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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.

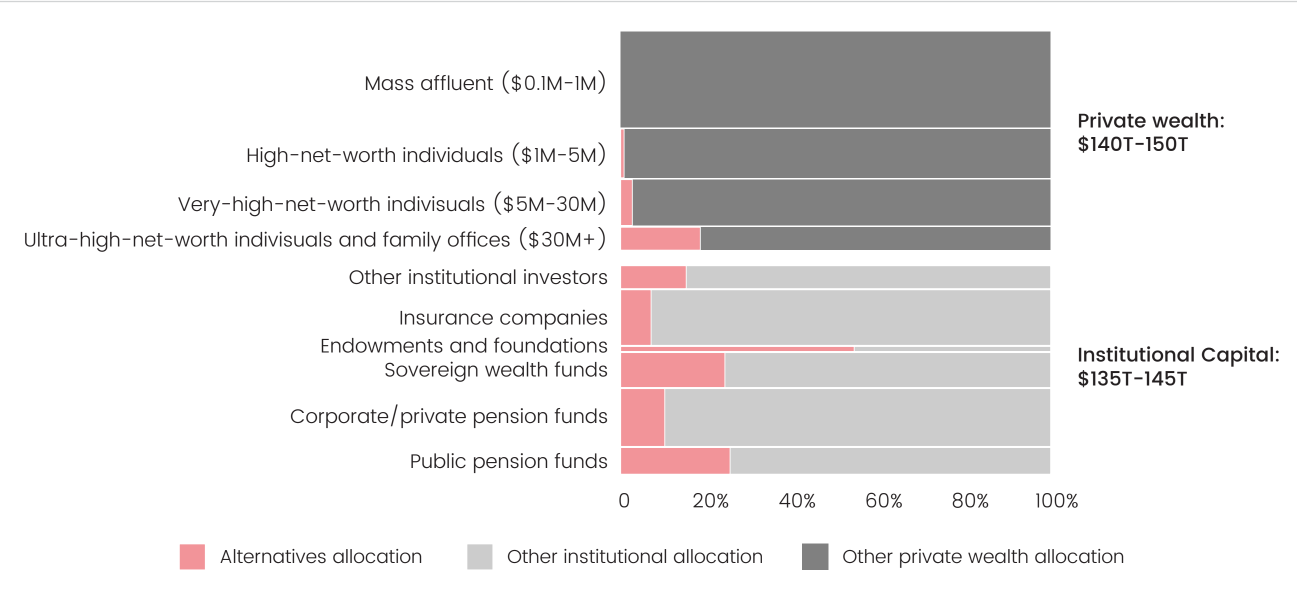
PE Inclusion: Unlocking Retail Investor Potential

The integration of retail investors into private equity (PE) is still in its early stages, with the industry yet to fully capitalize on this emerging market. Despite hurdles, the heightened focus on the largely unexplored retail sector indicates a favorable shift toward private market democratization, broadening investor access.

Retail investors are often reluctant to invest in PE due to its illiquid characteristics, which involve a lockup period and limited exit options. Furthermore, the complex structure, high risks in portfolio investments, lack of disclosures, regulatory barriers, and a fee structure that includes substantial fees and carried interest further deter retail participation. Research by Bain & Company indicates that individual investors accounted for about half of global assets under management (AUM), estimated at $275–295 trillion, yet represented only 16% of AUM in alternative asset funds in 2022.

PE firms are increasingly targeting retail investors, developing innovative fund structures and partnerships to tap into a largely unexplored market, and broadening access despite barriers like illiquidity and high fees.

