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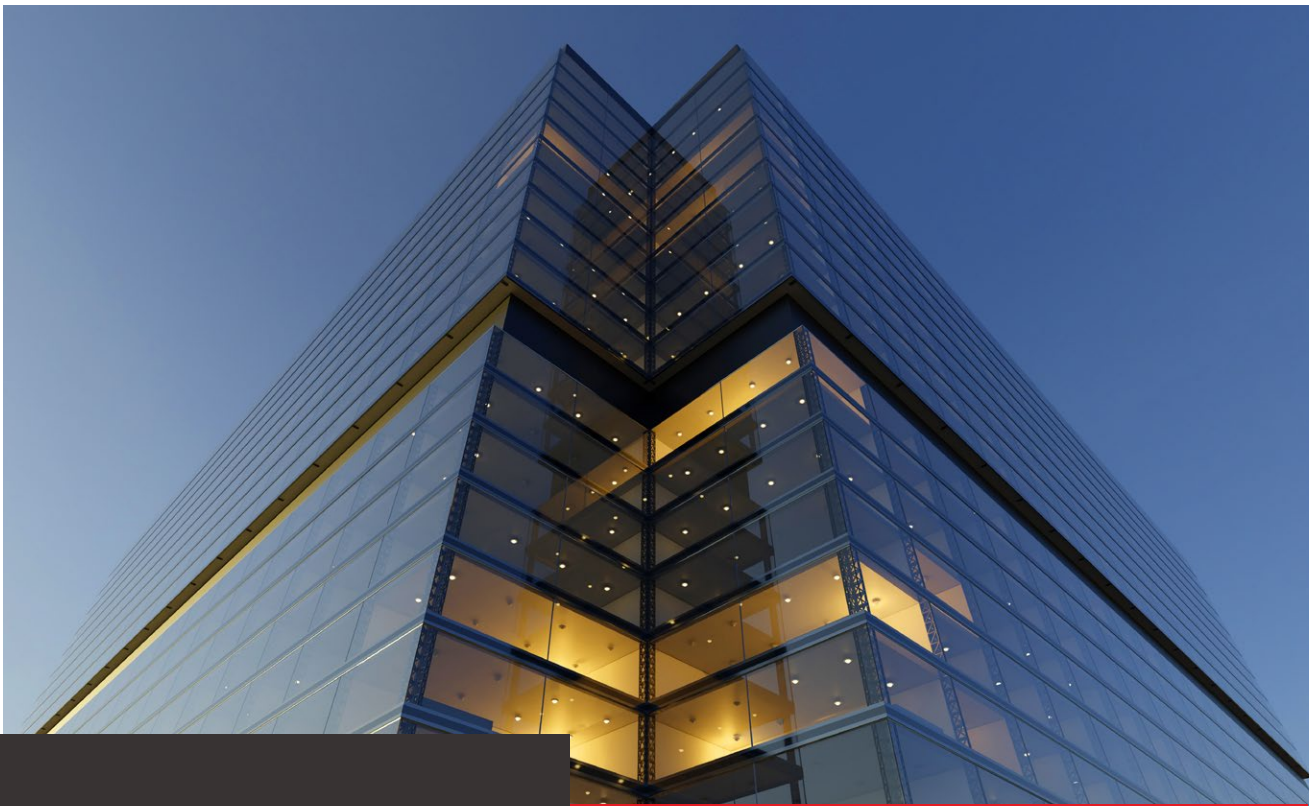
Issue 08 / September 2024



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Private Equity Newsletter

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.

The Road Ahead: The Impact of Rate Cuts on PE

Ares, Apollo, Blackstone, and KKR collectively deployed $160 billion in 2Q24, anticipating an increased buyout and merger activity following the rate cuts, according to The Financial Times.

