2024

Global Private Equity Outlook

Mergermarket

Dechert LLP

40 YEARS

PRIVATE EQUITY
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Contents

Methodology

In Q2 2023, Mergermarket, on behalf of Dechert LLP, surveyed 100 senior-level executives within private equity firms based in North America (45%), Europe, the Middle East & Africa (EMEA) (35%) and Asia-Pacific (APAC) (20%). To qualify for inclusion, the firms needed to have US$1 billion or more in assets under management (AUM) 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: Review, recalibrate, renew

The global private equity (PE) market has settled into a more measured cadence in recent quarters. Fund managers have been steering through a fundamentally different environment than the one they had become accustomed for the last 15 years.

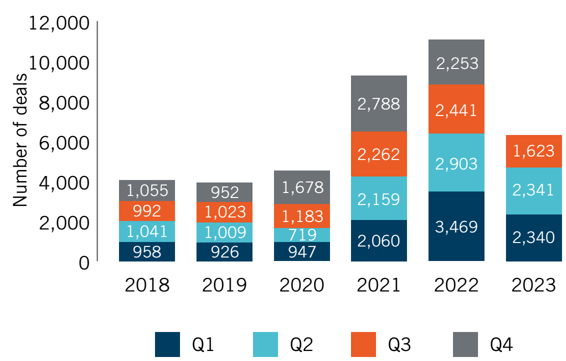
In 2022, central bank policy tightened considerably to tackle inflation, and these conditions pose severe challenges for the PE industry. Higher interest rates have significantly impacted deal economics and therefore transaction activity. Lower distributions from fewer exits are also straining fundraising efforts.

Global PE deal volume was down by 28% year-on-year in Q1-Q3 2023 to 6,304 deals. This decline is not as dramatic as it first appears. Q1 2022 was the most abundant quarter on *Mergermarket* record for PE deals, and Q2 of that year was among the top six quarters, all of which occurred post-pandemic. Total transaction value, meanwhile, has taken a sharp dive, falling by 45% compared with Q1-Q3 2022, to US$448 billion.

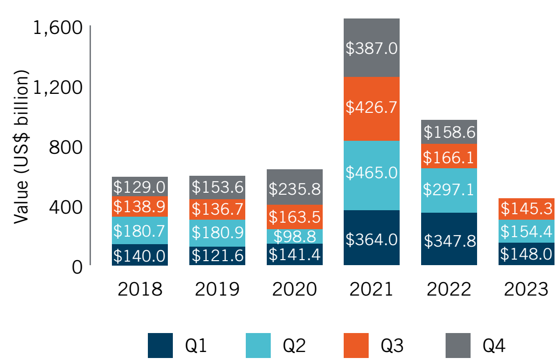
While this drop in aggregate value has been more precipitous than the decline in volume, and reflects markedly tighter debt financing conditions, the market has essentially recalibrated to its pre-pandemic baseline following a frenetic couple of years. The US$145.3 billion in total value recorded in Q3 2023 represents a decrease of 6% on Q2's US$154.4 billion. This was precipitated by a decline in deal count in Q3, after having held steady through H1.

While it is not yet clear if this marks a bottoming of PE deal value, our research indicates

NUMBER OF GLOBAL BUYOUT DEALS, 2018–Q3 2023



VALUE OF GLOBAL BUYOUT DEALS, 2018–Q3 2023



that GPs are greatly concerned by today's high-rate environment and its impact on their ability to close new deals over the next 12 months. In APAC, fund managers are comparatively optimistic, buoyed by the region's stronger economic outperformance and the powerful demographic tailwinds underpinning its immense long-term potential.

The first nine months of 2023 featured a slowdown in fundraising in the U.S. The total capital raised by closed funds was down 12.9% compared with the same period in 2022, according to *Pitchbook*. Headline fundraising fared better in Europe, with €86 billion raised as of end-September, up from €76.1 billion across 2022 as a whole. This, however, speaks in large part to the concentration in fundraising, with the three biggest funds in Europe representing 57.7% of funds raised through Q3 2023. Over the last decade, the top three's share of fundraising has never exceeded even 36%.

Not only is debt financing harder to secure on favorable terms, but there is also less new equity entering the system for investments. A lack of exits has caused distributions to slow, leaving LPs with less cash to recycle into new funds. Competition for capital among GPs is fierce, a reality flagged by our survey respondents, who are concerned about commitments flowing to other funds, with key investors downsizing their tickets and consolidating their GP relationships. Nevertheless, dry powder supplies remain vast. *Preqin* estimates that there is still a near all-time high of US$1.2 trillion still to be deployed.

Firms are increasingly broadening their horizons, adding new strategies such as private credit, infrastructure, venture capital, impact investing and hedge fund capabilities to their operations, as they realize their ambitions of becoming multi-strategy asset management firms to compete effectively in the current market. On the PE side, they are also embracing creative deal structures that satisfy all deal parties to close the valuation gap between buyer and seller.

This is yet further evidence that PE funds are some of the most adaptive investors. With EBITDA multiples having adjusted somewhat lower through 2022 and 2023 compared with previous years and profit margins under pressure, funds are doubling down on value creation in their portfolio companies. Firms with bona fide operational prowess and strategic vision are positioned to excel in these conditions; if anything, they are a test of firms' ability to deliver on their promise of building better, more prosperous businesses.

This extends to environmental, social & governance (ESG) considerations, which continue to gain traction across the industry, in spite of recent partisan pushback emanating from the U.S. ESG is a primary value lever for driving company performance. Promoting and embedding measurable sustainability strategies and practices will ensure that GPs can capitalize on the eventual recovery of the exit market, maximizing LP returns. Most PE firms, including those in the U.S., are cognizant of this reality and major LPs in red states are committed to some of the industry's largest impact funds.

The following annual report, produced in partnership with *Mergermarket*, is now in its sixth edition, over which time the PE industry has been through one of the most volatile periods in its history. The purpose of this latest issue is to determine how PE managers are overcoming today's challenges and setting themselves up for success amid demanding market conditions and industry shifts. This is not the first test the industry has faced and it won't be the last. PE managers are highly tenacious and the successful ones have evolved through multiple cycles to become more dynamic stewards of investors' capital. This time is no different.

Key findings

26%
of respondents, the largest share, believe that interest rates will have the single biggest impact on the deal environment over the next 12 months.

58%
of respondents see market conditions for exits as being either neutral or somewhat favorable over the next 12 months, suggesting GPs are confident in a recovery but remain realistic. This is a marked decline from 84% who shared this view a year ago.

35%
Responding to the U.S. regional bank crisis earlier this year, 35% of respondents intend to move more towards private credit providers, a trend visible across all parts of the world.

94%
of respondents say they are likely to consider pursuing take-privates at present, a marked departure from last year's edition of this survey when less than half said they were likely to do so.

92%
of GPs say that utilizing earn-outs is a strategy their firms are employing to manage the valuation gap that emerged last year in response to macro and market conditions.

71%
of respondents expect rising scrutiny from antitrust authorities to have a negative impact (46%) or significant negative impact (25%) on their dealmaking plans over the next 12 months.

78%

of respondents say their fund makes use of private credit for acquisition financing at the portfolio level and 73% of those whose firms do not already have a private credit investment strategy are considering adding one to their offering.

21%

of GPs cite competing with larger managers for capital as their chief fundraising concern. However, only 21% of respondents see direct access to PE vehicles expanding to retail investors.

91%

of respondents believe that the democratization of PE will have an impact on fee structuring, as retail investors gain further access to the asset class.

59%

of respondents are aiming to make a GP-stake divestiture over the next 24 months, broadly in line with the 63% of firms who had such plans a year ago.

78%

of respondents expect their firms to invest in hedge fund capabilities over the next 12 months, as larger managers strive to become multi-asset management firms that are able to take advantage of a higher interest rate environment.

72%

of respondents overall expect to see more distressed deals in response to today's prevailing macroeconomic conditions, up five percentage points on last year's survey.

26%

of EMEA respondents view their capacity to successfully raise continuation vehicles as a challenge, compared with 20% of APAC and just 13% of North American respondents.

Fund trends

For many, the pursuit of raising fresh capital has become more arduous. Market headwinds are such that GPs are having to spend longer on the road before they finally close their funds. *Preqin* data show that in 2019, before the pandemic put a hold on face-to-face meetings, the average time from launch to final close was 15 months. Since then, the average time is 19 months, towards the top end of the historical average.

Consequently, GPs are pursuing creative solutions to raise additional capital through annex funds or sidecar vehicles, or making use of alternative liquidity solutions such as GP-led secondaries and continuation vehicles (see *Liquidity events*, page 46).

For some time already LPs have been rationalizing their GP relationships. A more recent phenomenon is the liquidity crunch stemming from lower exit volumes, meaning LPs are being more selective in their commitment decisions. Although inflation figures are trending in the right direction, a considerable degree of macroeconomic uncertainty remains, meaning there is arguably more incentive than ever for investors to take a measured approach regarding which managers they are willing to back. Large-cap, multi-strategy asset management firms continue to be the biggest winners amid this concentration of capital.

"In the challenged market conditions that we're in right now, LP committee members are going to naturally be inclined to commit to larger well-established funds. That's why newer funds and those raising for frontier markets are

"In the challenged market conditions that we're in right now, LP committee members are going to naturally be inclined to commit to larger well-established funds."

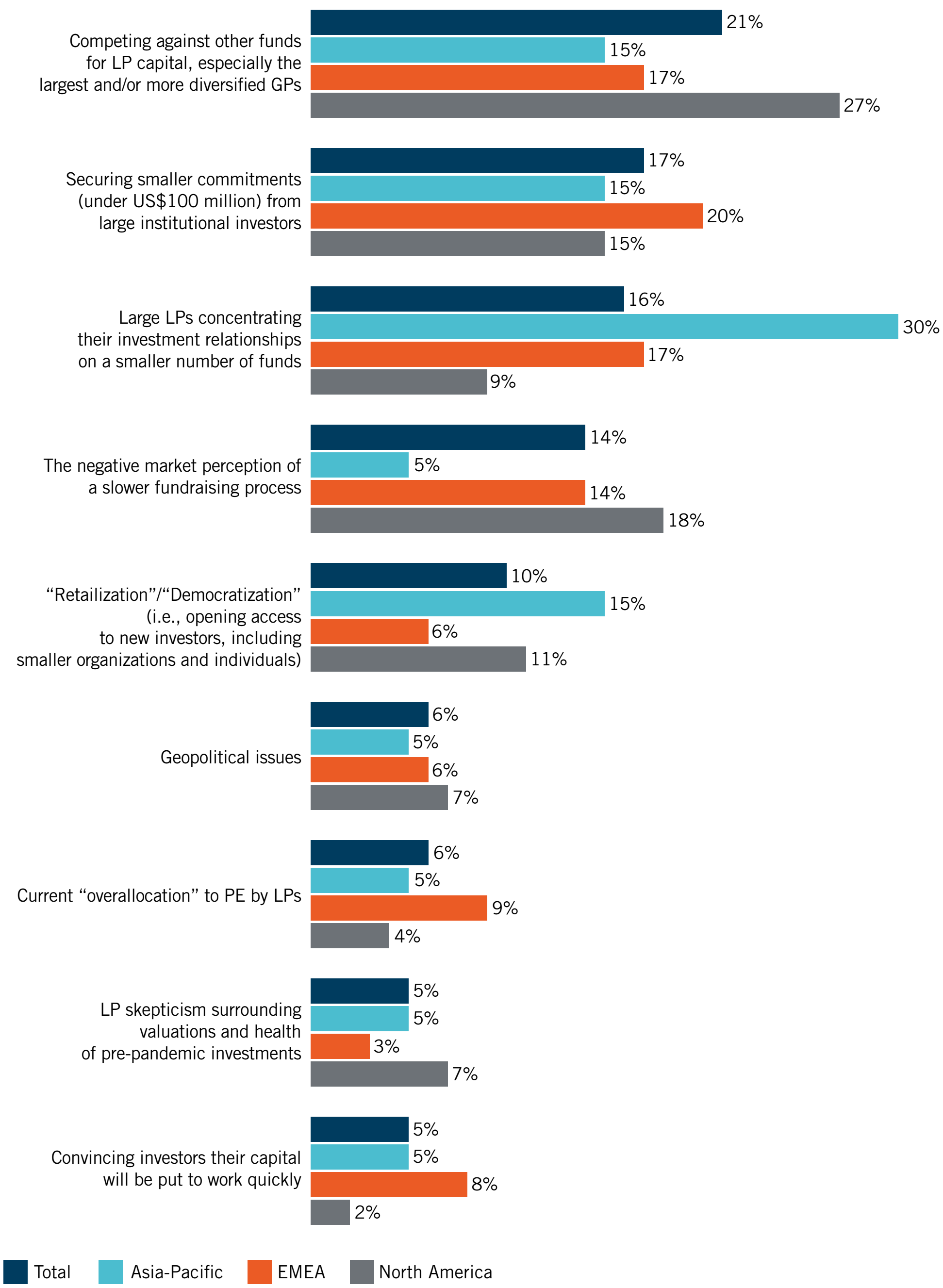
Sabina Comis, Dechert LLP

finding it harder now, too," says Sabina Comis, Dechert's Global Managing Partner based in Paris. "The big pension funds in particular also want to write large tickets and only have so much resource to conduct due diligence on the universe of thousands of PE funds, so there's a capital efficiency element there as well."

Our respondents share that the biggest challenge they currently face in replenishing their dry powder is competing against the largest and most diversified GPs, cited by 21% overall. This is of most concern for North American respondents (27%), a market in which investors seeking exposure to the U.S. are spoiled for choice. Marquee PE brands have continued their climb to the top of the fundraising leaderboard over the past decade, benefitting from their vast economies of scale. Perhaps the most notable of these is Blackstone, which in July 2023 reached a record US$1 trillion in AUM.

These findings echo last year's results, when 20% of GPs overall shared this as their top fundraising challenge. However, in a departure from our previous report, when 28% pointed to LPs concentrating their investment relationships to a smaller number of funds as a top challenge, only 16% now flag this manager-

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



relationship consolidation as a key issue, with APAC GPs being the outlier at 30%.

It appears that, on balance, GPs are less concerned about losing large, often cornerstone investors outright, but worry that these institutional backers are now dialing back on their ticket sizes. Last year only 4% highlighted institutional investors downsizing commitments as a top challenge, and this has now risen to 17%. Notably, as much as 20% of EMEA respondents are concerned by this, from as little as 3% a year ago.

A further potential fundraising obstacle as of August 23, 2023 is the Securities and Exchange Commission's (SEC) new private fund rules. Among other obligations, these require that GPs enhance disclosures around fees, conflicts of interest and investment strategies, and avoid giving investors preferential treatment that would negatively impact other LPs. Fund managers preparing to launch new funds should carry out a risk assessment by seeking legal advice on whether their current private placement memorandum documents align with their existing practices, to ensure compliance with the new rules.

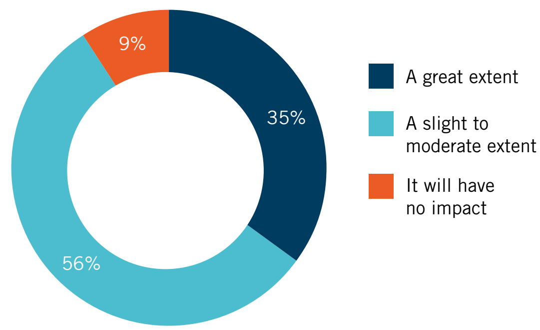
Retail, a new paradigm

Traditionally confined to institutional investors, family offices and the ultra-wealthy, PE has long been out of the reach of everyday investors. High capital demands and illiquidity meant PE was not part of the retail investor's portfolio. However, a shift is emerging that has the potential to transform how GPs raise capital.

The retailization of the alternative investments industry stems from a middle class seeking to diversify their assets and enhance their returns. Firms are turning their attention to this previously untapped reservoir of retail investor capital, creating tailored products such as feeder funds, tokenized blockchain-enabled products and funds-of-private-funds available to wealth manager channels and via digital platforms to capture growing demand. These products typically have lower minimum investment thresholds and more liquidity than traditional PE funds, opening the door to what was once a purely institutional and high-net-worth market.

Given intense competition to raise funds, those who successfully seize upon this emerging trend stand to capture the biggest amounts of commitments. However, the democratization of PE will not come without its challenges. For one, managers will have to build out their back offices to accommodate these changes.

TO WHAT EXTENT DO YOU THINK THE RETAILIZATION/DEMOCRATIZATION OF PRIVATE EQUITY WILL HAVE AN IMPACT ON FEE STRUCTURING? (SELECT ONE)



And then there's the matter of fee compression. Only 9% of respondents believe that the retailization of PE will have zero impact on fee structuring. Most say it will have an impact to a moderate extent (56%), while a sizable minority (35%) expect it to have a major impact. It is not yet clear where exactly the chips will land.

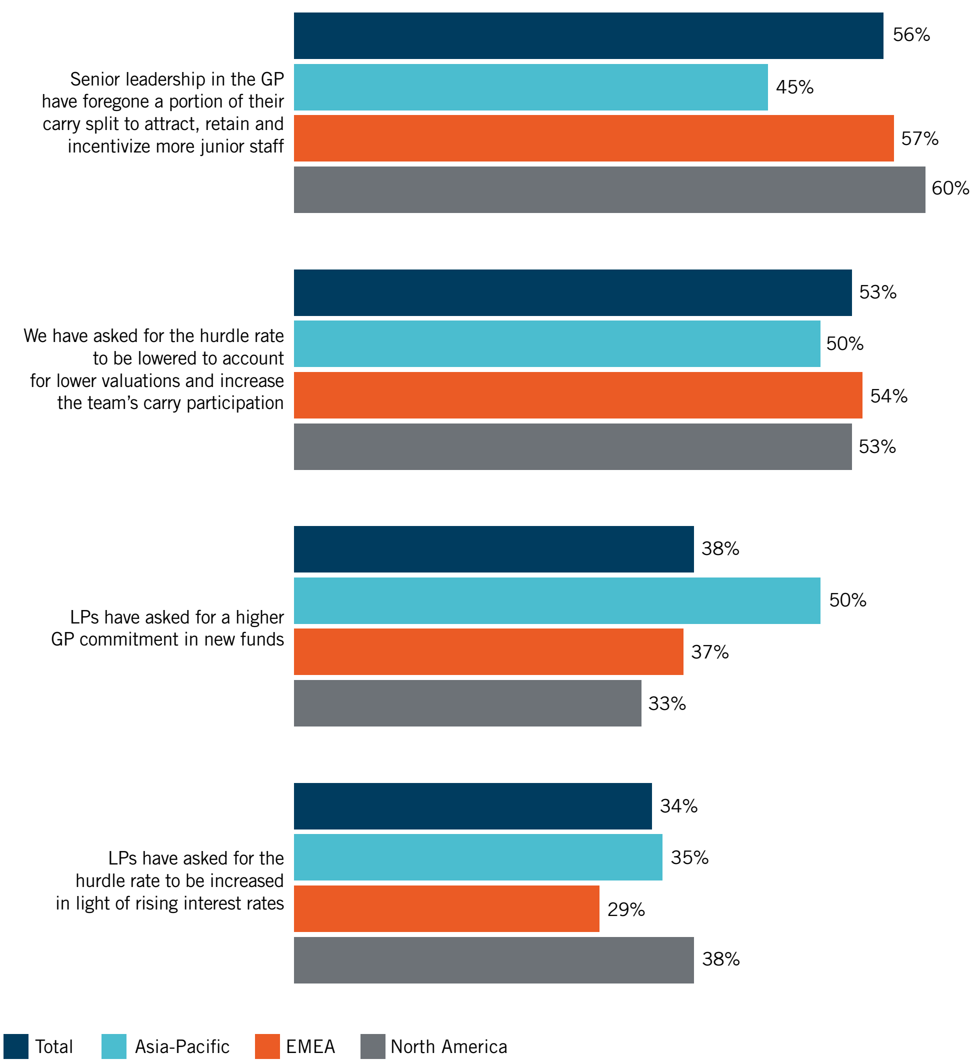
Lowering hurdles

Aligning the interest of investors with their fund managers is a delicate balance. Last year in the previous edition of this study we found that 64% of PE firms reported their LPs asking for higher GP commitments to their funds. This has since fallen to 38%, indicating that LPs recognize the slower pace of exits means less cash for managers to re-up into their own vehicles.

