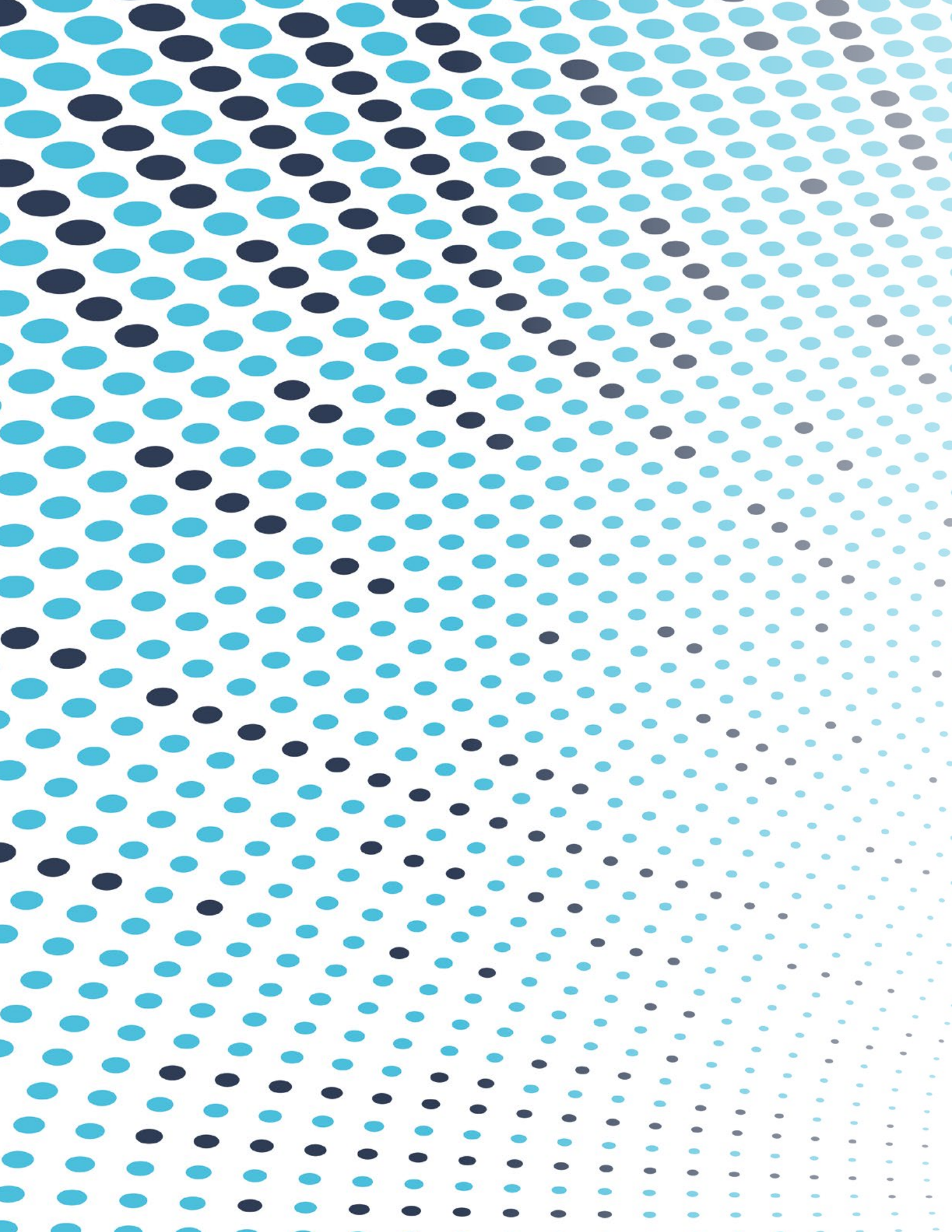




2023

Global Private Equity Outlook



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Methodology

At the beginning of the third quarter of 2022, Mergermarket, on behalf of Dechert LLP, surveyed 100 senior-level executives at private equity (PE) firms based in North America (45%), Europe, the Middle East and Africa (EMEA) (35%), and Asia-Pacific (APAC) (20%). To qualify for inclusion, a firm needed to have US\$1bn or more in assets under management and respondents could not be first-time fund managers. The survey included a combination of qualitative and quantitative questions, and all interviews were conducted over the telephone by appointment. Results were analyzed and collated by Mergermarket, and all responses are anonymized and presented in aggregate.

Introduction: A state of flux

A year ago, the PE industry was in full swing. Deal activity had spiked to levels never previously witnessed and credit was on tap amid the loosest monetary conditions buyout fund managers have ever experienced. To say that 2021 was an outlier is an understatement. Fast forward to the second half of 2022, and dealmakers are contending with markedly less accommodative market conditions.

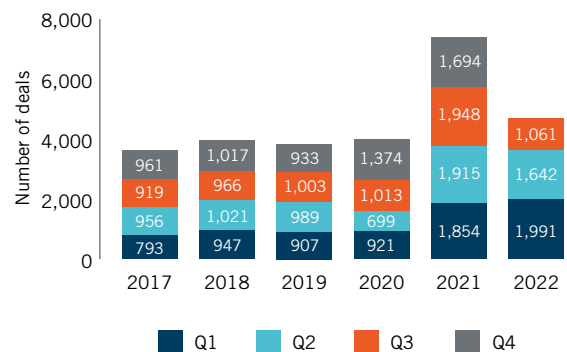
Despite the fall-off from 2021, global private equity (PE) deal activity has remained above pre-pandemic levels, and the market share of PE transactions as a proportion of global M&A activity has continued to steadily grow, reaching a record 23% as of Q3 2022, according to Refinitiv.

Even so, deal activity experienced a significant slowdown in the first three

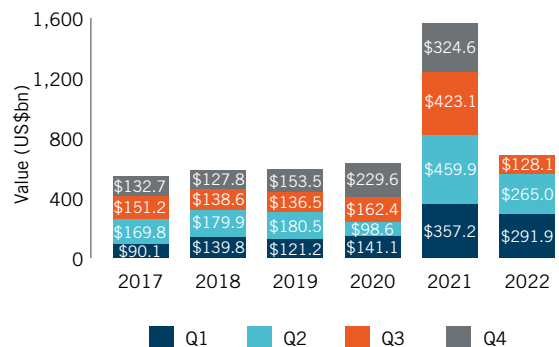
quarters of 2022 as the PE industry adjusted to tighter conditions and a clear pivot towards lower risk across asset classes. The number of deals dropped by 18% year on year, to a total of 4,694 deals in the first three quarters of 2022. Total value fell even more steeply, almost halving from US\$1.2tn in the Q1-Q3 of 2021 to US\$685bn in the same period of 2022. The overall decline in deal activity accelerated more sharply in the third quarter. There were only 1,061 PE deals globally in Q3, significantly lower than the two previous quarters (1,991 in Q1 and 1,642 in Q2).

This gap between volume and value is to be expected given the tightening cycle that central banks have embarked on this year. Nowhere is this more evident than the United States (US), where the Federal Reserve has made clear its

NUMBER OF GLOBAL BUYOUT DEALS, 2017–Q3 2022



VALUE OF GLOBAL BUYOUT DEALS, 2017–Q3 2022



commitment to tamping down inflation, raising interest rates six times this year alone, bringing rates up from 0%-0.25% to 3.75%-4.00% by November. This was the fastest rate of increase in Fed history—and Fed officials have indicated that they aren't done yet.

This hawkish push and the specter of weakened growth has had a clear impact on credit markets and, in particular, on leveraged financing conditions. The cost of capital is increasing and investors are showing reluctance towards buyout debt. This is one of the most, if not *the* most, defining characteristics of today's PE market. We find this year that 42% of North American respondents and 40% of APAC respondents agree that the availability and cost of leverage amid monetary tightening is a top challenge currently facing the PE industry.

We therefore anticipate that the remainder of 2022 and potentially much of 2023 will look similar to the first three quarters of this year, with relatively greater activity in the middle-market, as large-cap deal flow takes something of a breather after last year's excess. Until inflation is tamed—and historically it has been a tough nut to crack—PE fund managers can expect the high-yield bond and syndicated loan markets to remain challenging.

Dealmakers are contending with markedly less accommodative market conditions.

New capital

When it comes to fundraising, PE managers are finding that the firehose of capital is starting to taper off. *PEI* data show that PE fundraising dropped 16% by value and 30.6% by the number of funds closed through Q3 2022 compared with the same period last year.

This is a consequence of the rout in public markets, which has seen limited partners (LPs) overexposed to PE as a consequence of the denominator effect. Inflation and lower appetites for risk are making investors far more discerning about where and to whom they allocate their capital.

This will inevitably lead to longer fundraising cycles, with general partners (GPs) on average having to remain on the road for longer. It is also favoring managers with extensive track records and with whom LPs have existing relationships. In turn, this will further concentrate capital in the hands of a few firms, a trend that was already in play before the pandemic and which shows few signs of abating. This is top of mind for GPs, according to our research. Across all regions, we find that 28% of GPs see the single most

important global fundraising challenge to their firm being large LPs concentrating their investment relationships with a smaller number of funds.

Rates and costs

Geopolitical risks continue to loom large following the breakout of war in Ukraine at the beginning of the year. This is more of a concern for pan-European GPs with exposure to the weakened energy supply chain and assets in Eastern Europe. Current events are making inflation particularly pernicious in this market. This is likely to direct PE managers' focus toward steeling their existing portfolio companies by managing costs, and capital will be deployed judiciously. This instinct is not confined to Europe. The two-sided squeeze of rising costs on one side and rising rates on the other is a challenge for the global PE industry at large.

There is no question, then, that these are testing times. The PE industry has shown that, as a proactive steward of portfolio companies with a decades-long track record, it can successfully weather difficult market conditions. Now it is once again being asked to demonstrate that resilience.

Key Findings

42%

of North American and 40% of APAC respondents agree that the availability and the cost of leverage amid monetary tightening is a top challenge currently facing PE.

82%

of North American respondents and 80% of EMEA respondents are optimistic that market conditions for PE liquidity events in the next 12 months will be more favorable.

37%

believe retail access to PE vehicles will expand as an after-effect of the COVID-19 crisis.

51%

of respondents say that their firms' use of private credit financing has increased in the past three years.

65%

of APAC respondents and 58% of North American ones say they have increased their use of private credit to finance buyouts.

40%

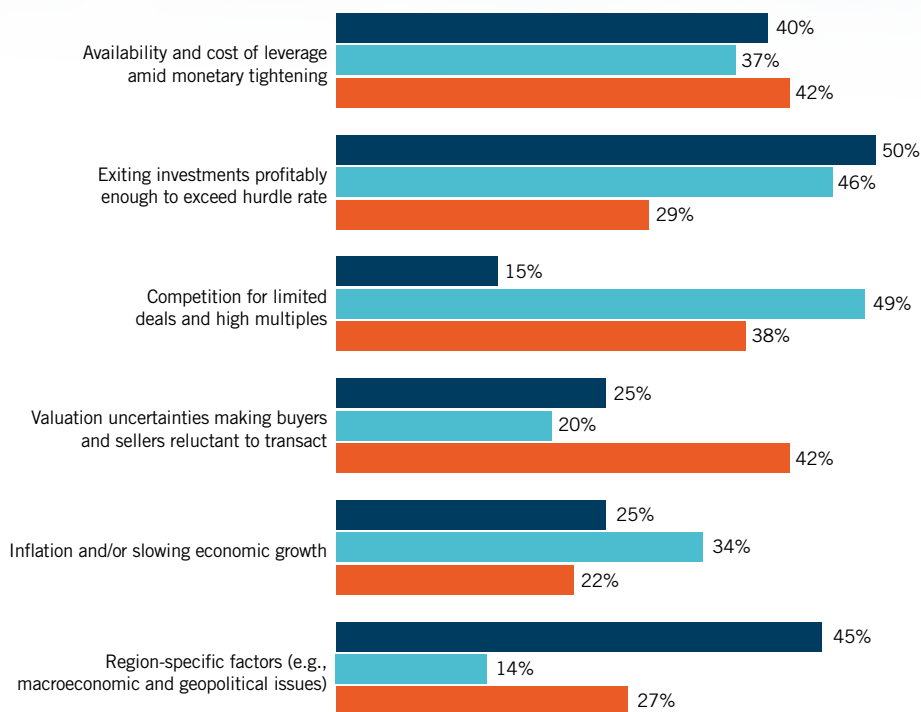
of APAC respondents say the single most important global fundraising challenge to their firm is that of large LPs concentrating their investment relationships with a smaller number of funds. 32% of EMEA and 20% of North American respondents agree with this.

Deal environment: Challenges, processes and auctions

GPs around the world have one thing in common: debt concerns. This is the one challenge that fund managers across different regions agree on—between 37% and 42% of respondents from each region agree that the availability and the cost of leverage amid monetary tightening is a top challenge, making it the most-selected answer option from the respondent pool as a whole.

Central banks around the world are taking different approaches. Across major, developed buyout markets, the US is taking the lead with the fastest pace of tightening in recent history. Europe is beginning to follow suit. APAC is taking a mixed approach, with China being an outlier in that it has limited inflation and is in fact loosening monetary policy amid a growth slowdown. But the fact remains that, in a more risk-averse

WHAT DO YOU SEE AS THE BIGGEST CHALLENGES CURRENTLY FACING THE PRIVATE EQUITY INDUSTRY? (SELECT TOP TWO)



■ Asia-Pacific ■ EMEA ■ North America

environment, deal financing will be harder to come by, especially at the upper end of the market.

Last year, valuation gaps were of little concern as there was considerable bidding strength for assets. With public equities having softened significantly during 2022, buyers are taking a far more cautious approach. Meanwhile, sellers may remain wedded to EBITDA multiples they have seen in recent years, which may no longer be realistic. More than two fifths (42%) of North American respondents say valuation uncertainty is among the top two challenges the PE industry is facing.

“Multiples went up significantly over the last two or three years. There is a lag between public and private markets, and over the coming months it should be expected that a price contraction of PE portfolio companies will play out,” says Markus Bolsinger, co-head of Dechert’s PE practice. “We’re seeing valuation gaps between seller expectations and what buyers are willing to pay. Parties are looking at ways to creatively bridge those gaps in auctions. At the higher end, the inability to obtain attractive financing is putting a lot of deals on hold.”

In APAC, the greatest perceived challenge is more local in nature. Half of these

respondents see exiting investments profitably enough to exceed hurdle rates as being one of the largest obstacles right now, with an additional 45% pointing to region-specific macroeconomic and geopolitical issues. The COVID-19 situation and renewed lockdowns in China in the first half of the year have been of particular concern as well, as this exacerbated already fraught supply chains. Economists have been trimming their forecasts of China’s GDP growth for both this year and 2023 as a consequence of its zero-COVID policy and signs of credit stress in its property market.

“There’s been a lot of uncertainty and fluctuations in the public markets in China, fueled in part by the tech crackdown, that have spooked investors,” says Siew Kam Boon, a partner in Dechert’s Singapore practice.

Hitting hurdle rates is less of a concern in North America, where PE returns have historically been strong, and the depth of liquidity has made for a healthy exit environment. That contrasts with APAC, where internal rates of return (IRRs) have been stymied by the relatively constricted exit market. “APAC has traditionally had fewer exits compared with North America and EMEA and many of these exits have taken

“We’re seeing valuation gaps between seller expectations and what buyers are willing to pay. Parties are looking at ways to creatively bridge those gaps in auctions.”
Markus Bolsinger, Dechert LLP

a longer time, which affects the funds’ IRRs. As a result, hurdle rates have been harder to achieve. We’re also therefore seeing a lot of continuation funds as a means of investors realizing liquidity,” adds Boon.

Forthcoming challenges

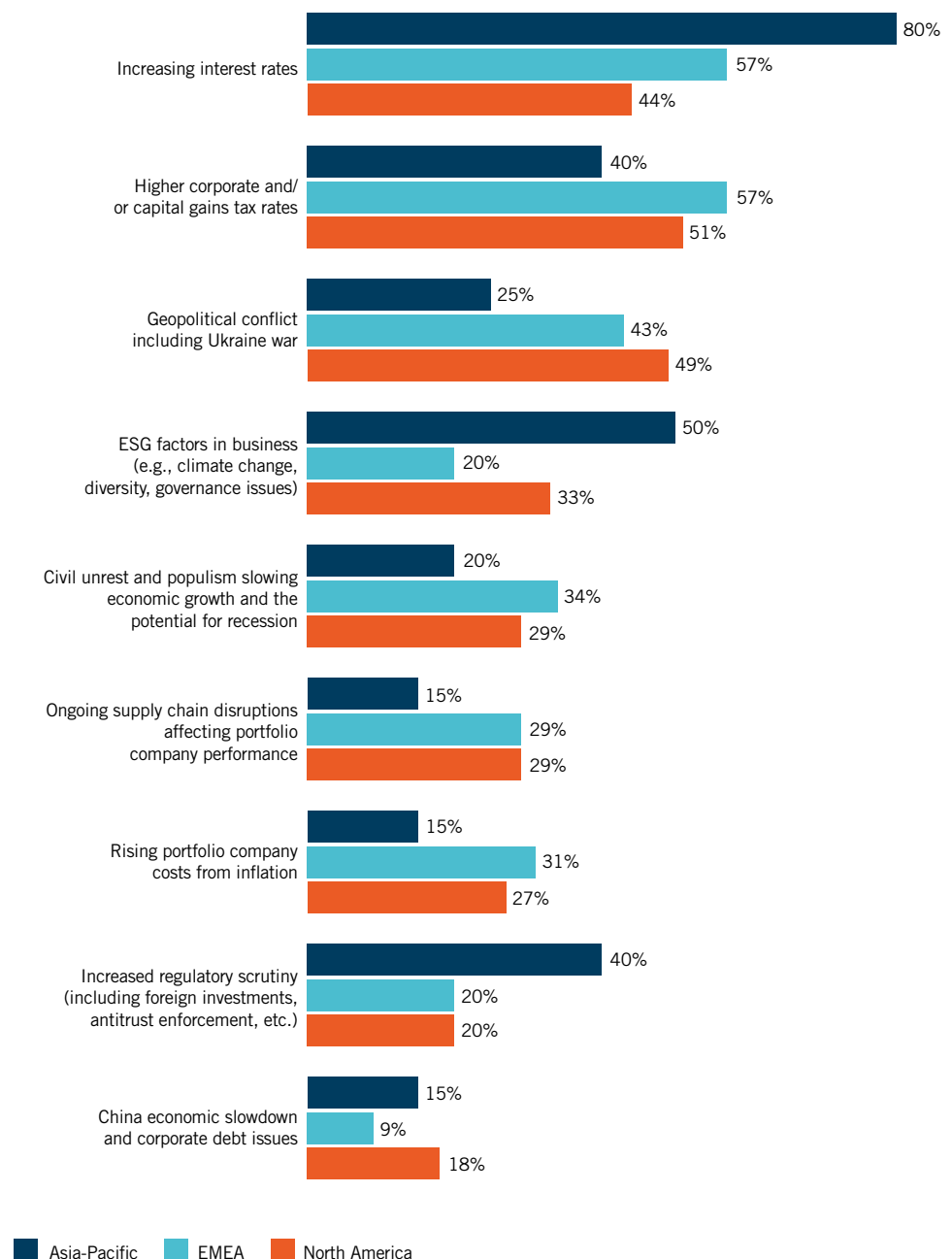
There is a clear focus of attention on the impact that rising interest rates will have on the dealmaking environment. An overwhelming 80% of Asia-Pacific respondents point to rate hikes as being a leading development that will influence deal activity over the next 12-18 months. APAC is notable for having a patchwork of monetary policies. In China, the largest buyout market in the region, interest rates are being lowered in an attempt

to revive credit demand and boost the economy following the slowing effect of COVID-19 lockdowns and to support its debt-laden property markets. Concurrently, India has been taking the opposite approach, upping its rate by 50 basis points in August to 5.4% to cool rising prices.