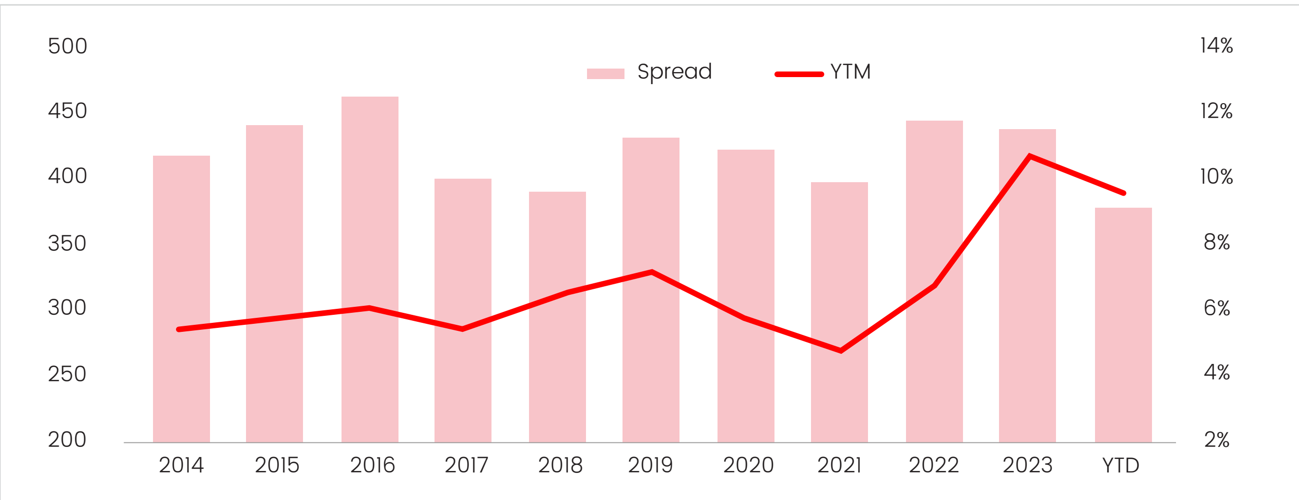
As the Fed starts its easing campaign, private equity (PE) firms remain optimistic about a market resurgence. Ares, Apollo, Blackstone, and KKR collectively deployed $160 billion in 2Q24, anticipating an increased buyout and merger activity following the rate cuts, according to The Financial Times. However, lower rates alone will not restore PE's pre-2022 boom, and firms must adapt to operating without the benefits of ultralow rates.

With both the job market and inflation easing, the Fed decided to reduce its key overnight borrowing rate by 50 basis points. This adjustment brings the federal funds rate down to a range of 4.75%-5%. While this rate directly affects short-term borrowing costs for banks, it also impacts various consumer products like mortgages, auto loans, and credit cards. Fitch Ratings projects that the Fed rate will decline by 200 bps by the end of 2025.

PEs are optimistic that the rate cuts will lower the cost of debt and increase investments. However, that will not be sufficient to boost the market activity levels back to 2021 highs.

The US benchmark rate averaged approximately 0.5% between 2009 and 2022. High inflation, which led the Fed to begin raising interest rates in 2022, ended this era of ultralow rates. Since 2022, the cost of leverage for PE firms has doubled to an average of 10%, up from 5%, according to PitchBook. This has made buyouts difficult to finance, with many firms struggling to sell their assets at expected prices. As a result, the US PE aggregate deal value has dropped by about 44% to $325 billion in 1H24, from $585 billion in 1H21, as per PitchBook.

Figure 1: M&A-related New Issue Loan Spread and YTM

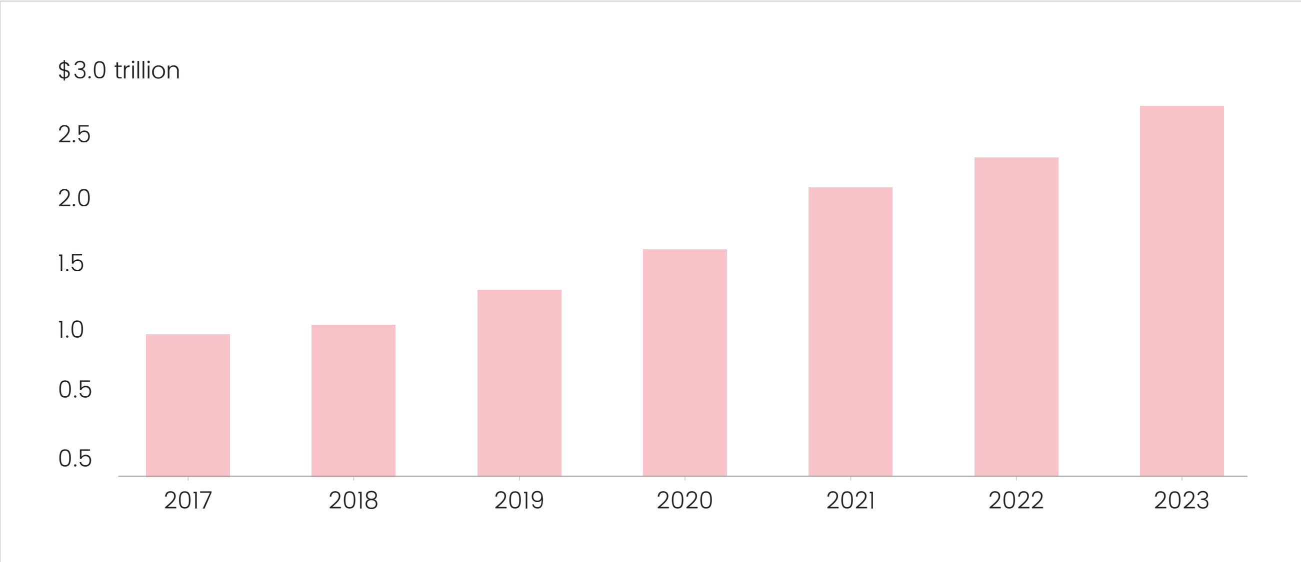


Source: PitchBook

While the rates have been high since 2022, it is important to note that they are only higher relative to this unusually low base. Years of ultralow rates have normalized the high valuation expectations, which were uncommon before the 2021 boom. The Fed is unlikely to return to the ultralow rates and the associated quantitative easing that brought them about soon, necessitating a recalibration of asset valuations.