Figure 1: Global Wealth by Investor Type, 2022



Soure: Preqin; GlobalData; Bain analysis

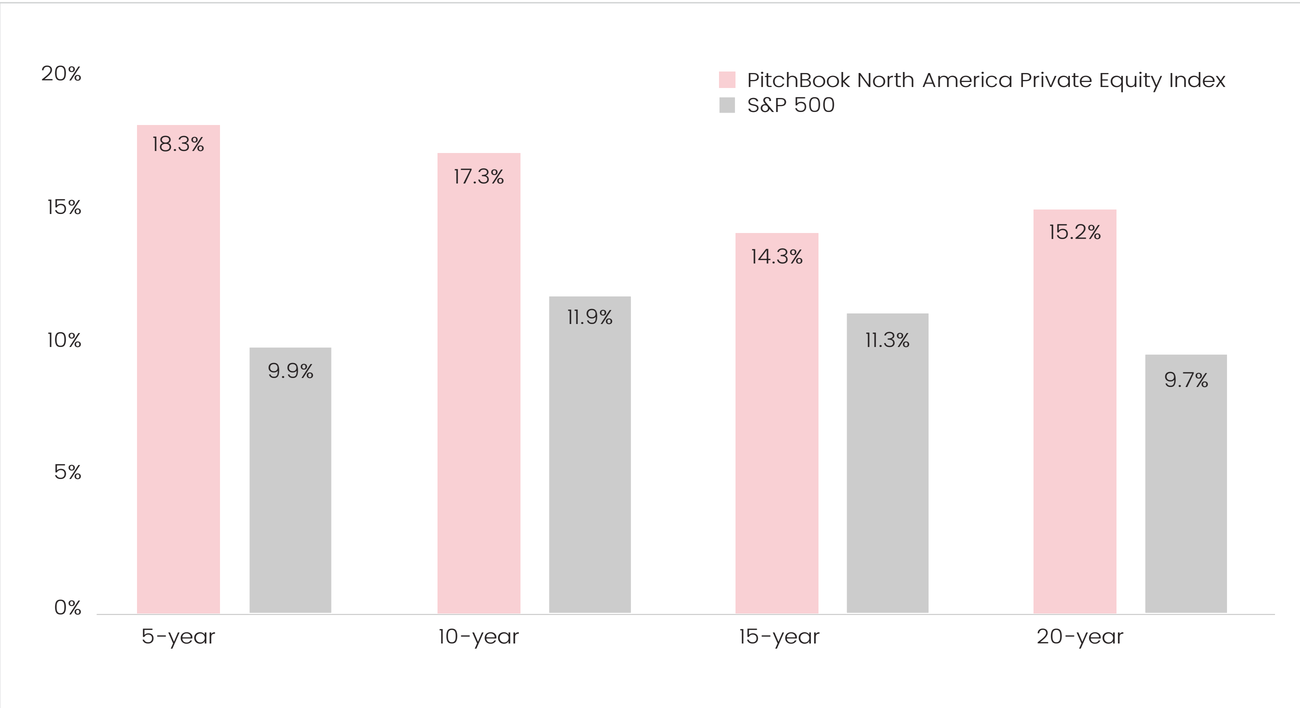
However, the scenario is changing, with PE firms increasingly inclined toward retail investors as they seek new capital sources amid declining inflows from institutional investors. With many institutional investors already overinvested in PE, firms are prompted to seek growth by tapping into a larger pool of affluent investors. Additionally, general partners (GPs) are innovating new, regulation-compliant fund structures to attract a broader segment of retail investors.

In September 2024, BlackRock and Partners Group partnered to increase retail engagement by launching a multi-private markets model solution, offering financial advisors diversified exposure to PE, private credit, and real assets within a single portfolio. In the same month, Apollo and State Street partnered with a focus on private credit investment, launching exchange-traded funds (ETFs) and other products to expand their offering to retail investors.

Similarly, in January 2024, Blackstone announced $1.3 billion in funding for its Blackstone Private Equity Strategies Fund, the largest-ever retail fund. This fund allows for quarterly redemption of up to 3% of its assets and offers lower management and performance fees than traditional PE funds in exchange for a lower hurdle rate.

Wealthy retail investors are increasingly exploring PE for its potential to provide diversification and provide better returns during downturns, outperforming traditional assets. Over the past 20 years, PE funds have outperformed the S&P 500, delivering an average return of 15.2% compared to 9.7% for stocks, per PitchBook. The shrinking opportunities and the challenge of generating alpha returns in public markets, as they have become more efficient, have made PE even more appealing to retail investors.