The most striking reversal, however, is how investors are viewing hurdle rates, which for PE are typically set at an industry standard of around 8%. The received wisdom is that as interest rates rise, so too should hurdles to reflect the performance PE is expected to deliver over and above risk-free assets. But this comes with a catch. If a fund is lagging and GPs are out of the carry, alignment becomes skewed, undermining this virtuous incentive for fund managers to effectively manage risks.

In this give-and-take, it can be beneficial for LPs to acquiesce to a lower hurdle on an existing fund to reincentivize the GP and avoid them adding more leverage risk in order to cross the performance threshold. On seeing central banks begin their hiking cycles in 2022, 53% of GPs said their LPs were inquiring about hurdles rising. A year on and with tighter conditions having weighed on asset prices and exit timelines, this has fallen to 34%. Now, 53% say they are having conversations with their investors about lowering the hurdle.

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)

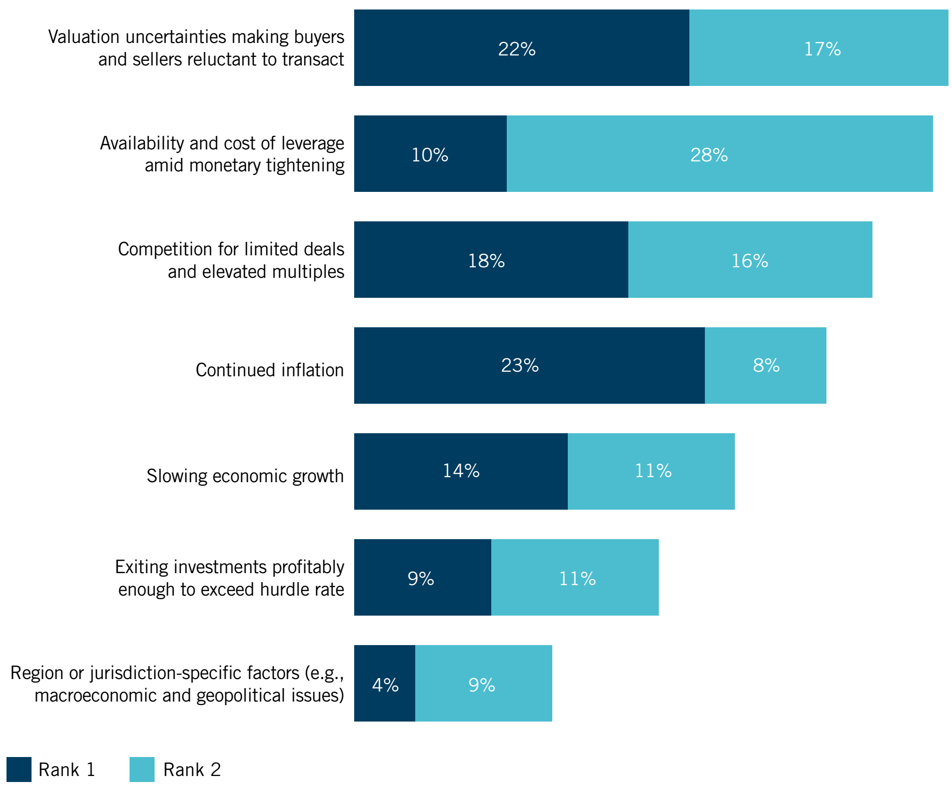


Deal environment: Challenges and changed processes

The PE industry has had to reorient itself amid the inflationary squeeze and high interest rate environment that has defined the past two years. This confluence of macroeconomic pressures clearly dominates GPs' concerns today, as they manage EBITDA margin compression from raised input and labor costs on one side, and significantly increased borrowing costs on the other. While we are not out of the woods just yet and activity has fallen from its record highs, deals are still being made in volumes consistent with the historic average.

When we interviewed industry participants at the end of Q2 2023, inflation running hot was still at the top of everybody's mind. According to 23% of respondents, the largest such share, the single

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



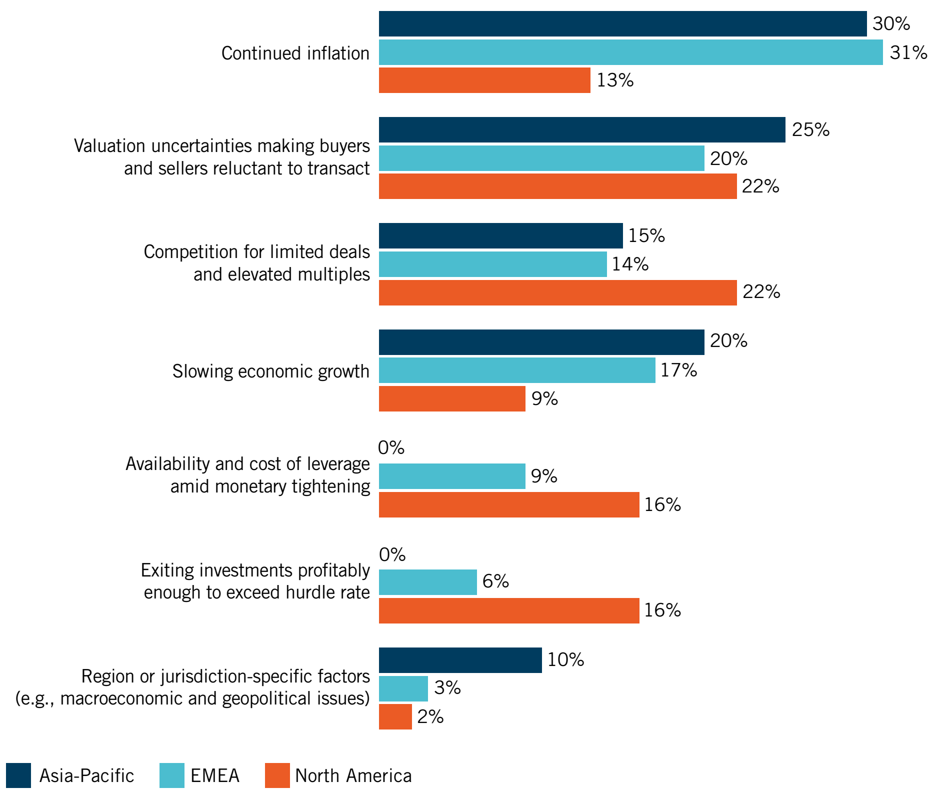
greatest challenge facing the industry is continued inflation. This trend has since shown signs of easing in some markets, including the U.S., though core inflation is proving to be quite persistent, and monetary conditions have the potential to remain tight for some time.

Higher rates correlate with lower asset prices. GPs have therefore had to contend with opposing forces: debt for underwriting new deals is more expensive, while attractive exit opportunities have been harder to come by. This has slowed the natural investment cycle in PE since the beginning of 2022 as the bid-ask spread between buyers and sellers stretched.

Not far behind inflation, 22% of respondents say that valuation uncertainties—making parties reluctant to transact—is the primary challenge they face and 17% say it is a significant secondary hurdle.

Unquestionably, 2022 was a reality check for sellers, and many were unwilling to sell their assets amid the market downdraft. Depressed exit activity has consequently seen GP-led secondaries and in particular continuation vehicles become a go-to tool in sponsors' toolkit for realizing liquidity for investors. However, there are signs that the tables are beginning to turn, sellers

WHAT DO YOU SEE AS THE BIGGEST CHALLENGE CURRENTLY FACING THE PRIVATE EQUITY INDUSTRY?



having recalibrated their expectations.

"There was a big valuation gap last year, and that definitely has shrunk since then," says Markus Bolsinger, co-head of Dechert's PE practice, based in New York. "There's been a realization and acceptance among sponsors that the lofty multiples of prior years have come down a notch or two in today's market, particularly in the U.S."

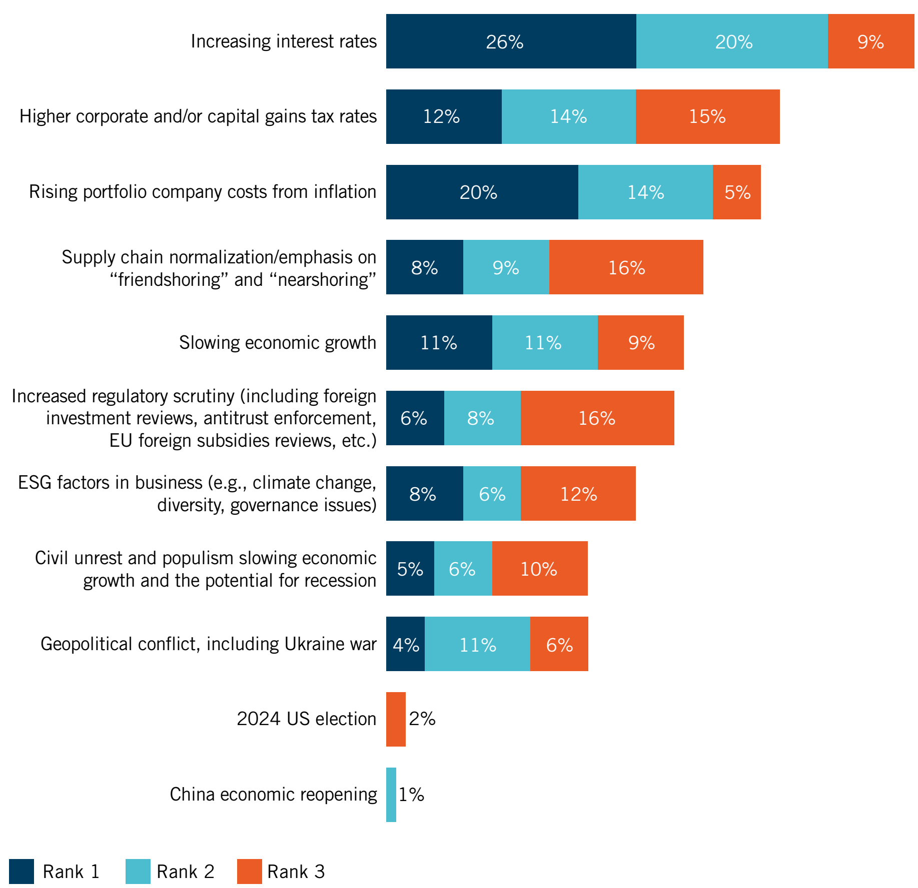
This is not the case across the board. Valuation gaps are still pronounced in many Asian markets. "India has been doing exceptionally well because of a confluence of factors, including its structural enablers (such as consumption growth and payment infrastructure), its broadening investor base, maturing corporate system, and more pertinently in the last year, fueled by the 'China Plus One' tailwinds," says

Siew Kam Boon, co-head of Dechert's PE group, based in Singapore. "Barring certain sectors like tech, where you see a lot of down rounds after some astronomical valuations, price expectations in Asia have not dropped in as considerable a fashion despite the current conditions. The message is taking its time to percolate and there's a general sentiment among sellers that Asia's growth story should support their valuation expectations."

Higher interest rates and rising debt burdens are an obvious pain point. Not only is the availability and cost of leverage amid monetary tightening flagged as a key concern for the PE industry by 38% of respondents, 26% also believe rates will have the single biggest impact on the deal environment over the next 12 months. They are also concerned about the related issue of elevated portfolio company costs from inflation, which garners 20% of first-choice votes.

"The bigger worry for our client base is not inflation per se, it's the rate hikes that have followed as a way to combat that inflation," says Chris Field, co-head of Dechert's PE practice and the firm's London corporate group. "And how long do those elevated rates persist, because even if they've reached a peak the question is, when do they come back down?"

IN YOUR ESTIMATION, WHICH CURRENT OR UPCOMING DEVELOPMENTS WILL HAVE THE BIGGEST EFFECT ON THE DEAL ENVIRONMENT OVER THE COMING 12-18 MONTHS? (SELECT TOP THREE AND RANK 1-2-3, WHERE 1 IS THE GREATEST EFFECT)



> "Barring certain sectors like tech, where you see a lot of down rounds after some astronomical valuations, price expectations in Asia have not dropped in as considerable a fashion despite the current conditions."
> Siew Kam Boon, Dechert LLP

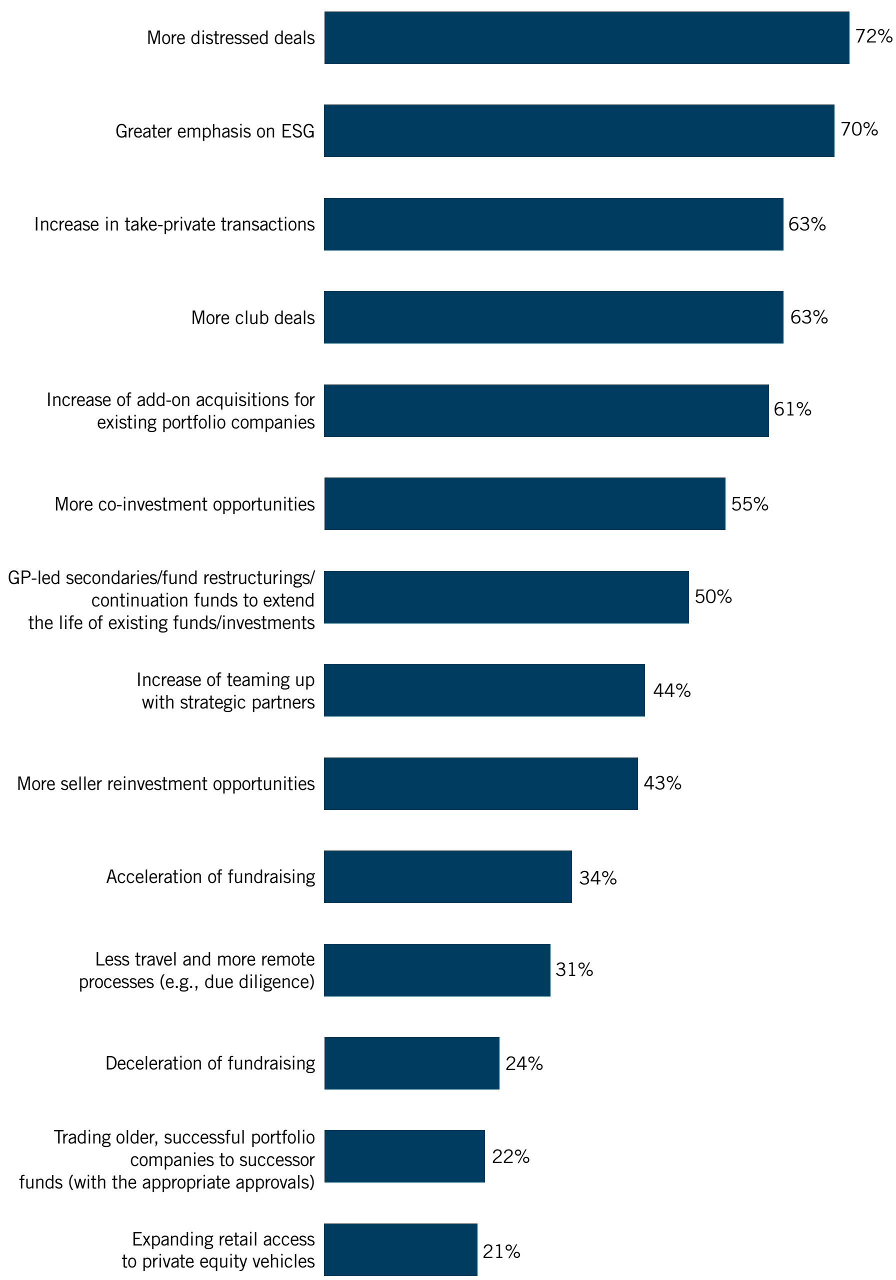
Stress test

Multi-decade high rates and slower economic growth mean businesses are facing some of the strongest headwinds of recent times. Refinancing conditions are extremely tight, and 72% of respondents overall expect to see more distressed deals in response to today's prevailing macroeconomic conditions.

Of course, there are varying degrees of stress and distress. In this capital-constrained environment, many companies facing liquidity issues are proactively engaging with lenders to discuss looming maturity dates and potential solutions to their cash requirements.

Many forecasters had been expecting an avalanche of distressed deals amid a default wave. That has not come to pass, but there has been an uptick in bankruptcy procedures. In the U.S., for example, the 4,553 commercial Chapter 11 bankruptcies filed between the start of the 2023 and the end of Q3 represent a 61% increase over the same period in 2022, according to Epiq Bankruptcy. That includes 459 corporate firms, already surpassing the full-year totals recorded in 2022 (373) and 2021 (408), according to S&P Global figures.

WHAT TRENDS DO YOU SEE GROWING IN RESPONSE TO THE CURRENT ECONOMIC DOWNTURN? (SELECT ALL THAT APPLY)



"There's clearly distress in the commercial real estate market, with some prominent investors turning over prime properties to lenders," says Field. "But if you look at assets in areas like energy transition and data centers, they are doing extremely well."

If higher rates persist, weaker-performing sectors are likely to provide deal flow via debt-for-equity swaps, recapitalizations and other forms of restructuring. Over the past four years, Dechert has set about augmenting its financial restructuring team to support both creditors as well as investors seeking to capitalize on pockets of distress in what is a highly complex regulatory environment.

Unlocking value with ESG

ESG is also expected to see greater emphasis as a result of current market conditions, as cited by 70% of respondents. In spite of recent political pushback in the U.S. and the APAC region having a long way to go, ESG remains firmly on the agenda, led by developments in Europe. This is partly driven by compliance requirements, such as the Sustainable Finance Disclosure Regulation (SFDR), but also increasingly by LPs demanding their GPs incorporate ESG into their engagement with portfolio companies.

With a sharpened focus on value creation through revenue and EBITDA growth, rather than simply buying and holding to sell at a higher multiple, funds are viewing ESG through a lens of risk mitigation and as a way to better position their assets in the market. Companies that have a demonstrable commitment to environmental sustainability and social inclusion are often more competitive businesses and are increasingly attractive to the buyer pool, and this typically results in improved exit outcomes.

Scanning stock markets

Take-privates are also very much on GPs' radar as a strategic response to current economic and market conditions. As we have seen in certain regions, take-private transactions have represented some of the largest deals. Sponsors continue to identify opportunities to acquire what they view as undervalued assets which they can then radically transform away from the burden of short-term quarterly reporting and the scrutiny of public markets. The findings of our survey show that 63% of respondents expect growth in take-privates.

Take-privates do, however, carry significant execution risks. Last year, many boards were circumspect about approaches from PE, although that reluctance appears to have softened. Nevertheless, gaining shareholder support can be challenging, particularly if there are vocal dissenting stakeholders or concerns about the fairness of the deal. Determining the fair value of a publicly traded company can be contentious if its share price has come under persistent pressure. The offer price must be attractive to shareholders while still leaving room for sponsors to meet their cost of capital. Valuation disputes have the potential to draw out negotiations and can give competing bidders the upper hand if the target exercises its "go shop" rights or its "fiduciary out" in response to a superior, competing offer. This in turn has the potential to escalate the deal's price and complexity.