Additionally, a major challenge for the industry has been the stagnant exit market. The backlog of unsold investments reached a record $2.86 trillion globally by the end of 2023, according to Preqin data reported by the Wall Street Journal. While the dealmaking has improved year-over-year, the sheer volume of accumulated assets may take firms years to clear, even with lower interest rates.

Figure 2: Unsold Asset Pileup Globally



Source: Wall Street Journal

Moreover, while there are hopes for a meaningful rebound in the valuation multiples, a Fed rate cut is unlikely to significantly alter business valuations. Furthermore, any boost to the asset values will take time, as it typically takes six to nine months for lower rates to impact the private market valuations, according to Wellington Management.

The rate cuts are certainly a positive sign for the industry. However, optimism that valuations and activity will return to 2021 levels should be tempered. To clear the deal backlog, firms need to recalibrate their asset value expectations to reflect today's market and focus on strategies for value creation alongside the expected rate cuts.

With financial engineering less effective due to higher leverage costs, firms should focus on operational improvements like boosting efficiency, cutting costs, and fostering innovation. Leveraging sector-specific expertise and thematic investing will help identify niche market opportunities. By prioritizing these strategies, PE firms can create substantial value, making their assets more appealing to buyers even in a challenging market.

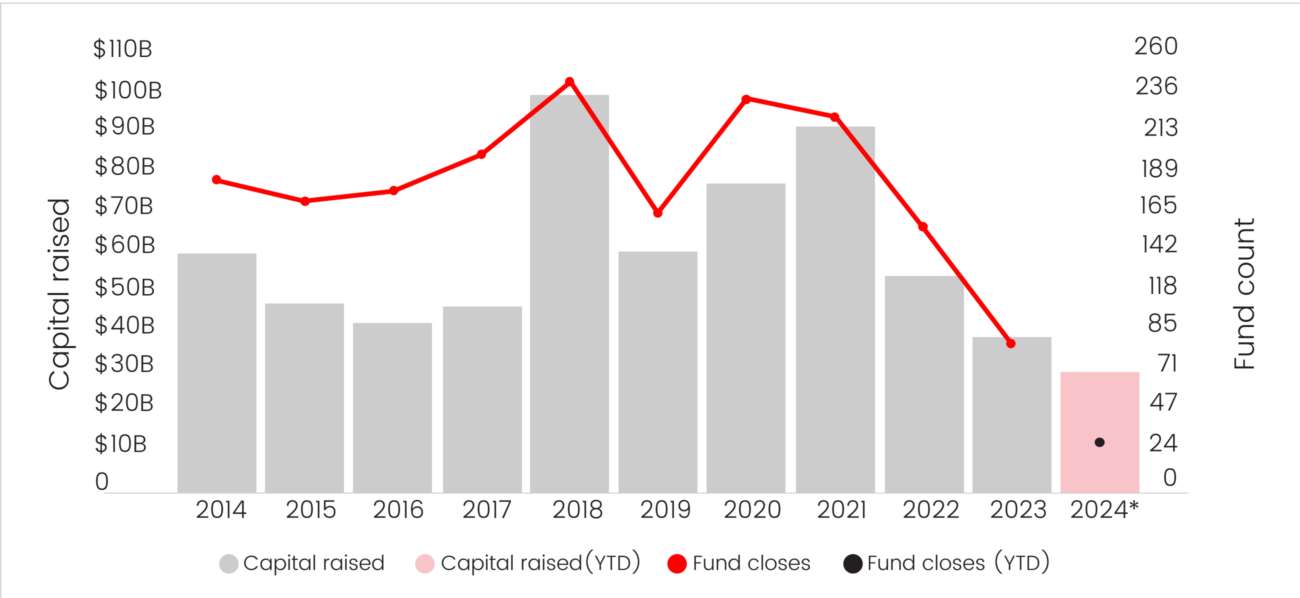
In conclusion, as the Fed begins its easing campaign, PE firms are hopeful for a market rebound. While reduced borrowing costs will benefit investments, they won't restore the high activity levels seen in 2021. The significant backlog of unsold assets and inflated valuations from previous ultralow rates highlight the need for PE firms to adapt to a changing climate. By recalibrating asset values and emphasizing value creation, firms can enhance their asset appeal and navigate current market challenges more effectively.