Figure 2: Return Comparison: Private vs. Public Equity



Source: PitchBook, as of December 31, 2023

Cerulli predicts that retail investment in alternative assets will grow from 13% in 2023 to 23% by 2026; thus, asset managers are seizing the opportunity to increase their stake in the market. By 2028, financial advisers are estimated to manage $3.6 trillion in alternatives for their individual clients – a 50% increase from $2.3 trillion in 2023. To capitalize on this expanding market, asset managers must overcome regulatory complexities and adapt their business models with disciplined strategies, such as creating retail-centric products, improving distribution, and designing adaptable operational models.

Regulatory bodies are also supporting this change. In 2020, the SEC expanded the definition of 'accredited investor' to include individuals with sufficient knowledge and expertise, beyond just wealth-based criteria, aiming to identify more investors who would participate in investment opportunities.

Overcoming Key Hurdles

Despite this progress, challenges remain as PE broadens access to retail investors, with illiquidity being a key issue. When Blackstone launched its Blackstone Real Estate Income Trust, it explicitly disclosed its redemption limits of 2% of NAV monthly and 5% quarterly to balance flexibility with liquidity constraints. However, during market volatility, redemption requests exceeded these limits, raising concerns about liquidity and threatening to derail its retail strategy. High fees also pose a challenge for retail investors, who are accustomed to paying management fees between 0.5% and 1% in mutual funds. In contrast, private funds come with more complex structures and historically higher fees than traditional mutual funds and ETFs.

Nonetheless, the alternative industry is actively exploring solutions to mitigate these obstacles. One such solution is the exploration of tokenization to optimize digital pathways. Firms like KKR, ADDX, and Hamilton Lane have introduced tokenized fund structures that offer greater liquidity and transparency mechanisms, making investments more accessible to individual investors. To achieve success, firms must tailor their products to meet the liquidity requirements of retail investors, who prefer to access their money when needed and are unfamiliar with long-term, closed-ended funds, as opposed to institutional investors.

There is a need to raise awareness by developing customized educational resources, as retail clients and their intermediaries often lack familiarity with the intricacies of alternative investments. Initiatives like Blackstone University, which educates private wealth advisors about private markets, are critical to this effort.

Conclusion

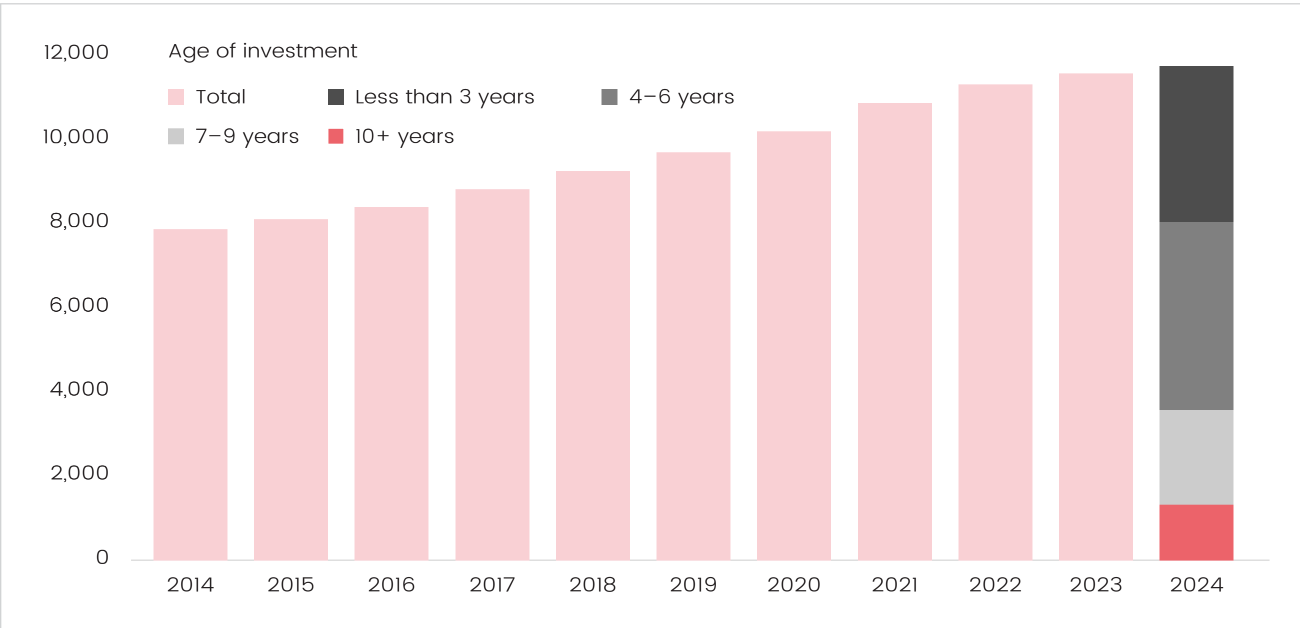
The PE industry is slowly shifting toward the retail market, but this transition is far from complete. Although few have made headway with high-net individuals, many remain to reach the extensive market in the retail space. The industry needs consumer-centric tactics, including developing target-marketed approaches and tailoring products for new audiences. Most individual capital is still sourced from traditional closed-end models, mainly from individual capital through private banks and wealth managers. As firms improve their capabilities with the changing landscape, PE stands ready to open new doors for growth and scale, especially at the retail investor level.