Sizable proportions of EMEA respondents (57%) and North America respondents (44%) also highlight rates as being one of the most impactful variables on deal conditions. The US is well ahead of Europe in its tightening cycle—the European Central Bank (ECB) hiked up key interest rates three times this year, compared to six hikes the Fed have implemented so far in 2022. This is despite the fact that inflation in Europe is outstripping the US, a function of Europe’s greater exposure to energy supply disruptions stemming from the war in Ukraine. With the European Central Bank having further to go to stop inflation in its tracks, the relative impact of rate hikes is still to come in much of EMEA compared with the US.

Higher rates will mean higher financing costs. This will not only affect new deals but existing holdings where floating rates have not been hedged. For companies with ample margins, this will not be a problem. However,

IN YOUR ESTIMATION, WHICH CURRENT OR UPCOMING DEVELOPMENTS WILL HAVE THE BIGGEST EFFECT ON THE DEAL ENVIRONMENT OVER THE COMING 12-18 MONTHS? (RANK THE TOP THREE 1-3, WHERE 1 IS MOST IMPORTANT)



if economic growth slows significantly or contracts, revenue and earnings growth will mostly follow and in many cases revenues and earnings at portfolio companies will decline. In highly levered capital structures, this will raise the prospect of business insolvencies and distressed restructurings.

In the case of new transactions, there is a silver lining to higher rates and leverage costs. Over the past decade, cheap debt combined with a superabundance of equity capital has made for frothy valuation multiples, which has made buying value a major challenge. Higher interest rates should attract investor capital toward fixed income, in turn slowing PE fundraising. At the same time as PE capital becomes less abundant, higher financing costs should also rein in deal bid levels. This could result in a compelling buying environment for those firms that are sitting on dry powder or are successfully raising funds and take a prudent approach to leverage, seizing on the opportunity to buy at attractive entry prices.

Tax is another focal point. Both EMEA and North American respondents were more likely to say that they expect higher corporate or capital gains tax rates to have the biggest effect

“There’s been a lot of uncertainty and fluctuations in the public markets in China, fueled in part by the tech crackdown, that have spooked investors.”

Siew Kam Boon, Dechert LLP

on the deal environment in the next 12 months (57% and 51%, respectively). In the US, the Inflation Reduction Act contains a 15% corporate minimum tax for companies that make in excess of US\$1bn a year. An analysis by Credit Suisse suggests that the impact is likely to be limited. The bank found that just over 170 companies in the S&P 500 paid less than 15% in taxes in 2021 and that less than half of these are likely to see an increase in 2023 as the legislation allows companies to use adjusted earnings. In addition, the Inflation Reduction Act imposed a 1% tax on stock buybacks by public companies, beginning in 2023. The full scope of the tax is not yet known, but due to the broad statutory language, the tax could apply in some LBOs, special purpose acquisition company (SPAC) transactions, tax-free boot, among others. While not significant, the tax could impact transactions at the margins.

More ambitious efforts are currently being made by the OECD to coordinate a 15% minimum global corporate tax rate. This would have the effect of preventing large multinational companies from relocating their profits to other jurisdictions. Instead, they would have to pay more taxes in countries where they have customers and less in low-tax jurisdictions where they base their headquarters.

Asia-Pacific respondents are far less concerned by the potential impact of tax developments on the deal environment than they are about the gamut of environmental, social and governance (ESG) factors, including climate change, diversity and governance issues, as being a possible bottleneck. Half of the respondents from this region saw this as among the top three biggest areas of concern.

APAC is generally considered to be far less mature in its commitment to ESG than other

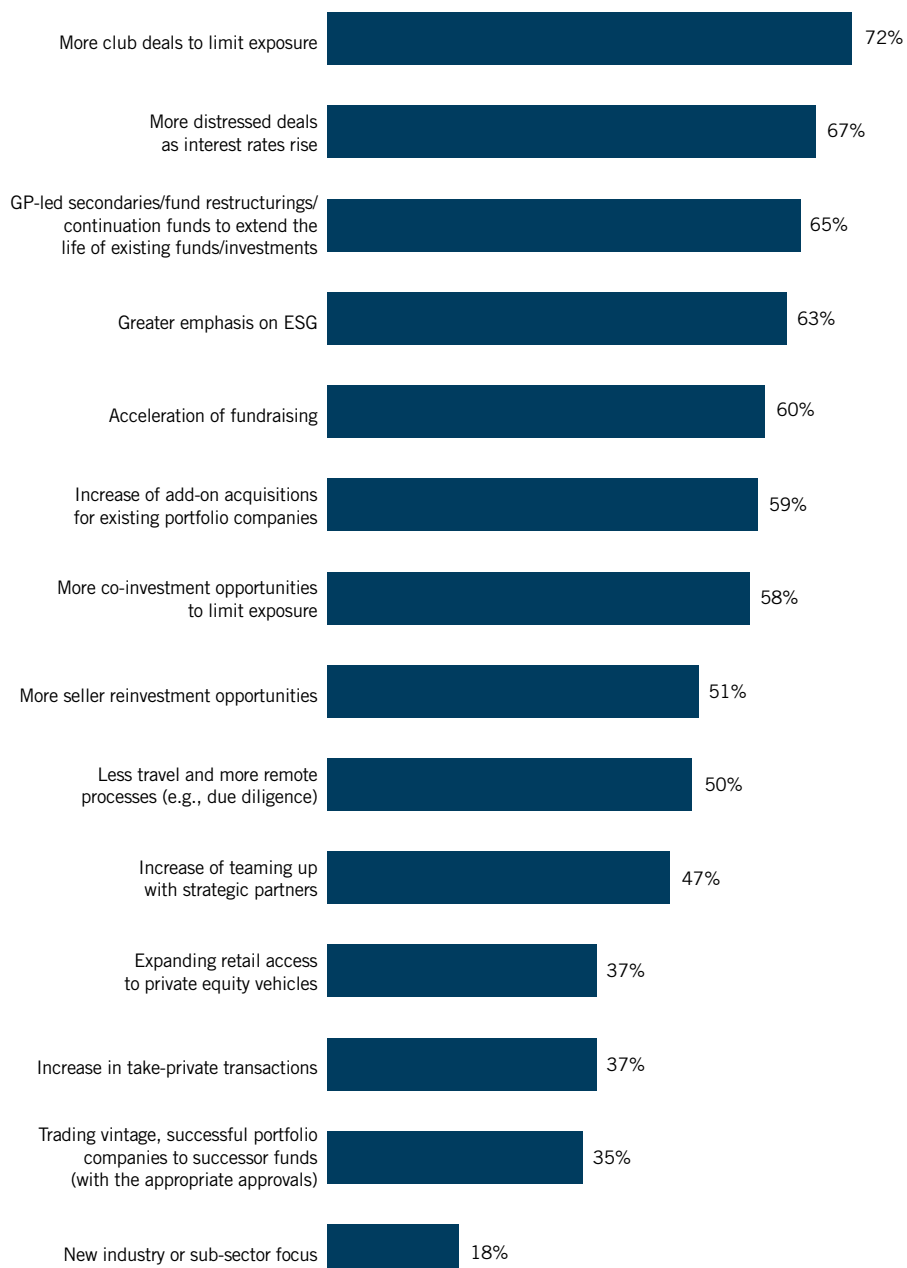
regions, especially Europe, which has led the regulatory push. A recent survey of business executives carried out by the Harris Poll and Google Cloud found that almost a third of those in the APAC region believe their organization is mostly focused on revenue growth even if it is harmful for the environment, and more than half think their organization is not serious about sustainability commitments. Therefore, APAC GPs may be looking at the road ahead and the progress that needs to be made as global institutional LPs increasingly prioritize ESG.

COVID's shadow

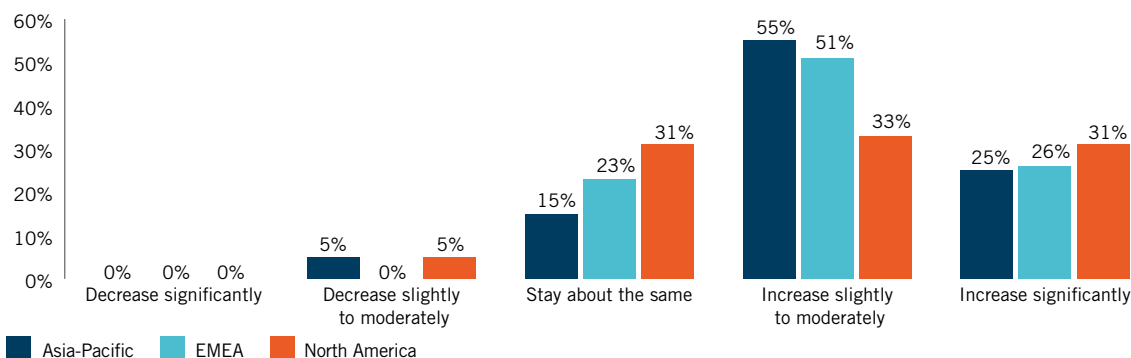
COVID-19 continues to cast a long shadow. Expansionary policy helped keep the global economy afloat, but the downstream effects of those policies coupled with ongoing supply chain challenges are now being felt the world over, causing runaway inflation that has dampened demand.

On considering which trends are expected as a continued after-effect of the COVID-19 crisis, 72% of respondents point to an increase in club deals to help limit exposure. When PE firms team up on deals, not only can they share insights and expertise for the benefit of the target company, they also spread their downside risk, which is especially pertinent at this point in time.

WHAT TRENDS DO YOU SEE GROWING AS AN AFTER-EFFECT OF THE COVID-19 CRISIS? (SELECT ALL THAT APPLY)



HOW DO YOU EXPECT THE USE OF REPRESENTATION AND WARRANTY INSURANCE OR WARRANTY AND INDEMNITY INSURANCE TO CHANGE IN EMEA/ASIA-PACIFIC/NORTH AMERICA IN THE COMING 12-18 MONTHS? (SELECT REGION ACCORDING TO RESPONDENT REGION)



Last year, there was notably less expectation of more club deals being a major trend, highlighted then by less than half of respondents (43%). By contrast, an expectation for increased distressed M&A has been baked into the market since 2021. Last year, 66% of GPs presciently expected an uptick in distressed deals in anticipation that interest rates would need to rise, in spite of central banks then seeing inflation as transitory. Similarly, 67% of respondents this year expect distressed deal flow to become a major trend as companies struggle with their financing costs.

Policy protection

It is inevitable that amid slowed growth and a tougher exit environment, representation and warranty insurance (RWI), or warranty and indemnity insurance as it is known in

EMEA and APAC, comes into sharper view. These policies protect buyers against any inaccurate representations, warranty breaches, or indemnities given by vendors. The non-use of RWI presents a major competitive disadvantage for buyers.

Without such coverage in place, vendors may be expected to place between 5% and 20% of their sale proceeds in escrow to cover any potential indemnification claims. Minimizing or nixing this escrow obligation outright maximizes liquidity and bumps up vendors’ IRRs. Therefore, those sales that GPs are able to successfully secure will benefit all the more from RWI policies in an environment where exits are harder to come by and where multiple compression may be weighing on expected returns.

A majority of respondents in each region expect the use of RWI insurance over the coming 12-18 months to increase in their respective regions. This is most true for those based in Asia-Pacific (80%), which has traditionally—other than in Australia, where RWI has a very strong following—had the least usage compared to other regions, followed by EMEA (77%) and North America (64%).

Rather than an aversion to RWI coverage, this lower expectation in North America is a function of the maturity of this insurance’s adoption in the world’s largest PE market. “It’s a phenomenal instrument if you use it correctly, and you’re now seeing that some regions, where its adoption has lagged, are catching up to how far the US has pushed it,” says Bolsinger.

APAC spotlight

PE dealmaking in APAC took a sizable tumble year over year. While a 17% drop in the number of buyouts—to a total of 707 deals in the first three quarters—was in line with global figures, the 60% decrease in deal value compared to Q1-Q3 2021 was far steeper than the 45% rate of decline globally.

China traditionally dominates activity given the size of its economy, and the country has generated no shortage of macro and market developments. In December of 2021, Evergrande was officially labeled a defaulter for the first time, the mammoth real estate developer's travails spooking markets and signaling that not all is well in the country. Since then, the contagion has spread through the property sector, with a number of other developers defaulting on their liabilities.

Months later, as the rest of the world was doing its best to put COVID-19 behind it, China reintroduced strict lockdowns to try and stem flare-ups of the virus in the major seaport city of Shanghai, among other locations. This put already strained supply chains back under immense pressure.

“APAC really is the most diverse buyout region in the world. There’s been a lot of happenings in China, which has really skewed the numbers so far this year,” says Siew

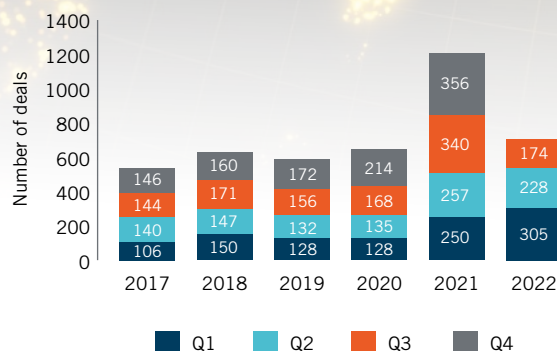
Kam Boon. “Traditionally, the country’s taken the lion’s share of deal value. However, people have been concerned about the geopolitical situation in China, the uncertainties around the regulatory policy affecting the tech sector and the extensive lockdowns. There has also been a lot of uncertainty and fluctuations in the public markets in China.”

Another sign of the unique issues affecting the Chinese market, the largest PE-related transaction in the country was the US\$4.7bn investment in semiconductor firm Innotron Memory by a consortium that included some of the country’s largest technology firms (Alibaba and Tencent), as well as a group of financial investors. The deal comes on the heels of growing Western protectionism around chip technology, which could limit Chinese tech companies' access to semiconductor technology owned by Western firms.

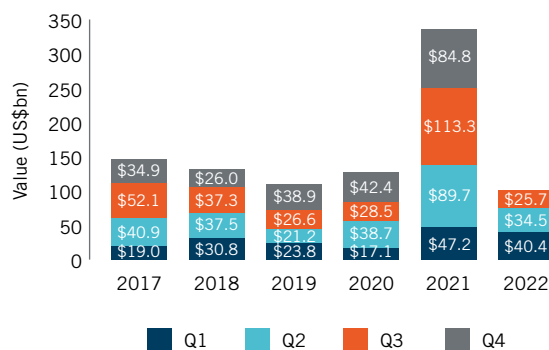
Big in Japan

As uncertainties cloud the Chinese market, the Japanese market continues to grow in its attractiveness to foreign PE. The weakness of the Japanese yen compared to the US dollar, combined with the political stability of the country and opportunities presented by traditional conglomerates looking to streamline, created conditions for the number

NUMBER OF APAC BUYOUT DEALS, 2017–Q3 2022



VALUE OF APAC BUYOUT DEALS, 2017–Q3 2022



of buyouts in the country to nearly double from 64 in 2020 to 124 in 2021—the highest annual volume on Mergermarket record (since 2006). The first three quarters of 2022 have already recorded US\$19.9bn combined in deal value, more than the entirety of 2021, which totaled US\$16.5bn.

The top two deals of the first three quarters of 2022 in APAC showcased the dominance of US-based PE in Japan, with both involving KKR. The largest was a US\$6bn bid for Japanese outsourced logistics provider Hitachi Transport System, from conglomerate Hitachi. KKR was also involved in the restructuring of Japanese auto parts supplier Marelli Holdings, which it already owned, with the company selecting the firm as its preferred partner to help put it on an even keel.

Southeast Asia shines

Southeast Asia is continuing to demonstrate strength amid the pullback in China. The subregion has seen its manufacturing activity expand as Chinese production has migrated to other parts of the continent over the past decade, accelerated by the pandemic and China's zero-COVID approach.