Monthly News and Analysis

PE Fundraising Shows Recovery in Asia

PE fundraising in Asia is beginning to recover after two years of decline. According to PitchBook, the Asian funds have secured $30.4 billion by mid-August this year, representing 77% of the total capital raised in the region in 2023. If this pace continues, the total for the year is projected to exceed $48 billion.

Figure 3: Asian PE Fundraising Activity



Source: PitchBook

Although fundraising appears to be recovering, the total number of fund closures is still declining as more capital consolidates into fewer, larger funds. As of August 19, 2024, only 31 PE funds have been raised in Asia, less than half of the 89 funds that closed last year, according to PitchBook. Hong Kong remains a key hub for fund domiciles, with five of the seven largest fundraises in the past five years originating from funds based there. Japan, which has gained attention this year, has seen a surge in fund activity, with a combined capital raise of $4.7 billion, already matching last year's total. Japan's attractiveness is partly due to its relatively low interest rates, even as the Bank of Japan shifts away from its negative interest rate policy. Additionally, the country has benefited from foreign capital moving away from Chinese investments.

PE Spotlight on Mental Health

Investor interest in the mental health sector has been strong for years, but until recently, deal activity had remained limited, primarily due to a lack of large, well-structured assets in the market. However, with labor inflation easing and several mental health and substance use disorder treatment platforms entering or preparing to enter the market, there is potential for an uptick in PE dealmaking in the mental health space.

Labor cost inflation has eased and stabilized, dropping from a peak of about 8% in late 2022 to under 5% by 4Q23, according to Acadia Healthcare. The market is shifting its focus from continuum-of-care models to outpatient mental health services, particularly partial hospitalization and intensive outpatient programs, as per PitchBook. With outpatient therapy margins below 10%, sector growth is largely driven by the recruitment and retention of providers. For instance, LifeStance, a mental health provider backed by TPG, Silversmith, and Summit, saw nearly 19% year-over-year revenue growth in 1Q24, supported by a 15% increase in its physician base, according to PitchBook. Furthermore, the low-margin, low-capital-intensive nature of outpatient mental health has limited the emergence of large, independent provider groups, presenting an investment opportunity. Several PE-backed mental health platforms, including Behavioral Health Group, Odyssey Behavioral, and Community Medical Services, are nearing maturity and could soon enter the market.

NFL Approves PE Ownership Rules

The National Football League (NFL) has approved a new policy allowing PE firms to hold ownership stakes in teams, making it the last major American sports league to do so. The move is driven by rising team sale prices and the liquidity opportunities they present for current owners.

While the NFL teams are often seen as recession-proof investments, PE limited partners may still face challenges. The NFL is placing stricter regulations on PE ownership compared to other leagues. Unlike traditional investments where firms take management and board roles, in sports, especially the NFL, firms have limited control over operations and personnel. Teams can only sell stakes to a list of preapproved firms, including Arctos Partners, Ares Management, and Sixth Street, among others.

Restrictions include no governance rights, no preferred-equity investments, and a requirement for investors to hold their positions for at least six years, with a maximum 10% ownership stake per team. Each of the approved groups may acquire stakes in up to six teams, with a minimum investment of $2 billion for a 3% stake. The league will also take a percentage of the profits private equity firms earn from these transactions. The new policy marks a significant step forward for the league, offering a valuable source of capital, particularly for funding stadium renovations or new construction – an investment that is becoming increasingly challenging to secure through local government subsidies.

PE Healthcare Funds Outpace VC

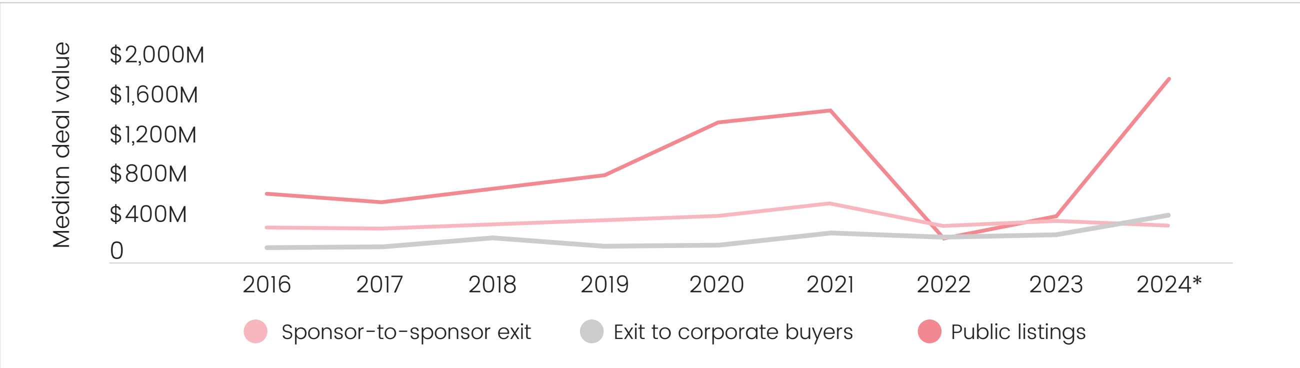
Healthcare-focused PE funds outperformed their VC counterparts in fundraising 1H24, fueled by strong limited partner interest and growing competition, according to PitchBook. PE healthcare managers are on track to match the record fundraising levels in 2023, while the VC market is undergoing a reset.