Monthly News and Analysis

PE Exit Rate Struggles to Clear Inventory Backlog

US PE exits surged in 3Q24, reaching $107.1 billion, the highest quarterly total since 1Q22, according to PitchBook. Simultaneously, the total number of portfolio companies owned by PE funds rose to 11,567 in 2Q24, a 26% increase from 2018. With exits occurring at the current pace of 1,378 per year, it would take GPs more than eight years to offload their holdings – a significant challenge, considering the usual 10–12-year lifespan of PE funds, as per PitchBook estimates.

Figure 3: PE-backed Company Inventory by Deal Year



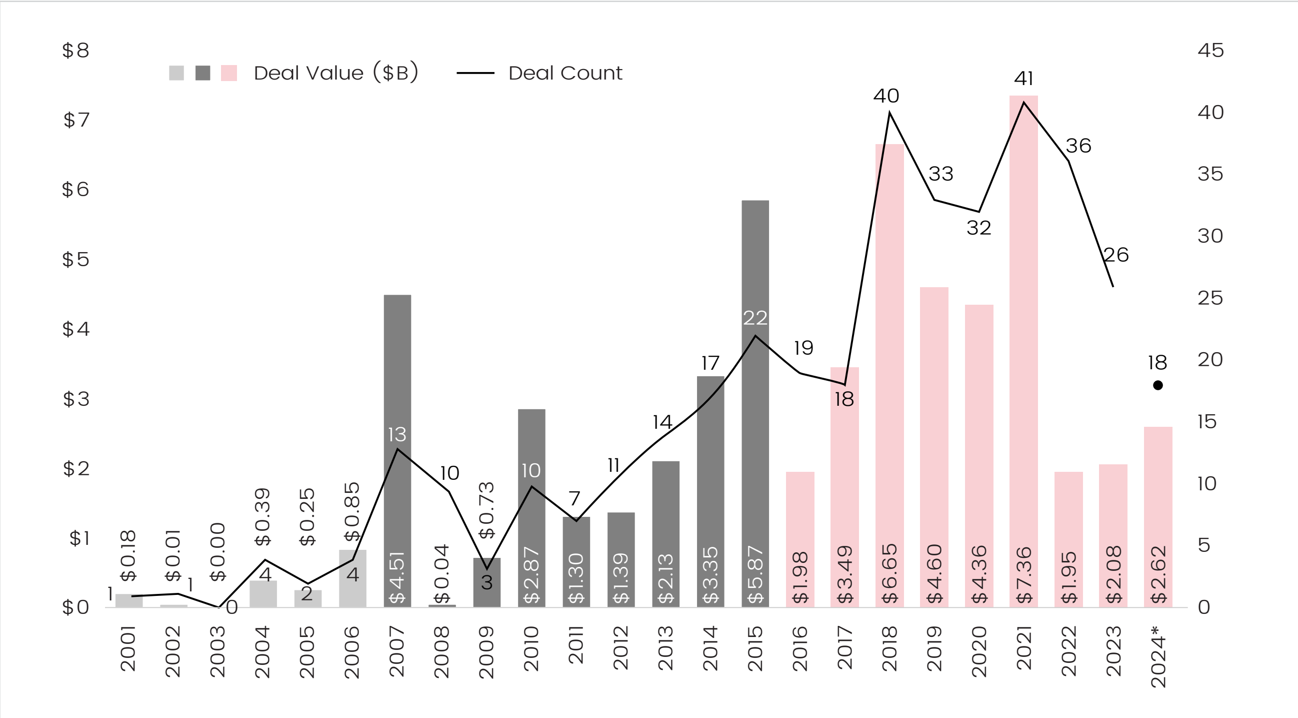
Source: PitchBook, as of September 30, 2024