"There's clearly distress in the commercial real estate market, with some prominent investors turning over prime properties to lenders."
Chris Field, Dechert LLP

Regulatory scrutiny

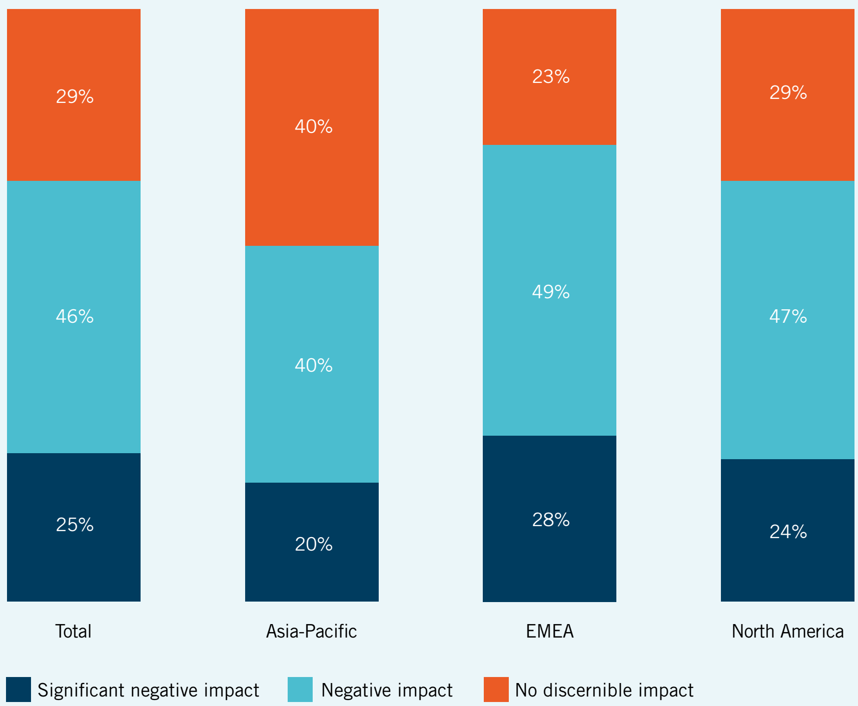
Antitrust

U.S. antitrust authorities have been bearing down heavily on M&A under the current administration and are becoming increasingly litigious. This emboldened approach has a significant probability of sinking deals.

The Dechert Antitrust Merger Investigation Timing Tracker (DAMITT) found that 60% of significant investigations in the U.S. in 2022 concluded with a complaint or abandoned transaction. This easily eclipsed the previous year's record of 37%.

Furthermore, these investigations have become increasingly drawn out. DAMITT shows that the average duration of significant investigations in the U.S. ticked up to 11.8 months, just shy of the 11.9-month DAMITT record set in 2019.

HOW DO YOU EXPECT GREATER SCRUTINY FROM ANTITRUST AUTHORITIES TO IMPACT YOUR FIRM'S DEALMAKING PLANS OVER THE NEXT 12 MONTHS? (SELECT ONE)



On June 27, 2023, the Federal Trade Commission (FTC) and Department of Justice proposed a change to the Hart-Scott-Rodino Antitrust Improvements Act rules that would essentially trigger a significant antitrust investigation for every transaction valued above the reporting threshold, which is currently US$111.4 million. This would be regardless of any substantive overlap between the parties and the deal's potential impact on competition. Besides capturing a swathe of PE deals within its scope, under the proposal one of the key provisions expressly mentions the disclosure of any PE involvement in deals.

The FTC filed a lawsuit in September 2023 against U.S. Anesthesia Partners (USAP) claiming the company's past roll-up acquisitions of anesthesia practices in Texas were anticompetitive. The FTC named PE firm Welsh Carson as a co-defendant based on its alleged involvement in actively directing USAP's major strategic decisions, particularly with respect to M&A. Welsh Carson held a minority stake of between 23%-45% when most of these acquisitions occurred and had the right to appoint a majority of the board of directors.

While the European Commission has not zeroed in on PE like the U.S. agencies, it has been heavily scrutinizing deals that it believes have the potential to undermine competition. The Commission is pushing through an overhaul of its policy and enforcement regime, the digital sector being a core focus of these changes. In April, meanwhile, the UK's Competition and Markets Authority blocked Microsoft's proposed acquisition of Activision Blizzard over concerns it would give the former undue control over the video games market. The regulator opened a new review of a restructured deal proposal submitted by Microsoft and the transaction was approved on October 13, 2023.

Following this trend of heightened scrutiny in these regions, GPs in North America and EMEA are far more likely to view intervention from authorities as a possible threat to their upcoming deals. Overall, 46% of PE fund managers globally expect such intervention to have a negative impact on their dealmaking plans over the next 12 months, and a further 25% anticipate a significant negative impact. APAC respondents are far less concerned than their peers, with 40% saying they expect no discernible impact on their future dealmaking, compared with 23% and 29% in EMEA and North America, respectively.

The managing director of a U.S. PE firm concerned about greater regulatory oversight told us: "If there is a target in a region where regulatory scrutiny is greater, we might avoid investing in the region altogether. Investing in emerging countries would be more favorable under these conditions."

As a rule of thumb, PE firms should proactively address and mitigate antitrust risk by anticipating and preparing for inquiries from regulatory authorities regarding potential competition concerns. A comprehensive understanding of the portfolio, encompassing even non-controlling minority stakes, to identify and address competition issues early in the dealmaking process is a must. Sponsors should be mindful of the presence of any interlocking directorates, avoiding any actions that could be perceived as enabling unlawful information exchange or coordination.

Document requests have become common in EU merger reviews. Firms therefore must set clear documentation creation and retention guidelines for their portfolio companies as a matter of best practice.

In light of the skepticism that some FTC commissioners have expressed towards PE firms as short-term operators, sponsors pursuing divestiture businesses should meticulously present their track records and business plans to allay any concerns regulators may have about their ability and commitment to maintaining effective competition over the long term.

Consulting with antitrust counsel early in the deal process can help PE firms identify and assess potential antitrust risks and develop strategies to mitigate those risks. This year Dechert has significantly added to its competition practice to meet client demand for advice and representation of companies facing enforcement litigation, specifically building out its high-tech expertise in light of authorities' focus on this particular sector.

Foreign investment control

With respect to incoming foreign direct investment (FDI), the U.S. government remains as focused as ever on managing the impact of foreign investments on U.S. national security. Compared with prior years, the Committee on Foreign Investment in the United States (CFIUS) appears to be clearing fewer transactions on initial review and is requiring more investigations and more national security agreements as a condition to clearance. In addition, parties are abandoning increasing numbers of transactions after they are unable to agree to mitigation measures with CFIUS.

Of relevance to PE firms, CFIUS recently demonstrated the intense scrutiny it may apply to a transaction, including with respect to parties only tangentially involved. In an update to its frequently asked questions, CFIUS stated that it "may request follow-up information with respect to all foreign investors that are involved, directly or indirectly, in a transaction, including LPs in an investment fund." This is the case even if there are arrangements in place to limit the disclosure of the non-U.S. person LP's identity. Further, CFIUS can "request information with respect to any governance rights and other contractual rights that investors collectively or individually may have in an indirect or direct acquirer or the U.S. business… to facilitate the Committee's review regarding national security risk-related considerations." Thus, parties must know their LPs—and those LPs' beneficial owners—and carefully consider transaction arrangements.

U.S. government scrutiny of certain inbound investments will soon be joined by scrutiny of certain outbound investments. In August, President Biden issued an executive order on "Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern," establishing an outbound investment regime that is likely to go into effect next year once the Treasury department issues final regulations. Under the regime, the U.S. government will either prohibit or require notification of certain investments by U.S. persons in companies located in China, Hong Kong or Macau that are involved in activities connected with certain advanced technologies. These include semiconductors and microelectronics, quantum information technologies and AI systems. Many details of the proposed regime are yet to be solidified and remain something to look out for in the year ahead.

North America **spotlight**

Dealmaking in North America may have come down since the short-term boom that began in the latter half of 2020, but volume remains above historical levels and has largely been flat since H2 2022, suggesting that activity may have found a floor. There were 2,461 buyouts announced in Q1-Q3 2023, down 33% compared to the same period in 2022. These were valued at US$248 billion, a year-on-year fall of 38%.

This volume/value disparity is proof that sponsors are concentrating on smaller bets for which sourcing debt financing is less onerous. It also reflects the fact that, even though TMT has continued to dominate, sponsors have deployed less capital in the mega-cap tech segment in recent months. It is no coincidence that this space saw some of the steepest valuation drawdowns of any sector in 2022, meaning deal sizes have inevitably shrunk.

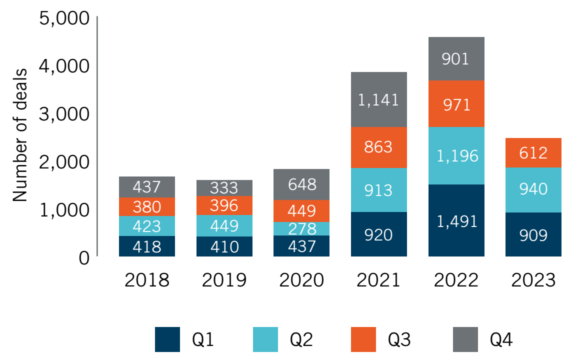
However, this is only half of the story. TMT deal volume was down by 42% in North America in Q1-Q3 2023, substantially undershooting the cross-sector year-on-year average. Total value meanwhile came to US$105 billion, compared with US$209 billion in the same period in 2022 when large-cap tech specialists such as Thoma Bravo and Vista Equity Partners were especially active—a massive 50% correction.

"Technology companies were commanding extremely high multiples during the pandemic and that narrative clearly changed through 2022 and much of 2023, as interest rate pressures began to bite," says Bolsinger. "That has dampened activity in the sector, but we could be nearing a turning point after an industry-wide valuation reset. Stocks in the sector outperformed in the first half of the year around the AI narrative, demonstrating that there is investor appetite."

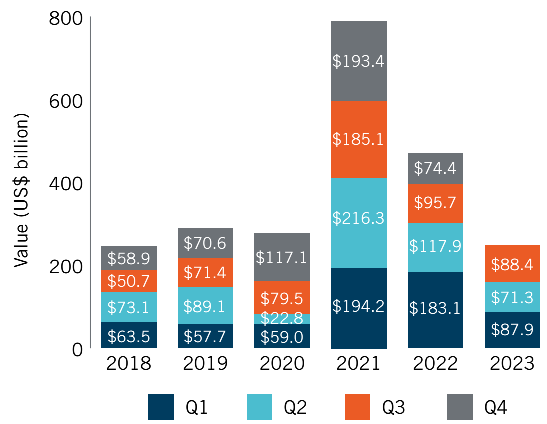
PE tech mavens, however, have still been active, with Silver Lake Group's acquisition of experience management software company Qualtrics International from SAP for US$11.9 billion and Thoma Bravo's sale of Adenza Group, a provider of mission-critical risk management and regulatory software to the financial sector, to Nasdaq for US$10.7 billion providing recent examples. The tech sector has also seen its fair share of activity in the middle market, such as the recent acquisition of Barcoding, Inc., an innovator in supply chain automation, by investment firm Graham Partners.

Pharma, medical & biotech (PMB) maintained its second-place position behind TMT in Q1-Q3 2023 with 394 deals worth an aggregate US$32 billion. Impressively, PMB transaction value came down by only 34% year-on-year, thanks to some sizable plays. Two of these were among the region's five largest transactions of the year: General Atlantic and Newlight Partners secured a US$10.6 billion sale of medical clinic network operator Oak Street Health to CVS; and on a similar scale, a consortium comprising Veritas Capital Fund Management, Elliott Investment Management and Patient Square

NUMBER OF NORTH AMERICA BUYOUT DEALS, 2018–Q3 2023



VALUE OF NORTH AMERICA BUYOUT DEALS, 2018–Q3 2023



Capital purchased Syneos Health for US$7.4 billion. Contract research organizations such as Syneos or Emmes—a portfolio company of New Mountain Capital that acquired VaxTRIALS in October 2023 and was advised by Dechert—have been popular with PE as they help pharma and biotech companies reduce their overheads and can expedite development tasks. At the same time, they capitalize on the fundamental demographic pressures that are driving demand for healthcare without being exposed to the hit-or-miss of drug candidate development.

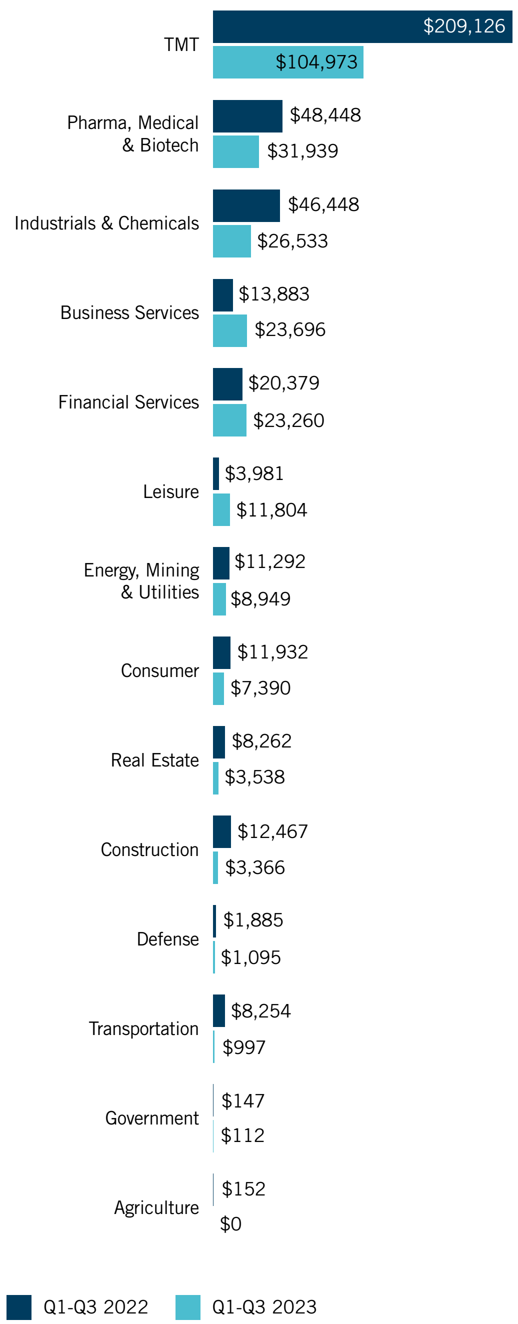
Measured by value, the industrials & chemicals (I&C) and business services sectors were neck and neck with US$26.5 billion and US$23.7 billion worth of deals. However, for I&C this represented a year-on-year decline of 43%, versus an increase of 71% for business services. The latter outpaced I&C with 293 deals to 266.

Sponsors continue to see opportunity in backing B2B companies that provide essential services and keep client costs to a minimum following the recent inflationary phase. The sector's biggest deal of the year saw Apollo Global Management and the Abu Dhabi Investment Authority (ADIA) take chemicals distributor Univar private in a US$8.2 billion transaction. Univar benefits from the diversification effect of an expansive network and its distribution of a wide range of industrial, specialty and agricultural chemicals.

The middle market has also been a haven for sponsor-to-sponsor deals. In one such transaction, KKR acquired Industrial Physics, a leading manufacturer of testing and measurement instruments used by thousands of customers across food and beverage, packaging and other diversified markets, from Union Park Capital. Industrial Physics marks the third investment for KKR's Ascendant Strategy, which invests in middle market businesses in North America as part of KKR's Americas Private Equity platform.

Digitalization is an obvious ongoing theme within services, and data centers continue to see unwavering interest from PE. One of the latest examples in North America saw Ontario Teachers' Pension Plan and Brookfield Infrastructure Partners pay US$5.7 billion in June for Compass Datacenters. Brookfield has a hearty appetite for data center assets, having acquired rival French firm Data4 for US$3.8 billion just two months prior and holds other related assets in its portfolio, including a 50/50 joint venture with Digital Realty Trust, one of the largest data center real estate investment trusts in the world.

PE BUYOUT VALUE BY SECTOR IN NORTH AMERICA (US$ MILLION), Q1-Q3 2022 VS Q1-Q3 2023



Private credit

The U.S. regional banking crisis in early 2023 that saw the collapse of Silicon Valley Bank and Silvergate Bank, and the Federal Deposit Insurance Corporation's (FDIC) seizure of Signature Bank and First Republic Bank, rattled markets. Tellingly, 31% of North American respondents specifically say they will move to large financial institutions that are systemically important. This falls to 20% and 12% of APAC and EMEA respondents, respectively, who say the same.

As recently as August, Moody's downgraded the ratings of U.S. lenders including Commerce Bancshares, BOK Financial, M&T Bank and Old National Bancorp. A crop of bigger banks were also placed under review for a potential downgrade, including Bank of New York Mellon and U.S. Bancorp, citing risks to profitability amid weaker economic conditions that continue to weigh heavily on the commercial real estate sector.

This disruption is making alternative lenders look comparatively attractive to PE, fueling a trend that was already well under way. Over a third of respondents (35%) say they intend to move more towards private credit providers in light of recent banking stresses and the flexibility that alternative credit structures provide, a trend visible across all parts of the world.

"Sourcing loans from private debt funds is very relationship-driven and, particularly in the current environment, that gives you downside protection," says Field. "If a portfolio company gets into difficulties, the GP is only dealing with one lender or a limited number of direct lenders that often have

"If a portfolio company gets into difficulties, the GP is only dealing with one lender or a limited number of direct lenders that often have financed multiple companies and have extended relationships across that PE manager's portfolio."
Chris Field, Dechert LLP

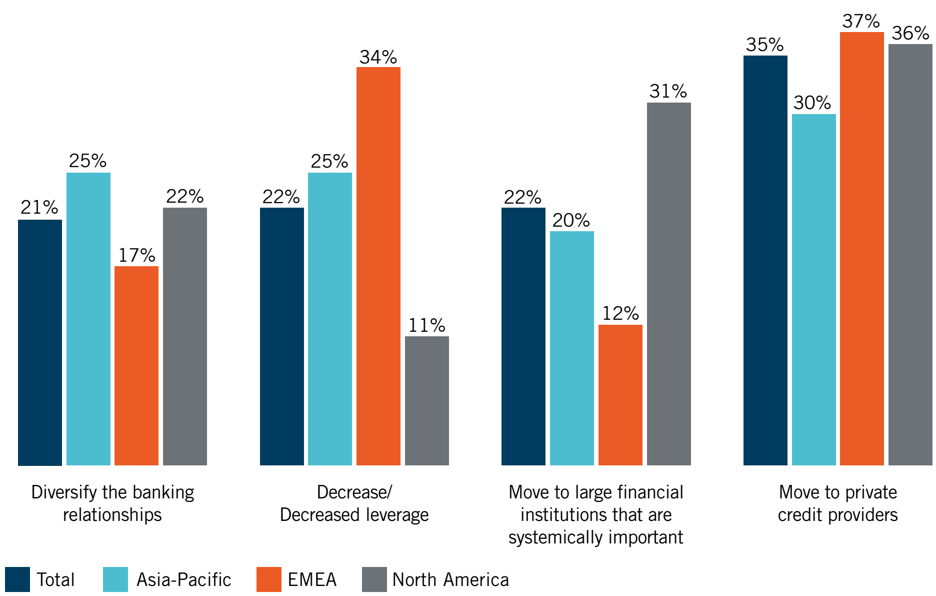
financed multiple companies and have extended relationships across that PE manager's portfolio. That makes it a very different discussion than dealing with disparate lenders that have no particular interest in your continued survival."

It is no surprise that portfolio-level acquisition financing is the most popular use of private debt facilities, according to 78% of respondents overall. However, alternative lenders today offer a whole suite of products tailored to PE's needs, some of which are especially relevant in today's environment. For instance, as much as 62% of North American respondents and 54% of those in EMEA say they rely on these funds at the GP level for capital commitment facilities.

