SG Analytics
Life's Possible

A X I A

us.sganalytics.com

Issue 09 / October 2024

Private Equity Newsletter

Contents

SG Analytics' premier private equity monthly newsletter and your window to the latest trends, deals, and strategies reshaping the industry. Each edition of Axia will bring you an exclusive feature article and topical news developments with our experts dissecting critical topics, offering insights and commentary that go beyond the headlines.

PE Giants Shift Focus: The Rise in Mid-market Opportunities

Private equity (PE) giants, like KKR and Thoma Bravo, are increasingly turning their attention to the middle market. The backlog of unsold mid-market assets combined with its outperformance of the larger-cap space and private equity firms holding record levels of dry powder, presents a broad range of opportunities for these firms to capitalize on.

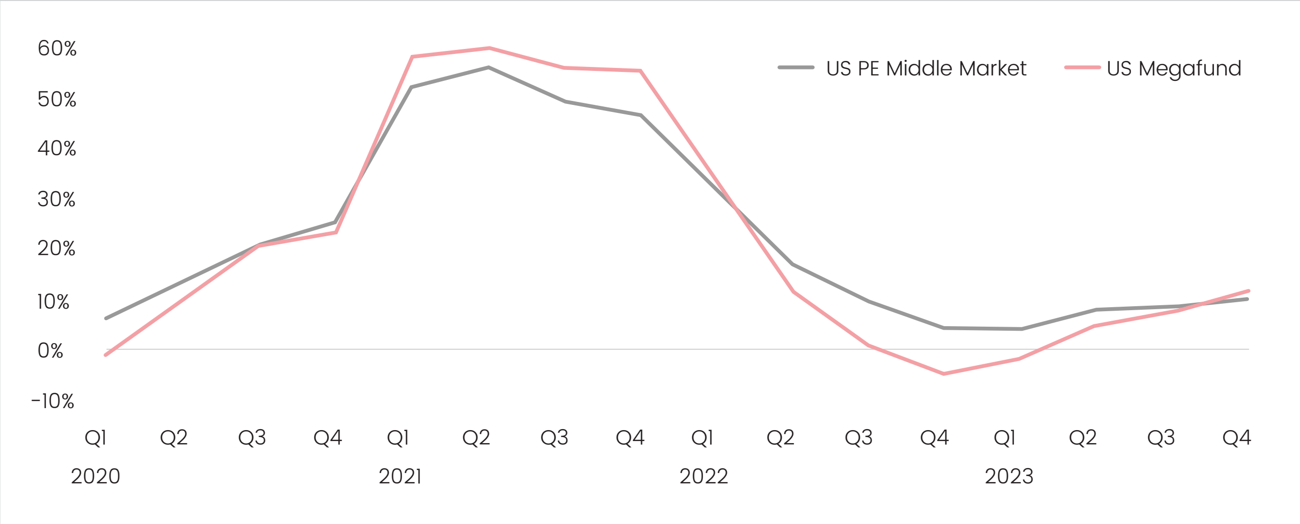
Mid-market exits, in line with the broader PE industry, have faced a challenging couple of years. General partners (GPs) who delayed exits in hopes of improved conditions extended the median holding period for PE investments, which hit a record 6.4 years for U.S. mid-market assets in 2023, according to Pitchbook. There are around 4,500 PE-backed mid-market companies awaiting sale, with 36.2% held for over five years. This has created a substantial opportunity for large managers to offer liquidity in a difficult exit environment.

In 1H24, sponsor-to-sponsor exits dominated mid-market exit activity, representing over 55% of all exits, excluding public listings, according to Pitchbook. This contrasts with the broader U.S. PE industry, where sponsor-to-sponsor exits account for a smaller portion, and corporate exits take the lead. This suggests the GPs have been preferring the smaller scale of mid-market PE assets compared to larger platform companies.

With PE firms holding a record amount of dry powder, mid-market companies have emerged as attractive acquisition targets. This trend is reflected in the outperformance of mid-market funds compared to larger-cap funds, particularly in terms of resilience in deal activity, capital distribution to limited partners (LPs), and internal rate of return (IRR). According to Pitchbook, while the overall market value of deals fell by 33% in 2023, mid-market deals saw a smaller decline of just 19%. Mid-market fund managers distributed a net $22.4 billion to LPs, whereas U.S. mega-funds experienced a negative outflow of $30 billion in 2023. Additionally, mid-market funds outpaced mega-funds in terms of IRR for six consecutive quarters, although this trend has recently shown signs of a marginal reversal.