The heightened competition in healthcare PE has been leading specialists to adopt more sophisticated investment and operational strategies. Many have been focusing on thematic investments to build unique market insights and gain an edge in the less saturated areas. As a result, fundraising has become concentrated among a few larger funds. By June, nine PE funds had closed, raising a total of $8.9 billion. In contrast, for the first time since 2017, life sciences fundraising in the VC space slowed during the first half of the year, putting it on track to fall below $10 billion in 2024. Other areas of healthcare VC experienced even tougher conditions. While interest in the venture space remains, investors are looking to return capital to GPs, and many digital health startups, although gaining traction, are yet to achieve the momentum needed for acquisitions, IPOs, or significant venture funding.

PE's Preference for Strategic Buyers

PE firms are increasingly favoring exits to strategic buyers, alleviating their exit pressure while intensifying competition on the buy side. According to PitchBook, the median deal value for PE assets sold to strategic buyers surged by 70.8% in 1H24, reaching $480 million, up from $281 million in 1H23. In contrast, the median deal value for sponsor-to-sponsor exits declined, dropping to $375 million in 1H24 from $420 million in 1H23.

Figure 4: Corporate Buyer Spending More on PE Assets



Source: PitchBook

A survey by BDO USA found that 57% of the respondents plan to pursue sales to strategic buyers for exits over the next 12 months, up from 33% last year. Meanwhile, only 9% expect to exit through public listings, a significant drop from 29% the previous year. Additionally, fewer respondents anticipate selling to PE sponsors compared to the prior year. As per PitchBook, the shift is largely driven by higher premiums offered by corporate buyers, who have greater flexibility due to their ability to access cash reserves, stock, or investment-grade debt and benefit from lower capital costs. Corporates are also motivated by the potential to realize cost and revenue synergies from acquisitions. In contrast, PE firms are facing asset backlogs and higher borrowing costs, making them more price-sensitive and selective when pursuing deals.

Deals Flash

THL Acquires Majority Stake in YA Group

THL Partners, a Boston-based PE firm, has acquired a majority stake in YA Group, a Missouri-based professional services firm established in 1997. YA Group offers forensic consulting, engineering, and risk mitigation services to the insurance and public sectors. With a team of over 600 experts, the company handles complex projects in 27 countries. Over its 25-year history, YA Group has expanded through both organic growth and six strategic acquisitions since 2022. This investment is designed to boost YA Group's capabilities and accelerate growth, enabling the company to utilize THL's expertise and resources to expand its services and foster innovation.

RF Investment Acquires Rent-A-John

RF Investment Partners, a New York-based PE firm, has acquired Rent-A-John, a North Carolina-based portable sanitation rental solutions business. The investment marks RF's first acquisition under its new portable sanitation platform. Rent-A-John, known for its comprehensive range of sanitation services, operates across multiple regions, making it a strategic addition to RF's portfolio. The deal aims to enhance RF's offerings in the essential services space and leverage Rent-A-John's established market presence to drive growth and innovation within the sector.

Citation Acquires Majority Stake in Aptive Environmental

Citation Capital has acquired a majority stake in Aptive Environmental, a Utah-based residential pest control company. Founded in 2015, Aptive serves over half a million households by offering a wide range of pest prevention services. The company employs around 4,000 staff members and has rapidly grown since its inception to become the fifth-largest pest control company in the US. It is ranked as the top pest control company on Best Company. Citation Capital will support Aptive's efforts to advance technology and enhance operational efficiency, with the goal of improving customer experiences and bolstering its market position.

One Equity to Acquire EthosEnergy

One Equity Partners (OEP), a New York-based PE firm, has acquired EthosEnergy, a Scotland-based provider of energy services and solutions. Formed in 2014 as a JV between John Wood Group and Siemens Energy AG, EthosEnergy offers services such as turbine and generator repairs, as well as maintenance and technical support for power generation assets. With a workforce of over 3,600 employees across 23 global sites, this acquisition allows OEP to tap into EthosEnergy's expertise and international reach, with a focus on fostering growth and innovation in the energy services industry.