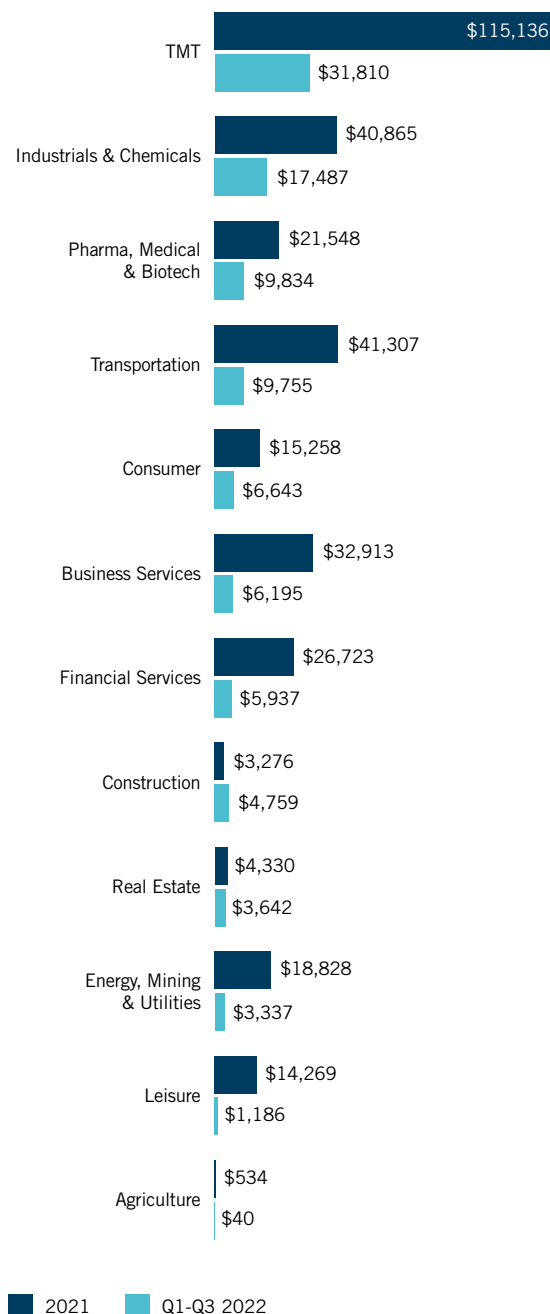
The region's digitalization initiatives, spearheaded by the Association of Southeast Asian Nations (ASEAN), are also well aligned with Southeast Asia's young and tech-savvy population. Tech-centric deals dominate in countries like Indonesia and Singapore, the territory having birthed its first generation of unicorns including ride-hailing app Grab, multi-service platform and digital payment technology

group Gojek and online mall Blibli. This is drawing interest from global investors and competition for deals is intensifying in a world in which tech increasingly underpins business activity and growth, in spite of the valuation rout that has been observed this year. Encouraged by the success in these countries, investors are also looking further afield to the Philippines, Malaysia, Vietnam and Thailand.

"We see that with a lot of the travel restrictions being lifted this year, our clients are returning to in-person deal sourcing and it's the Southeast Asian region where they're going to tap opportunities. We are also tracking a lot of interest from funds that have traditionally not invested in the region in a significant manner, spending time learning about the region with a view to making meaningful investments here," says Siew Kam Boon.

Among the largest PE deals so far this year have been Blackstone's US\$1.6 acquisition of Singapore-based engineering firm Interplex and Hong Kong-based PE RRJ's US\$1bn acquisition of Fullerton Health, a Singapore-based health company which operates across Singapore, Malaysia, Indonesia, India and Hong Kong.

PE BUYOUT VALUE BY SECTOR IN APAC (US\$M), 2021-Q3 2022



Fund trends

PE fundraising is up against some of the strongest headwinds it has faced in recent memory amid declining equity markets. Once again, the denominator effect has reared its head: when the value of public stocks in investor portfolios contracts, by default they become over-allocated to PE and other alternative investments, whose fund valuations lag public markets. Add to this the less-discussed numerator effect: LPs leaned heavily into PE in 2021 and at market-top valuations, magnifying asset-allocation skews in the face of recent stock underperformance. However, it is not just the denominator and numerator effects at play this time. The combination of high interest rates and high inflation, not seen in the US for 40 years and in Europe for 30 years, as well as the residual effects

of the COVID-19 pandemic (e.g., reconfiguration of supply chains and softening demand for office real estate) and economic sanctions imposed by various actors on others, add to these headwinds.

All of this is causing LPs to be more selective in the commitments they make to new PE funds, while spurring high secondary market activity as investors seek to rebalance their portfolios. Renewed caution inevitably favors marquee PE names with extensive experience and the full gamut of fund offerings. Analysis by S&P Global and Preqin revealed that the top 25 PE firms globally held half of the total unallocated capital in the PE industry in 2021.

“It’s a trend that has been developing over the past few years already,” says “Sabina

“There’s a gap between the smaller funds and the very large funds, of which there aren’t that many. A lot of LPs are looking to deploy larger amounts with fewer relationships because it’s easier to manage.”

Sabina Comis, Dechert LLP

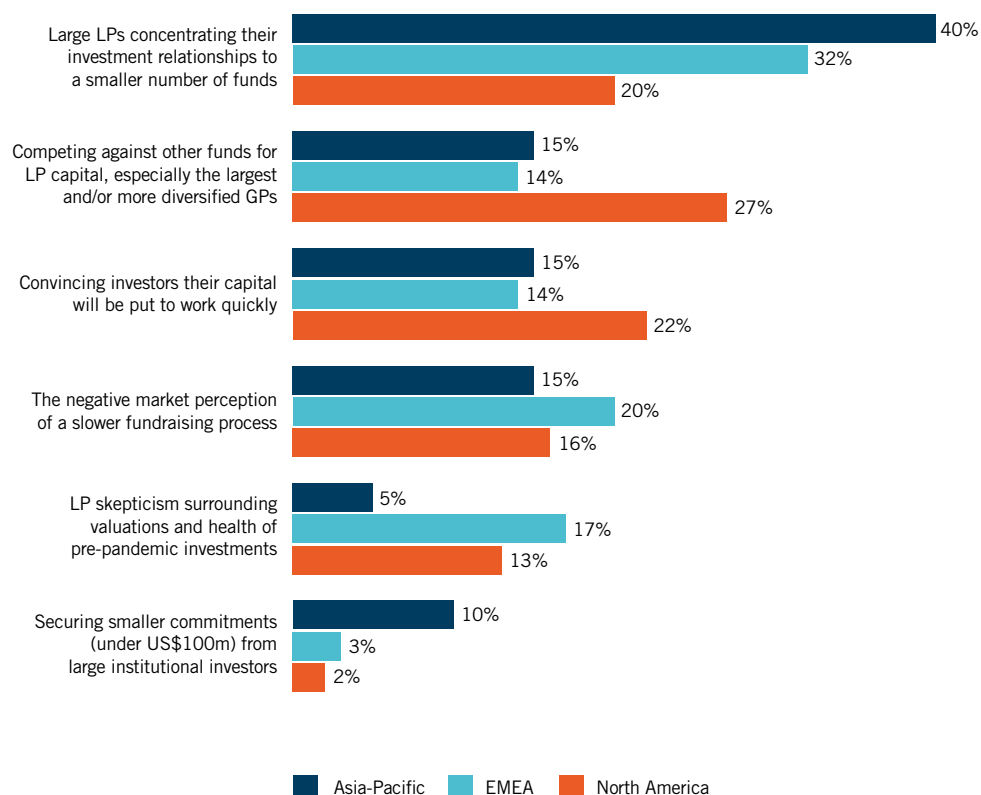
Comis, a funds and tax partner in Dechert's Paris practice. "There's a gap between the smaller funds and the very large funds, of which there aren't that many. A lot of LPs are looking to deploy larger amounts with fewer relationships because it's easier to manage. It's becoming a vicious circle in which smaller managers are finding it hard to establish the track records for which LPs are looking and the gap keeps getting wider and wider."

According to two in five Asia-Pacific respondents, the single most important global fundraising challenge to their firm is that of large LPs concentrating their investment relationships with a smaller number of funds; 32% of EMEA and 20% of North America respondents agree with this.

More than a quarter (27%) of North American respondents also point to the challenges of competing against other funds, particularly large and more diversified GPs, for LP capital.

According to *Pitchbook* data, US private equity firms raised US\$258.8bn across 296 funds through Q3 of 2022. Despite this, it is expected that the year will end on a weaker note, owing to many LPs having already hit their allocation targets for the year, according to *Pitchbook*. Globally,

WHAT IS THE BIGGEST GLOBAL FUNDRAISING CHALLENGE YOUR FIRM HAS FACED? (SELECT THE MOST IMPORTANT)



fundraising across most private asset classes declined in 2022 compared to 2021. In addition, the average timeframe for achieving a final closing of a fund is the longest it has been over the past years. According to Preqin, during H1 2022, 72% of PE funds took 13 or more months to reach a final close, compared to 56%, 50% and 38% of PE funds in 2021, 2020 and 2019, respectively.

In spite of the headwinds, Q2 2022 saw the largest number of PE funds being raised in the global market at any time over the last five years. This has resulted in a very congested market and many LPs inundated with solicitations from the sponsors of those funds, further complicating fundraising efforts.

In last year's survey, respondents were far more concerned about convincing investors that their capital would be put to work quickly. Valuations were running high and LPs at the time were understandably questioning potential capital deployment challenges. With the valuation reset this year, it follows that GPs with capital should have less trouble finding more conservatively priced deals and will therefore be able to deploy the capital. This comes with a caveat: debt financing has

become much harder to come by amid the tighter monetary conditions and the outflux of market liquidity, which is disproportionately affecting deal activity at the top end of the market.

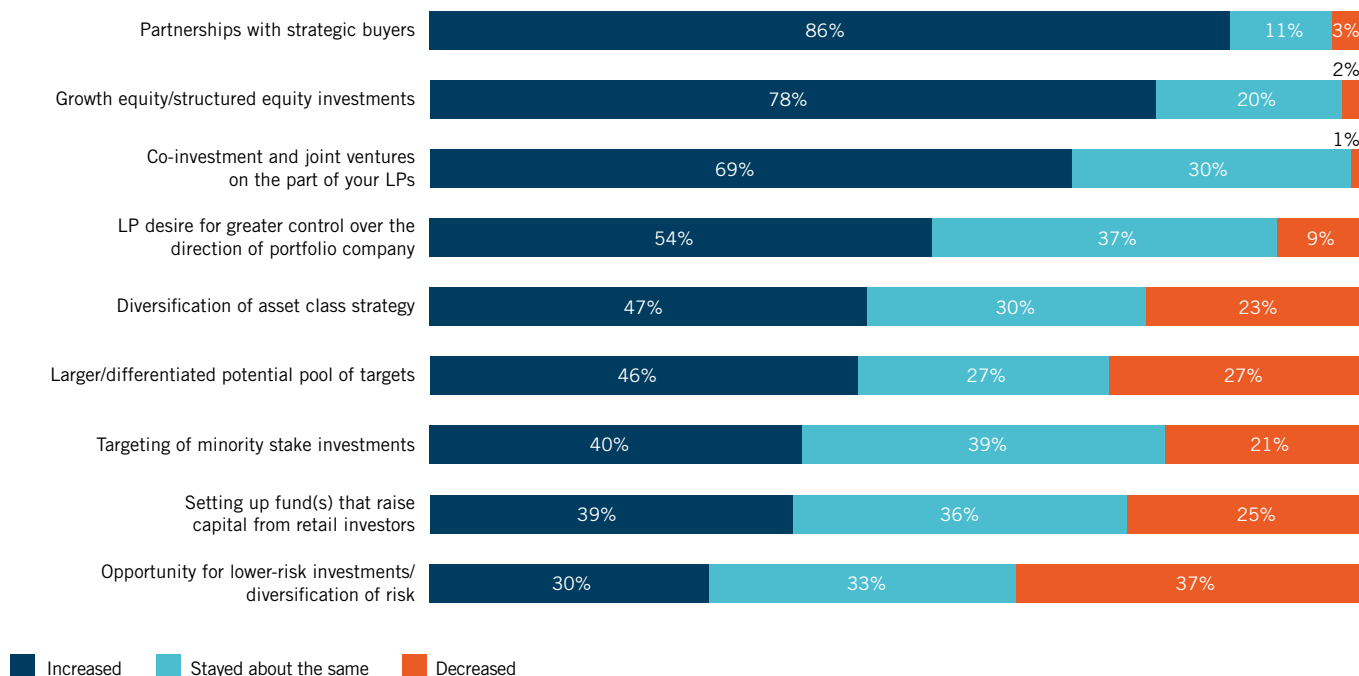
Overcoming hurdles

Interest alignment at the fund level has now come to the fore. For the past decade or more, GPs and LPs have had little cause to consider interest rates. Now that central banks are in hiking mode to tame inflation,

investors are becoming more conscious of performance hurdle rates, typically an 8% IRR over which GPs are rewarded with carried interest.

This rate is approximately the yield available on treasuries with a similar maturity to the average life of a PE partnership—in other words, the return investors could achieve by simply parking their money in government bonds over the same period. As yields are now increasing, it is only natural that LPs want to see

OVER THE LAST 12-24 MONTHS, HAS THE LEVEL OF INTEREST IN THE FOLLOWING INCREASED, DECREASED OR STAYED ABOUT THE SAME?



the bar raised for their GPs. Across all regions, 53% of respondents say that LPs have asked for higher hurdles over the past 12 months.

There are competing interests at play here that LPs and GPs will have to negotiate carefully. “On the one hand, interest rates are going up, so LPs look for a higher hurdle rate. On the other hand, valuations are down and so fund teams are asking for the hurdle rate to go down to trigger their carry. There’s a tug of war in terms of alignment of interests here,” says Sabina Comis. “Increasing the hurdle rate is a big give because it makes it harder for fund managers to earn their carried interest. In addition, we are seeing LPs asking for larger GP commitments.”

Respondents acknowledge that bigger GP commitments are a key bargaining chip in realigning the interests of fund managers with those of investors. More than half (58%) of North American respondents say their LPs have asked for them to put more of their own capital into new funds. Two thirds of EMEA respondents say the same, while 69% point to LPs asking for hurdle rates to be increased.

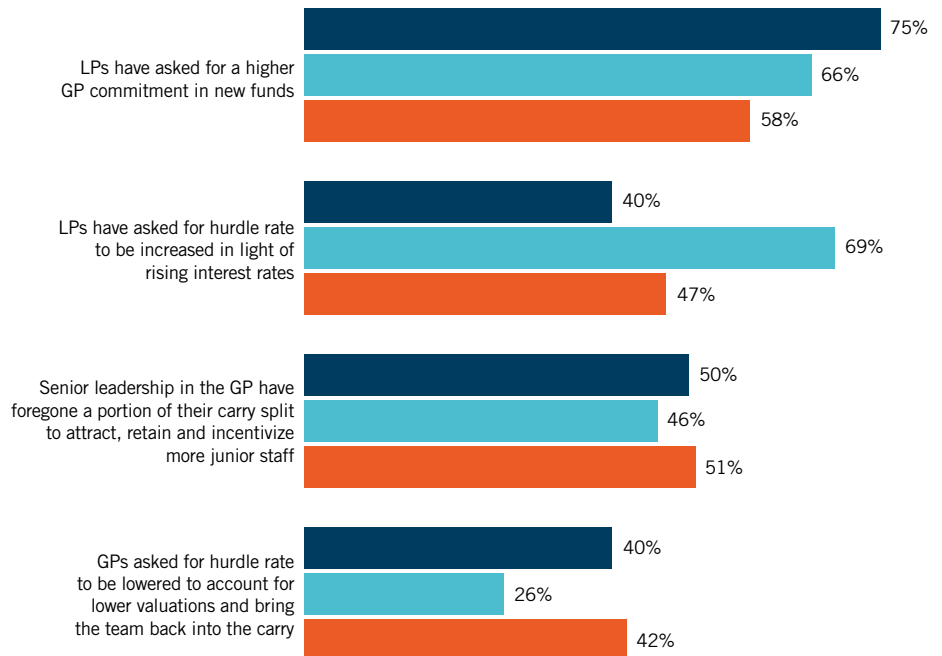
Partnering up

In the face of a more challenging deal environment, respondents say that there is more interest in co-investments and joint ventures on the part of their LPs, as well as partnerships with strategic buyers. Almost nine in ten respondents (86%) say that interest in partnerships with strategic buyers has risen in the past 12-24 months,

compared to only 74% who said so in last year’s survey.

The rise in the level of interest in co-investments is even starker. In last year’s survey, 45% of respondents said that their LPs’ level of interest in co-investments and joint ventures had risen in the past 12-24 months, compared to 69% of those polled in 2022 who said the same.

WHAT, IF ANY, ACTIONS HAVE BEEN TAKEN (OR CONSIDERED) IN THE PAST 12 MONTHS TO BALANCE INCENTIVIZATION WITH THE ALIGNMENT OF LP INTERESTS IN YOUR FIRM? (SELECT ALL THAT APPLY)



■ Asia-Pacific ■ EMEA ■ North America

The retail route

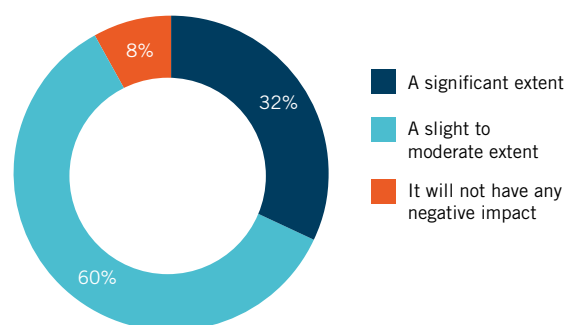
One of the most prominent watch words in PE is “retailization.” Retail investors continue to look for ways to beat public markets and have limited opportunities for direct exposure to PE funds’ outperformance. There are numerous constraints on retail investors investing in PE. Regulations preclude all but “sophisticated” high-net-worth and institutional investors from participating in PE funds. Then there are the high minimum commitments that GPs require for entry into their funds, combined with long-term illiquidity constraints and the opacity that comes with periodic valuations.

Opening up access to PE will make more capital available to GPs. That should be good news. However, there is potential for this to weigh on the asset class’s performance as it increases deal competition. A third of respondents believe that this democratization of PE will have a significantly negative impact on returns, with a further 60% believing the impact will be slightly to moderately negative.