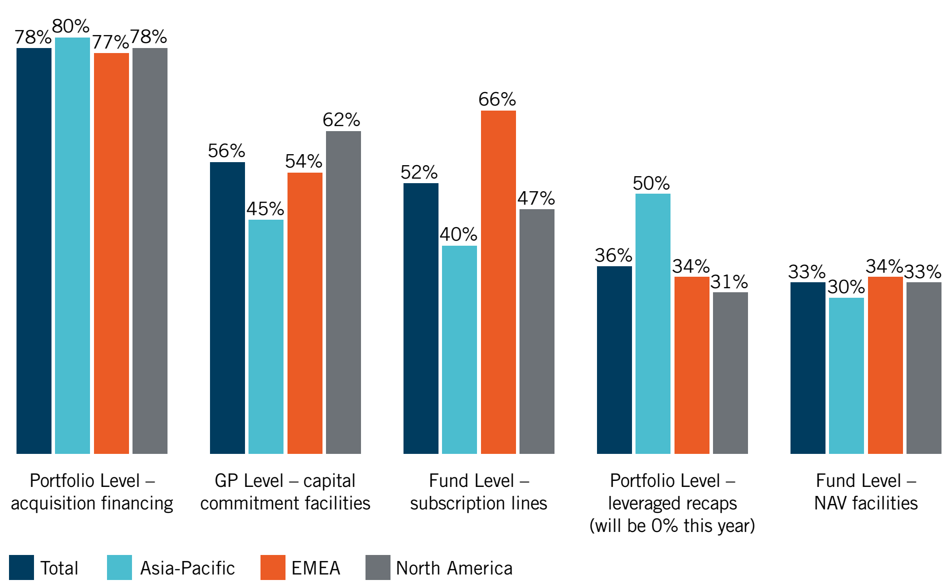
As the PE industry's total AUM have continued to climb, so has the median fund size. Two years ago median fund size surpassed US$1 billion in the U.S. for the first time, according to *Pitchbook*. Add to that LP demand for more "skin in the game" to better align interests and it is clear that private credit fulfills an important role by enabling GPs to finance their personal commitments, which has now also become all the more difficult to achieve from exit proceeds.

Fund-level financing is also becoming an increasingly

IF YOU USE LEVERAGE AT THE FUND LEVEL, HOW WILL YOUR FIRM RESPOND/HAS YOUR FIRM RESPONDED TO THE U.S. REGIONAL BANK CRISIS? (SELECT ONE)



WHERE IS YOUR FUND USING PRIVATE CREDIT? (SELECT ALL THAT APPLY)

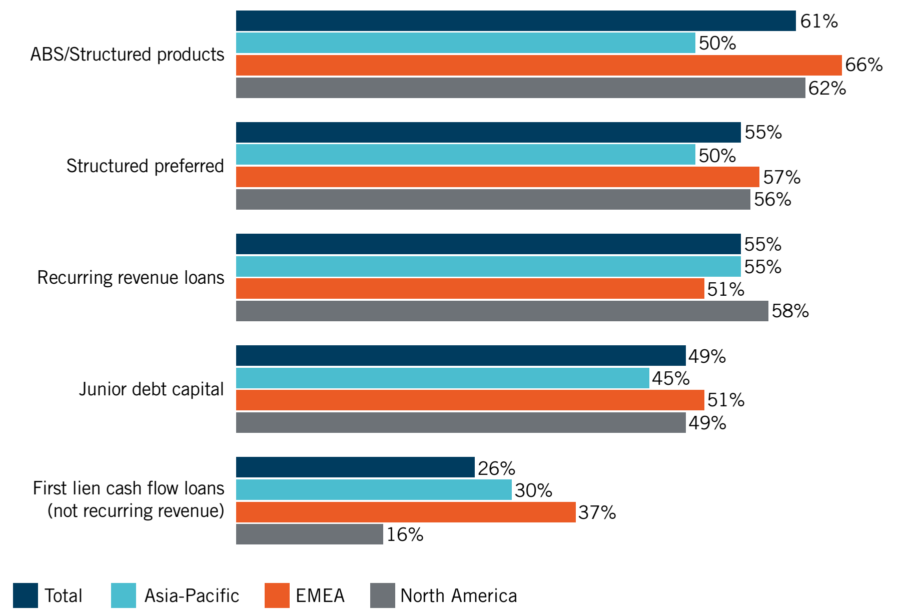


popular use of private credit, encompassing net-asset-value (NAV) facilities secured by the NAV of the fund's underlying investments, and subscription lines of financing secured against the undrawn commitments of the fund's LPs. Both are effective tools for improving capital efficiency, being used to rapidly back new acquisitions without the need for irregular drawdowns from investors, while NAV facilities are multi-purpose and often fund early distributions and working capital requirements for managing the fund. Of the two, it is subscriptions lines that are most popular, with 66% of EMEA respondents saying they turn to alternative lenders for these purposes.

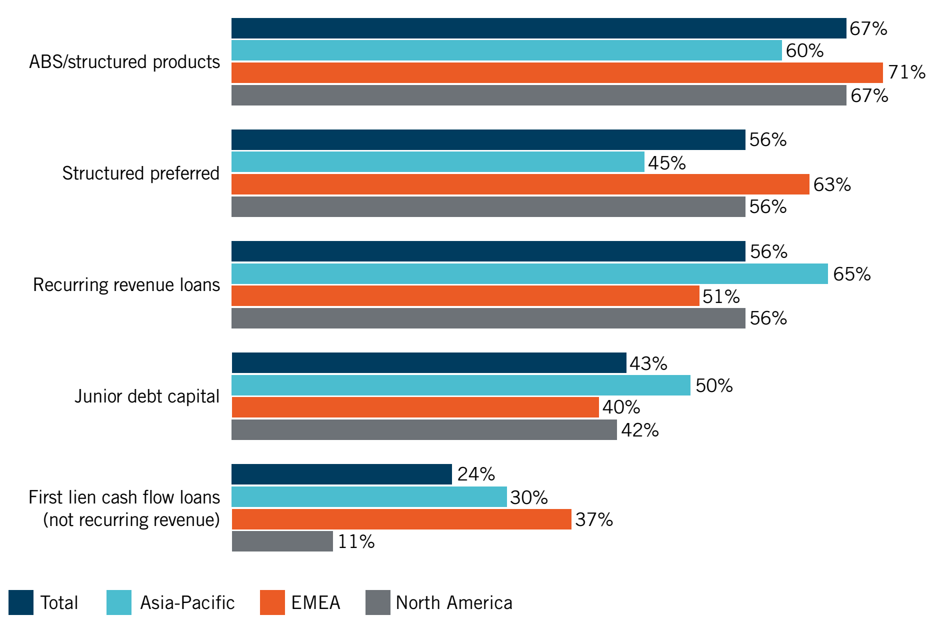
Half of APAC respondents use private credit at the portfolio level not to back new deals but to fund leveraged recaps. "Exit volumes have typically been lower and taken longer to realize in Asia compared with more established markets such as the U.S. and Europe," says Boon. "Recaps in APAC are providing sponsors with a way to return cash to their LPs while their investments come to fruition."

In terms of the structures most widely used by sponsors when seeking private loans, most respondents overall use ABS/structured products (61%), as well as structured preferred capital (55%) and recurring

WHICH OF THE FOLLOWING TYPES OF PRODUCT DOES YOUR FIRM USE IN PRIVATE CREDIT? (SELECT ALL THAT APPLY)



AND OF THOSE TYPES OF PRODUCT, WHICH DO YOU EXPECT YOUR FIRM TO USE WITH INCREASING FREQUENCY OVER THE NEXT 12 MONTHS? (SELECT ALL THAT APPLY)



revenue loans (also 55%). All of these products are expected to be increasingly employed over the next 12 months.

Recurring revenue loans have been critical for growth-stage companies with low or negative EBITDA to access financing over the past two decades, particularly in the U.S. ARR loans are especially well suited to pre-profit software-as-a-service businesses; however, higher inflation and earnings margin pressure could see wider adoption of these products.

From equity to credit

PE firms themselves are increasingly turning their hand to private credit. For instance, Dechert represents clients such as KKR, Bain Capital and The Carlyle Group, all of which have entered the fray, and Centerbridge Partners, which recently launched Overland Advantage, a BDC benefitting from a strategic sourcing relationship with Wells Fargo that focuses on direct lending to non-sponsor North American middle-market companies.

Although credit underwriting requires its own skill set, private equity and private credit are highly complementary. Both rely on the precise valuation and incisive due diligence of private companies, separating the wheat from the chaff and pricing their equity or debt accordingly.

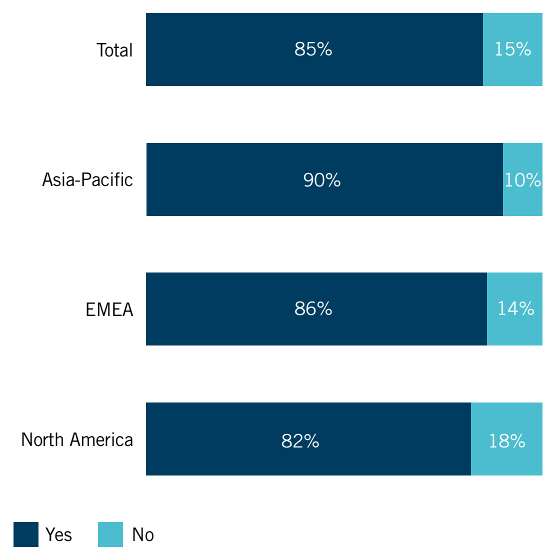
Moreover, private credit has become highly sought after among investors as it is currently delivering superior risk-adjusted returns. Each successive year since 2020 has seen record sums raised, according to *Preqin*, with 2022's total amounting to US$225.7 billion globally. This has made it the largest private capital strategy after PE.

Although fundraising has cooled off in 2023 owing to uncertainty over the future of central bank policy and the potential for a forthcoming pivot, total AUM in the private credit industry is forecast to reach US$2.3 trillion in 2027, according to *Preqin* forecasts.

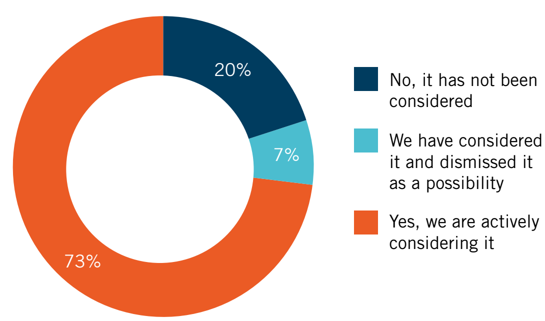
The vast majority of respondents across all regions (85%) say their firm already has a private credit investment strategy in place. "Our credit fund took shape about four years ago and has been working well for us," says the managing director of a PE firm in the U.S. "We're lending into high-growth sectors that have proven to be resilient during this more challenging economic period and aim to raise further funds."

As yet further evidence of this strategy's popularity, of the remaining 15% of respondents that are not currently active in private debt, 73% say they are considering expanding into this ascendant asset class.

DOES YOUR FIRM CURRENTLY HAVE A PRIVATE CREDIT INVESTMENT STRATEGY IN PLACE? (SELECT ONE)



IF "NO," ARE YOU CONSIDERING ADOPTING A PRIVATE CREDIT INVESTMENT STRATEGY? (SELECT ONE)



EMEA **spotlight**

Mega deals were off the menu in EMEA in Q1-Q3 2023, following the lowest year for leveraged loan volume in a decade. This meant that total PE deal value fell by 60% year-on-year, to US$112 billion from US$277.3 billion a year prior. This is a steeper decline than any other region. Conversely, volume held up better than anywhere else in the world. The 2,282 transactions recorded in EMEA during the period represents a 19% shortfall from Q1-Q3 2022.

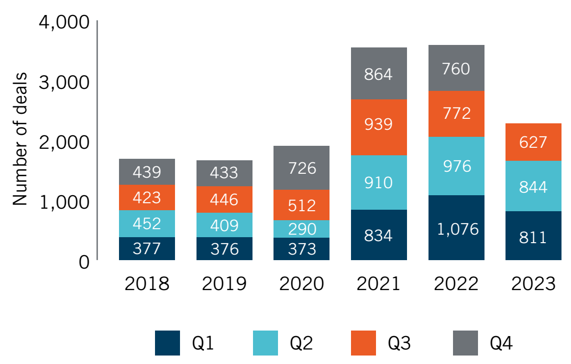
Tellingly, only one PE mega deal was announced in EMEA in Q1-Q3 2023. FTSE 250 constituent Dechra Pharmaceuticals, a veterinary pharma group, was taken private by EQT Partners and ADIA for US$6.1 billion.

"The deal is symptomatic of the keen interest that sponsors are currently taking in UK public markets, with the London Stock Exchange presenting opportunities for attractively priced assets compared with private markets," says Comis. Indeed, the third largest buyout across EMEA in Q1-Q3 2023 was a US$2.9 billion takeover by a Brookfield-led consortium of Network International Holdings (NIH) at a 64% premium to the company's pre-offer price. Also a FTSE 250 constituent, NIH provides digital payment solutions in the Middle East and Africa. Brookfield already owns a 60% stake in Magnati, the payments business of First Abu Dhabi Bank, so has the potential to scale the company through a merger.

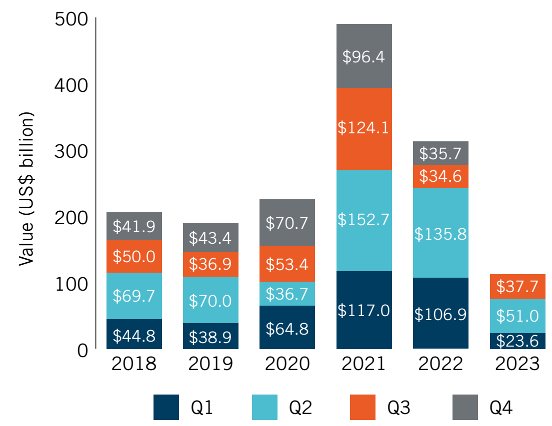
TMT leads in spite of value slump

If there is one key thread that runs through all of this activity, it is that Europe's stock markets represent value to PE. The region's public equity indices have performed well this year, and yet the perennial valuation discount to U.S. markets persists. Even with European markets trending up, inflows have been muted and digging into the indices for select opportunities is providing ample deal flow for sponsors. These take-privates have been relatively small due to ongoing friction in the debt financing markets, but they have certainly not been in short supply.

NUMBER OF EMEA BUYOUT DEALS, 2018–Q3 2023



VALUE OF EMEA BUYOUT DEALS, 2018–Q3 2023



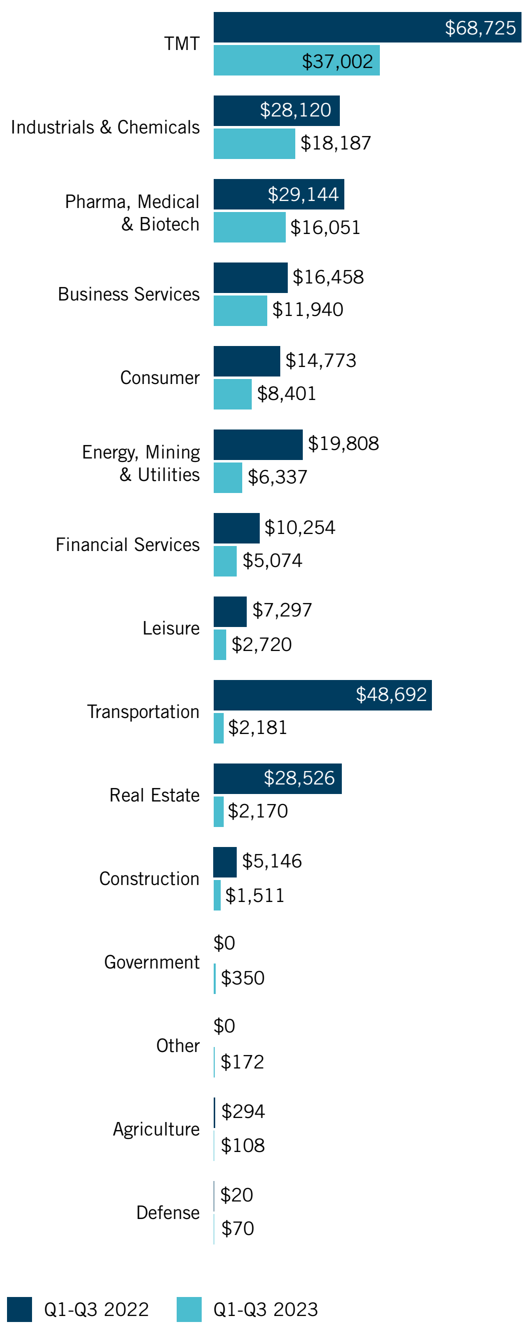
> "The London Stock Exchange [is] presenting opportunities for attractively priced assets compared with private markets."
> Sabina Comis, Dechert LLP

"It is clear that sponsors are making the most of valuation resets in Europe's stock markets," says Field. "Even with the rebound in public equities seen in the region since Q4 2022, PE funds are seizing upon attractively priced companies. The difference now is that corporate boards have had a period of time to psychologically adjust to these new valuations and now appear to be more open to incoming offers priced with premiums."

"It is clear that sponsors are making the most of valuation resets in Europe's stock markets."

Chris Field, Dechert LLP

PE BUYOUT VALUE BY SECTOR IN EMEA (US$ MILLION), Q1-Q3 2022 VS Q1-Q3 2023



Deal trends

Take-privates

In a major reversal from 2022, GPs are now purposefully scouring the public markets for deals. Almost all (94%) tell us they are likely to consider a take-private. A year ago just 13% of GPs had firm intentions of pursuing take-privates.

Q4 2022 marked a change of fortunes for many stock markets following a punishing rout. The S&P 500 Index returned more than 16% in the first six months of 2023. However, this rebound was almost entirely led by the so-called ‘Magnificent Seven’ of Big Tech stocks, whose valuations fell deeply in 2022. Between them, Nvidia, Microsoft, Apple, Amazon, Tesla, Alphabet and Meta accounted for more than 60% of the rise in the S&P 500 Index. There is still ample opportunity for sponsors, who now have more confidence that markets may have found their bottom.

“It took a while for shareholders of public companies to adjust to the reduced valuations and get comfortable that this was the new normal for them,” says Field. “We’ve now seen a continued upturn but, even though the market as a whole is up, that’s not true on a company-by-company basis. PE firms are seeing a lot of opportunity there and there’s now a greater willingness to engage. The long-heralded wave of take-privates has now finally arrived.”

Distressed deals

Second to take-privates are distressed deals, with 90% of respondents saying they are either very likely (64%) or somewhat likely (26%) to consider these now, up from 79% combined in our 2022 edition of this study. This is indicative of just how challenging sustained high rates are proving to be for some companies, particularly those suffering from margin erosion due to inflation and with highly levered balance sheets, with floating rate loans.

Highly levered capital structures and tighter refinancing conditions provide firms that have expertise in financial restructuring with additional opportunities. Acquiring discounted debt and negotiating with debtors for an equity exchange can deliver outsized returns. This requires pin-point due diligence and robust liability protections, and, in the case of an in-court workout, the need for bankruptcy court approvals. Firms must think carefully about employee benefits, pension, environmental and other control group type risks in these special situations, specifically if these represent a major financial liability that has the potential to impact returns.