Although PE exit activity has recovered, a gap remains between capital deployed and realized, estimated at $300 billion in 3Q24, per PitchBook. PE firms need to exceed 2,000 exits annually to rebalance the market, potentially bringing lower-tier assets to sale, according to an estimate by a PitchBook analyst. As borrowing costs reduce with interest rates easing, sponsor-to-sponsor deals would improve liquidity in the market. While dividend recapitalization could provide a temporary solution by delivering immediate returns to LPs and easing short-term pressure on PE firms, highly leveraged companies may face increased financial risk, making them less attractive to buyers. This would further deter the exit path, prolonging the backlog. Moreover, as market conditions improve, the recovery of the merger and acquisition (M&A) market would accelerate the exit process. With the given inventory pile and longer exit timelines, there is an increasing need for GPs to devise efficient strategies for reducing their holdings. This would require GPs to manage the balance between deploying capital and realizing exits to effectively manage the backlog, particularly as market conditions improve.

Texas PSF Takes GP Stake in Velocity Capital

In October 2024, the Texas Permanent School Fund (PSF), a sovereign wealth fund that supports public primary and secondary education in the US, announced the acquisition of a minority GP stake in Velocity Capital Management's Opportunity Fund, a New York-based PE firm. Texas PSF will also commit additional capital for co-investment, credit, and real estate opportunities within Velocity's investment focus and operational expertise, which spans the sports, media, and entertainment sectors.

Figure 4: Global PE GP Stakes Deal Activity (2008-YTD*)



Source: PitchBook, *as of October 09, 2024

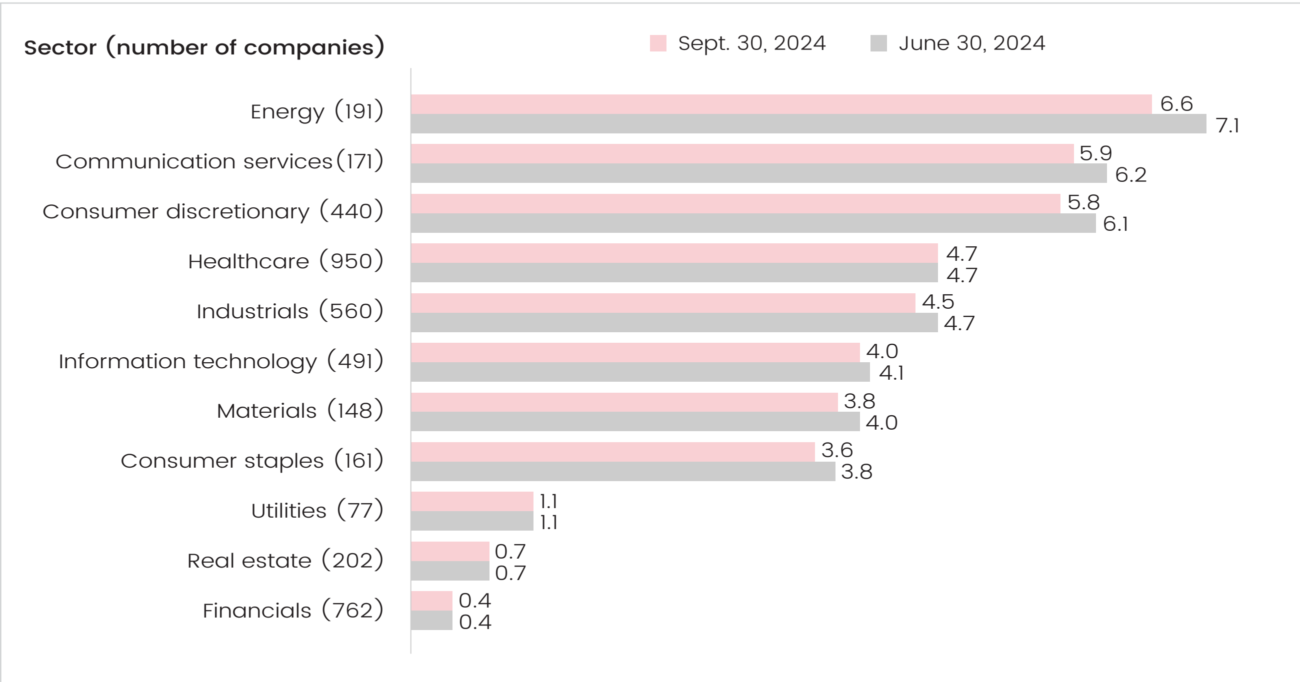
GP stakes investing has become a significant strategy over the years, offering investors access to top-tier management and steady returns in the evolving PE landscape. Earlier, when GP stakes were uncommon, LPs and large asset managers directly invested minority stakes in PE firms based on their long-term relationships. However, this strategy has evolved significantly with the rise of new, dedicated GP stakes funds. For instance, in October 2024, Eldridge Industries announced the acquisition of a 10% interest in Blue Owl GP Stakes Fund III, a passive minority investment vehicle that owns shares in PE firms. These GP stakes funds provide GPs with liquidity to renew efforts in business renovation, along with the benefit of operational expertise and specialized knowledge.