Another consideration is what retailization will mean for PE’s traditional 2% management fees. The inexorable rise of index investing over the past several decades has

decimated fee structures in the asset management industry. Could it be that a similar story is on the cusp of unfolding across PE? “As the large, traditional managers continue to push into alternatives and the PE industry targets retail investors, will the convergence also extend to fee structures? We’ve seen this before,” says Christopher Field, co-head of Dechert’s PE practice and London corporate group. “People don’t know exactly what that will look like, but it’s coming.”

TO WHAT EXTENT DO YOU THINK RETAILIZATION/ DEMOCRATIZATION OF PRIVATE EQUITY WILL HAVE A NEGATIVE IMPACT ON RETURNS?



“As the large, traditional managers continue to push into alternatives and the PE industry targets retail investors, will the convergence also extend to fee structures?”

Christopher Field, Dechert LLP

Private credit

Private credit is continuing to enjoy the spotlight. Global stores of dry powder in private credit funds climbed by more than 13% over the 12 months to the end of Q2 this year, from US\$364bn to US\$413bn, *Preqin* data show. Despite the fractures showing in high-yield bond markets this year and investors flocking from leveraged credit as they pivot toward less risky assets, LPs are still drawn to private credit as a strategy. Unsurprisingly, there currently appears to be a tilt toward distressed debt. For example, one of the largest funds that closed in H1 was Ares Special Opportunities Fund II at US\$6bn. However, senior credit funds are still being raised, such as Crescent Direct Lending III, which also amassed US\$6bn.

It is estimated that, despite the macro and debt market turbulence, private credit fundraising has a chance of coming a close second to 2021's record-breaking fundraising performance. The first half of 2022 saw US\$93bn collected globally, versus US\$213.7bn across the entirety of 2021. It appears that LPs are being drawn to the relative safety of the strategy, which benefits from floating rate exposure amid monetary tightening, as well as capital

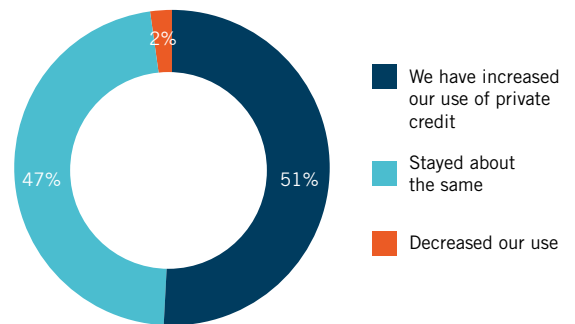
seniority compared with higher-risk equity.

Whatever the motivation for LPs topping up these funds' coffers, PE managers are enthusiastically seizing on the availability of deal financing from these private sources, as banks struggle to offload buyout loans and high-yield bond market activity suffers paralysis. The proportion of respondents who report increasing their use of private credit over the past year has risen for all three regional groups, particularly for those based in APAC, from 40% in 2021 to 65% in 2022. Well over half (58%) of North American respondents say the same, and across all regions 51% disclose their use of direct lending is up, an increase on last year's 45% who said the same.

Banks have consistently lost market share to credit funds over the past decade, first in the US and then in Europe, with the trend now playing out in APAC. Equity sponsors appreciate the certainty of execution that comes with dealing with a single creditor rather than banking syndicates and the various counterparties once that debt is sold down in the secondary market.

We find that 60% of Asia-Pacific respondents now

IN THE PAST THREE YEARS, HOW HAS YOUR FIRM'S USE OF PRIVATE CREDIT FINANCING IN BUYOUTS CHANGED, IF AT ALL? (SELECT ONE)



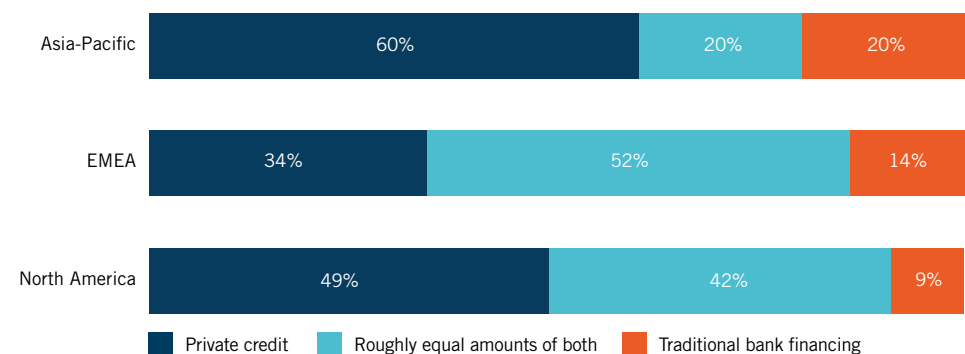
use private credit more than traditional bank financing for their buyout deals, compared with 52% of EMEA respondents and 42% of North America respondents who report using private credit and traditional bank financing in roughly equal measures to back their deals. This is a massive step up from last year, when 35% of APAC GPs said they were primarily tapping credit funds to bankroll their deals.

The move away from banks is seen across the board, too, and has been a consistent theme over the last ten to 15 years. Last year, 26% of GPs across geographies were still using traditional sources of debt, a proportion that has since fallen to as little as 13%. There is certainly no shortage of advantages available to PE

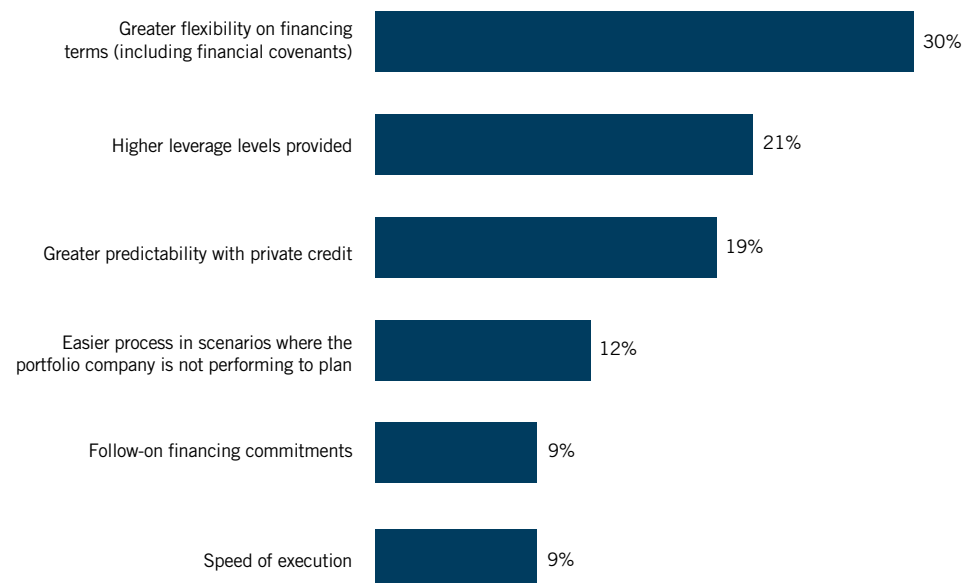
funds opting for non-traditional debt. Over the past year, the relative importance of those benefits has shifted.

A year ago, GPs were mainly taking on private credit due to the certainty of securing this type of financing, as cited by 26% of respondents. This has now fallen to 19%, and the greater flexibility of private credit terms including financial covenants has taken precedence, with 30% highlighting this as the reason to take this route. This is more than double the proportion of PE executives who said the same last year (14%). This is a clear signal that sentiment has changed in the more challenging economic environment. During times of economic stress, PE funds are far more likely to turn their attention to downside risk and the potential for earnings erosion to trip covenants that may cause painful restructurings and cost them part or all of their equity positions. As part of this, there is likely to be an even greater focus on who the credit counterparties will be—counterparties with whom they may need to negotiate if things turn south.

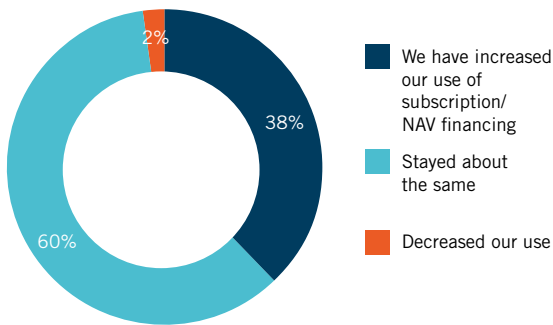
DOES YOUR FIRM USE PRIVATE CREDIT OR TRADITIONAL BANK FINANCING MORE OFTEN IN ITS BUYOUT DEALS?



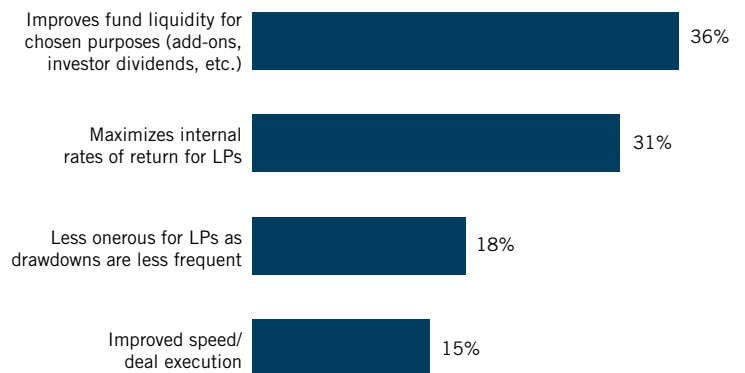
IN YOUR OPINION, WHAT IS THE GREATEST ADVANTAGE OF USING PRIVATE CREDIT AS COMPARED TO TRADITIONAL BANK FINANCING CURRENTLY?



IN THE PAST THREE YEARS, HOW HAS YOUR FIRM'S USE OF SUBSCRIPTION/NAV FINANCING CHANGED, IF AT ALL? (SELECT ONE)



IN YOUR OPINION, WHAT IS THE GREATEST ADVANTAGE OF USING SUBSCRIPTION/NAV FINANCING FACILITIES? (SELECT ONE)



Facilitating flexibility

NAV facilities and subscription line facilities are other increasingly popular uses of credit across the PE industry. These loans, backed by the net asset value of the fund's assets and the creditworthiness of LPs, respectively, offer a lot of flexibility to sponsors. NAV facilities provide PE funds with readily available liquidity to support their portfolio companies with critical investments into their operations and to help finance bolt-ons. They can also be used to cover GPs' commitments to their own funds and to fund distributions to investors ahead of exits.

Subscription lines, meanwhile, mitigate the immediate need for LP capital calls in connection

with each buyout, which is especially important in a competitive sales process when time is of the essence.

Over a third of respondents (36%) believe that improvement to fund liquidity for chosen purposes is the top advantage of using NAV facilities. One of the upshots of using subscription lines to finance deals before drawing down capital from LPs is that it can juice up IRRs, by reducing the length of time that investors' capital is put to work. The GPs we surveyed agree with this notion—a third see the maximization of IRRs as the biggest advantage of using subscription lines.

Given the wealth of benefits that come with tapping NAV facilities

and/or subscription lines, it follows that as many as 38% of respondents say their firms have increased their use of this type of financing over the past three years, 60% have maintained their use and practically no GPs (2%) say they have backed off from using these loans.

North America spotlight

Like other regions, North America's buyout market shifted down a gear in 2022. The number of transactions declined by 15% while their aggregate value sunk by 43% from the Q1-Q3 period in 2021 compared to the equivalent period in 2022.

Yet, the outlier nature of 2021 must be kept in mind. The 2,081 buyouts worth US\$333.4bn in the first three quarters of this year are already above the value and volume total in any full-year period in the decade before 2021.

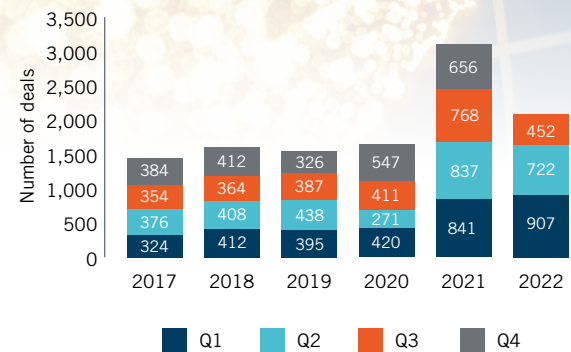
The largest buyout in the region so far this year saw Vista Equity Partners and Evergreen Coast Capital Corporation acquire Citrix for US\$16.6bn in a go-private deal. Citrix is a cloud computing company that provides server, application and desktop virtualization and networking software-as-a-service. Under the deal, it is being combined with existing Vista portfolio company TIBCO, a data analytics business that helps its customers predict business outcomes. The combined enterprise is expected to benefit from the digitalization trend and shift to hybrid working, combining real-time analytics with digital workspace functionality in one product.

The transaction is a significant step down from last year's standout buyout, in which a consortium featuring Blackstone, Carlyle and Hellman & Friedman paid US\$34bn for Medline, the club deal being the largest of its kind since the heady days leading up to the global financial crisis more than a decade prior.

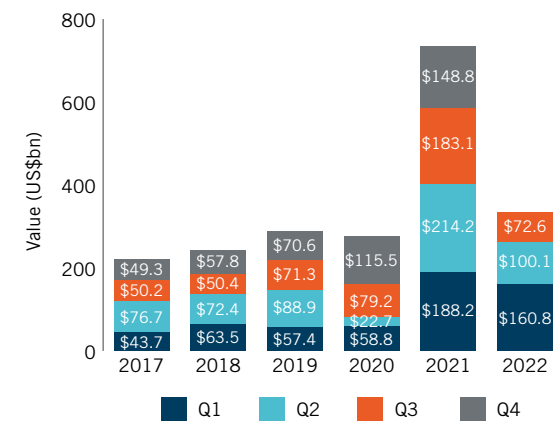
Nevertheless, the Citrix deal still accounted for almost 10% of the total value of all TMT sector buyout activity in the first three quarters of 2022 across North America. TMT remains the region's dominant buyout sector by far and technology is arguably one of the US's greatest economic strengths. The top six largest deals of 2022 to date—Citrix, Nielsen, Zendesk, Anaplan, Avalara, SailPoint Technologies—all belong to the sector. Vista and Thoma Bravo, both tech buyout specialists, were involved in two each.

Within technology, software-as-a-service (SaaS) is demonstrating particular appeal. In addition to the Citrix transaction, another notable example of a business-to-business (B2B) software take-private this year saw Hellman & Friedman, Permira, the Abu Dhabi Investment Authority, and GIC front a US\$10.4billion offer for Zendesk. Zendesk is a SaaS customer support

NUMBER OF NORTH AMERICA BUYOUT DEALS, 2016–Q3 2021



VALUE OF NORTH AMERICA BUYOUT DEALS, 2016–Q3 2021



“Multiples had gone up significantly over the last two or three years and we’re now seeing a contraction.”

Markus Bolsinger, Dechert LLP

and sales business and one of many to benefit from companies digitalizing their operations to gain efficiencies, productivity and growth.

Despite PE continuing to capitalize on this secular trend, it is doubtful that last year’s breathtaking deal market performance, underpinned by TMT, will be repeated on an aggregate value basis. This is not a simple function of the wider deal market slowing—technology valuations in particular have come under added pressure since inflation became entrenched and the Fed set about tightening rates at pace.

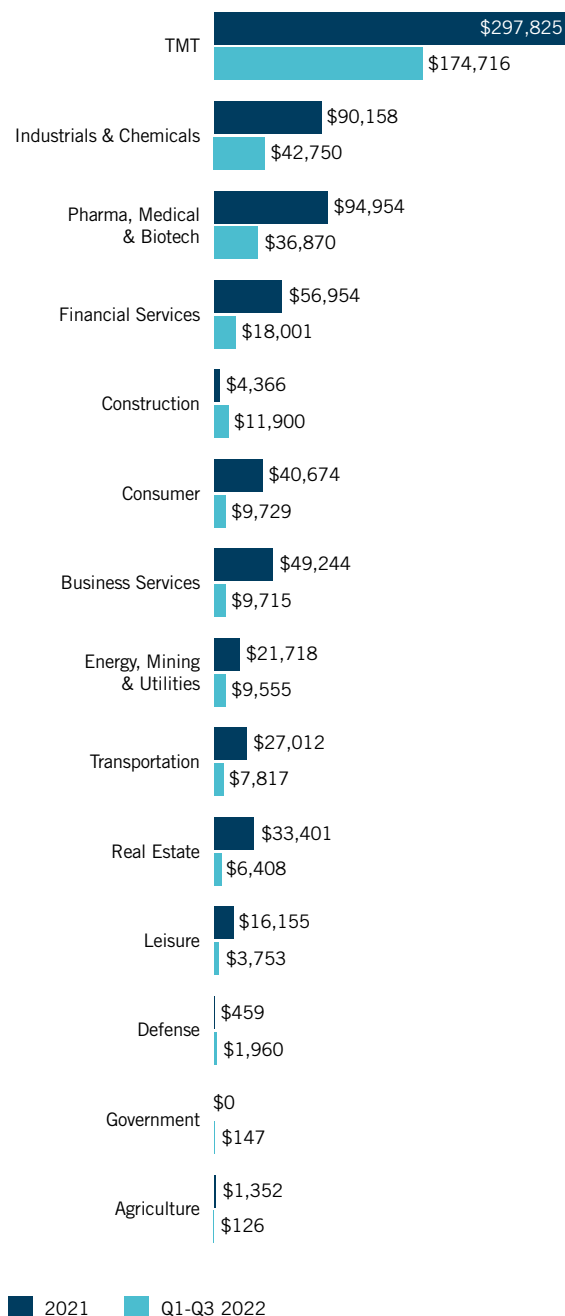
Markets are inherently forward-looking. Investors in the tech space value these companies based on their projected cash flows. As interest rates rise, expected future cash flows have to be discounted more heavily to account for the increased return from passively depositing money.