This trend is reflected in the outperformance of mid-market funds compared to larger-cap funds, particularly in terms of resilience in deal activity, capital distribution to LPs, and IRR.

Figure 1: Quarterly Rolling One-year PE Fund IRR by Fund Size



Source: PitchBook

Several factors contribute to the mid-market's resilience, making it an attractive option even for PE behemoths looking to diversify their portfolios.

First, mid-market deals are generally easier to finance due to their relatively lower debt levels, a significant advantage in periods of high interest rates. Second, there is substantial potential for higher alpha generation, as mid-market companies are often well-positioned for operational improvements and growth. Over the past decade, revenue and EBITDA in PE-backed mid-market companies have grown by an average of 115% and 124%, respectively, according to Morgan Stanley. Finally, the mid-market offers greater flexibility in exit strategies.

Looking ahead, mid-market fund managers are more optimistic about future deal prospects compared to their larger peers. In an S&P survey, as reported by Moonfare, nearly 75% of respondents managing between $500 million and $10 billion in assets under management (AUM) expect deal activity to improve in 2024. This contrasts with just 50% of those managing over $10 billion in AUM, highlighting a more favorable outlook for the mid-market.

Consequently, KKR recently announced the closing of its KKR Ascendant Fund at a hard cap of $4.6 billion, marking its first PE vehicle focused solely on mid-market opportunities. Thoma Bravo is also entering the mid-market space with its Discover Fund V, which is aiming to raise $7 billion in capital, according to Bloomberg via Pitchbook. More private equity firms are expected to follow suit to capitalize on the growing opportunities in this segment.

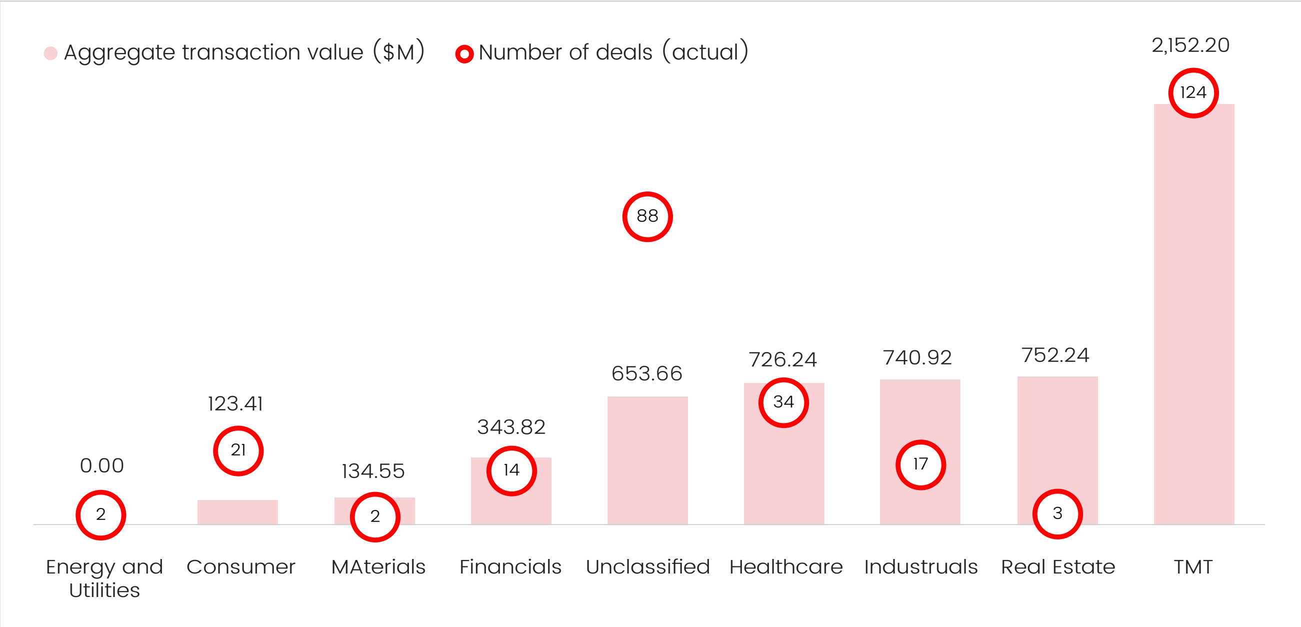
In conclusion, the mid-market continues to present significant opportunities for PE giants, driven by a backlog of unsold assets, lower debt levels, and greater alpha potential. As these companies outperform their larger-cap counterparts, mid-market deals remain resilient in volatile economic conditions, offering flexible exit strategies and stable returns. With a record amount of dry powder at their disposal, PE firms are well-positioned to capitalize on these trends.