Additionally, investing in GP stakes offers investors several benefits, including a share of management fees, access to the fund's governance and investment insights, and potential equity appreciation, as demonstrated by Blue Owl GPS Fund IV's reported net internal rate of return (IRR) of 20.4%. However, there are a few challenges, such as undervaluation by traditional investors and limited participation due to its specialized, capital-intensive nature. With its potential for consistent income and strategic advantages, GP stakes investing continues to attract investors seeking long-term growth and unique insights into the industry.

Decrease in Default Risk in US Market Sectors

In 3Q24, the default risk for US corporate debt saw a notable decline across most sectors, marking an improvement compared to 2Q24. As of September 30, 2024, the median probability of default scores dropped in seven out of eleven market sectors, while healthcare, utilities, real estate, and financials remained relatively steady compared to June 30, 2024, according to S&P Global.

Figure 5: Median RiskGauge Scores by US Sector (%)



Source: S&P Global, as of October 3, 2024

In early 2024, US corporate debt defaults surged, driven by persistent inflationary pressures, low consumer spending, increased wages, and elevated interest rates, all of which strained the balance sheet of highly leveraged companies. However, the landscape is beginning to change with a decrease in corporate defaults. By September 2024, 67 defaults had been reported, 10 fewer than during the same period in 2023, according to S&P Global. This prominent shift is due to the stabilization of interest rates after a period of aggressive hikes by the Fed, making it easier for companies to service their existing debts. Additionally, lower inflation has resulted in businesses controlling their operational costs, enabling them to maintain profitability, which is vital for sustaining debt repayment schedules. This combination will further improve the outlook for corporate solvency in the coming months, signaling a potential turning point for many firms.

Increasing Concern over PE Clawbacks

According to research by Upwelling Capital Growth in 4Q24, around one in 14 US PE funds is expected to face clawbacks. Similarly, a September report by Citco found that one in four GPs has either already experienced or anticipates facing a rise in clawback risk within the next 12 months.

The increasing risks of potential clawbacks in PE have prompted the need for more robust ways to curb foreseeable liabilities. These preventive measures include creating clawback reserve escrow accounts and setting up provisions into waterfall agreements that allow funds to maintain a structure, thus reducing risks. A limited number of PE firms have created third-party escrow or segregated reserve accounts to secure their clawback obligations, as per a study by Paul, Weiss, Wharton & Garrison in May 2024. Additionally, LPs should request periodic reviews of profit to ensure that any potential clawbacks are addressed before the fund closes, mitigating the risk of large repayments later. Negotiations with GPs also aim to waive management fees in the event of a clawback, lessening the burden on them. The secondary market offers opportunities for buyers to reduce clawback risks by renegotiating the Limited Partnership Agreement, ensuring that liabilities are addressed upfront to prevent financial impacts during the transaction. However, if GPs fail to make the clawback payment, and the fund has underperformed for a prolonged time, the unresolved obligations could turn the fund into a zombie vehicle, persisting without resolution.