“Multiples had gone up significantly over the last two or three years and we’re now seeing a contraction, especially in certain pockets and sectors,” says Markus Bolsinger. “Rates are significantly higher than they were a year ago, so discounting cash flows at that rate brings valuations down. In addition, reduced availability of leverage

at higher interest rates puts additional pressure on prices buyers are willing to pay.” And the greater the speculation, or further out those cash flows are projected, the deeper that valuations become discounted on a time-weighted basis.

What the deal data show, however, is that the number of transactions has remained surprisingly robust. Less capital is being put to work, that much is certain, but GPs so far this year have remained highly active on smaller transactions—at least for the time being. “There is always something going on in the middle-market, whether it is new platform deals or add-on acquisitions. Even though the amount of capital being invested has fallen, private equity has really demonstrated its resilience,” adds Bolsinger.

PE BUYOUT VALUE BY SECTOR IN NORTH AMERICA (US\$M), 2021–Q3 2022



Creative approaches

Today's challenging deal environment calls for more creativity on the part of PE fund managers, both as it applies to their deals and the kinds of fund strategies they pursue. For example, with valuation gaps between hopeful sellers and scrutinous buyers running wide, earn-outs have once again become a way to bridge that distance. Earn-outs have become notably more popular over the past year, being employed by 57% of respondents now compared with just 27% in 2021.

"Earn-outs have typically been more common in high-growth company situations where valuations had become stretched for years and therefore these arrangements gave buyers and sellers more confidence to transact," says Markus Bolsinger. "We're now seeing seller notes that are tied to

certain performance metrics and other features coming back in more standard buyouts that had not been used for a few years."

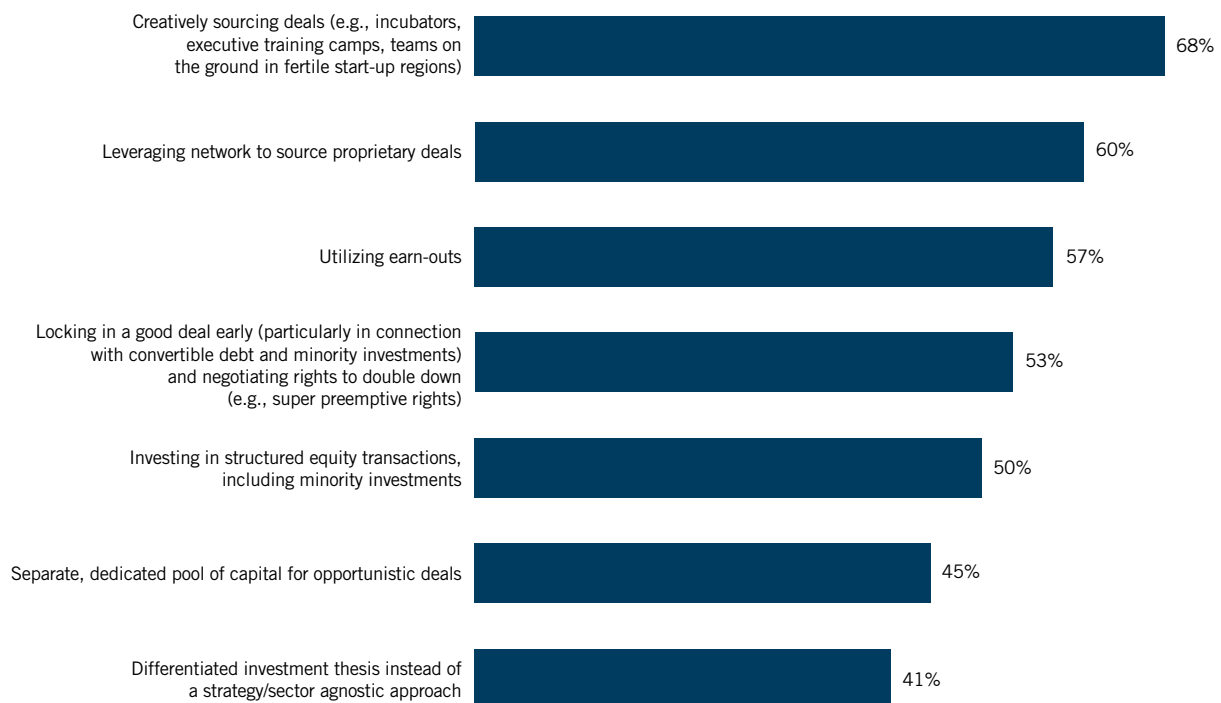
Another smart approach is to source off-market transactions, circumventing the need to participate in auctions. This may become more necessary as today's buyer's market progresses and PE funds begin ramping up their capital deployment to take advantage of attractive EBITDA multiples. Almost seven in ten (68%) respondents say that they are creatively sourcing deals such as from incubators and executive training camps to help ensure they stay ahead of the competition. Additionally, 60% say they are leveraging networks to source proprietary deals for the same purpose.

Partnering up with co-investors is another way in which GPs

"Strategic buyers are partnering with financial sponsors for a variety of reasons, including to benefit from their deal sourcing and creative deal execution expertise."

Siew Kam Boon, Dechert LLP

IN THE CURRENT ENVIRONMENT, WHAT STRATEGIES DOES YOUR FIRM EMPLOY TO ENSURE IT STAYS AHEAD OF THE COMPETITION? (SELECT ALL THAT APPLY)



are thinking smart in their dealmaking right now. Three quarters of firms say they are very likely to consider partnerships with strategic buyers and there is increasing incentive for corporates to seek these arrangements as competition authorities bear down on mergers.

“Strategic buyers are partnering with financial sponsors for a variety of

reasons, including to benefit from their deal sourcing and creative deal execution expertise. Increasingly, strategic buyers are teaming up with financial sponsors for a variety of regulatory reasons, including antitrust and foreign direct investment restrictions,” says Siew Kam Boon. These arrangements are symbiotic, with sponsors gaining equal benefit from the strategic and market knowhow of a corporate

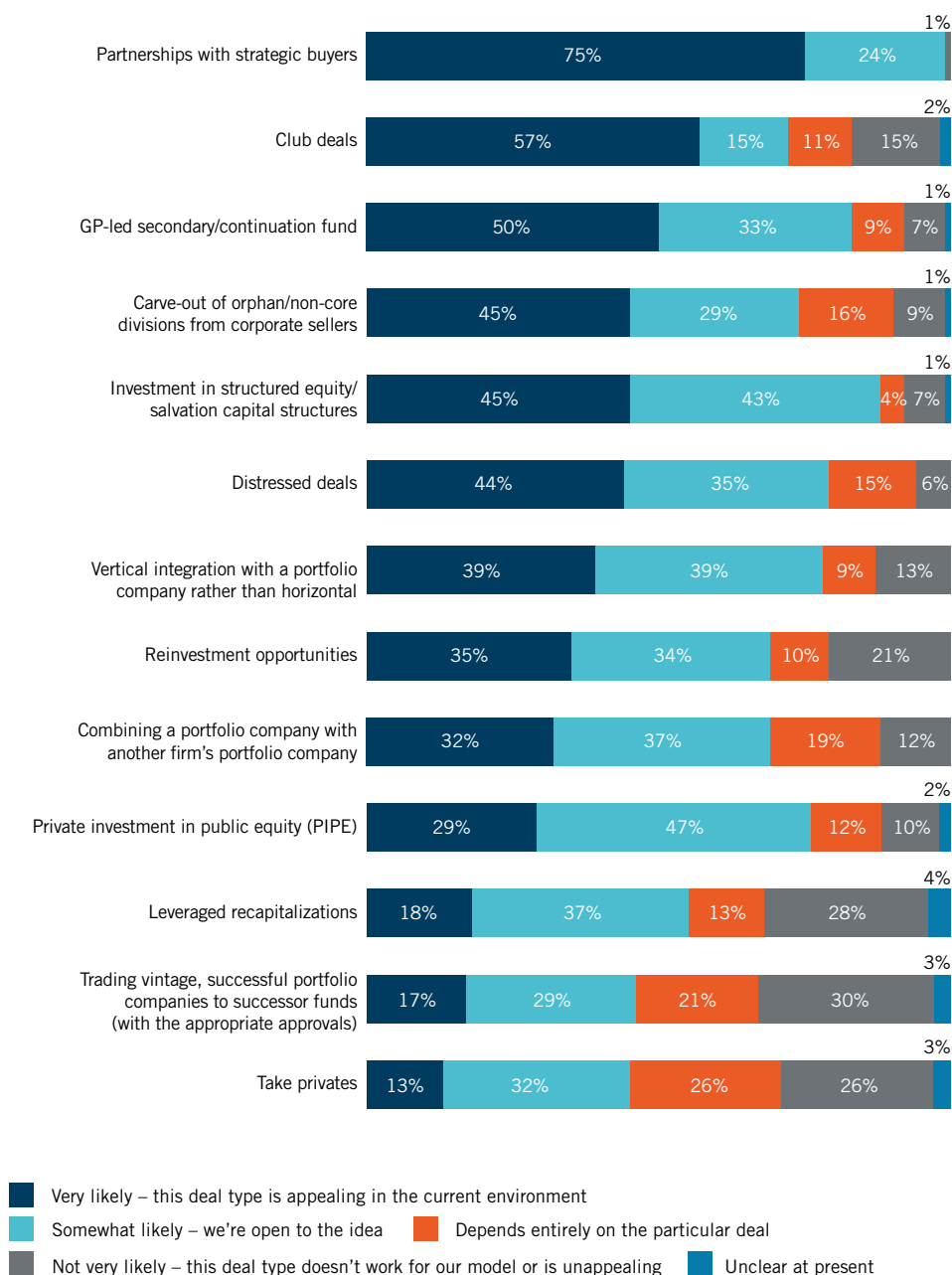
that can be applied to upscaling the target company. There is also the added benefit of a possible exit route if the co-investor asks for the right of first refusal on later acquiring the company in question.

A further 57% of GPs say they are currently very likely to consider a club deal with one or more of their PE peers. These kinds of partnerships have the advantage of

spreading investors' equity risk by reducing their exposure to any one deal, which is especially pertinent in light of today's macro challenges. Accordingly, enthusiasm for these types of partnership deals has jumped significantly from last year, when only 41% of respondents said they were very likely to consider partnerships with strategic buyers and 32% said they were very likely to consider club deals. Club deals are also useful for GPs looking to make more meaningful investments in jurisdictions with which they may be less familiar. Partnering with a more experienced investor can help PE managers learn about new regions.

Unexpectedly, take-privates are the least favored deal choice, with over half of respondents saying they are either not very likely to consider a public-to-private as an option (26%), or reservedly saying it would depend entirely on the specific deal (26%). Some of the largest buyouts in 2022 have involved publicly listed targets, such as Atlantia and Citrix. However, these deals are not for everyone. US publicly traded companies have grown larger in value and smaller in number over the decades. A paper published on the Harvard Law School Forum on

HOW LIKELY IS YOUR FIRM TO CONSIDER THE FOLLOWING DEAL TYPES AT PRESENT?



Corporate Governance found that, as of early 2017, the average market capitalization of a US-listed company was US\$7.3billion, the median being US\$832m. For all but the largest fund managers, this puts swathes of the stock market off-limits for PE firms managing diversified fund portfolios. Therefore, although valuations have come down off their 2021 highs, making take-privates more attractive, this activity will be concentrated among the larger sponsors in a case of value over volume.

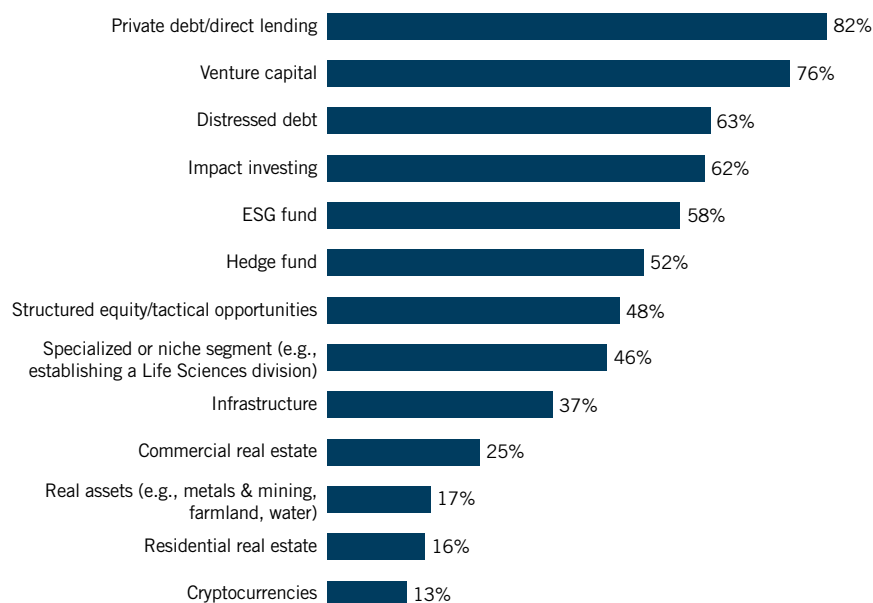
Creative fund strategies

Liquidity is top of mind for GPs and their LPs right now. With exits harder to come by in 2022, fund managers are thinking creatively about how to return capital to investors.

“We’re witnessing an increase in GP-led secondaries and fund financing,” says Sabina Comis. “These strategies, including continuation funds, allow GPs to keep a hold of quality assets without having to offer them up to the world at large as an exit, only to return capital to investors.”

There has been a notable drop-off in the proportion of respondents considering trading vintage, successful portfolio companies to successor funds, from 70%

WHICH OF THE FOLLOWING ASSET CLASSES IS YOUR FIRM CONSIDERING INVESTING IN OVER THE NEXT 24 MONTHS? (SELECT ALL THAT APPLY)



who said they were likely to pursue this last year to 46% who now see this as a likely possibility moving forward—and as little as 17% seeing this as very likely.

When asked about the asset classes that respondent firms are considering investing in over the next 24 months, private debt is the clear winner. As much as 82% of PE firms report that they are weighing up adding direct lending to their strategy over the next two years, a course of action that is likely to have

been confirmed by sponsors relying so heavily on private credit in recent months. GPs are well aware of the secular shift toward financing deals with private loans and want in on the action. Adding venture capital to the asset class mix was not far behind, with 76% of GPs weighing early-stage strategies, and distressed debt taking third place with 63% thinking about taking advantage of credit market dislocations and business insolvencies with loan-to-own strategies.

GP-stake divestiture strategies

In January of 2022, MBK Partners, a North Asia-focused PE firm founded by billionaire Michael Kim, sold a 13% stake to Dyal Capital Partners. It joined a growing list of GPs turning to a more permanent means of raising cash by divesting a piece of their PE firms to specialist investors. It is expected that MBK will use the proceeds to move beyond its core buyout and special situations strategy into real estate and growth capital to expand its deal options.

Dyal, a subsidiary of Blue Owl Capital, is one of a select few firms, alongside Blackstone, Aberdeen Standard Investments and Goldman Sachs' Petershill funds, that currently target GP stakes. The purpose of these cash raises is manifold. In some cases, it is secondary capital that goes directly to the firm's partners, allowing them to cash out of the business to bridge succession events as younger blood moves up the ranks to run the business and founders depart. In other cases, such as MBK, the proceeds are primary capital that is invested directly into the business for expansion or to cover GPs' commitments to their own funds.

Our research shows that as many as 63% of PE firms are planning to make a GP-stake divestiture in the next 24 months. Of these, 59% say the proceeds will go toward GP commitments for the next fund. The same proportion say it will go toward vertical investment, while 54% say that fueling growth is one of the motivations for seeking such a deal.

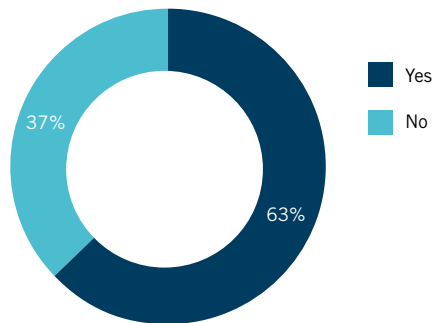
A smaller proportion (32%) point to founder liquidity as being the reason for selling a piece of the PE business. In Europe, there are strong signs of an increase in this activity. In August, it was reported that Dyal was in discussions with PAI Partners, one of France's most well-established PE firms, for a potential minority stake in the firm.

"Several strategies are actually at play here. The first one is often related to the fact that there is a change of generation that is playing out now in continental Europe among successful PE houses," says Sabina Comis. "In addition, LPs are asking for increased GP commitments and/or, in certain jurisdictions, larger carried interest subscriptions, in order to spread the carry more widely amongst the team members. Interestingly, GP stakes can also allow GPs to

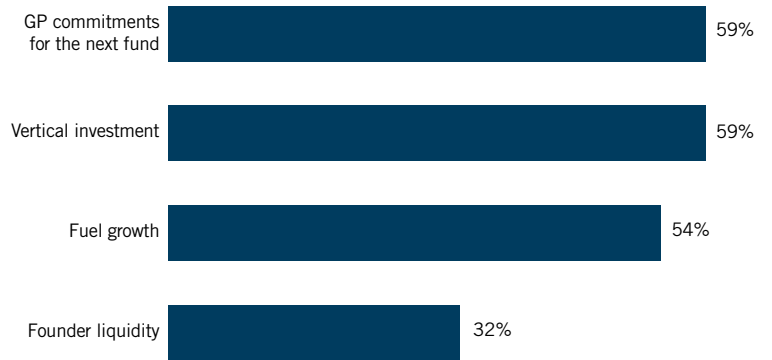
"LPs are asking for increased GP commitments and/or, in certain jurisdictions, larger carried interest subscriptions. Interestingly, GP stakes can also allow GPs to secure a portion of their next fundraising by having the GP-stake buyer commit to invest, as an LP, in one or more of their next funds."