Monthly News and Analysis

Middle East Poised for Rebound in Deal Value

According to S&P Global, the Middle East attracted $2.28 billion in deals in 3Q24 till September 27, surpassing the $2.16 billion deal value for the entire 2Q24 and nearly double the $1.19 billion from 1Q24. However, the annual total is projected to fall significantly short of the $11.60 billion secured in 2023, primarily due to the ongoing military conflicts involving Israel, Palestine, Lebanon, and Iran.

Figure 2: Global PE/VC-backed Investments in the Middle East in 2024



Source: S&P Global

PE and VC investments in the Middle East have surged in 2024, with a clear shift toward sectors beyond oil & gas. Leading the activity is the technology, media, and telecommunications industry, which accounted for 124 deals totaling over $2.15 billion, according to S&P Global. Real estate followed with $752 million in deal value, while the industrial sector attracted $741 million. In contrast, the energy & utilities sector saw minimal interest, with only two undisclosed deals, despite a global rise in PE investments in fossil fuel and renewable energy companies. In the Middle East, renewable energy projects have taken a backseat as the region grapples with ongoing armed conflicts, which have become the most pressing concern. Additionally, some renewable energy ventures, such as Saudi Arabia's green hydrogen initiatives aimed at reducing oil dependence, have proven less attractive to investors and developers. Similarly, investments in carbon capture and storage from industrial processes such as steel and cement production, as well as fossil fuel-based power generation, face significant challenges in the oil-dominated economy of the region.

Doeren Mayhew Partners with Audax for Strategic Growth

Doeren Mayhew, a national CPA and advisory firm, has partnered with Audax Private Equity through an alternative practice structure to fuel the firm's future innovation and growth.

PE firms have increasingly turned their attention to accounting firms, with major players such as Grant Thornton and Baker Tilly selling a majority stake to PE funds. According to the Financial Times, PE firms could soon acquire as many as 10 of the 30 largest accounting firms in the U.S., setting the stage for further international market expansion. These partnerships offer significant advantages, most notably access to capital, which fuels growth and innovation. Despite concerns that external PE funding could compromise auditors' independence, the benefits are substantial. One key advantage is improved talent acquisition, as PE-backed firms can offer competitive salaries and performance-based incentives. This comes at a time when accounting firms face a shrinking talent pool, with a decline in CPAs entering the field. In 2023, the American Institute of Certified Public Accountants reported an 18% drop in CPA degrees awarded compared to six years ago, as more young professionals are drawn to higher-paying industries like investment banking and data analytics. PE firms, on the other hand, are drawn to the stable, recurring revenue of accounting firms, and the fragmented nature of the industry presents opportunities for consolidation.

Surge in Dividend Recapitalization in 2024

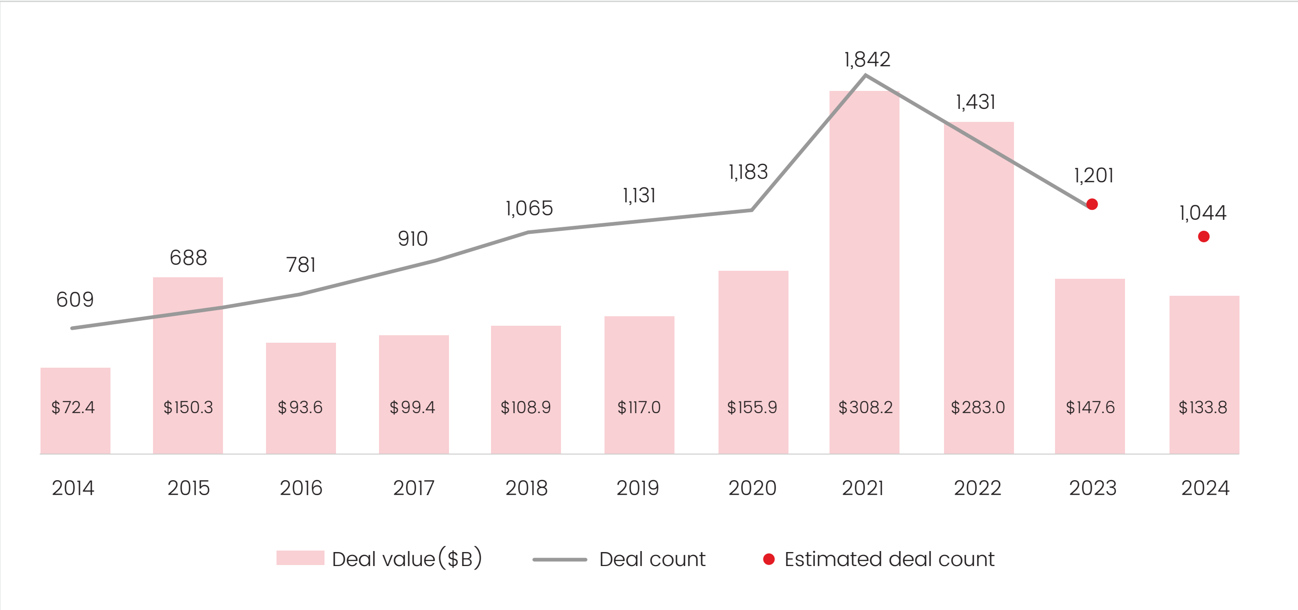
The YTD dividend recapitalization (recap) volume in the U.S. for PE-backed companies through September 24 reached $69.3 billion, and this year's annual total is expected to cross 2021's record high of $76 billion, according to Pitchbook. Despite the potential risks, 2024 may see a record year for dividend recap due to challenging market conditions.