Deferred consideration

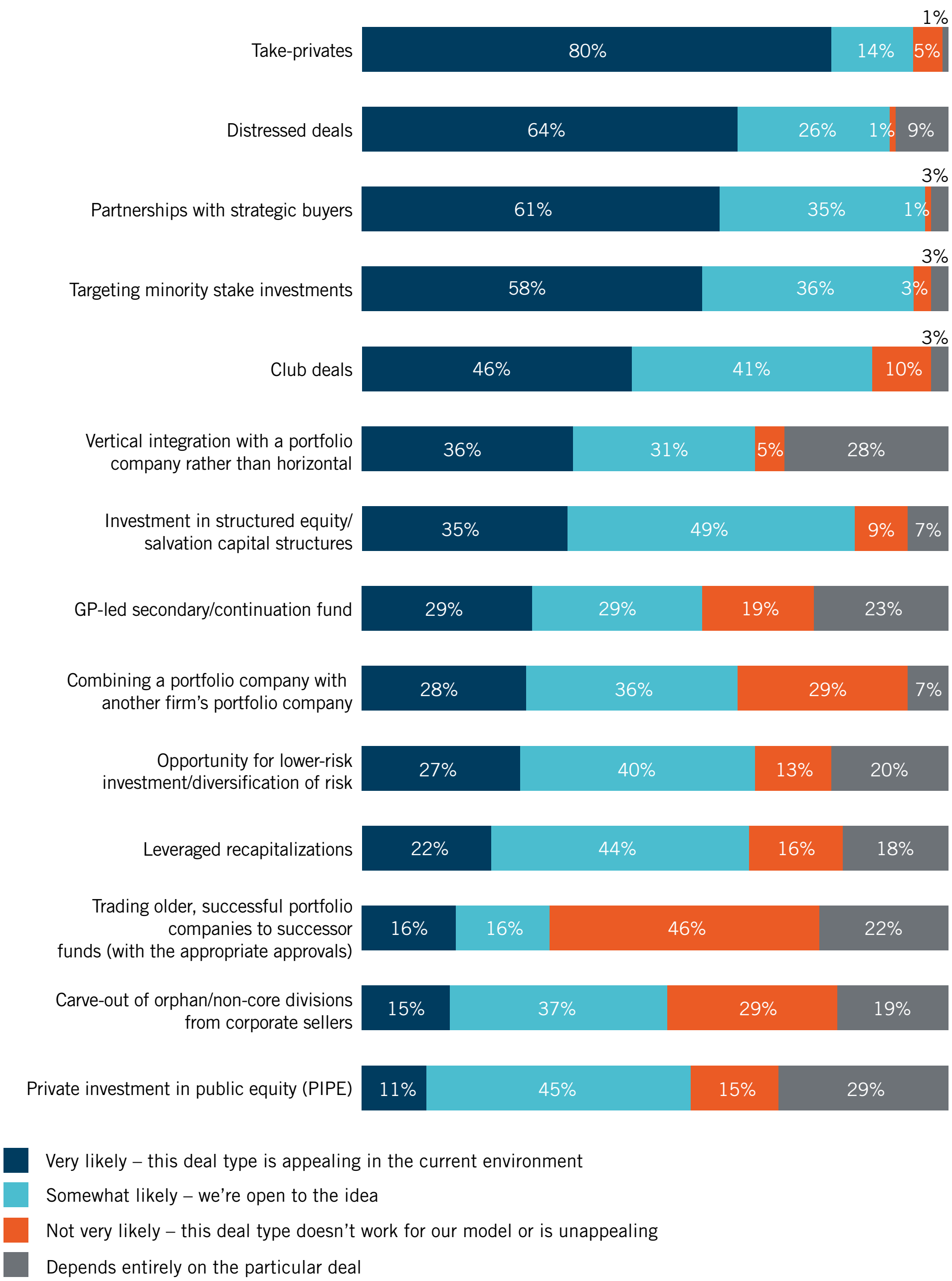
Valuation gaps were a major setback to deal volume in 2022. Although the distance between buyers and sellers began to close in early 2023, buyers are still commonly employing ways to protect their downside risk. For instance, the vast majority of respondents (92%) say that utilizing earn-outs is a strategy their firms are following to navigate current market conditions.

"It's not just earn-outs that are popular but also seller loan notes and other forms of deferred consideration. These are all things that are less attractive from a seller perspective but allow them to protect the headline price they are looking to achieve," says Field. "These creative mechanisms have really helped to bridge the gap."

Add-ons

While earn-outs are popular, only 13% of respondents say this is the most critical strategy they are currently employing in today's market. Instead, 20% tell us that pursuing add-ons is the foremost approach they are taking to navigate current macroeconomic conditions,

HOW LIKELY IS YOUR FIRM TO CONSIDER THE FOLLOWING DEAL TYPES AT PRESENT? (SELECT ONE FOR EACH TYPE)



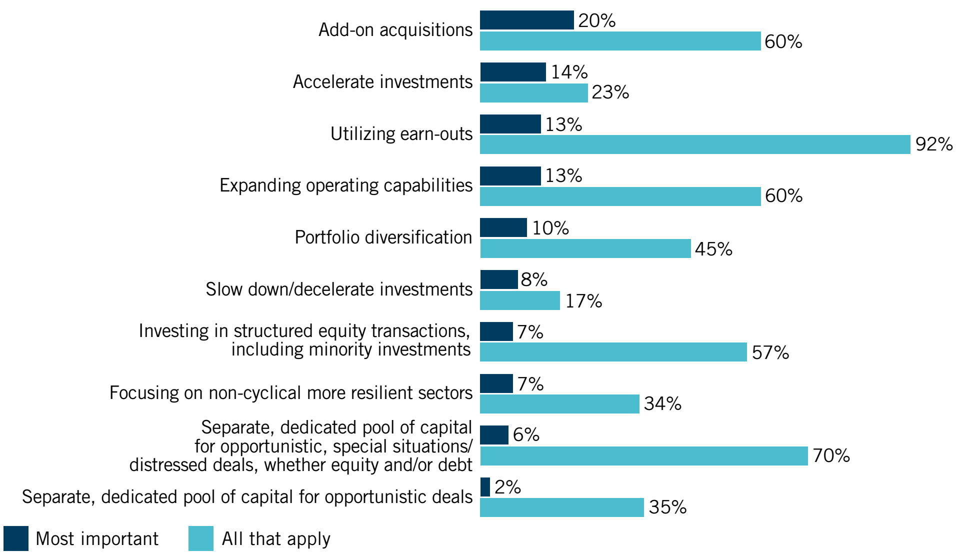
and 60% say build-ups are one of a number of strategies they are following. North American respondents (24%) are more likely than their peers elsewhere in the world to cite add-on acquisitions as their preferred strategy. GPs are looking to scale up their existing portfolio companies through add-ons that can boost their overall EBITDA multiples while requiring less leverage to execute than larger investments into new platforms.

Buyer-friendly structures are also showing up in these smaller build-up plays. "There is more interest in add-ons this year and there are smaller cash components and larger share-for-share components embedded into these transactions," says Boon. "Many companies are not at peak performance in this market but are still looking at ways to prepare themselves for an exit. People are hoping that when the market recovers, they can try to exit in a bigger way. These share components are not something sellers would typically be willing to accept in a stronger market, and even now only apply to certain deals."

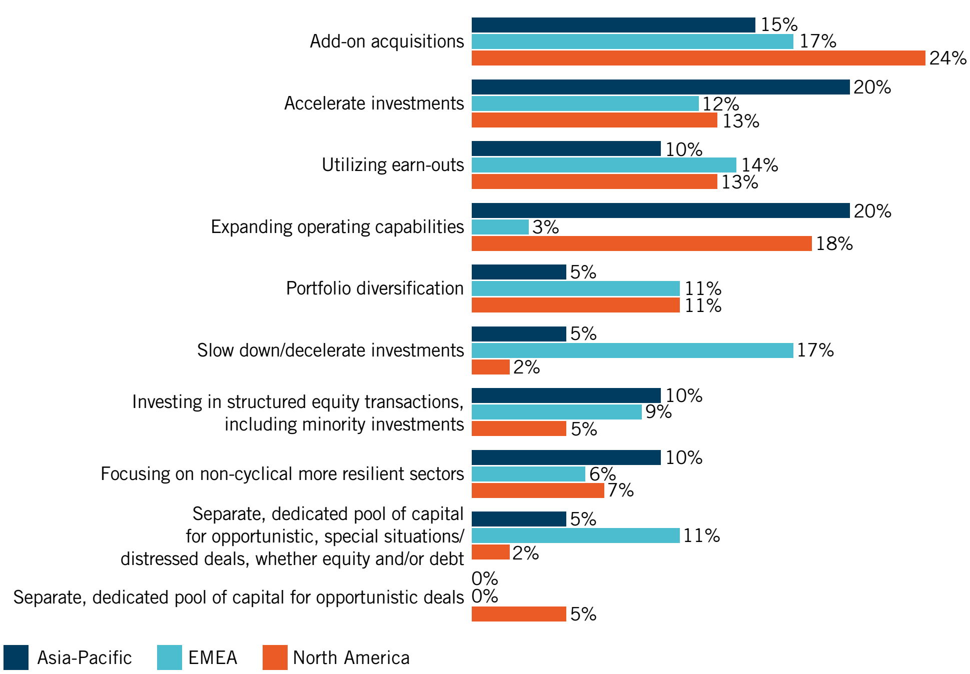
Diversification

It is debatable whether the very largest names in the industry are even PE firms at all, at least in the strictest sense. They have long since metamorphosed into multi-strategy asset management

IN THE CURRENT ENVIRONMENT, WHAT STRATEGIES DOES YOUR FIRM EMPLOY TO NAVIGATE THE ECONOMIC DOWNTURN? (SELECT ALL THAT APPLY AND IDENTIFY THE MOST IMPORTANT)



IN THE CURRENT ENVIRONMENT, WHAT STRATEGIES DOES YOUR FIRM EMPLOY TO NAVIGATE THE ECONOMIC DOWNTURN? (SELECT THE MOST IMPORTANT)

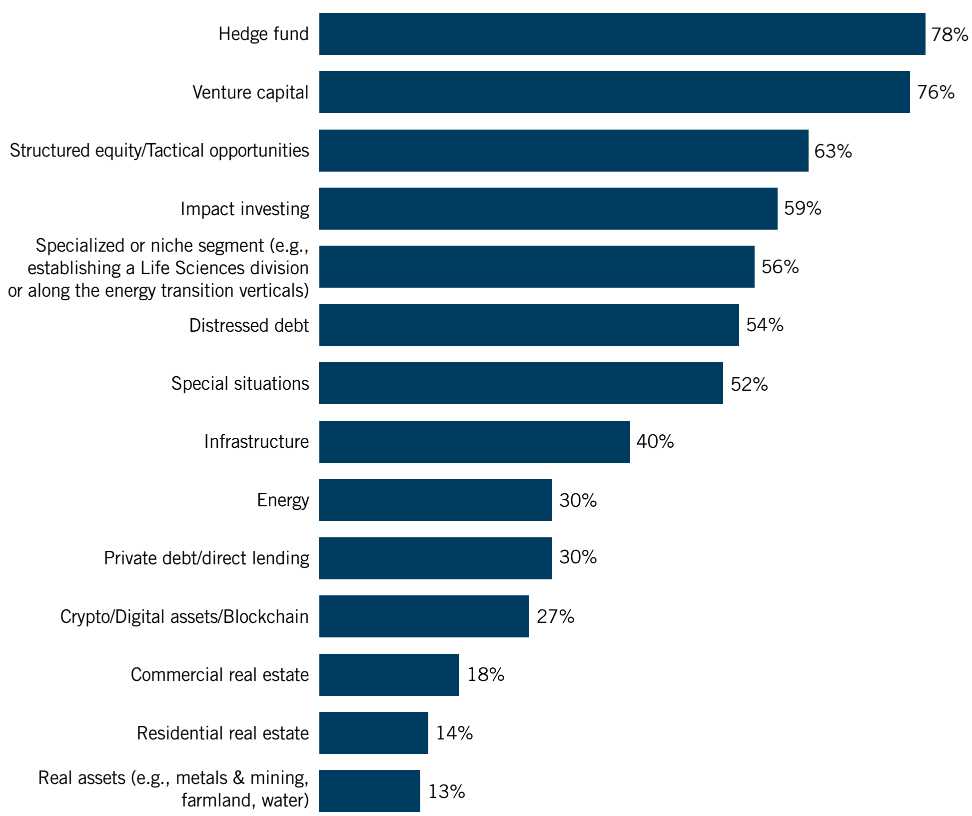


firms with a core PE platform and tentacles that span the private capital spectrum. And now many GPs are even looking beyond private assets in their pursuit of growing their AUM. More than three-quarters (78%) of GPs say they are expecting to add hedge fund capabilities to their repertoire.

"There's a broad convergence underway. On one side, you see hedge funds are looking to add PE, while the large, multi-strategy asset managers that already have PE, private credit, infrastructure and real estate are now looking to gain public market exposure by adding the hedge fund capabilities," says Bolsinger. To support this next phase of the industry's expansion, Dechert recently added two partners in the U.S. to its hedge fund practice to advise clients on the formation of hedge funds and the related regulatory issues they face in doing so.

Second to hedge funds is venture capital, with 76% of those surveyed anticipating broadening their strategic scope to encompass early-stage investing. Venture capital funds have had an especially challenging time lately, with net asset values of tech portfolios plummeting through 2022 and startups raising down rounds to extend their cash runways. This could prove to be the most opportune time in the past decade for GPs with the appropriate resources and expertise to move into the space.

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



When asked for last year's edition of this research how they were intending to expand their business, 82% of respondents identified private debt/direct lending as the next immediate frontier. This year, however, only 30% of respondents report that this is their next move. This is consistent with the finding discussed earlier in this report that no less than 85% of GPs now have some form of private credit fund strategy in place, the asset class having established itself as a mainstream complementary offering to PE.

Buy-and-build

Add-ons have been gradually growing their share of buyout activity over the past decade. In the U.S., 76% of all PE deals struck between Q1-Q3 2023 involved an existing portfolio company acquiring another business, up from 59% in 2013, according to *Pitchbook* data. And although the US$759.6 billion in global add-on value recorded in 2022 was slightly behind 2021's all-time high, it was nonetheless the second highest measure on record.

There is good reason for build-ups to be more compelling in the current macroeconomic environment. Although many markets now look like they may be avoiding previously anticipated recessions, sluggish economic dynamics have made organic growth harder to achieve. Bolstering revenues and EBITDA with selective add-ons is an effective way to increase portfolio value, especially if there is multiple arbitrage to be captured by assembling smaller businesses into larger entities.

"These smaller-sized deals de-risk portfolio companies by adding scale and require lower quantums of debt financing to execute," says Bolsinger. Because sponsors have a clear path to realizing significant cost synergies in these situations, they can take comfort in putting more equity into add-ons. This is a highly pragmatic way of mitigating the reliance on costly leverage in capital structures.

"We have been following an add-on acquisition strategy in these circumstances. We do not want to take any chances investing in larger deals," says the partner of a U.S. PE firm. "Add-on deals can really fill in the talent or technology gaps within larger portfolio companies."

The buy-and-build strategies that respondents most frequently employ include building a dominant player in an emerging sector (30% of first-choice selections), building up a platform company around a core technology or core business model (27%), and acquiring synergistic/complementary products (24%).

Meanwhile, the greatest challenges that firms face when executing add-ons include formulating a strategy to achieve synergies and growth for the enlarged company (21% of first-choice votes, plus 21% and 12% of secondary and tertiary votes, respectively), and upgrading the existing management team to deal with a larger and more complex footprint (also 21% of first-choice votes, but only 13% and 14% of secondary and tertiary votes, respectively). Perhaps unsurprisingly, given today's stringent financing conditions, almost as many respondents

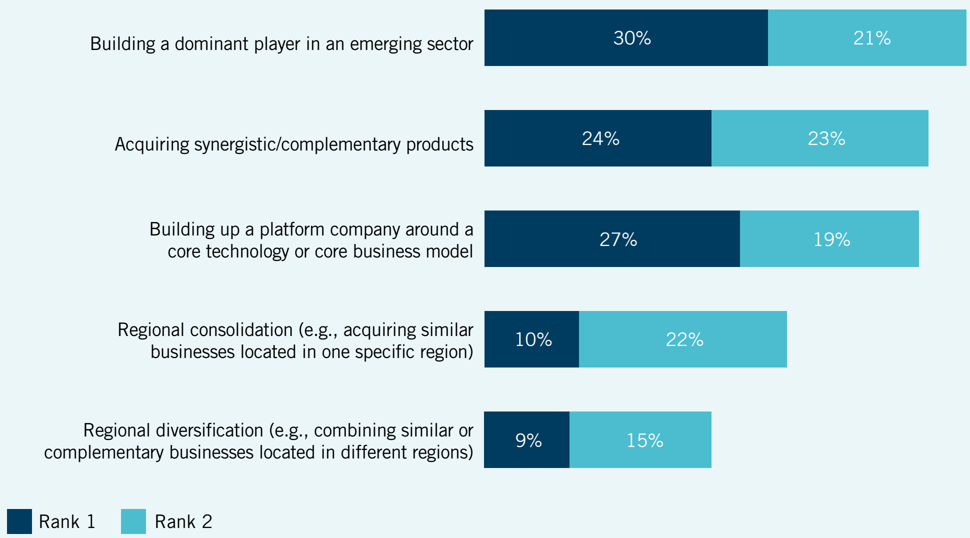
> "PE firms can often use the accordion features pre-baked into the existing credit agreements arranged for their platform companies. But in a lot of cases some of the conditions can no longer be met."
>
> Markus Bolsinger, Dechert LLP

(18% of first-choice votes) say raising enough capital including debt at the platform company to make add-on purchases is the primary hurdle they face in completing these roll-ups.

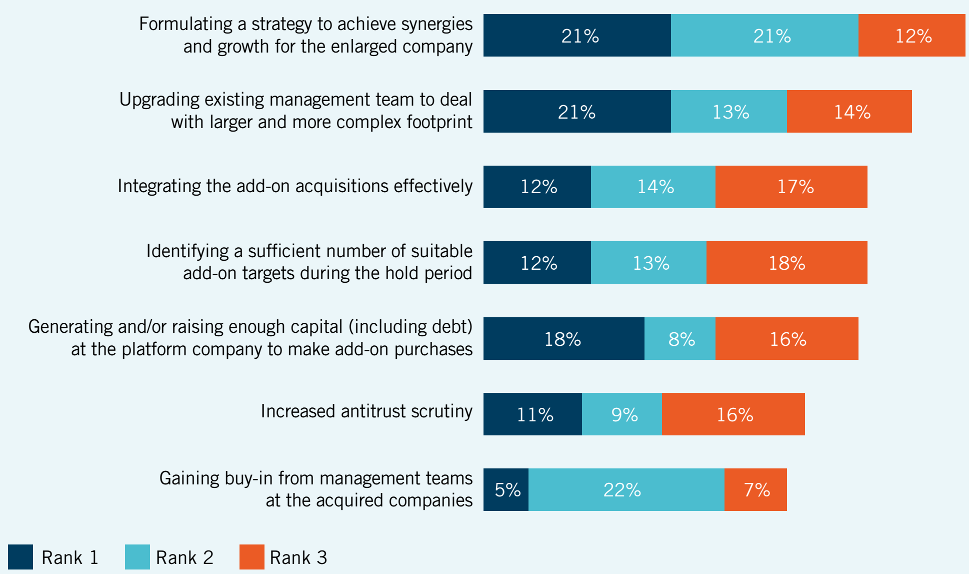
"PE firms can often use the accordion features pre-baked into the existing credit agreements arranged for their platform companies. But in a lot of cases some of the conditions can no longer be met," says Bolsinger. "Previously you could make an add-on acquisition and keep the same debt multiple, expanding your credit at the same level. Now a lot of companies are having to de-lever before they can draw on those existing credit facilities."

Gaining buy-in from the target company's management team is also a major challenge, highlighted by 22% of respondents as a secondary hurdle. More than that, it is crucial that sponsors work closely with the management teams of both the acquiring and investee companies to ensure close alignment on strategic and operational goals. This collaborative approach is a critical ingredient for success in any bolt-on.