Sabina Comis, Dechert LLP

IS YOUR FIRM PLANNING TO MAKE A GP-STAKE DIVESTITURE IN THE NEXT 24 MONTHS? (SELECT ONE)



IF YOU ARE PLANNING A GP-STAKE DIVESTITURE, WHAT WILL THE PROCEEDS GO TOWARD? (SELECT ALL THAT APPLY)



secure a portion of their next fundraising by having the GP-stake buyer commit to invest, as an LP, in one or more of their next funds. From the GP stake buyer’s viewpoint, this can also be a means to make a strategic move into a given sector in a given jurisdiction where they have no real footprint yet. There is no doubt that this market will increase significantly in the next few years in Europe.”

in 2021, more than double the traditional expectation of 1% to 2% in times past. Typically, GPs would cover this commitment using the carried interest proceeds from their predecessor funds. However, in the current exit-constrained environment and with the standard GP commitment increasing, strategic divestitures are becoming a smart solution to PE fund managers’ liquidity needs.”

The need for liquidity to cover GP commitments comes at a time when LPs are expecting their fund managers to front more of their own capital in their funds. According to a survey by Investec published this year, the average GP commitment reached 4.8%

Buy & build

Buy-and-builds could backstop weakened buyout activity over the coming months. With debt financing harder to come by, large platform deals will be harder to execute, potentially encouraging funds to turn their attention to picking off smaller synergistic plays that can help their existing portfolio companies to achieve inorganic growth amid an economic slump.

There are other reasons for PE to pursue this approach in the current climate. Successfully executing bolt-ons and realizing synergies typically not only accrues to EBITDA but earnings margins too, as superfluous costs are cut out of the combined business. Buy-and-builds have also long been sold as a shrewd multiple arbitrage play. With less competition toward the lower-cap end of deal markets, sponsors typically pay lower EBITDA multiples on these deals. This has never been more relevant following a feverishly active period for PE in 2021, when valuations were running hot. By buying and building, GPs have the potential to average down the EBITDA multiple they have paid on assets. With the success stories surrounding

tech-enabled platforms, GPs are also teaming up with industry players to pursue buy-and-build strategies to create a mega tech-enabled platform to immediately compete with other platforms or bridge existing market gaps.

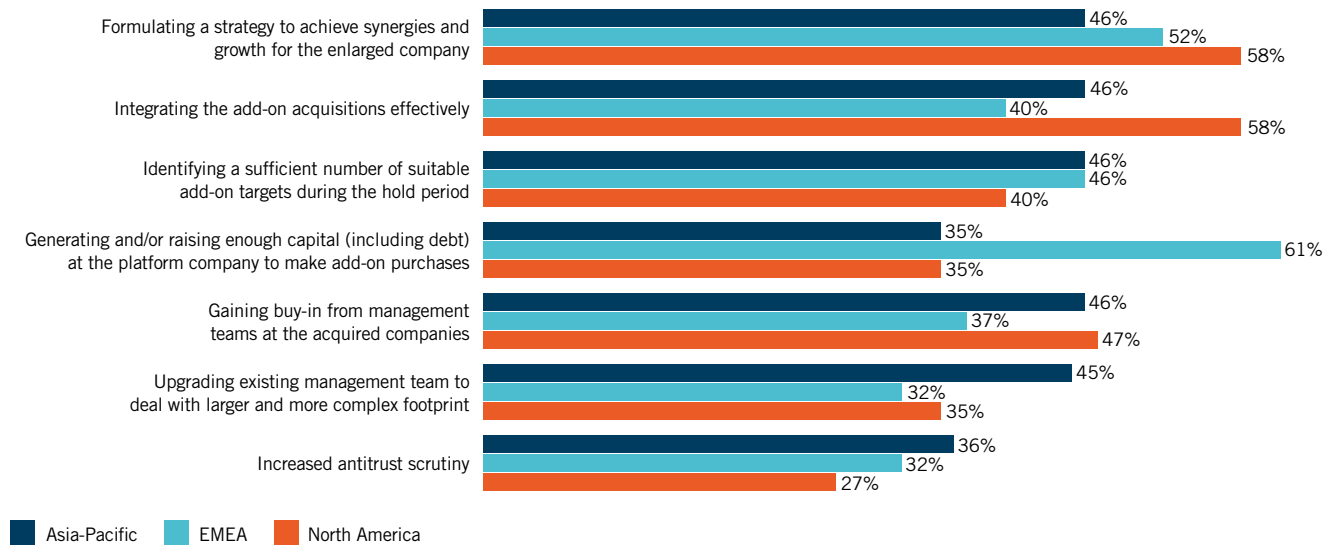
Naturally, combining companies is not without its challenges. The most commonly cited of these is formulating the appropriate strategy to achieve synergies and growth for the enlarged company. This selection is particularly top-of-mind among North American respondents (58%), as is the challenge of integrating add-ons effectively once the deal has closed.

EMEA respondents take a different view. For 61% of this cohort, the biggest challenge is raising enough capital (including debt) at the platform company to make add-on purchases. This is where fund-level financing may come in useful. As touched on earlier in this report, fund NAV facilities have various liquidity-boosting benefits as they can be used for numerous purposes. It is possible that these facilities, which can be drawn just like revolving credit lines, may be tapped to finance smaller

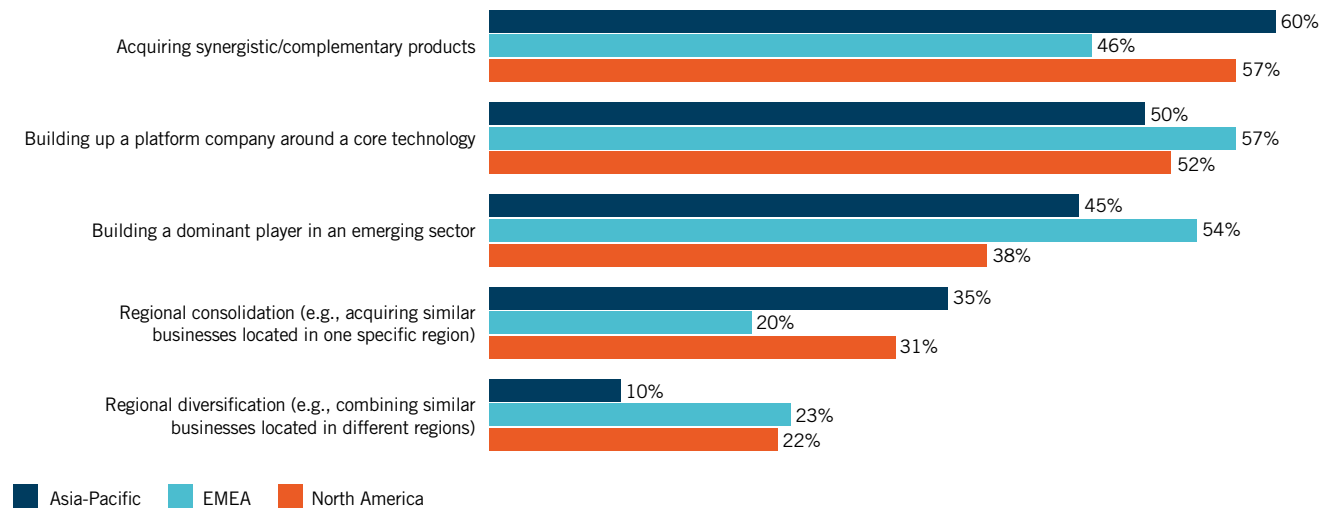
add-on plays rather than GPs having to rely on volatile credit markets for landmark platform acquisitions.

When it comes to planning their buy-and-build strategies, respondents based in EMEA were most likely to say they concentrated on building up a platform company around a core technology (57%), while those based in North America and Asia-Pacific appear to be more likely to pursue a strategy of building a portfolio of complementary or synergistic products (57% and 60%, respectively). These are not mutually exclusive, of course. Acquiring a company with complementary products can be a crucial step toward building a market leader in a nascent sector, and a core technology could be the star product in a target company's product portfolio. Whatever the motivation for pursuing an add-on or multiple follow-ons, GPs must have a clear strategic rationale before taking the plunge.

WHAT ARE THE BIGGEST CHALLENGES YOUR FIRM FACES WHEN MAKING ADD-ON ACQUISITIONS FOR A PLATFORM COMPANY? (SELECT TOP THREE)



WHICH BUY-AND-BUILD STRATEGIES DO YOU CURRENTLY USE MOST OFTEN? (SELECT TOP TWO)



Carve-outs

A recent report by the American Investment Council found that PE firms invested over US\$119bn to carve out nearly 600 business units last year, setting them up to forge futures as independent companies under PE ownership. This was a 52% increase over 2020.

Regionally, 76%, 70%, and 63% of those based in North America, APAC and EMEA, respectively, expect to pursue more of these corporate spin-offs, compared with 58%, 40%, and 40% of respondents from these regions who said the same in 2021.

Even with today's various dealmaking challenges, carve-out activity will likely be a major focal point for fund managers over the next 12-18 months. Indeed, seven out of ten respondents expect the number of carve-outs they target to increase over this period, compared to 48% who said the same in last year's survey.

Opinions on what will drive this activity have also shifted over the past 12 months. The need for corporates to pay down excessive debt loads was considered the primary motivator for carve-outs a year ago, cited by 29%. That has since fallen to 18%.

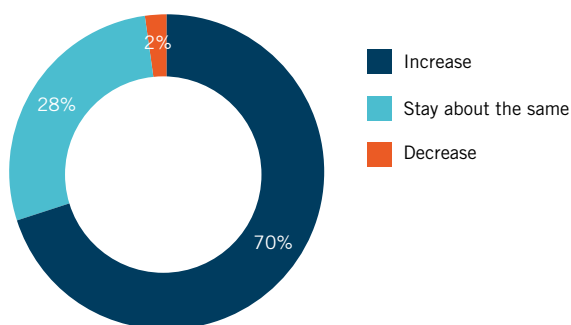
Private sector debt levels fell for the first time in eight years between 2021 and 2022, albeit minimally. The Janus Henderson Corporate Debt Index shows that global corporate net debt has fallen by 0.2% and that 51% of companies have managed to reduce their indebtedness, which now stands at US\$8.15tn. Debt levels are still excruciatingly high—but may have topped out.

Antitrust issues

Less than one percent (<1%) of the approximately 4,130 HSR merger filings made in 2021 required or resulted in divestitures in the US as of the end of the third quarter of 2022. Still, 40% of North American respondents see corporate divestitures as being primarily driven by the requirements of regulatory authorities, including merger control.

That view might in part be based on the Biden administration assembling a noteworthy team of antitrust specialists that includes Lina Khan, chairwoman of the Federal Trade Commission; Jonathan Kanter, head of the Department of Justice's Antitrust Division; and Tim Wu, the White House official responsible for Technology and Competition policy. All

IN THE NEXT 12-18 MONTHS, WHAT DO YOU EXPECT TO HAPPEN TO THE NUMBER OF CARVE-OUTS TARGETED BY YOUR FIRM? (SELECT ONE)



three are known for favoring a tougher stance on merger control and antitrust. Notably, these officials have expressed strong concerns against certain acquisitions by PE firms. AAG Kanter has stated that roll-up acquisitions by PE firms in an industry is a “business model [that] is very much at odds with the law and very much at odds with the competition we’re trying to protect.”

Similarly, FTC Chairwoman Khan has stated that a PE firm’s business model “may distort ordinary incentives in ways that strip productive capacity and may facilitate unfair methods of competition and consumer protection violations.” FTC Chairwoman Khan has also stated that new DOJ and FTC Merger

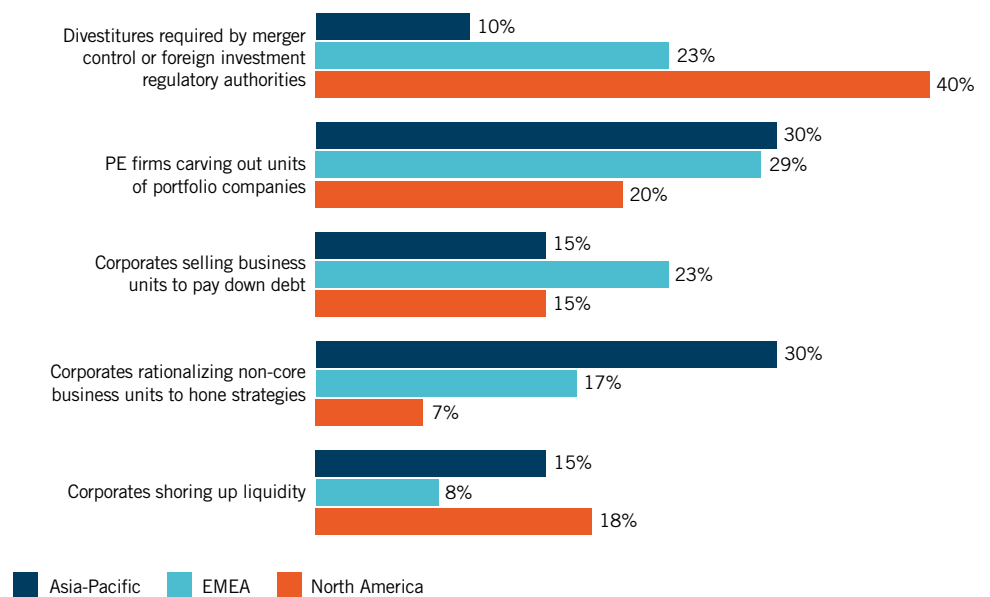
Guidelines, which are currently being drafted, will address “roll-up play by private equity firms.” Going forward, PE firms need to be aware that their acquisitions may face increased antitrust scrutiny, especially if a PE firm is in the process of acquiring multiple companies in the same sector.

Foreign direct investment (FDI)

In addition to stepped up antitrust enforcement and concerns, add to this foreign investment scrutiny. In September, President Biden issued an executive order titled “Ensuring Robust Consideration of Evolving National Security Risks by the Committee on Foreign Investment in the United States,” in response to rising national security threats.

The order calls on the Committee on Foreign Investment in the United States (CFIUS), which has already become more hawkish over the past five years, namely against Chinese investments, to consider certain factors when reviewing deals. These include transactions that may impinge on supply chain resilience or the US’s technology leadership, incremental investments that may facilitate a technology transfer, any associated cybersecurity risks, and risks to US citizens’ sensitive data

IN YOUR OPINION, WHAT IS THE MOST IMPORTANT CURRENT DRIVER OF CARVE-OUT ACTIVITY? (SELECT ONE)



that could be de-anonymized. These priority focus areas are not new to CFIUS; it is notable, however, that the Biden Administration thought it necessary to signal the marketplace more broadly by issuing public guidance of this sort, and by using an executive order (rather than an agency guidance) as the means to deliver the message. Both the European Union (EU) and the United Kingdom have also strengthened their foreign investment regimes.

More blocked deals and forced strategic divestments will only

contribute to PE deal flow, as corporates’ pain becomes PE’s gain. That said, the new foreign subsidies regime on which the EU has recently reached political agreement may also raise issues for PE. Under the new regime the European Commission is empowered to investigate deals that have an EU nexus and involve a financial contribution from a non-EU government—which would include a sovereign wealth fund—in excess of €50m.

EMEA spotlight

The number of EMEA buyouts fell by 22% from the first three quarters of 2021 to the equivalent period this year—a steeper rate of decrease than global activity. However, the rate of decline in value (37%) was lower than the overall drop globally, with activity in the region being dominated by two large transactions, the buyouts of Atlantia and Mileway.

Atlantia is Italy's largest airport and motorway operator and was taken over by Blackstone and the Benetton family holding company Edizione, which already owned a third of the business, in a deal valued at US\$46.4bn. As Atlantia is a critical infrastructure operator, the Italian government had special veto powers over the transaction, but the Italian market watchdog cleared the deal in early October, resulting in the largest take-private ever made on European soil.

Mileway, meanwhile, was sold between two Blackstone funds in a transaction worth US\$23.8bn. The company owns the largest last-mile portfolio in Europe and the recapitalization saw Blackstone real estate investors realize value while investors in the firm's long-hold Core+ strategy gained long-term exposure to one of the firm's highest conviction themes: logistics. The deal was another record-breaker, being the largest

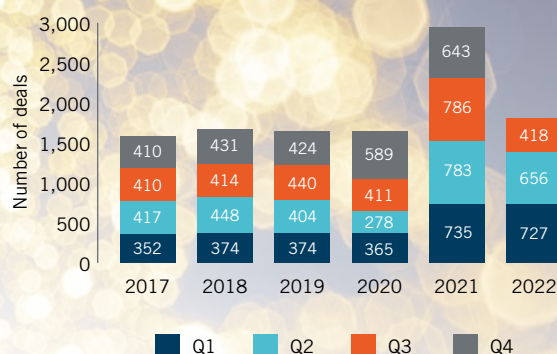
private real estate transaction on record.

Blackstone's precedent-setting plays aside, deals in the region have understandably been more modestly sized recently. The next two largest deals saw KKR pay US\$5.8bn for British power generation company ContourGlobal and US\$5.5bn for Dutch soft drink maker Refresco. No other buyout in EMEA was valued above US\$5bn in the first three quarters of 2022.

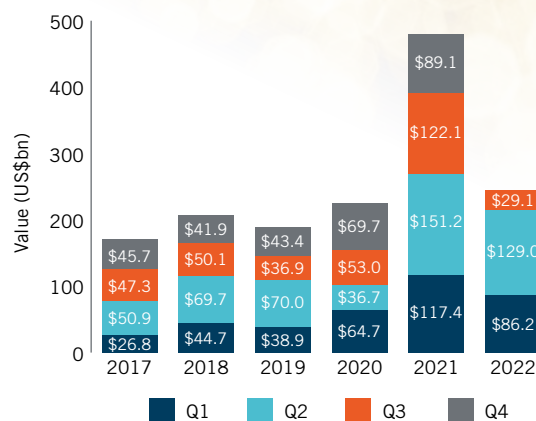
Investors have spent 2022 rotating out of higher-risk assets and seeking refuge for their capital—a task that has proven challenging as even government bonds have lost their allure amid surging inflation and widespread monetary tightening. High-yield buyout debt has been off the menu, causing large-cap deals to be put on hold as investors digest the macro outlook and await more healthy EBITDA multiples and leverage ratios.