As PE firms face challenges in exiting their investments through M&As or IPOs, dividend recaps offer an alternative to return capital to LPs and boost returns, particularly as the fiscal year draws to a close. Given the current market conditions, especially following the Federal Reserve's rate cut with inflation under control, short-term liquidity for shareholders is expected to rise through dividend recaps. However, even in a low-interest-rate environment, dividend recap remains a risky strategy for over-leveraged companies. These firms may struggle to manage higher interest expenses and debt repayments, increasing the risk of bankruptcy. Such financial strain could lead to long-term instability for portfolio companies and attract regulatory scrutiny, particularly if economic conditions deteriorate. Looking ahead, as the economic landscape improves, PE sponsors are likely to find more opportunities to exit their investments, with lenders favoring M&A due to its more efficient use of leverage. While dividend recaps provide short-term returns for investors, they also carry the risk of undermining the long-term financial stability of companies. This highlights the need for careful assessment of the trade-offs between immediate shareholder rewards and the sustainable growth and operational health of the businesses involved.

Strong Rebound in Technology Deals in 3Q24

In 3Q24, the PE landscape in the technology sector signaled a strong rebound in deal activity. The YTD deal value reached $133.8 billion, representing a 28% YoY increase, according to Pitchbook. An estimated 1,044 technology PE deals have been recorded so far in 2024, marking a 17% rise compared to the same period last year.

Figure 3: Technology PE Deal Activity



Source: PitchBook

PE firms are deploying capital with an eye on a more favorable interest rate environment in the next 12 months. The software segment is driving the broader tech sector's resurgence in deal activity. In the first three quarters of 2024, software PE deals totaled $90.4 billion across 694 transactions, with annualized deal values projected to rise by a significant 33% YoY and deal volume up by 27%, as per Pitchbook. PE acquisitions tend to succeed as target companies often see a sharp increase in profitability under PE ownership. This is especially evident in the software industry, where high gross margins allow even small operational improvements to significantly boost profit margins, often shifting from 20% to 30–40% quickly. Several IT deals including Smartsheet's acquisition by Blackstone and Vista Equity Partners, 8 Instructure by KKR, and Envestnet by Bain Capital occurred in 3Q24. These megadeals reflect the ongoing momentum in the tech PE space.

China's Stimulus Sparks Hope for Asia Deals

China's central bank has introduced its most significant stimulus since the pandemic, aiming to lift the economy out of deflation and steer it back toward the government's growth target. The broader-than-expected package includes increased funding and interest rate cuts, marking policymakers' latest effort to restore after a prolonged structural slowdown. A clearer and more detailed policy roadmap, however, is still anticipated.

Asian markets surged in the week following China's stimulus announcement, indicating that the package has eased concerns about the government's commitment and capacity to take bold steps to revive economic growth. However, it remains to be seen whether this optimism will translate into tangible improvements in consumer confidence, increased private and state-owned investment, and a resurgence in foreign direct investment in the coming months and years. With China's stimulus measures coinciding with the U.S. Federal Reserve entering a rate-cut cycle, financing conditions are expected to improve. This could drive a recovery in exit activity and asset valuations, narrowing the valuation gap between buyers and sellers, and creating more dealmaking opportunities. PE-backed M&As in Asia Pacific rose by 14% year-on-year to $105 billion in the first three quarters of 2024, according to LSEG. This growth was significantly boosted by the $16 billion acquisition of Australian data center provider AirTrunk by a Blackstone-led consortium.