Further Scrutiny into PE Healthcare Deals

The increasing scrutiny of PE healthcare deals has drawn significant industry attention, with various government agencies launching investigations amid concerns that anti-trust tendencies in such transactions may prioritize profits over patient care quality. Recently, California introduced Assembly Bill 3129, aimed at empowering the state's Attorney General to review and ensure that PE acquisitions do not compromise patient care quality and affordability. However, Governor Newsom vetoed the bill on September 28, 2024, citing concerns over duplicating efforts with the state's Office of Healthcare Access (OHCA), which already reviews healthcare transactions.

The increased scrutiny of PE deals highlights the need for firms to align financial goals with long-term value creation, ethical business practices, and stakeholder interests. Numerous regulatory proposals aimed at ensuring this alignment have surfaced over the past year, though most have stagnated due to reluctance to step up administrative oversight. A Connecticut Bill (H.B. 5319), which aimed to regulate PE ownership in healthcare facilities, has been stalled in committee and will be revisited in early 2025. Similarly, a Minnesota Bill (HF 4206, in conjunction with SF 4392) restricting PE and real estate investment trusts ownership of healthcare providers also remains in committee and would not be revisited until 2025. Several stalled bills like these are expected to resurface in 2025.

Regulations should enhance oversight of PE healthcare acquisitions through stringent disclosures, stricter anti-trust measures, restrictions on post-acquisition debt, and improved reporting requirements to detect harmful trends earlier.

Deals Flash

ArchStar Invests in Packaging Strategies

ArchStar Capital, a Minnesota-based PE firm, has invested in Packaging Strategies, a Baltimore-based provider of hard plastic packaging containers. Founded in 1995, Packaging Strategies specializes in manufacturing durable, rotationally molded cases for various industries, including mobile virtual reality training systems, aircraft and drones, satellite and maritime equipment, weaponry, computer systems, and medical equipment. This transaction represents ArchStar's third platform investment in 2024 and supports the firm's objective of becoming the preferred investment partner for founder-owned manufacturing, distribution, and service businesses.

Pioneer Power Exits PCEP to Mill Point Capital

Mill Point Capital, a New York-based PE firm, has acquired Pioneer Custom Electrical Products (PCEP) from Pioneer Power Solutions, a New Jersey-based electrical power system provider. The sale includes $48 million in cash and $2 million in equity considerations, along with the assumption of certain liabilities. PCEP's Electrical Infrastructure division offers energy solutions that help users safeguard and manage their electrical energy use and requirements under the 'E-Bloc' brand. This sale will allow Pioneer Power to sharpen its focus on its Critical Power and eMobility business segments.

Audax Carves Out Clinical Services Business of Avantor

Audax, a Boston-based PE firm, has acquired the clinical services business of Avantor, a Pennsylvania-based biotechnology, chemicals, and pharmaceuticals company. This $650 million carve-out deal involves rebranding the unit as Resonant Clinical Solutions. With a focus on growth through organic and inorganic development and strategic acquisitions, Audax aims to enhance Resonant's service offerings to meet the growing demand in the outsourced clinical services sector. This deal will enable Avantor to strengthen its balance sheet and concentrate on strategic growth opportunities in its manufacturing and lab operations.

Tecum Equity to Invest in Kadon Precision

Tecum Equity, a Pittsburgh-based PE firm, will invest in Kadon Precision and Aerospace, an Illinois-based aerospace and defense manufacturing company. Founded in 1952, Kadon focuses on Swiss turn, mill, lathe, and multi-axis precision machining and assembly for aerospace, defense, space, and industrial applications. Tecum plans to grow Kadon through add-on acquisitions to broaden its production capabilities. This investment will allow Kadon to leverage Tecum's expertise in precision manufacturing and proven growth approach, supporting the company's expansion while upholding its commitment to a team-focused culture.