MidOcean Acquires SI Solutions

MidOcean Partners, a New York-based PE firm, has acquired SI Solutions, a North Carolina-based company specializing in engineering, testing, inspection, compliance, maintenance services, digital solutions, and expert consulting for power and critical infrastructure sectors. This acquisition marks MidOcean's fourth investment in engineering and critical infrastructure. The firm aims to help SI strengthen existing customer relationships and expand its market presence. With a workforce of over 450 employees, SI delivers technical expertise that ensures the reliability and resilience of US power markets, regulatory compliance of critical assets, and the growth of both public and private infrastructure in the US and globally.

Consello Capital Acquires EHE Health

Consello Capital, a New York-based PE firm, has acquired EHE Health, a California-based provider of employer-based preventive healthcare. Founded in 1913, EHE, which operates over 200 clinics across the US, focuses on offering comprehensive preventive care to help companies reduce healthcare costs and improve employee well-being. The acquisition allows Consello to expand its portfolio in healthcare services and support EHE's growth. EHE's services have a proven track record in improving employee health and reducing absenteeism. This buyout marks a strategic partnership aimed at leveraging Consello's capital and expertise to further scale EHE's operations.

Fort Point Acquires NewBold

Fort Point Capital, a Boston-based private equity firm, has acquired NewBold Corporation, a managed technology services provider. Founded in 1994, NewBold specializes in point-of-sale systems, automated identification and data capture, and payment device services. This partnership marks Fort Point's third platform investment from its FPC Small Cap Fund III. NewBold serves industries like quick-service restaurants, retail, warehousing, and healthcare. Fort Point aims to support NewBold's continued growth through strategic acquisitions and expanding service offerings.

Pelican Energy Acquires Electrical Builders Industries

Pelican Energy Partners, a Houston-based PE firm, has acquired Electrical Builders Industries (EBI), a Minnesota-based service provider specializing in electric bus duct installation and repair. EBI, known for extending asset life at generation facilities, serves over 75% of the US commercial nuclear fleet, reinforcing Pelican's commitment to the nuclear sector. This partnership is expected to drive EBI's growth in North America's power sector. Pelican plans to leverage EBI's expertise to support expanding baseload power for data center facilities.

Pelican Energy to Acquire GSE Solutions

Pelican Energy Partners, a Houston-based PE firm, has acquired GSE Solutions, a Maryland-based clean energy solutions company, in a take-private transaction. Pelican purchased GSE's outstanding shares at an estimated price of $4.10 each, which represents a 50% premium over GSE's closing price on August 7, 2024. GSE, which has completed over 1,100 installations for customers across more than 50 countries, is expected to see growth and enhanced capabilities in nuclear energy under Pelican's ownership. The merger, approved unanimously by GSE's board, is anticipated to be finalized in late 2024, subject to shareholder approval and other standard conditions.

TPG, South Street Acquire the King and Prince Beach & Golf Resort

South Street Partners, a Carolina-based PE firm, and TPG Real Estate, a California-based real estate investment platform, have established a JV to acquire The King and Prince Beach & Golf Resort, a golf club, from MMI Hospitality Group, a family-owned investment firm based in Mississippi that specializes in the service industry. Situated on St. Simons Island, the 142-key resort covers nearly six acres and features direct beach access, bars, restaurants, swimming pools, and sports courts. The JV plans to enhance the resort and club through a comprehensive renovation of rooms and common areas. This investment is part of South Street's inaugural SSP GP Fund I.