Deals Flash

NewSpring Acquires C Speed

NewSpring Holdings, the PE strategy of NewSpring, a Pennsylvania-based PE firm, has acquired C Speed, a California-based provider of radar systems. Founded in 2022, C Speed provides advanced radar systems and engineering solutions for civilian and military applications. This acquisition will create a platform company within the NewSpring holding federal platform, a collective of businesses delivering essential services and solutions to address the complex needs of the U.S. government. This acquisition will support NewSpring's objective of growth and innovation within the national security and defense sector.

Renovus Capital Partners Announces Majority Investment in Angeion Group

Renovus Capital Partners, a Pennsylvania-based PE firm, has acquired a majority stake in Angeion Group, a Pennsylvania-based class action case management solutions provider. Founded in 2012, Angeion Group provides settlement administration and legal notice services and specializes in managing class actions and other types of mass litigation. This partnership will enable Angeion to accelerate the buildout of its management, client service, and delivery teams, while increasing investment in its exclusive class action technology solutions and VSS to seek organic and inorganic growth opportunities for the business as the PE ecosystem evolves.

VSS Capital completes Platform investment in Treya Partners

VSS Capital Partners, a New York-based PE firm, has completed a platform investment in Treya Partners, a California-based management consulting firm. Founded in 2006, Treya specializes in procurement value creation, strategic sourcing, and spend management advisory services for its middle-market PE-backed clients. This partnership will allow Treya to expand its product offerings and explore strategic M&A opportunities, utilizing VSS's buy-and-build approach. Additionally, VSS will be able to capitalize on organic and inorganic opportunities for business as the PE ecosystem evolves.

Waud Capital Acquires Science Exchange

Waud Capital Partners, a Chicago-based PE firm, has acquired Science Exchange, a California-based provider of life sciences procurement and supplier management SaaS solutions. Founded in 2011, Science Exchange provides a modern cloud supplier orchestration platform, delivered through a transparent SaaS subscription model. This acquisition will allow Science Exchange to expand its product portfolio, invest in innovative technologies, and elevate its market presence to reinforce its standing as the premier SaaS supplier orchestration platform in the life sciences sector.

Levine Leichtman Acquires Majority Stake in Expert Institute

Levine Leichtman Capital Partners, a Los Angeles-based PE firm, has acquired a majority stake in the Expert Institute, a New York-based provider of outsourced legal services, from Spectrum Equity, a Boston-based PE firm. The Expert Institute, founded in 2010, serves over 5,000 firms nationwide through its cloud-based Expert iQ platform, which offers sophisticated case management solutions and expert sourcing capabilities. This partnership will allow Expert Institute to expand its platform, enhance service offerings, and accelerate growth for its clients and employees.

Renovus Capital Exits LeapPoint to Omnicom

Renovus Capital Partners, a Pennsylvania-based PE firm, has sold its portfolio company, LeapPoint, a Virginia-based Adobe Gold Solution Partner, to Omnicom, a New York-based media company. Founded in 2006, LeapPoint allows organizations to improve the orchestration and performance of their marketing lifecycle. It helps Fortune 1,000 enterprises optimize the performance of their marketing organizations by strategically integrating people, processes, and Adobe technology. Renovus invested in LeapPoint in 2021 and since then, the company has built extensive expertise across Adobe Experience Cloud and has received Adobe's Content Supply Chain Ready badge.

Waud Capital Acquires Science Exchange

Blackstone will sell G6 Hospitality, a Texas-based economy lodging franchisor, to Oyo, an India-based hotel operator. The acquisition of G6 – the parent company of brands Motel 6 and Studio 6 – will allow Oyo to strengthen its international presence. Blackstone purchased Motel 6 and Studio 6 in 2012 for $1.9 billion, and since then, has heavily invested in the brand and pursued a strategy that converted the chain into a franchise. The deal will be an all-cash transaction for $525 million and is expected to close by the end of 2024.

Godspeed Invests in BNP Associates

Godspeed Capital Management, a Washington-based PE firm, has invested in BNP Associates, a Colorado-based air transport design and engineering company. Founded in 1971, BNP is a full-service air transportation consulting and engineering firm focused on global airport infrastructure projects. The investment establishes BNP as the platform brand of the firm's new aviation-focused design and engineering services provider. This partnership will allow Godspeed to increase operational capacity and pursue strategic acquisitions to establish BNP as the premier partner for air transportation infrastructure projects worldwide.