This has inevitably skewed PE activity toward mid- and small-cap deals, which are not subject to the caprice of the high-yield bond and syndicated loan markets. Instead, smaller managers benefit from tapping bilateral loans from local relationship banks and direct lending funds. This debt financing gap has been shaping PE activity in 2022 across

NUMBER OF EMEA BUYOUT DEALS, 2017–Q3 2022



VALUE OF EMEA BUYOUT DEALS, 2017–Q3 2022



regions, as seen by deal value falling far more sharply than deal volume.

Tensions rising

The ongoing war in Ukraine has been a cloud hanging over Europe for much of this year. Energy prices have been spiraling due to the disruption

of liquid natural gas supplies, massively increasing businesses' input costs. These externalities appear to be putting a damper on deal appetite as investors scan the horizon for risks that could impact their assets.

The Baltic region continues to be the hardest hit by inflation. Estonia is experiencing the highest rate of price rises in the eurozone, almost quadrupling from 6.4% in September 2021 to 24.2% a year later. It is a similar story in other parts of Eastern Europe, although on the farthest side of the continent the Netherlands had the biggest monthly increase in prices between August and September in 2022, with inflation soaring from 13.7% to 17.1%. And this is before the colder seasons when energy demand surges. "The Ukraine-impacted energy crisis looms large and has yet to fully manifest itself," says Christopher Field. "As it bears down going into this winter, you're likely to see even further contraction in activity, as people are going to be very focused on keeping portfolio companies alive and well rather than new deal activity."

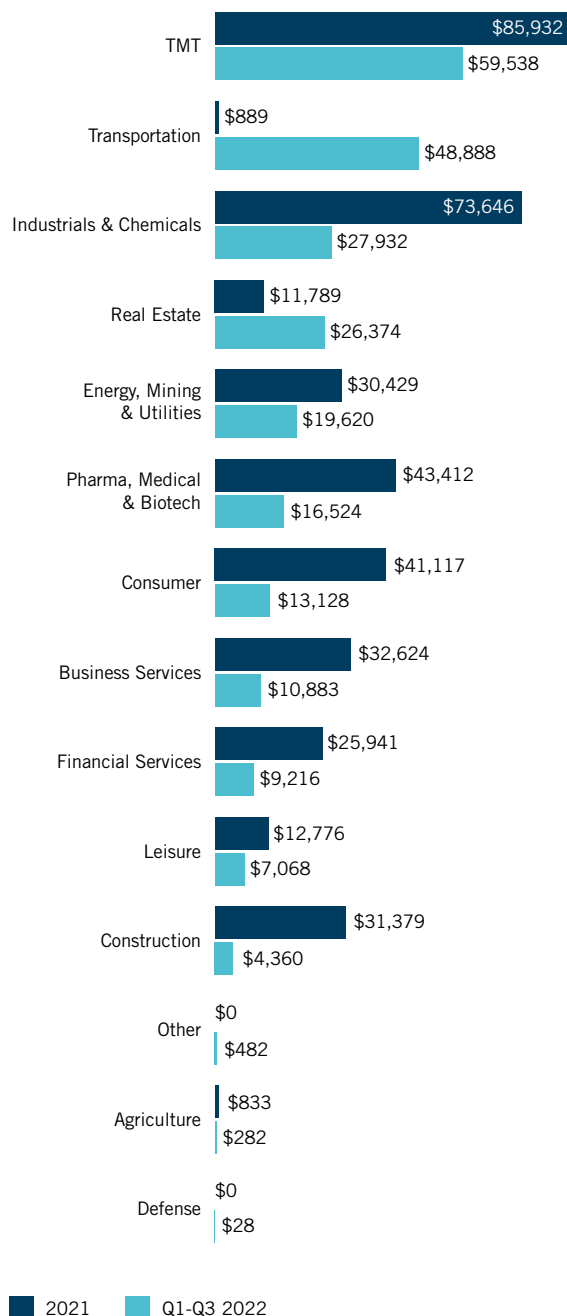
Another theme playing out is the weakness of currencies relative to the US dollar. The DXY index, which measures the strength of the greenback versus a basket of major currencies including the euro and the pound, reached a two-decade high in Q3. This

has implications for PE and its investors. For one, LPs need to think carefully about whether they are sufficiently diversified across their PE portfolio to mitigate against currency risk, or whether hedging facilities need to be put in place. It should also see US PE houses go on the offensive, putting dollar-denominated buyout funds to work in Europe as they get more bang for their buck.

"There's a strong possibility that we'll see a wave of take-privates by US acquirers buying businesses that are exposed to headwinds or have fallen out of favor with investors, where they can pick those up in the local currency," says Field. "Then, in the UK, you have the multiple changes in government. The Truss administration initially attempted an unfunded lowering of taxation in a highly inflationary environment and markets did not react kindly."

A subsequent U-turn by that government after the pound fell to an all-time low of US\$1.03 means that the originally envisaged fiscal expansion is now off the table, as is Ms. Truss, who resigned in mid-October and has been replaced by the more fiscally constrained Rishi Sunak. However, if there is one thing that investors do not like, it is uncertainty. And if 2022 has proven to be anything, it has proven to be unpredictable.

PE BUYOUT VALUE BY SECTOR IN EMEA (US\$M), 2021–Q3 2022

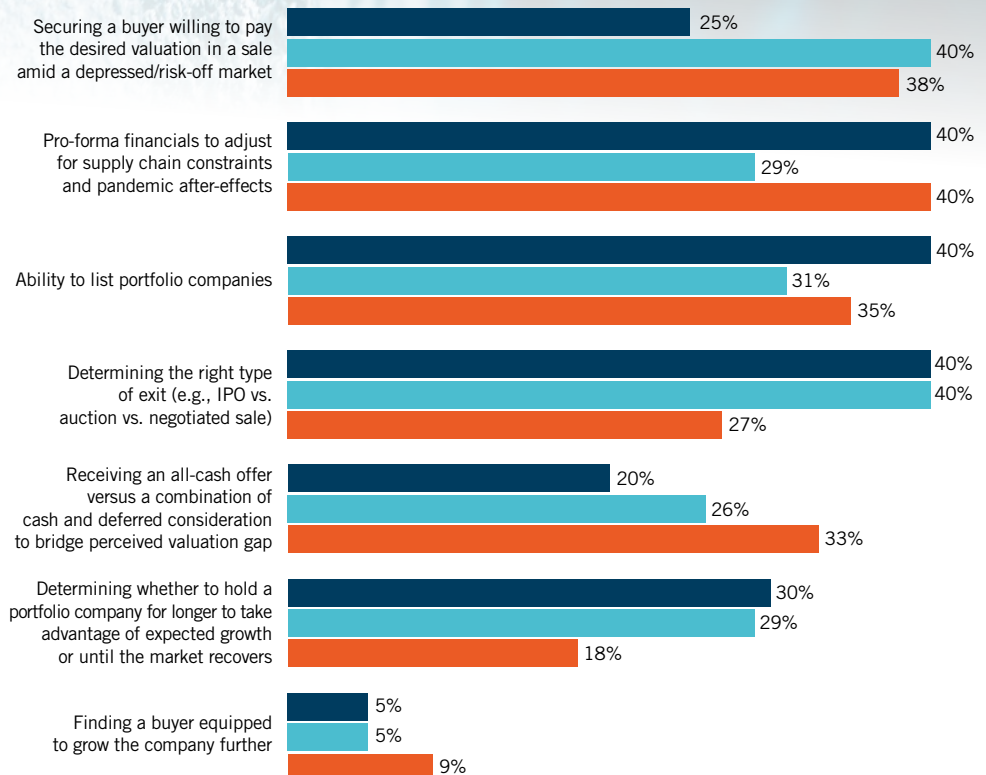


Liquidity events

In light of the difficult deal environment, it should come as no surprise that the volume of exits in the first three quarters of 2022 dropped substantially year on year. A total of 1,695 deals were announced between the start of the year and the end of the third quarter—39% below the same period the previous year. Value fell by a similar proportion, down 32% to US\$474.1bn globally.

In many instances, sellers remain wedded to the rich valuations at which they marked their assets last year and are reluctant to part with these at the prices that buyers are willing to offer today. Until there is a marked macro improvement, with inflation showing signs of topping and therefore less need for central banks to pump the brakes with monetary tightening, it should be expected that headwinds will persist.

WHAT ARE THE BIGGEST CHALLENGES YOU EXPECT TO FACE WHEN IT COMES TO EXITING INVESTMENTS OVER THE COMING 12 MONTHS? (SELECT TOP TWO)



■ Asia-Pacific ■ EMEA ■ North America

Respondents are cognizant of this reality. When reflecting on the biggest challenge to returning capital to LPs over the next year, 38% of North America respondents and 40% of EMEA respondents highlight difficulty in securing a buyer willing to meet their desired valuation amid the current risk-off environment. The same proportion of EMEA respondents also point to challenges in determining the right type of exit, with 40% of Asia-Pacific respondents also seeing this as a top challenge, compared with just 27% of North American respondents.

“IPOs are effectively shut off at the moment. So, sellers are required to choose between running an auction or pursuing a bilateral negotiation, which may often be the preferred option if they can’t drive sufficient competitive tension for their assets,” says Christopher Field. “The geopolitical backdrop in Europe has been especially difficult.”

The drying up of options in the SPAC space is also a factor. Whereas a boom in SPAC listings offered a bevy of exit opportunities for privately held companies in the second half of 2020 and first quarter of 2021, regulatory changes and poor stock price performance post-deSPAC mergers has

caused this market to slow down significantly.

With valuation gaps in mind, GPs are understandably giving some consideration to the potential drag on returns and what it may mean for their compensation. Sell below expectations and this will weigh on the fund’s IRR. Holding out for a higher multiple for an extended period will also put pressure on IRRs.

It seems, however, that GPs are optimistic about the near-term outlook and that perhaps the brunt of the market drawdown may have already played out. A sizable majority of EMEA respondents (80%) and North American respondents (82%) believe that exit market conditions in the next 12 months will be more favorable. If they are not bullish on the remainder of 2022, hopes are high that 2023 will have more to offer. The average length of a bear market for the S&P 500 is 289 days, which would put a bottom for the US equity markets in Q4 this year. However, bear trends during recessionary phases typically last for extended periods, which could push the current down-market out toward the latter half of 2023 or beyond.

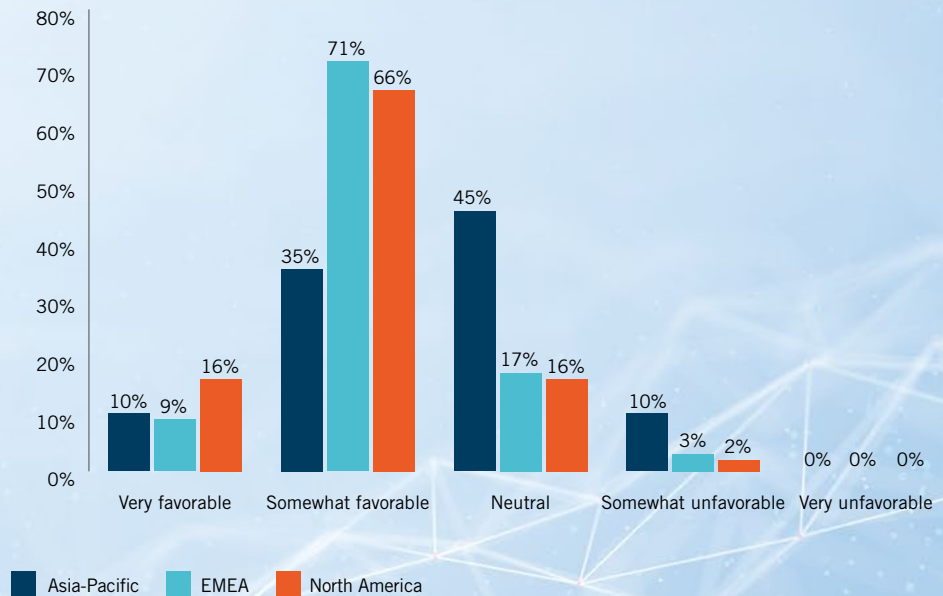
“IPOs are effectively shut off at the moment. So, sellers are required to choose between running an auction or pursuing a bilateral negotiation, which may often be the preferred option if they can’t drive sufficient competitive tension for their assets.”

Christopher Field, Dechert LLP

Asia-Pacific respondents are much more pessimistic than their counterparts, with only 45% saying they expect exit conditions will be favorable in the coming year. Meanwhile, 10% say that conditions will be unfavorable, compared with only 2% and 3% in North America and EMEA, respectively.

This sentiment gap may reflect some laggardly performance among certain Asian indices. For example, the Hang Seng China Enterprises Index, which tracks companies listed on the Hong Kong Stock Exchange, in September reached its lowest ebb since the global financial crisis 14 years prior, falling by as much as 14% in that month alone. China's strict lockdowns have not been kind to asset valuations, and while COVID-19 infection rates have fallen since peaking in April, the prospect of a repeat in the winter months and the recency bias of having just endured strict lockdowns is potentially fueling investor pessimism relative to other geographic markets.

HOW FAVORABLE DO YOU THINK MARKET CONDITIONS WILL BE FOR PRIVATE EQUITY LIQUIDITY EVENTS IN THE NEXT 12 MONTHS?



ESG

ESG is here to stay and the PE industry is still coming to grips with managing everything that comes with it, from rising compliance requirements to the increasing reporting demands of LPs. The very largest private capital firms, however, had already been making progress, embedding investment practices long before ESG became a hot button issue in the media. The UNPRI, the world's largest voluntary corporate sustainability initiative, has over 7,000 signatories—more than 1,000 of which are PE and venture capital firms—four times the count from five years ago.

Regionally, Europe has been the torchbearer for ESG regulations, both across listed capital firms and private markets. A cornerstone of this push saw the EU introduce the

Sustainable Finance Disclosure Regulation (SFDR) last year, under which GPs are not only integrating ESG considerations into their investment decisions and processes, but also launching impact funds that meet the SFDR's Article 9 standards. These so-called “Dark Green” funds are those with an expressed sustainable investment objective.

Meanwhile, the “S” in ESG is gaining traction in line with societal expectations and as companies' ESG approaches mature. For many businesses, especially asset-light tech and software companies, environmental impacts are a relatively simple puzzle to solve, with the next port of call being diversity, gender, equality and inclusion (DEI) issues. Our research shows that in EMEA, of which Europe is by far the biggest market, GPs see their

Our research shows that in EMEA, of which Europe is by far the biggest market, GPs see their portfolio companies as making great advances on more social-oriented key performance indicators (KPIs).

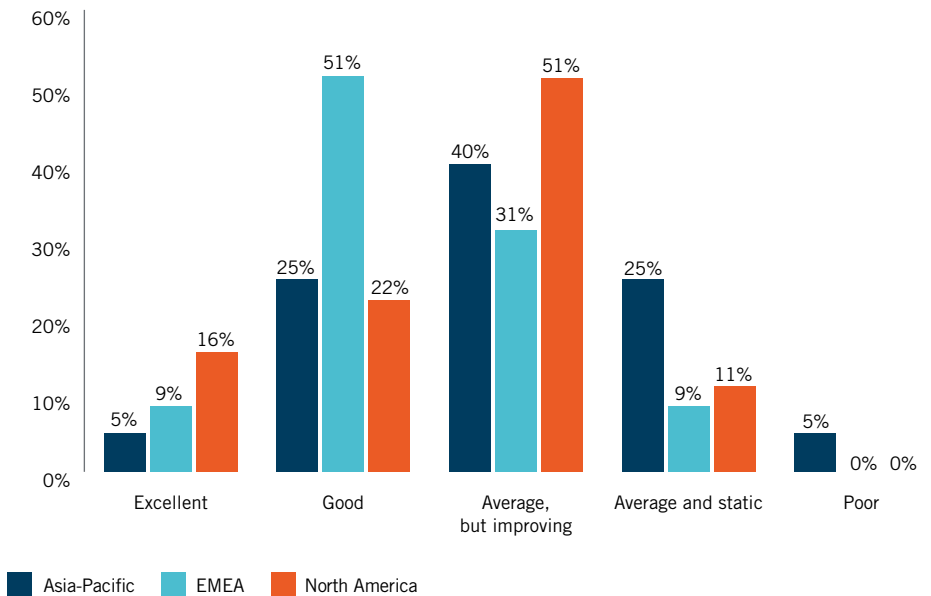
portfolio companies as making great advances on more social-oriented key performance indicators (KPIs).

Six in ten respondents from the region describe DEI initiatives among C-suite executives in their portfolio companies as either good (51%) or even excellent (9%). Far fewer respondents from other regions report the same level of progress, with only 30% and 38% of those based in APAC and North America, respectively, giving the same positive appraisal, instead more commonly describing DEI initiatives in their portfolio companies as average but improving (40% and 51% respectively).

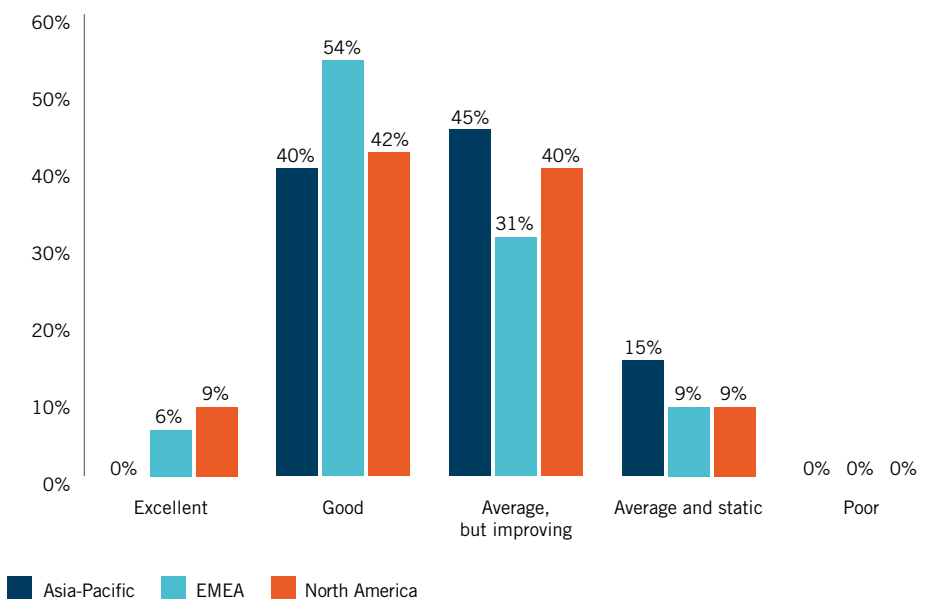
This echoes respondents' view of DEI within their own industry. Once again, three in five EMEA respondents are complimentary about these initiatives at the GP level. Their counterparts in North America are lagging (51%), but not nearly to the extent of APAC GPs.