TRENDS AND STATS

August Middle Market Deal Summary

49.8%
of the deals were made in the Business Products and Services (B2B) sector

65.2%
of the B2B deals were in Commercial Services

17.8%
of the deals were in the Information Technology sector

75%
of the IT deals were in Software

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

75.1%
of the deals were buyout deals

Figure 5: August Middle Market Deal Summary

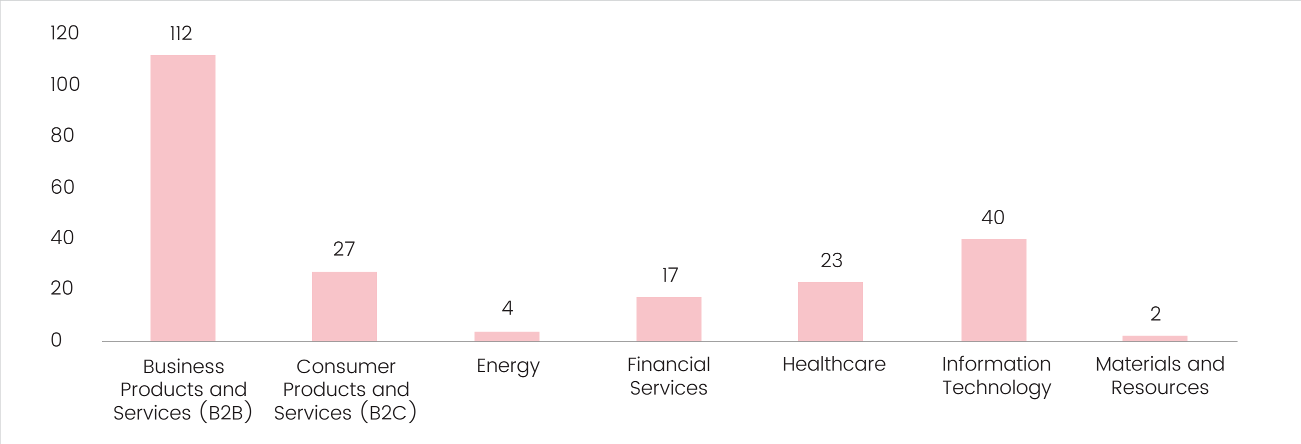


Figure 6: Consumer Products and Services

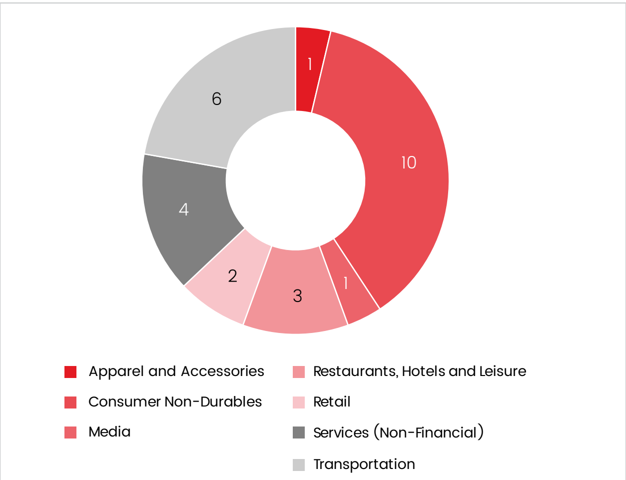
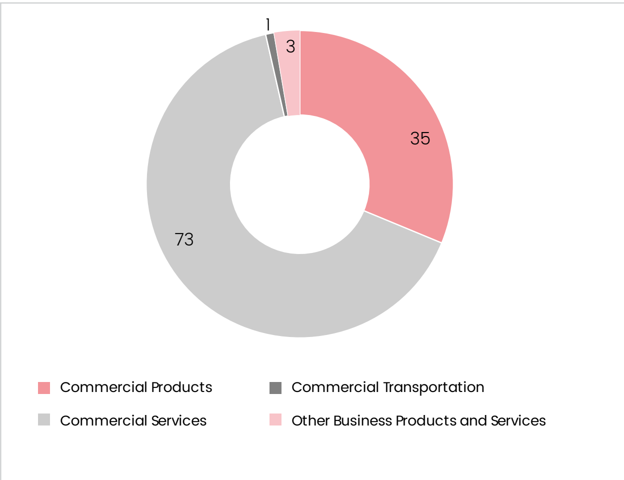