Swander Pace Sells Reliance Vitamin to Impetus Wellness

Swander Pace Capital, a California-based PE firm, has sold Reliance Vitamin, a New Jersey-based manufacturer of plant-based products, to Impetus Wellness Group, a California-based wellness platform backed by AEA Small Business PE. Founded in 1978, Reliance formulates and manufactures private-label vitamin, mineral, and supplement products. Swander Pace partnered with Reliance's founder, investing in the company through its Branch Brook Holdings partnership with Jefferson Capital and United Natural Foods. Formed in 2012, this partnership allowed investment in North American organic, natural, and specialty consumer product companies.

New Heritage Takes Majority Stake in Brilliant

New Heritage Capital, a Boston-based PE firm, made a majority investment in Brillant, a California-based provider of corporate gifting services. New Heritage's acquisition was based on its Private IPO solution, enabling the current management of Brilliant to retain operating control of the business. Founded in 2015, Brilliant offers corporate gifting and branded merchandise solutions, powered by its technology platform and a global fulfillment infrastructure. The fully integrated corporate gifting solution stands out in the field of pure-play tech companies and legacy promotional marketing firms, driving customer satisfaction and taking market share from their competitors.

TRENDS AND STATS

September Middle Market Deal Summary

46.2%
of the deals were made in the Business Products and Services (B2B) sector

63.5%
of the B2B deals were in Commercial Services

15.8%
of the deals were in the Information Technology sector

62.8%
of the IT deals were in Software

Texas and Florida
experienced the most dealmaking activity, followed by California

79.5%
of the deals were buyout deals

Figure 4: September Middle Market Deal Summary

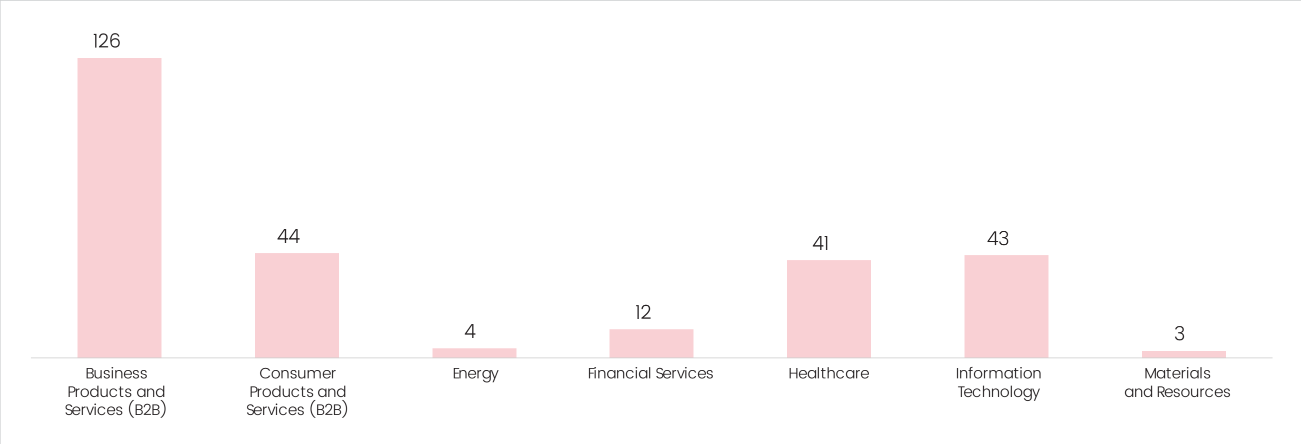


Figure 5: Consumer Products and Services

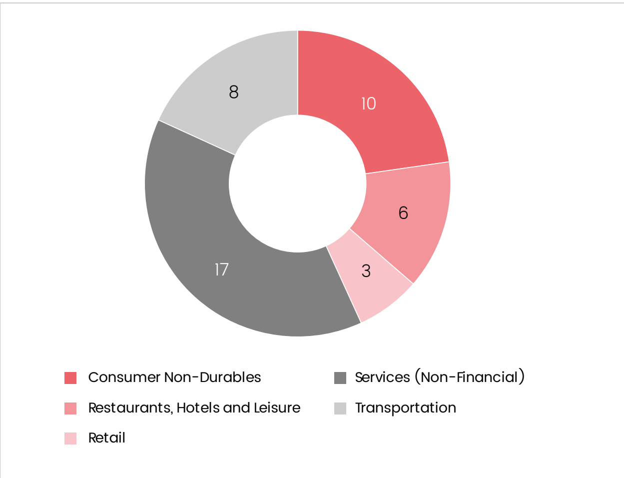
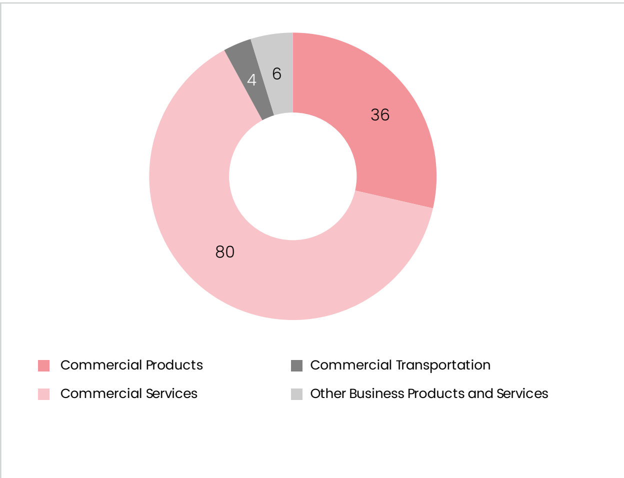