WHICH BUY-AND-BUILD STRATEGIES DO YOU CURRENTLY USE MOST OFTEN? (SELECT TOP TWO AND RANK 1-2, WHERE 1 IS MOST COMMON)



WHAT ARE THE BIGGEST CHALLENGES YOUR FIRM FACES WHEN MAKING ADD-ON ACQUISITIONS FOR A PLATFORM COMPANY? (SELECT TOP THREE AND RANK 1-2-3, WHERE 1 IS MOST IMPORTANT)



APAC **spotlight**

Asia's PE market has witnessed a decline in both value and volume, in line with a more challenged global deal environment. There were 1,482 transactions announced between Q1-Q3 2023, down 30% year-on-year, in line with the global decline in volume. These PE deals were worth a combined US$84 billion, 35% lower than the same period in 2022. A quarter-on-quarter assessment likewise offers no cause for celebration—Q3 saw 358 deals announced, down 32% from 530 in Q2, and aggregate value declined by 42% from US$31.1 billion in Q2 to US$17.9 billion in Q3.

Many hoped the reopening of China towards end-2022 would spur economic growth and lift PE deal activity. That has not been the case. Through the first three quarters of 2023, PE deals targeting Chinese assets constituted 5.15% of global volume, down from 5.7% last year and 10.6% in 2021. Over the past year, Japan has overtaken China, with its share of global PE deals maintaining above historic levels, claiming almost 9% of all transactions through Q3 2023.

Ongoing geopolitical tensions with the U.S. have seen China fall further out of favor. On August 9, 2023, President Joe Biden signed a long-awaited executive order that many have described as the "reverse CFIUS," in reference to the Committee on Foreign Investment in the United States' restrictions on inbound Chinese investments in strategically sensitive areas of the U.S. economy. The order is intended to address national security concerns related to outbound investment in certain technologies and industries. Regulations defining its scope and the process for reviewing affected deals are expected to be issued in the coming months.

Simultaneously, India has been enjoying growth unmatched by any economy of its size and Southeast Asia is rapidly ascending, supported by government initiatives to boost inbound investment. Various markets are drawing sponsors' attention away from China as investors look to minimize risk and capture the region's immense growth potential.

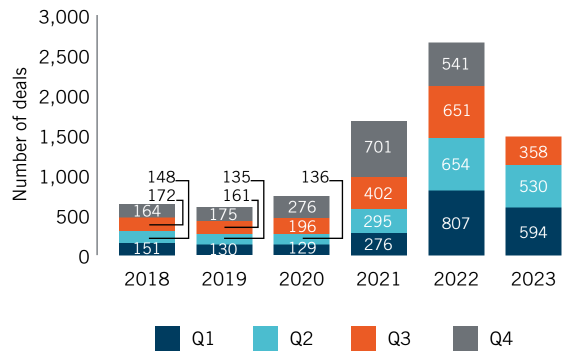
India's moment

India is currently far outpacing China and Japan in terms of economic growth and is expected to maintain this lead for the foreseeable future. The country's GDP is on course to expand by 6.7% for each of the next three years, according to S&P, which would make it the fastest-growing major economy in the world.

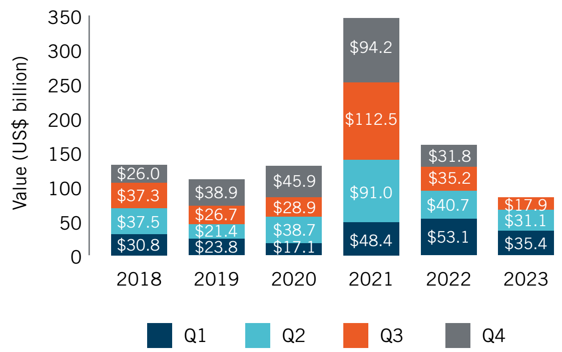
While India is still a far smaller PE market than either China or Japan, international investors are showing a keen interest as they pivot away from China, encouraged by global companies reconfiguring their supply chains, the buoyancy of India's stock markets, and its economic and demographic tailwinds—this year India overtook China to become the world's most populous nation.

"The world is now paying much closer attention to India, but the country has been on an upward trend for some time already," says Boon. "Global GPs have already been

NUMBER OF APAC BUYOUT DEALS, 2018–Q3 2023



VALUE OF APAC BUYOUT DEALS, 2018–Q3 2023



increasing their India allocation from 10% to around 20%-40% over the past few years. PE has been ahead of the curve."

In India's biggest buyout of 2023 through Q3, BPEA EQT and ChrysCapital Investment Advisors paid US$1.1 billion for HDFC Credila, a lender that finances Indian students' access to higher education. The carve-out is billed as the largest ever PE buyout in India's financial services sector and follows mortgage firm HDFC's US$40 billion merger with HDFC bank in 2022, in what was India's largest M&A transaction on record. The nation's low penetration of credit coupled with its fast-rising middle class and the digital imperative to accelerate market access make financial services an especially compelling sector for investors.

Southeast Asia

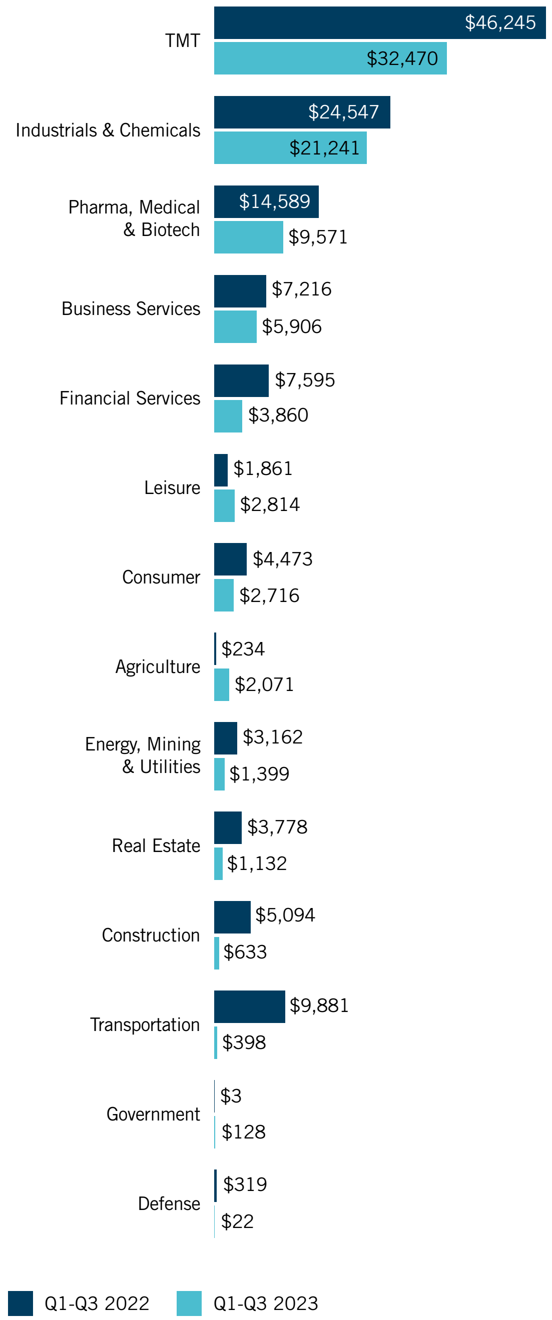
Like India, Southeast Asia is benefitting greatly from 'China Plus One' tailwinds, with numerous funds and companies relocating their headquarters to Singapore as a result. The number of family offices being formed in the country is at unprecedented levels, fueled too by China-Taiwan pressures.

In a milestone announcement, Capital Square Partners and Basil Technology Partners in January merged through a new US$700 million continuation fund, creating what is believed to be the largest technology services dedicated fund in Southeast Asia. The secondary deal, understood to likely be the first of its kind in the region, includes US$250 million of fresh capital that can be used for follow-on investments in the existing portfolio or to acquire new companies.

Sponsors who are already active in the market will be closely watching special purpose acquisition companies (SPACs). In January 2022, the Singapore Exchange welcomed a number of SPACs for the first time. The clock is ticking on these vehicles' investment deadlines—whether they manage to secure deals before their expiry will be a true test of whether Singapore SPACs are a viable exit option for PE sponsors.

"Countries such as Indonesia, Southeast Asia's largest economy, as well as the Philippines, Thailand and Vietnam continue to make growing contributions to APAC's PE deal market," says Boon. "Young populations, rising incomes, and rapid urbanization and digitization are all powerful catalysts supporting growth. They are also all benefitting from China's rising labor costs and companies' desire to circumvent trade protectionism and mitigate supply chain risks. The long-term outlook for these markets could not be brighter."

PE BUYOUT VALUE BY SECTOR IN APAC (US$ MILLION), Q1-Q3 2022 VS Q1-Q3 2023



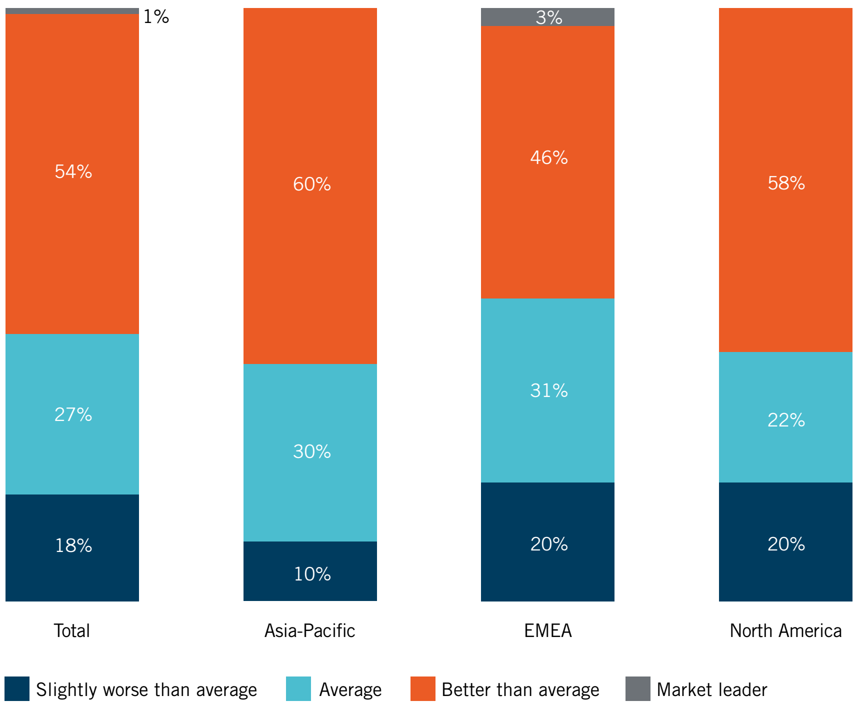
Artificial intelligence

The transformative power of technology is reshaping PE in numerous ways. Firms are at various stages of adoption but all recognize that keeping pace with market developments will be critical in order to compete with their peers. GPs cannot afford to rest on their laurels.

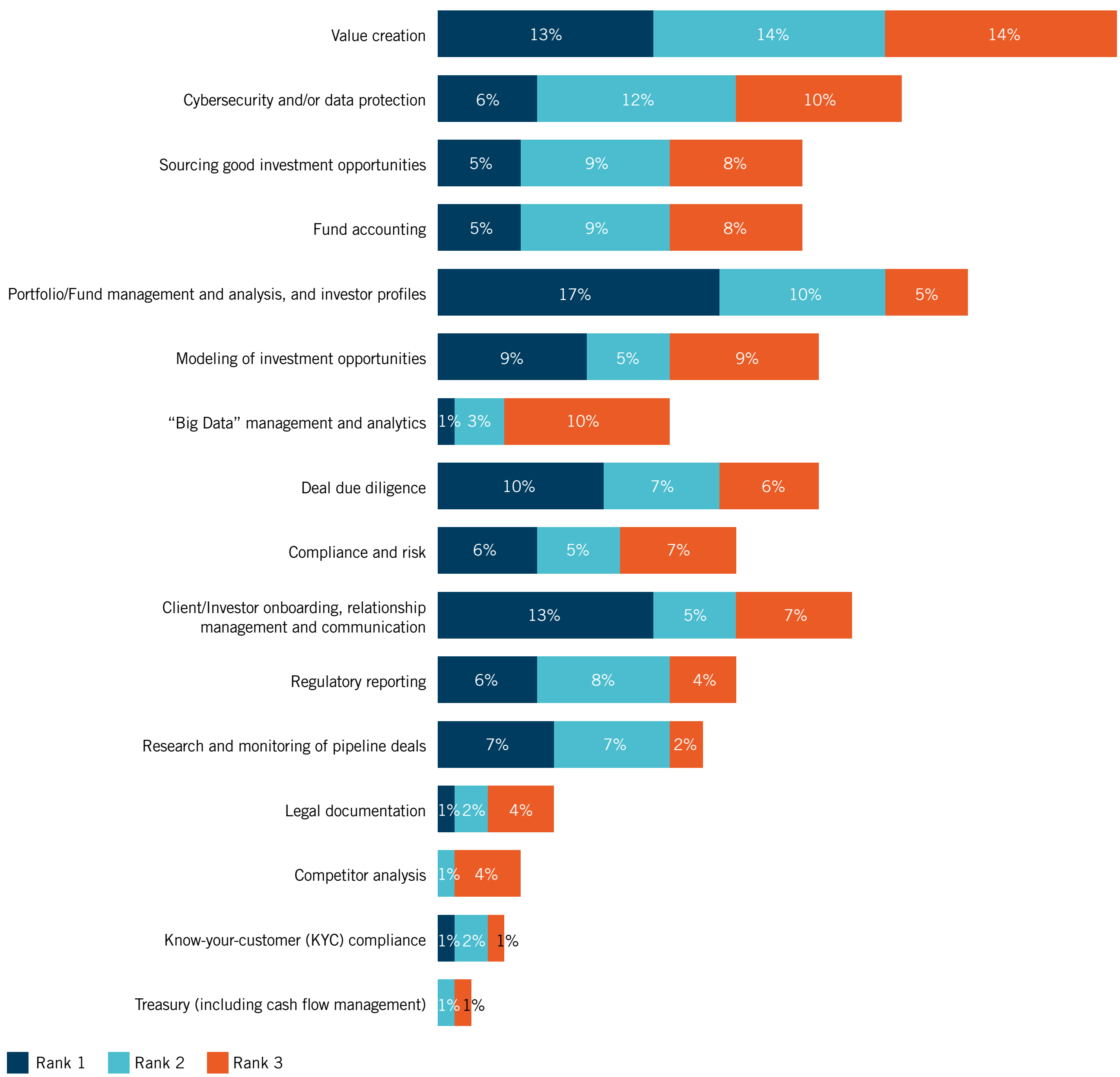
Asked to compare their technology capabilities to those of their competitors, 54% of respondents overall believe their offering is better than average. Just under a fifth (18%) concede that their tech capabilities are slightly worse than average, with APAC respondents least likely to say this (just 10%). AI is rapidly layering into all areas of tech, introducing deeper levels of analysis and automation.

There are increasing opportunities for GPs to leverage these capabilities for

HOW DO YOU THINK YOUR FIRM COMPARES TO YOUR COMPETITORS WITH REGARD TO TECHNOLOGY CAPABILITIES? (SELECT ONE)



IN WHICH OF THE FOLLOWING BUSINESS FUNCTIONS DO YOU THINK THE DEPLOYMENT OF ARTIFICIAL INTELLIGENCE WOULD PROVIDE THE MOST BENEFIT TO YOUR FIRM? (SELECT TOP THREE AND RANK 1-2-3, WITH 1 BEING THE FUNCTION OF HIGHEST PRIORITY)



numerous applications. AI can be used to track deal flow and filter investment opportunities. Due diligence can also be streamlined by parsing vast volumes of data, with machine learning models recognizing patterns and potential red flags that might otherwise remain hidden in traditional manual analysis, minimizing the chance of overlooking critical information. PE firms are also using AI-powered tools for portfolio management purposes and to expedite the onboarding of LPs.

> "The large, multi-strategy asset managers are already there when it comes to incorporating AI into their deal sourcing investment and fundraising models."
>
> Markus Bolsinger, Dechert LLP

"We have our own platform for monitoring the performance of portfolio companies," says the managing partner of a PE firm in France. "We have good technology support in-house. They have streamlined a lot of the functions by integrating the latest technologies. Collaboration during dealmaking is also easier now since there is a platform for sharing deal information."

Measuring benefits

For 41% of our respondents, the biggest benefit from their deployment of AI is expected to accrue to value creation. Furthermore, just under a third cite portfolio management and analysis, and investor profiles (32%), including 17% of first-choice selections, the largest such share. However, the extent to which sponsors have already begun deploying this technology very much depends on their infrastructural bandwidth, with smaller firms with fewer available resources being lower on the adoption curve.

"The large, multi-strategy asset managers are already there when it comes to incorporating AI into their deal sourcing investment and fundraising models," says Bolsinger. "They're all testing it and we know of at least one private credit platform that has an AI process in place for their investment model generation that has been thoroughly tested on historic investments and is consistent with their manual work, but takes 10 minutes rather than two weeks. Firms with scale, significant AUM and the back-office bandwidth are already doing this, but in the mid- and the lower mid-market, they are in more of an exploratory phase."

AI is still a relatively new technology in cybersecurity, but has the potential to revolutionize the way that systems and data are protected, augmenting security operations. For instance, machine learning and natural language processing are being applied to threat intelligence, sieving through reams of research to deliver insights and dramatically cut response times. More than a quarter (28%) of our respondents see cybersecurity and data protection as being a function that will benefit from the use of AI moving forward, though these largely comprise secondary and tertiary votes.

IR tasks such as investor onboarding, relationship management and communication are also highly anticipated to benefit from advances in AI, accruing

25% of respondents' votes overall and 13% of their first-choice selections. At a time when investors are being more selective with their commitments and funds are taking longer to close, anything that can reduce friction is a major benefit.

"We're seeing AI providers swiftly moving into the onboarding space, replacing the existing mechanical, manual tools for distributing the subscription agreements funds need to issue to hundreds of LPs," says Comis. "It's already beginning to solve that logistical piece and is becoming instrumental for our clients."

"We're seeing AI providers swiftly moving into the onboarding space, replacing the existing mechanical, manual tools for distributing the subscription agreements funds need to issue to hundreds of LPs."
Sabina Comis, Dechert LLP

ESG: Adoption continues amid political pushback

PE has largely embraced ESG, with the vast majority of firms having already taken proactive ESG measures. Just 6% of respondents overall say they are at the beginning of their firm's ESG journey, while 65% have already implemented some capabilities, and a further 29% have integrated ESG capabilities that adhere to industry best practice. Respondents representing smaller firms (those with AUM of between US$1 billion-US$5 billion) are more likely than their larger peers to have already implemented some ESG capabilities—almost three-quarters of this subset (72%) say that is the case, versus 63% of respondents from firms with AUM of between US$5 billion-US$10 billion and 58% of those with AUM exceeding US$10 billion.

Of all regions, Europe has been the polestar for the adoption of sustainable investment practices, including in PE with the adoption of the SFDR, which mandates PE firms and other asset managers to make relevant ESG disclosures to their investors. Asia, meanwhile, does not have a governing body that can promulgate sustainability regulations similar to the European Commission, and consequently PE funds in Asia as a region lag slightly behind their peers in Europe on ESG adoption.

"The data is clear that ESG adoption is past the tipping point and it is increasingly a requirement and expectation," says Boon. "In Asia, we're seeing a host of international LPs driving their Asia-based GPs to incorporate ESG policies into the portfolios and so that best practice is carrying over into investment policies, due

"The data is clear that ESG adoption is past the tipping point and it is increasingly a requirement and expectation."

Siew Kam Boon, Dechert LLP

diligence, portfolio monitoring and disclosure processes of such Asia-based GPs."