Figure 7: Business Products and Services

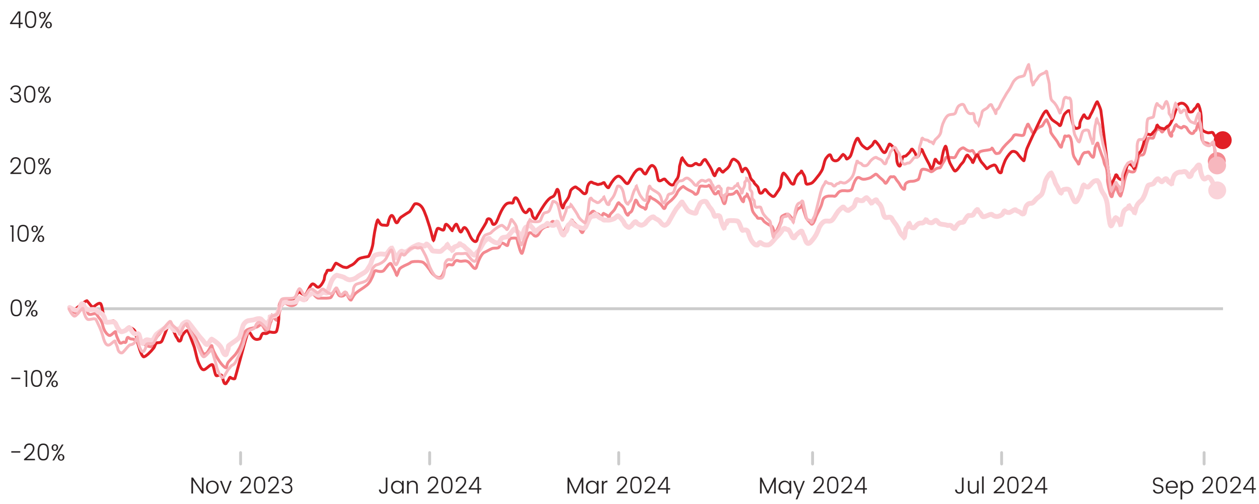


Source: SG Analytics Research

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

1D 5D 1M 6M YTD 1Y 5Y MAX

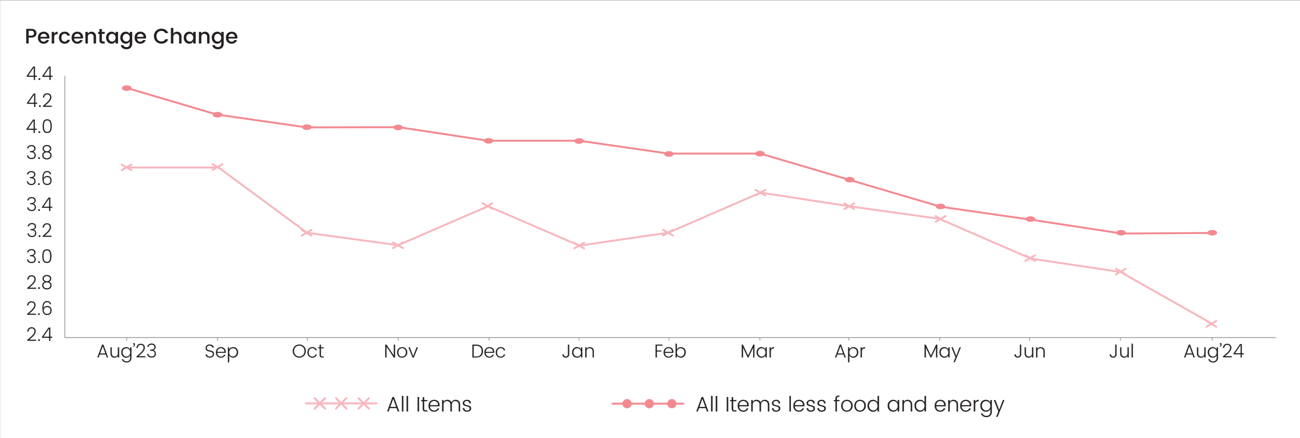


S&P Listed Private...	230.15	+43.56	23.35%
S&P 500	5,408.42	+920.96	20.52%
Nasdaq Composite	16,690.83	+2,772.92	19.92%
DOw Jones Industries...	40,345.41	+5,681.69	16.39%

Data as of September 9, 2024

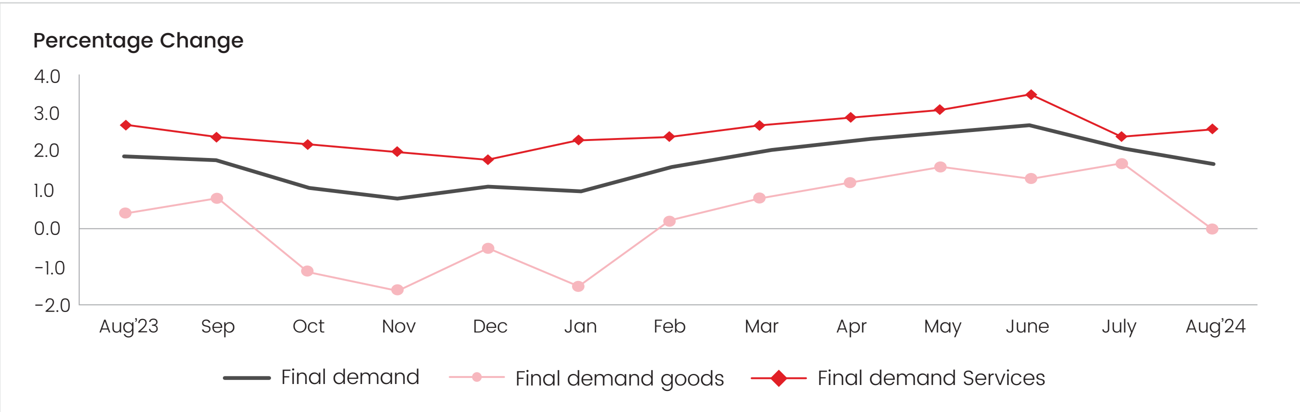
Index	Month-over-Month	YTD
Consumer Price Index	0.2%	2.5%
Producer Price Index	0.2%	1.7%

Figure 8: 12-month Percent Change in CPI For All Urban Consumers, Not Seasonally Adjusted



Source: US Bureau of Labor Statistics

Figure 9: 12-month Percent Change in Selected PPI Final Demand Price Indexes, Not Seasonally Adjusted



Source: US Bureau of Labor Statistics

Upcoming Events

Investor Relations & Fundraising Forum San Diego 2024	September 25–26, 2024	The Westin San Diego Bayview, San Diego
ACG Philadelphia | M&A East	September 30 to October 1, 2024	Philadelphia Marriot Downtown, Philadelphia
19th Annual Private Equity Conference	October 21, 2024	540 Michigan Ave, Chicago

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