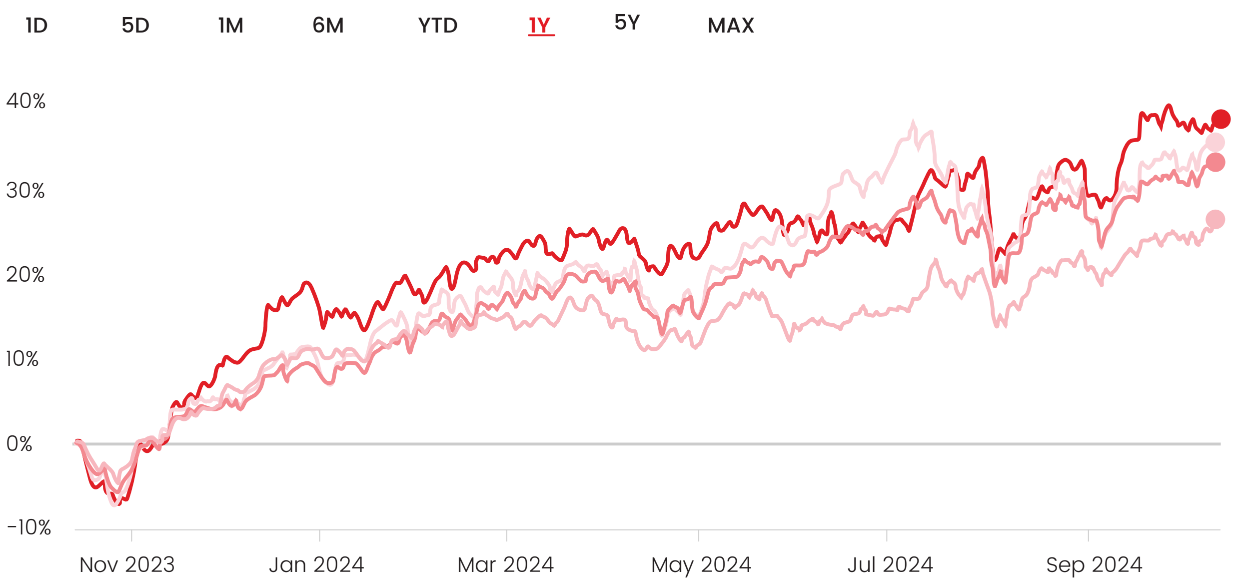
Figure 6: Business Products and Services



Source: SG Analytics Research

Note: This dataset specifically targets investor fund preferences within the $2–8 million EBITDA range. It is important to note that the summary provided focuses solely on these investor preferences and does not include details related to deal sizes.