Not a single APAC respondent considered the DEI initiatives at the GP level to be excellent, and while 40% said progress on diversity was good, respondents more frequently said it was average yet improving (45%), versus North America respondents (40%) and EMEA respondents (31%).

HOW WOULD YOU DESCRIBE THE DIVERSITY, GENDER, EQUALITY AND INCLUSION INITIATIVES AMONG C-SUITE EXECUTIVES IN YOUR PORTFOLIO COMPANIES?



HOW WOULD YOU DESCRIBE THE DIVERSITY, GENDER, EQUALITY AND INCLUSION INITIATIVES AT THE GP FUND LEVEL?



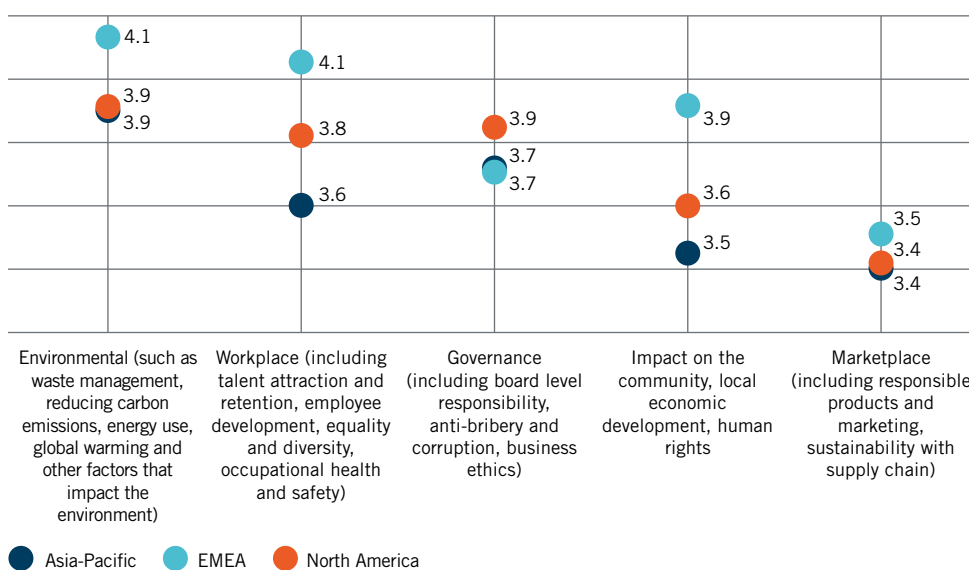
In a continuation of a theme, EMEA GPs ascribe more importance to the diversity KPIs of companies when deciding to push the button on a deal than fund managers elsewhere in the world. Workplace factors such as DEI and health and safety score on an almost level pegging (4.06) with environmental factors (4.14). Further, EMEA PE dealmakers are notably more conscious of marketplace-related ESG considerations, such as responsible products and supply chains, which are far lower in importance for North American and APAC GPs.

Adaption barriers

While research has shown that integrating ESG into dealmaking is value-additive, building out the capabilities to achieve this requires investment in and of itself. Many portfolio companies are reluctant to embrace ESG initiatives because they see them as a costly compliance exercise with little direct or immediate financial benefit—to say nothing of the political backlash against ESG in some regions in the United States, as discussed below.

When considering the most significant barriers to greater adoption of ESG initiatives in their funds or portfolio companies, 60%-75% of respondents point to the added costs and resources to retain qualified talent and create capabilities to identify,

ON A SCALE OF 0 TO 5, HOW IMPORTANT ARE THE FOLLOWING ESG CONSIDERATIONS WHEN ADDRESSED AT THE GP LEVEL IN MAKING PORTFOLIO COMPANY INVESTMENT DECISIONS? (WHERE 0 IS NOT IMPORTANT/CONSIDERED AT ALL AND 5 IS EXTREMELY IMPORTANT/TOP PRIORITY)



track and manage ESG risks and opportunities.

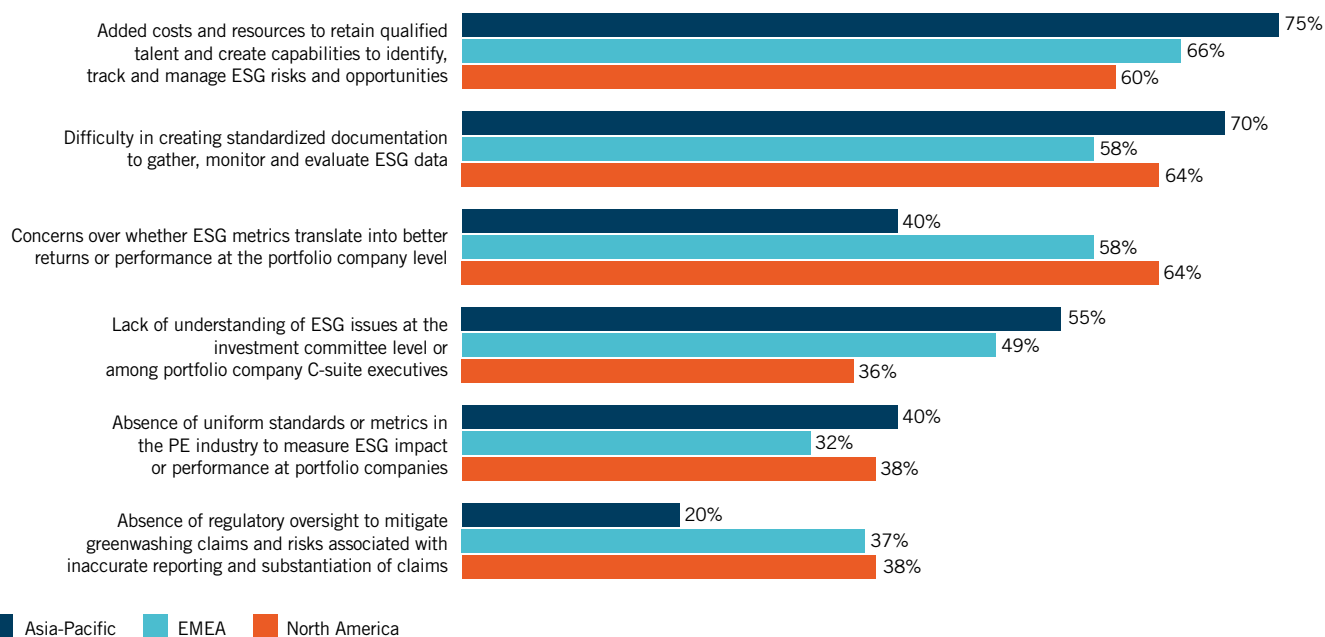
This is closely followed by the difficulty in creating standardized documentation to gather, monitor and evaluate ESG data, cited by 58% of those based in EMEA, 64% of those in North America and 70% in APAC. Private markets are inherently less transparent than their public equivalents. Many private companies do not disclose comprehensive information on their ESG performance, and the lack of standardization around what constitutes an ESG-friendly

investment means it is difficult for PE firms to compare different deal opportunities and make informed decisions about where to allocate capital. In spite of these challenges, forward-thinking PE firms are overcoming these obstacles and reaping the benefits of being the earliest adopters of responsible investing.

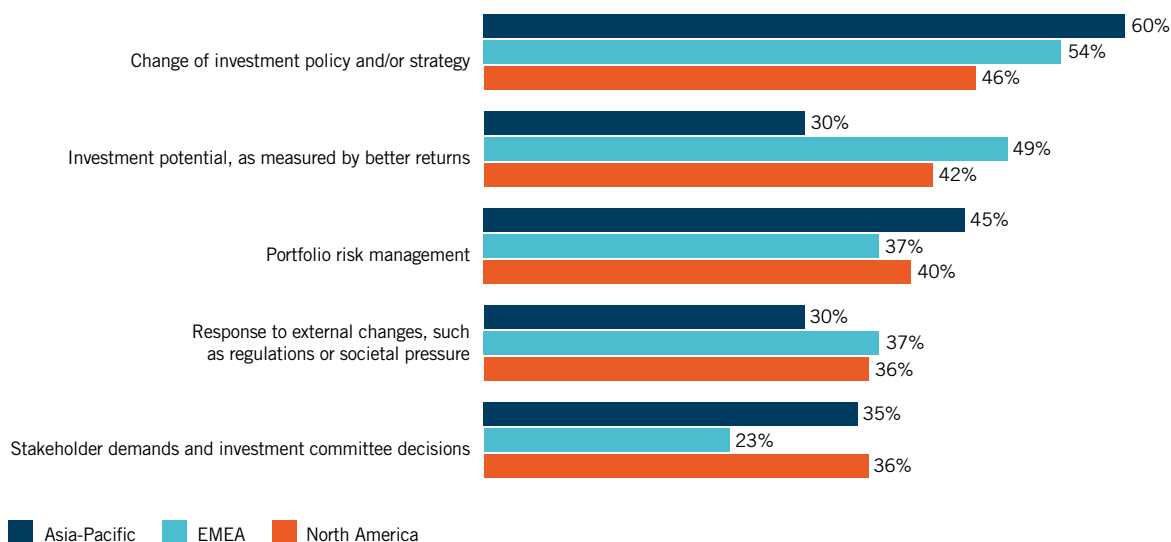
Answering to LPs

Private equity firms are coming under increasing pressure from their investors to incorporate and integrate ESG. The investors are motivated by a number of factors.

WHAT ARE THE MOST SIGNIFICANT BARRIERS TO GREATER ADOPTION OF ESG INITIATIVES IN YOUR FUND OR IN YOUR PORTFOLIO COMPANIES GENERALLY? (SELECT TOP THREE)



WHAT ARE THE MAIN DRIVERS FOR LPs WHEN MAKING ESG INVESTMENT DECISIONS? (SELECT TOP TWO)



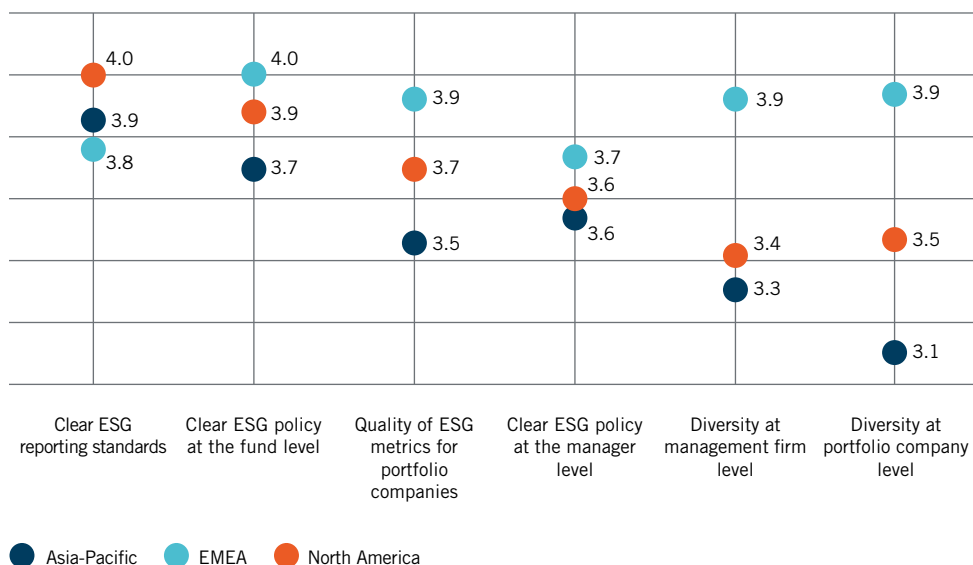
First, there is a recognition that sustainability is important for the long-term success of businesses. A growing body of evidence suggests that enhancing portfolio companies' ESG progress can have a material impact on financial performance, thereby generating superior returns. Second, LPs are increasingly conscious of the reputational risks associated with backing PE teams that do not take ESG seriously, driven by the fact that many institutional investors have their own fiduciary stakeholders to answer to. GPs that do not take steps to address LPs' concerns may find it increasingly difficult to raise capital in the future.

When asked what they view as the main drivers influencing LPs' ESG-led investment decisions, the biggest share of respondents across geographies point to a fundamental change of investment policy or strategy by investors. Unlike family offices and high-net worth individuals—many of whom access the asset class through funds of funds—pension programs, sovereign wealth funds, endowments and insurance companies have trustees and customers that have increasingly high expectations with regard to ESG.

Of course, the purpose of private equity is to deliver attractive risk-adjusted returns and 49% of EMEA respondents and 42% of dealmakers from North America believe that LPs are primarily motivated by the potential for ESG integration to deliver this outperformance. Only 30% of APAC respondents highlight this driver, instead seeing portfolio risk management as being a strong attraction for the decisions made by their investors that are motivated by ESG considerations.

In terms of the due diligence that LPs apply to GPs to understand their ESG progress, EMEA respondents report that the greatest emphasis is put on diversity at the portfolio company level, giving it an average importance rating of 3.9 out of 5. This compares with 3.5 and 3.1 average ratings given by their North America and APAC counterparts, respectively. While large funds have globally diversified investor bases, they tend to skew toward LPs in the same region, particularly as

HOW SIGNIFICANT A PART DO THE FOLLOWING INITIATIVES PLAY IN THE DUE DILIGENCE PROCESS OF GPs AND ESG POLICIES? (WHERE 5 IS EXTREMELY IMPORTANT AND 0 IS NOT SIGNIFICANT AT ALL)



GPs offer concessions to their earliest backers. Therefore, European LPs seem to have moved up the maturity curve in their analysis of GP progress by zoning in on DEI progress within their portfolios.

Across regions, respondents highly rate the significance of ESG initiatives in the diligence process undertaken by LPs when considering where to invest. Respondents score clear ESG reporting standards between 3.8 and 4.0 out of 5 as being investors' primary focus in their ESG due diligence, with a clear ESG policy at the fund level scoring between 3.7 and 4.0 out of 5. PE firms would do well to keep this in mind before launching new funds and having to field pointed questions about how they are integrating ESG into their own operations and those of their portfolio companies.

A backlash

At the same time, there is a growing backlash to ESG. Most notably, in August, the State Board of Administration of Florida, which manages the state's public sector pension fund, approved a resolution that prevents the state's pension fund from considering ESG factors when making investment decisions. At least nine other states have adopted anti-ESG regulations in the form of investment resolutions, decisions by the state's board

of investment, or state attorney general opinions. Additionally, Louisiana and Missouri have divested a combined US\$1.2bn from BlackRock over the asset manager's ESG push.

The stated aim of these actions has been to force investors to consider financial returns above other considerations. This ignores that studies have consistently found a correlation between high ESG ratings and stronger financial returns. Moreover, as BlackRock's CEO Larry Fink wrote in his much-read letter to CEOs in 2020, "Climate risk is investment risk." Climate catastrophes around the world will have a significant impact on the global economy and it is prudent to manage those risks.

A growing body of evidence suggests that enhancing portfolio companies' ESG progress can have a material impact on financial performance, thereby generating superior returns.

Conclusion

PE is nothing if not resilient. As an industry, it has proven time and again that it outperforms public markets, especially so through down-cycles. Some of the best fund vintages over the past two decades fell immediately after the dotcom bubble burst and amid the global financial crisis. This is because PE funds have relative flexibility to invest

over a three- to five-year (or even longer period) and so can dial up their deployment when the opportunity strikes. Now, another one of those opportunities is presenting itself (albeit this time in a high interest rate environment). Another industry advantage is PE's operational skills, which allows for active shareholder engagement and fund

managers putting their extensive networks and specialist knowhow to work. If there is one watchword as it pertains to PE during this uncertain time in markets the world over, it is resilience. As the industry confronts these challenges, it is once again being asked to demonstrate that resilience.

Tap private credit and NAV facilities

Debt availability and the cost of this financing is clearly a key concern right now. While private credit does not come cheap, these funds are well equipped with dry powder and have shown a willingness to step in as banks and capital markets have pulled back. Expanding networks and building relationships with debt funds and other sources of non-traditional financing give PE funds the best chance possible of supporting new deals and shoring up the balance sheets of existing portfolio companies, as well as returning capital to LPs by harnessing NAV facilities.



Roll up your sleeves

Private equity's calling card is its ability to transform companies. Given the more difficult exit environment, GPs should focus on leveling up their existing assets whether by rationalizing costs or seizing market opportunities as direct competitors come under pressure, or even improving their portfolio businesses' ESG credentials. This will help to attract buyer interest as conditions improve and ultimately maximize returns on capital.



Set realistic fundraising expectations

As LPs become more judicious with their capital commitments, GPs that need to replenish their funds should plan their fundraising on the assumption that the process will take significantly longer to conclude than in recent years, as well as consider creative solutions to ensure they have additional capital to deploy, such as interim funding vehicles based around a single asset and continuation funds. With stock markets in the doldrums, there has been less incentive for investors to allocate to PE. The ongoing capital concentration effect calls on fund managers to truly stand out and articulate how they will be able to replicate past successes.



Selective bets

Valuations have not been equally hit across all sectors. Fund managers will need to play to their strengths, but there may be rare opportunities in areas of the economy that have been most severely stretched by spiraling inflation and rising interest rates, and which investors have withdrawn capital from in the flight to safety. Stressed and distressed companies in the tech and consumer discretionary industries, for example, have the potential to offer handsome rewards once inflation rolls over and there is a clearer view on near- to medium-term economic growth.



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