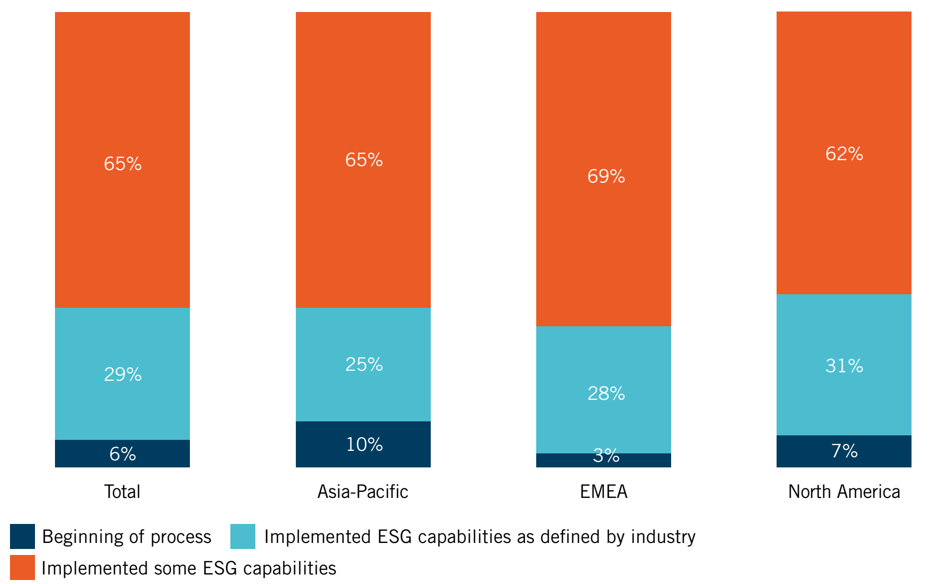
Rising resistance

The U.S. is something of a special case. The SEC intends to bring in disclosure requirements about climate risk for public reporting companies, and a taxonomy for asset managers and regulated funds, so there is regulatory momentum at the federal level. Politically and for the states, however, ESG has become a hot-button topic, with notable pushback coming from "red states" over the past year, or zealous prodding of ESG-related principles in certain "blue states." For the most part, global PE is opposed to this politicization of the issues. Nearly three-quarters of respondents (73%) believe this is an unfortunate development and that business leaders should be encouraged to take account of ESG issues in their decision-making.

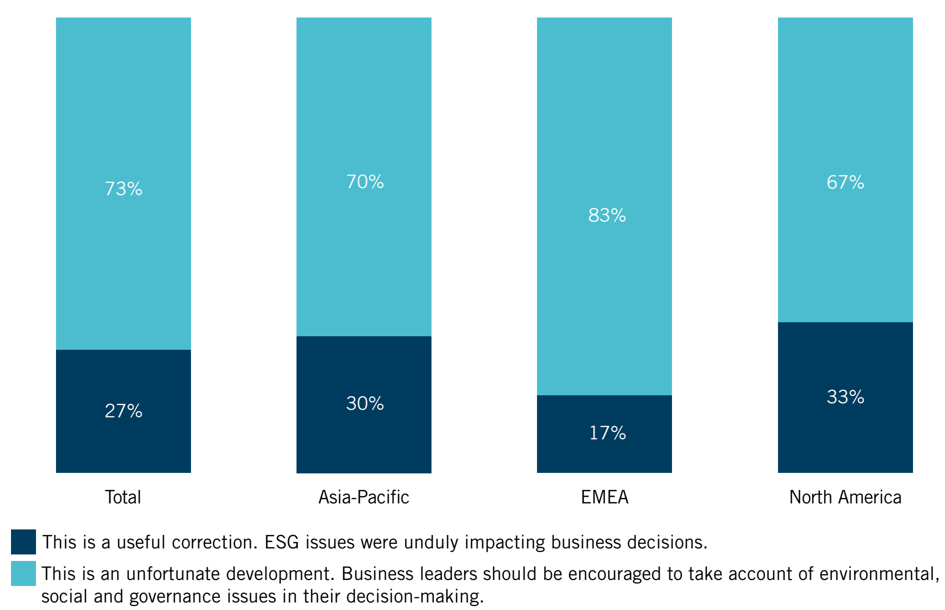
This view is held most widely among EMEA firms, with 83% agreeing with the sentiment. While 67% of North American respondents concur, that still leaves a third in the region who view this political situation as being warranted on the grounds that ESG issues are unduly impacting business decisions.

"We have not observed any regional divergence across

HOW WOULD YOU DESCRIBE YOUR FIRM'S PROGRESS SO FAR ON ITS ESG JOURNEY? (SELECT ONE)



THERE HAS BEEN POLITICAL PUSHBACK AGAINST ESG AND "WOKE" CAPITALISM, PARTICULARLY IN THE U.S., IN THE PAST YEAR. WHICH OF THE FOLLOWING STATEMENTS COMES CLOSEST TO REFLECTING THE VIEW OF YOUR FUND ON THIS DEVELOPMENT?



the U.S. PE landscape and sponsors do not appear to have modified their ESG diligence procedures or focus in investor presentations to their LPs resulting from the recent politicization of ESG in the U.S.," says Bolsinger, "However, close attention is, and should be, paid to appropriate disclosure in the fund documentation. The bottom line is that GPs are addressing performance and value creation as part of their ESG investment programs, rather than emphasizing political or social causes that are inconsistent with those goals."

E versus S

One of the most common critiques of ESG is that it conglomerates a broad range of issues under one umbrella term, and often these issues are unrelated or even conflict with one another. Where does a company stand if it prioritizes environmental sustainability at the expense of social progress, for example? And how exactly should companies begin pulling the various levers that are available to them?

What is clear from our research is that PE views environmental issues with the greatest priority among ESG topics when making investment decisions. As much as 37%, the largest share, say that matters such as energy usage and bringing down carbon emissions are

HOW IMPORTANT ARE THE FOLLOWING ESG CONSIDERATIONS WHEN ADDRESSED AT THE GP LEVEL IN MAKING PORTFOLIO COMPANY INVESTMENT DECISIONS? (SELECT TOP TWO AND RANK 1-2, WHERE 1 IS THE MOST IMPORTANT)

their number-one priority, and a further 27% cite these as secondary priorities. That said, socially-oriented workplace considerations such as diversity, equity & inclusion (DEI) are by no means being ignored, with 23% and 26% of respondents, respectively, citing these are primary and secondary priorities in their investment decisions.

Further to this, almost half of respondents (45%) think the DEI initiatives among C-suite executives in their portfolio companies are either 'good' or 'excellent', and a further 45% believe they are 'average, but improving.' This marks a slight improvement from last year's edition of this research, when 44% described these initiatives as good to excellent, and 42% viewed them as average but progressing.

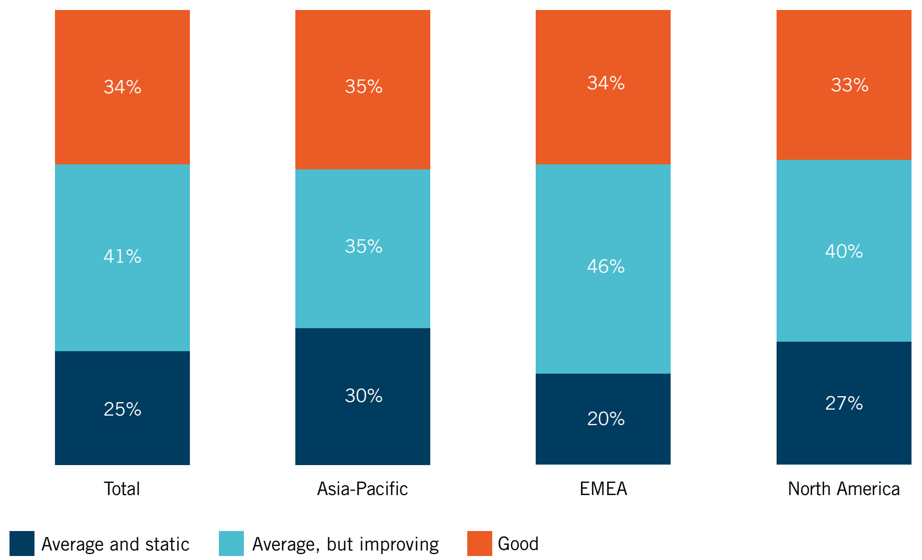
Investor demands

Much of the progress being made by the PE industry is being engendered by GPs' most valued LPs. Many pension funds, endowments and other institutional investors have adopted internal ESG policies to meet their own fiduciary duties, meaning they are only able to invest in funds that fulfill certain criteria. This is applying pressure on PE fund managers to develop and implement ESG programs in order to attract and retain LPs. The rise of LP co-investment is also a driver: co-investing gives LPs direct access to the ESG performance data of portfolio companies that GPs in turn can no longer ignore or interpret materially differently from co-investing LPs.

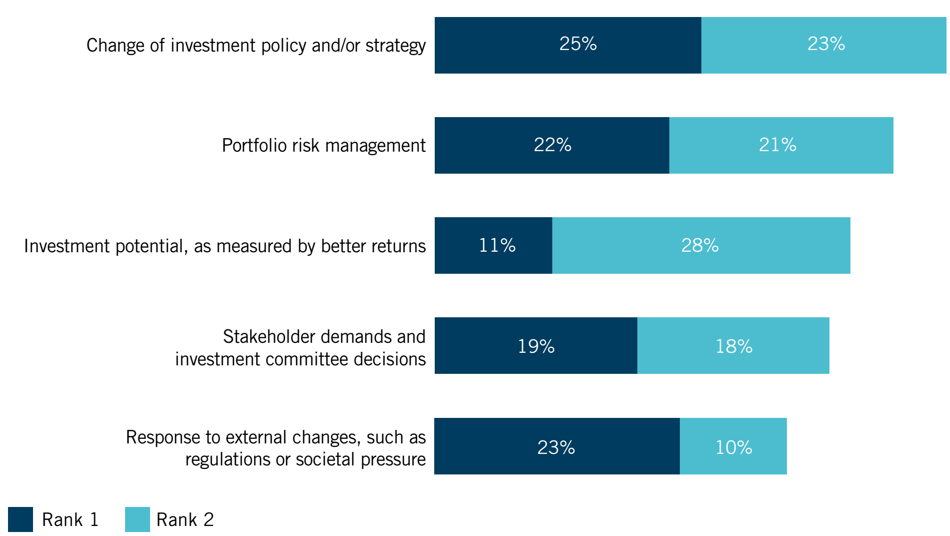
"There is definitely a sense that GPs need to align with their investors' values. Then there is the regulatory pressure to disclose ESG risks and how they are being managed and the opportunity to create long-term value in portfolio companies," says Comis. "Not all sponsors have responded to these in the same way—some have elected to have ESG investment be the primary focus of their fund's strategy, while most have elected to only participate in addressing certain ESG metrics in their businesses, or not at all. But the more that LPs demand action, the more action we will see."

Nearly a fifth (19%) of respondents say that stakeholder demands are the main reason for LPs making ESG investment decisions, and a further 18% say this is a secondary motivator. However, there are a number of reasons that investors are moving in this direction and none stand out as being materially more impactful than any other. For instance,

HOW WOULD YOU DESCRIBE THE DIVERSITY, GENDER, EQUALITY, AND INCLUSION INITIATIVES AT THE GP FUND LEVEL AND AMONG C-SUITE EXECUTIVES IN YOUR PORTFOLIO COMPANIES? (SELECT ONE FOR BOTH (A) AND (B)): GP



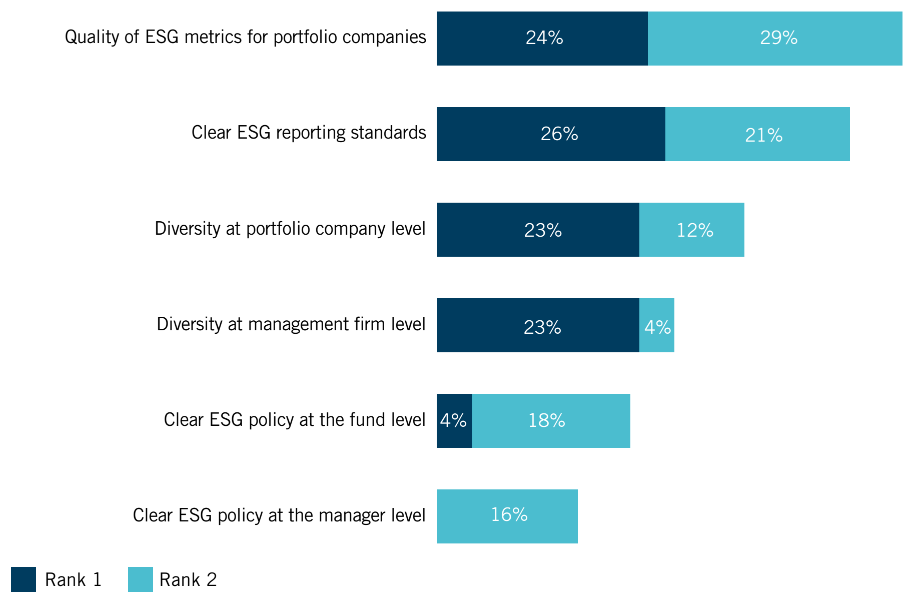
WHAT ARE THE MAIN DRIVERS FOR LPS WHEN MAKING ESG INVESTMENT DECISIONS? (SELECT TOP TWO AND RANK 1-2, WHERE 1 IS THE TOP DRIVER)



a change of investment policy/strategy is cited by 25% of respondents as the primary driver for LPs when making ESG investment decisions, and 23% cite it as a key secondary factor. Other major drivers include responding to external changes, such as regulations or societal pressure (23% of first-choice votes) and portfolio risk management (22% of first-choice votes, as well as 21% of secondary votes.) GPs are recognizing that climate risk is a financial risk and that what might seem like an excellent investment opportunity based on today's financials may ultimately end up as a stranded asset due to climate-related issues (including changes in environmental policies and laws).

By any measure, GPs are adapting their due diligence and portfolio management practices not only to encompass core operational, financial and commercial risks and opportunities, but also ESG-related measures. The numbers suggest that a large number of GPs are now viewing ESG as a value driver, one which has the potential to positively impact a target company's performance and value potential.

HOW SIGNIFICANT A PART DO THE FOLLOWING INITIATIVES PLAY IN THE DUE DILIGENCE PROCESS OF GPS AND ESG POLICIES? (SELECT TOP TWO AND RANK 1-2, WHERE 1 IS THE MOST IMPORTANT)



Reporting and performance standards

Among the various initiatives that have the greatest influence on GPs' progress in this area, clear reporting standards that companies can conform to and quality ESG metrics for benchmarking progress lead the way, accruing 26% and 24% of first-choice votes, respectively. Diversity at the portfolio company level and at the fund management firm level also garner large shares of primary votes (both 23%), indicating that GPs recognize the positive influence of including more voices and perspectives around the decision-making table, whether in their own investment committees or among the C-suites of their investee companies.

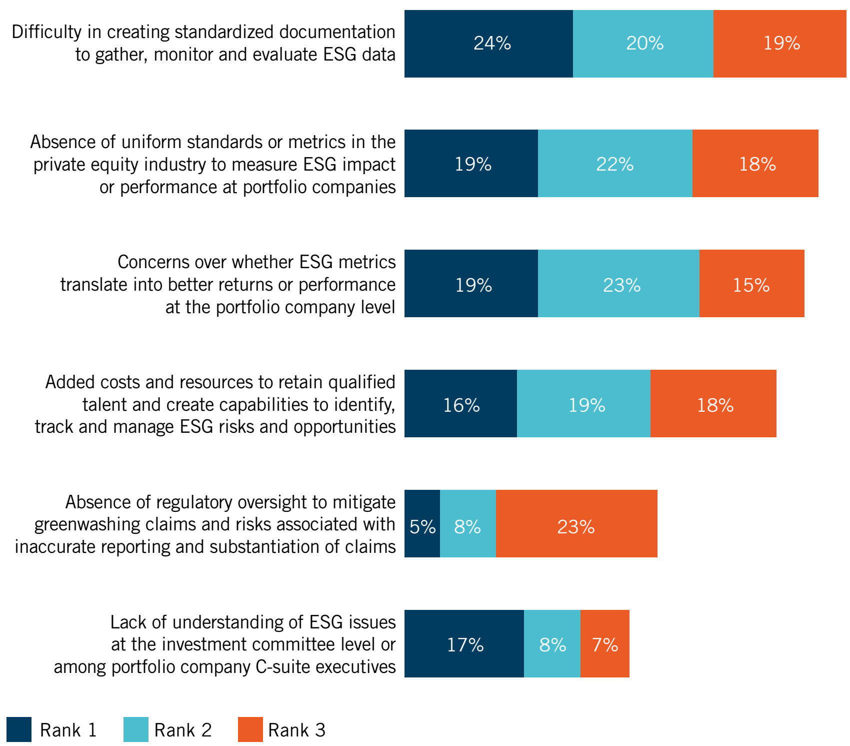
As essential as standard-setting and performance measurement are to progress, however, this is also the area that is tripping sponsors up. According to the largest share of respondents (24%), the single greatest barrier to ESG adoption within their funds or portfolio companies is the difficulty in creating standardized documentation to gather, monitor and evaluate relevant data, and 63% cite this among the top-three challenges. On a related note, 19% say that the absence of uniform standards or metrics to measure ESG impact or performance is the primary hurdle to greater adoption and

59% consider this to be among the top three obstacles.

In June 2023, the International Sustainability Standards Board published its voluntary framework intended to reshape ESG reporting norms, in the same way the International Financial Reporting Standards did two decades ago. Though it is much too soon, at the time of writing, for any investors to have adopted these new standards, they and similar conventions are gaining traction and may provide a baseline for consistency in ESG disclosures and reporting by PE sponsors.

It is abundantly clear that the ESG train has already left the station and the PE industry is making considerable efforts to align itself accordingly. Most PE sponsors have, in fact, devised their own bespoke standards that best suit their mix of portfolio companies. Nonetheless, there will be bumps and detours along the way as investors of every kind determine what exactly true ESG performance looks like and how it can be objectively measured.

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



Liquidity events: Swimming with the current

IPO markets have been quiet for much of 2022 and 2023, with only a smattering of high-profile listings. U.S. restaurant chain Cava debuted on the New York Stock Exchange in June, though at end-September its shares were trading around 45% lower than their end-July high. There followed the hotly-anticipated offerings by Arm and Instacart, which listed on the Nasdaq in September, though shares in both companies have also fallen by more than a fifth from their highs in both cases.

M&A activity, meanwhile, has been slower and debt financing more costly for sponsors to execute sponsor-to-sponsor buyouts. All of this has meant liquidity via traditional exit routes has been down, slowing the cadence of the industry's natural fundraising cycle.

Having endured this logjam for more than a year, GPs are divided on what to expect in the near term. Overall, 42% of respondents believe market conditions for PE exits over the next 12 months will be either somewhat unfavorable (34%) or very unfavorable (8%). Almost the same number (41%) are neutral on the matter, while only 17% think conditions will be even somewhat favorable. This represents a change in sentiment from last year's study, when 74% of GPs saw the exit outlook as either somewhat or very favorable.

"There is something of a recency bias informed by a steady stream of negative data and news, and the experience of weathering recent market conditions. People are often in the moment and share how they view the current situation,

> "There is something of a recency bias informed by a steady stream of negative data and news, and the experience of weathering recent market conditions."
>
> Markus Bolsinger, Dechert LLP

projecting that into the future," says Bolsinger. "We are actually more optimistic today about the outlook than 12 months ago, albeit cautiously so."

Regional differences

A counterpoint is the fact that APAC respondents are comparatively upbeat versus their peers elsewhere in the world, reflecting the relative economic momentum being enjoyed in much of Asia. Over a third of this cohort (35%) see conditions over the next year as being somewhat favorable, falling to 20% of North American dealmakers and just 2% of EMEA respondents, where growth has been flattest.