S&P Listed Private Equity Index

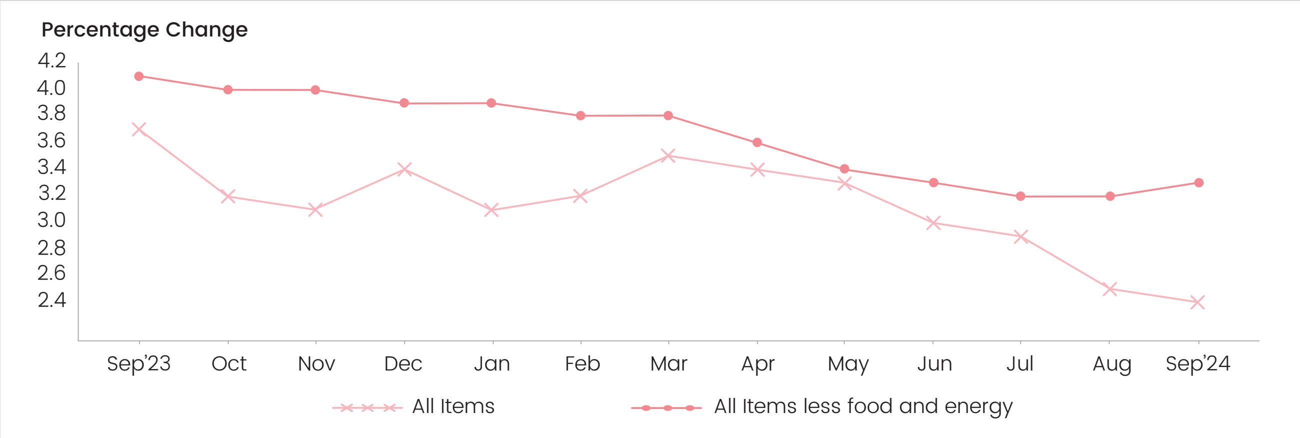


S&P Listed Private...	248.25	+68.22	↑ 37.89%
S&P 500	5,815.03	+1,441.40	↑ 32.96%
DOw Jones Industries...	42,863.86	+8,879.32	↑ 26.13%
Nasdaq Composite	18,342.94	+4,774.96	↑ 35.19%

Data as of October 14, 2024

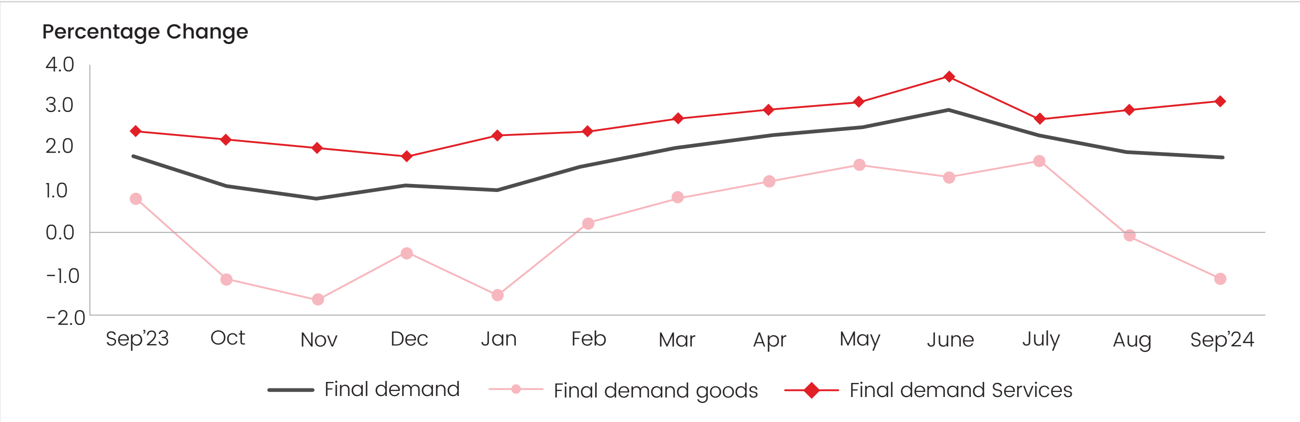
Index	Month-over-Month	YTD
Consumer Price Index	0.2%	2.4%
Producer Price Index	0	1.8%

Figure 7: 12-month Percent Change in CPI For All Urban Consumers, Not Seasonally Adjusted



Source: US Bureau of Labor Statistics

Figure 8: 12-month Percent Change in Selected PPI Final Demand Price Indexes, Not Seasonally Adjusted



Source: US Bureau of Labor Statistics

Upcoming Events

SuperReturn Private Credit U.S.	November 12–13, 2024	The Marriott Marquis, New York
PERE America Forum 2024	November 13–14, 2024	New York
Florida ACG Capital Connection	November 13–15, 2024	JW Marriott Miami Turnberry, Florida

SGA Newsletter Team

Steve Salvius

Kunal Doctor

Sandeep Jindal

Anwar Jakhal

Shreyanka Pal

Disclaimer

This document makes descriptive reference to trademarks that may be owned by others. The use of such trademarks herein is not an assertion of ownership of such trademarks by SG Analytics (SGA) and is not intended to represent or get commercially benefited from it or imply the existence of an association between SGA and the lawful owners of such trademarks. Information regarding third-party products, services, and organizations was obtained from publicly available sources, and SGA cannot confirm the accuracy or reliability of such sources or information. Its inclusion does not imply an endorsement by or of any third party.

SG Analytics
Life's Possible

www.sganalytics.com

in

Pune | Hyderabad | Bengaluru | London | Zurich | New York | San Francisco | Amsterdam | Toronto | Wroclaw