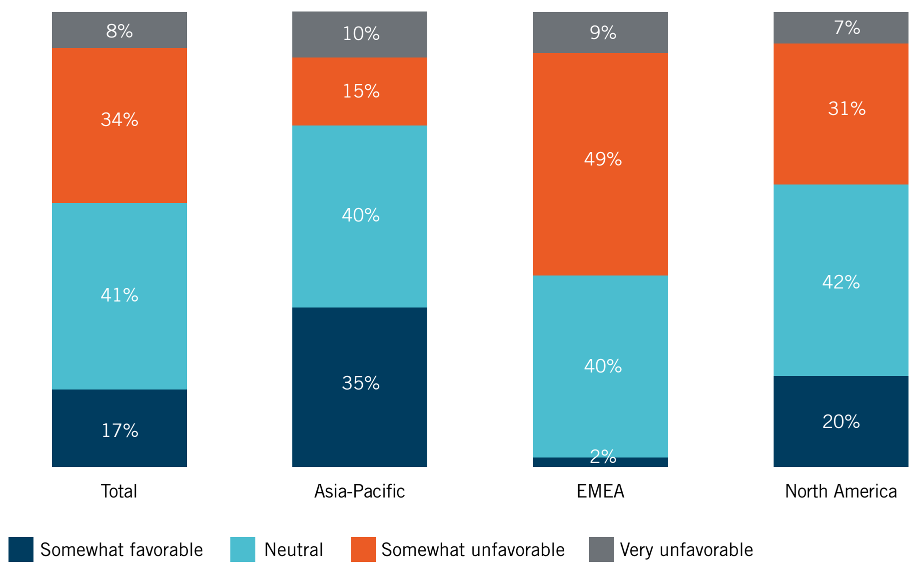
"Asia is outpacing the rest of the world and so it's only natural that sponsors are comparatively upbeat about their exit prospects," says Boon. "However, everything is relative. It remains the case that the region has lower exit volumes than North America and EMEA."

Asked to identify the biggest challenges they expect to endure in returning capital to LPs over this time horizon, a few potential hurdles stand out from the pack. These include determining whether or not to hold a portfolio company for longer to take advantage of expected growth or until the market recovers, cited by 35% as one of their top two challenges; securing a buyer willing to pay the desired valuation in a sale amid a risk-off market (33%); and determining the right type of exit (30%).

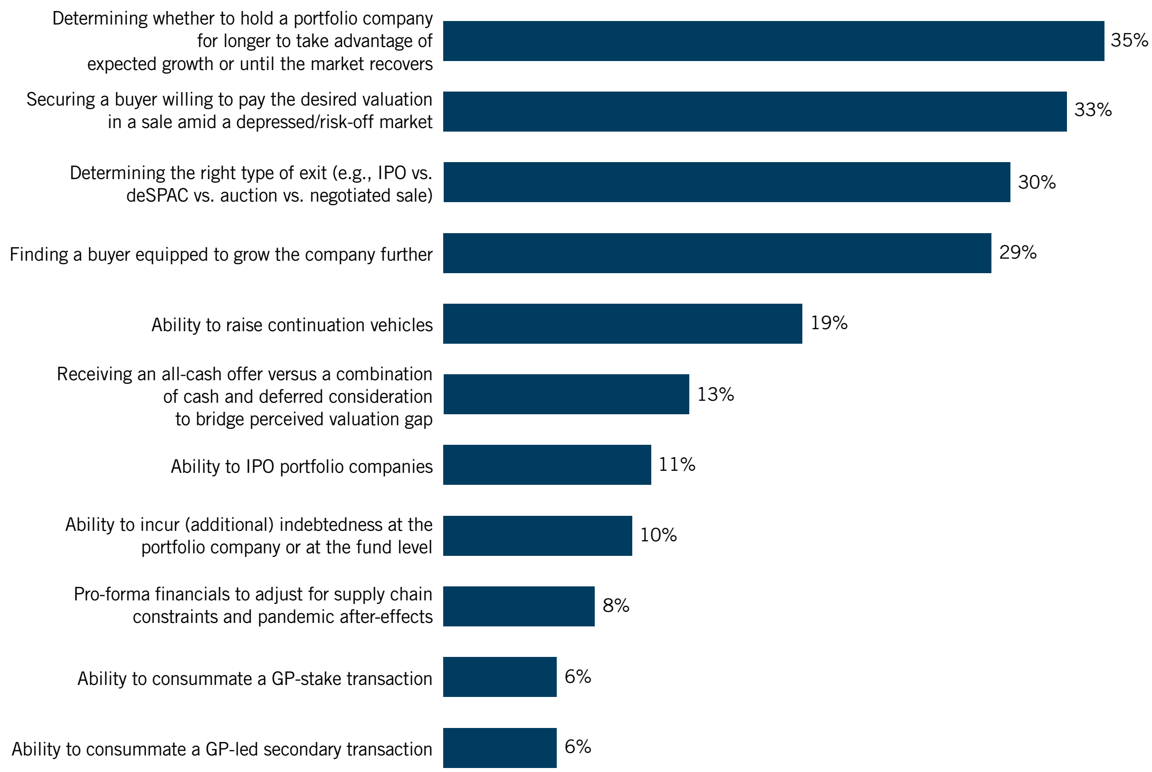
From a region-by-region perspective, North American respondents more commonly cited the tribulations of determining whether to prolong their hold times, with 45% flagging this as a challenge compared with 31% and 20% of EMEA and APAC respondents, respectively. In APAC, GPs are notably more concerned about securing a buyer willing to meet their desired valuation, with 40% of respondents in this market highlighting this versus 31% of EMEA and North American respondents apiece.

Limited exit volumes in Asia and its relative economic outperformance mean that GPs in the region are less likely to follow the wait-and-see tactic of extending their holding periods to benefit from a market rebound. Instead, they are seeking to crystallize returns in the immediate term, provided buy-side offers meet their expectations.

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



WHAT ARE THE BIGGEST CHALLENGES YOU EXPECT TO FACE WHEN IT COMES TO RETURNING CAPITAL TO YOUR INVESTORS IN THE NEXT 12 MONTHS? (SELECT TOP TWO)



In EMEA, respondents are more preoccupied than their peers about their ability to raise continuation vehicles, which have become a popular way for PE firms to hold onto their prized assets, bringing in follow-on capital via secondary transactions and providing a liquidity option for existing LPs. Of this cohort, 26% view their capacity to successfully achieve these GP-led secondaries as a challenge in returning capital to LPs, falling to 20% of APAC survey participants and just 13% of those based in North America.

Alternative liquidity solutions

U.S. treasury yields have continued to climb through 2023, putting GP's performance under further scrutiny as the risk-free rate of return rises. With NAVs having come down over the past 18 months, there is a concern that fund managers will be "out of the carry," which has serious implications for their alignment with investors.

As much as 60% of GPs globally believe there is a moderate (46%) or high (14%) risk that, due to NAV write-downs, fund performance will fall below the hurdle rate. This concern is most acute in the economically lagging EMEA region, where 57% of respondents describe the risk as moderate and a further

17% see it as high. In APAC, conversely, as much as 55% of GPs say this risk is either low or negligible.

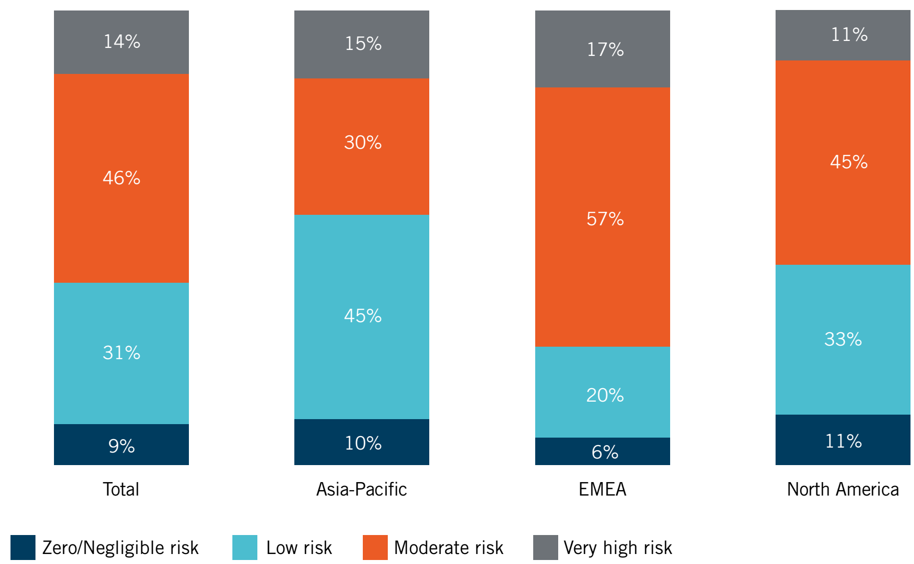
GP-led secondary market

Deciding whether to prolong hold periods, sizing up continuation vehicle arrangements and funds dipping below their hurdles all closely intersect. A direct result of there being fewer liquidity events occurring is the sharp rise in GP-led secondary market activity. These transactions accounted for a mere 1% of the PE secondary market in 2012. Today, that figure exceeds 40%, according to *Preqin* data.

"Most of this activity is concentrated in continuation funds, which allow existing LPs to either realize liquidity from the incoming investor/LP or choose to roll over into the new fund. These arrangements allow GPs to continue backing assets they believe have further to run," says Comis. "Crucially, they are also an opportunity for fund managers whose carried interest is underwater to reset their economics. This comes typically in the form of discounted management fees combined with a tiered carry structure."

The explosion in GP-led secondaries is testament to the PE industry's innovation and adaptability. Once considered a last resort for laggardly funds,

TO WHAT EXTENT IS THERE A RISK THAT, DUE TO DECREASED VALUATIONS IN 2023, EXISTING INTEREST INCENTIVE STRUCTURES WILL PUSH FUND PERFORMANCE BELOW THE HURDLE RATE AT YOUR FIRM? (SELECT ONE)



GP-leds have entirely lost their stigma to become one of a number of alternative liquidity solutions in the industry's growing toolkit.

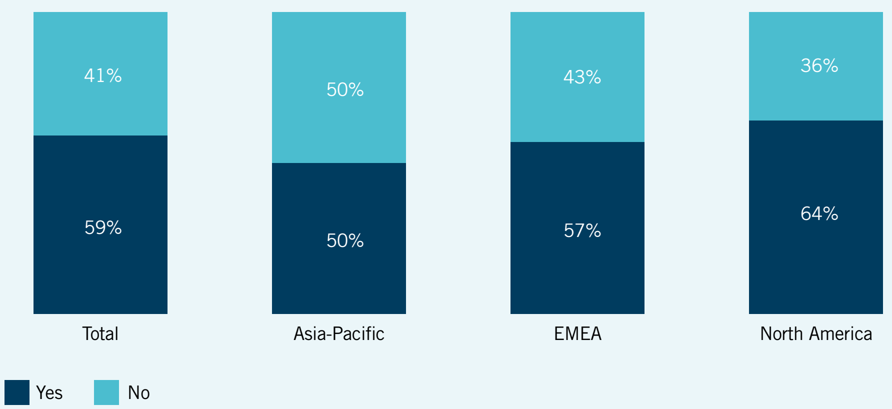
"Managers lacking the confidence that they will be able to return capital to their investors through a traditional exit route still need to be seen to be offering alternative liquidity options to drive the fundraising cycle," says Field. "It's not just continuation funds but tender offers and NAV facilities—there is a host of alternatives that have emerged and are actively being used at the moment to address that liquidity gap."

GP-stake divestitures

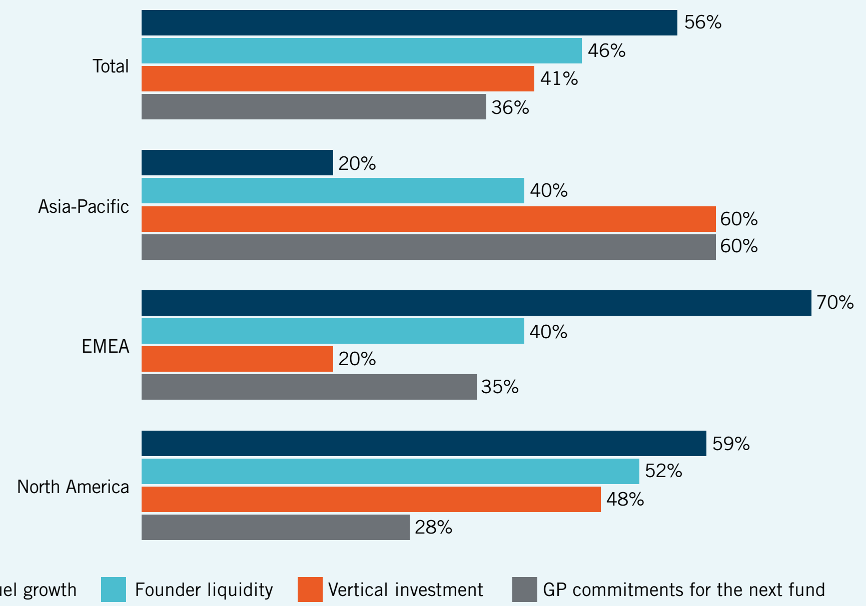
Over the past decade, GP-stake investing has gained considerable traction. Investors view the strategy as a means of gaining better access to PE managers and potential co-investment deal flow, not to mention fee earnings, carried interest and potential capital gains from their equity stake. For GPs' part, bringing in a sizable minority investor provides an infusion of liquidity that can be used for various purposes, as well as potential expertise, strategic guidance, and access to invaluable networks.

Much of this is being spurred by the maturity of the industry and the need to ensure firms' continuity. Although it remains a relatively niche strategy, sizable sums of capital have been raised for these purposes. In January, Blue Owl Capital, one of the market's biggest players, closed Dyal Capital Partners V on US$12.9 billion, having already deployed 70% of the capital acquiring positions in firms including CVC Capital Partners, HIG Capital, KPS Capital Partners, MBK Partners, and PAI Partners.

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



IF "YES," WHAT WILL THE PROCEEDS GO TOWARDS? (SELECT ALL THAT APPLY)



Sizing up this opportunity to raise cash, more than half of all firms (59%) are currently planning on making a GP-stake divestiture over the next 24 months. This is expected to be particularly popular among North American PE firms, 64% of which aim to divest, falling to 57% and 50% of EMEA and APAC respondents, respectively, who share these ambitions.

Of those who have their eyes on the sale of a stake in their firm, the leading motivation is growth. This tracks with the ongoing expansion and diversification of PE firms into adjacent asset classes such as private credit, infrastructure and hedge funds. Over half (56%) of GPs who plan to sell say the proceeds will go towards fueling growth, although this is largely weighted towards EMEA (70%) and North American respondents (59%).

It is not only GPs who are looking to broaden their horizons via these arrangements, but investors too. "We're seeing a larger number of fund platforms and investors who want to enter different markets. They see this as an efficient, fast-track way to gain access to an industry or market they don't have exposure to while simultaneously gaining a revenue share," Comis adds.

Only 20% of APAC firms say the proceeds from these sales would be directed towards expanding their business. Instead, 60% would put the fresh capital towards GP commitments for their next fund and 60% say the same for vertical investment.

"PE liquidity has been comparatively scarce in Asia, limiting GPs' ability to raise new funds and meet personal commitments to their own funds. Notably, 2022 was challenging for China, the region's largest PE market, with strict COVID-19 measures weighing on the performance of public equities, limiting IPO options and corporates' ability to raise deal funding," says Boon. "Southeast Asia, meanwhile, has relatively underdeveloped capital markets, besides the relative immaturity of the PE secondary market in this part of the world. The sale of a strategic stake in their management firms is therefore one alternative solution that cash-constrained managers may find worth exploring to raise capital for their GP commitments."

"PE liquidity has been comparatively scarce in Asia, limiting GPs' ability to raise new funds and meet personal commitments to their own funds."

Siew Kam Boon, Dechert LLP

Conclusion

A year of steeply rising interest rates and slower growth has been particularly tough for PE. Fundraising is down. Dealmaking is down. Debt is costlier and scarcer. And yet PE continues to find a way. 2023 has also continued to be an adjustment period and sponsors have repeatedly demonstrated their adaptability. Smaller deal tickets are the norm and buyers and sellers are frequently employing creative structures that satisfy both parties.

For the industry's natural cycle to turn with more momentum requires higher exit volumes. This is dependent on IPOs and M&A activity picking up steam. There are some positives on this front. Public equities reignited through the first nine months of 2023, lifting mark-to-market valuations and potentially paving an exit route for large-cap portfolio holdings.

Economic signals also suggest recessionary pressures may be easing, in spite of persistent yield curve inversions. A more stable outlook should equate to more acquisitive strategic buyers. And inflation has begun to ease in most markets, a sign that central bank policy is having its desired effect and that higher rates may not become the norm.

Nothing is guaranteed and PE firms, like other investors, prefer certainty over the unknown. They need willing buyers in order to harvest their holdings, kickstart their fundraisings and sustain their investment cycles. Taking some confidence from the more positive indicators that have begun to show as we head towards 2024, on the following page are four key takeaways from this year's report.

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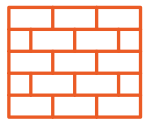
Build portfolio resilience



GPs see interest rates as the biggest drag on dealmaking in the short term and there is little chance of meaningful change here in the next six months. Funds should anticipate using more equity in their deals than pre-2022 and may even opt for all-equity situations if they have high conviction in an investment they believe can be refinanced at a later date. Rather than going all in on large platform plays, sponsors eager to maintain their pace of deployment should actively build up their trophy portfolio companies through modestly sized add-ons to achieve top- and bottom-line growth and de-risk by scaling. Where possible, or necessary, the de-levering of existing holdings can strengthen valued direct lender relationships, which will require a continued focus on operational performance to deliver margin growth, or possibly even asset sales.

Think creatively to ensure success

Earn-outs, vendor financing and other deferred purchase price mechanisms are helping deals to get over the line and are likely to remain a common feature for the time being. The gap between buyers and sellers has begun to narrow as more positive economic data has emerged and capital markets have returned to form. However, the cost of financing is such that buyers are looking for any means possible to secure transactions on financial and structural terms that are mutually beneficial. In certain circumstances, sellers should be open to giving up some immediate cash in return for later upside. Parties on both sides of a transaction need to keep an open mind about what is required to see a deal through to completion and should seek advice on what structures are currently being actively employed to ensure success.

Capitalize upon public markets

Take-privates remain attractive, particularly in undervalued markets such as Europe and parts of Asia. The slowdown in dealmaking since 2022 means there are still large stores of dry powder in the system, and this has buttressed private market valuations. Having endured a bear market and adjusted to the change in market conditions, management teams of listed companies appear to have lowered their guard to approaches from PE funds, especially where sponsors have a clear vision and strategy for realizing the company's true potential. The complexity of these deals means they require collaborative stakeholder management. Sponsors must think carefully about how to pitch their vision of the company's future under private ownership, being mindful of the high level of scrutiny that boards' fiduciary duties are under at public companies and the development of aiding and abetting claims against suitors in Delaware.

Use ESG as a value lever

Consensus ESG metrics may be some way off, but that should not stop fund managers from driving positive change through their portfolios. Prioritizing sustainability and inclusion can translate to value creation via new revenue, cost reduction, improved access to finance and higher employee engagement and productivity. This can better position companies to prospective buyers and ultimately equal better returns for LPs. In some cases, it may be prudent to engage litigation teams to perform risk management analyses, thereby uncovering potential red flags that PE owners can address, away from the spotlight. GPs are well advised to refrain from window dressing or greenwashing as hollow claims of leveling up portfolio companies' ESG credentials will be transparent when it comes time to exit. Buyers are becoming more attuned to such claims and know what to look for.

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