Truelink to Acquire GES from Viad

Truelink Capital, a Los Angeles-based PE firm, will acquire GES, a subsidiary of Viad, an Arizona-based diversified company focused on the attractions and hospitality industries. With over 2,600 employees, the GES business entity is a collective of companies, including GES Exhibitions, a provider of global exhibitions and logistics services; Spiro, a global experiential agency; and onPeak, SHOWTECH, and Visit, which provide event accommodation, power, lighting, and registration services. The deal is expected to close by the end of 2024. Upon completion, GES will become a privately owned, independent entity within Truelink's business portfolio.

Eagle Merchant Acquires Majority Stake in SamCo

Eagle Merchant Partners, an Atlanta-based PE firm, has acquired a majority stake in Sam the Concrete Man (SamCo), a Denver-based concrete services franchisor. Founded in 1989, the company offers various home concrete services, such as patios, driveway and sidewalk replacement and repair, and other minor concrete tasks. This acquisition will enable Samco to expand its reach and strengthen franchisee support. Further, it will facilitate Eagle Merchant Partners to grow SamCo's franchise network, increase brand awareness, and explore new services that complement the business's key competencies.

One Equity Acquires Yorktel

One Equity Partners, a New York-based PE firm, has acquired York Telecom Corporation (Yorktel), a New Jersey-based global IT service provider. Founded in 1985, Yorktel is a next-generation global systems integrator and managed services provider that supports various blue-chip enterprise customers and government agencies with an array of IT solutions, including AI-based monitoring for hybrid work environments. This acquisition will allow Yorktel to expand its solutions and offerings, enhancing its customers' digital workplace experience. Additionally, it will enable One Equity Partners to leverage Yorktel's solutions to meet the growing demand for productivity and collaboration technologies.

Riverside to Exit PFB Assets to Carlisle Companies

The Riverside Company, a New-York-based PE firm, will sell the Plasti-Fab and Insulspan business units of its portfolio company PFB Corporation, an Alberta-based provider of EPS-based insulation products, to Carlisle Companies, an Arizona-based supplier of building envelope products and solutions. The business will be sold for about $260 million, and the deal is expected to close in 4Q24. PFB will retain and continue to operate its PFB Custom Homes Group subsidiary post-sale. This acquisition will allow PFB to leverage its strategic alignment with Carlisle Companies, expanding its insulation products business and contributing to Carlisle's ongoing growth.

NewSpring Acquires Xpect Solutions

NewSpring, a Pennsylvania-based PE firm, has acquired Xpect Solutions, a Virginia-based enterprise IT and security solutions provider. Founded in 2004, Xpect Solutions offers cybersecurity solutions, cloud services, network infrastructure, and data center management, with a focus on supporting federal government agencies. This acquisition expands NewSpring's federal platform, enabling the delivery of mission-critical solutions for law enforcement agencies. Further, this acquisition allows NewSpring to strengthen its momentum in the federal sector to meet the evolving complexity of federal law enforcement through Xpert's technical expertise and strategic capabilities.

Kava Acquires Arrowhead Contracting

Kava Equity Partners, a Denver-based PE subsidiary of the Southern Ute Indian Tribe Growth Fund, has acquired Arrowhead Contracting, a Kansas-based environmental remediation services provider. Founded in 1990, Arrowhead specializes in environmental remediation projects and general contracting for commercial, federal, and Native American clients. This acquisition will support Kava's plans to enhance Arrowhead's operating efficiency and expand its position in the construction and environmental remediation industries by utilizing its resources. Additionally, Arrowhead will retain its existing management team and continue to provide high-quality services by using Kava and the Growth Fund's resources and expertise.

TRENDS AND STATS

October Middle Market Deal Summary

48.4%
of the deals were made in the Business Products and Services (B2B) sector

57.9%
of B2B deals were in Commercial Services

18.1%
of the deals were in the Consumer Products and Services (B2C) sector

32.5%
of B2C deals were in Services (Non-financial)

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

79.3%
of the deals were buyout deals

Figure 6: October Middle Market Deal Summary

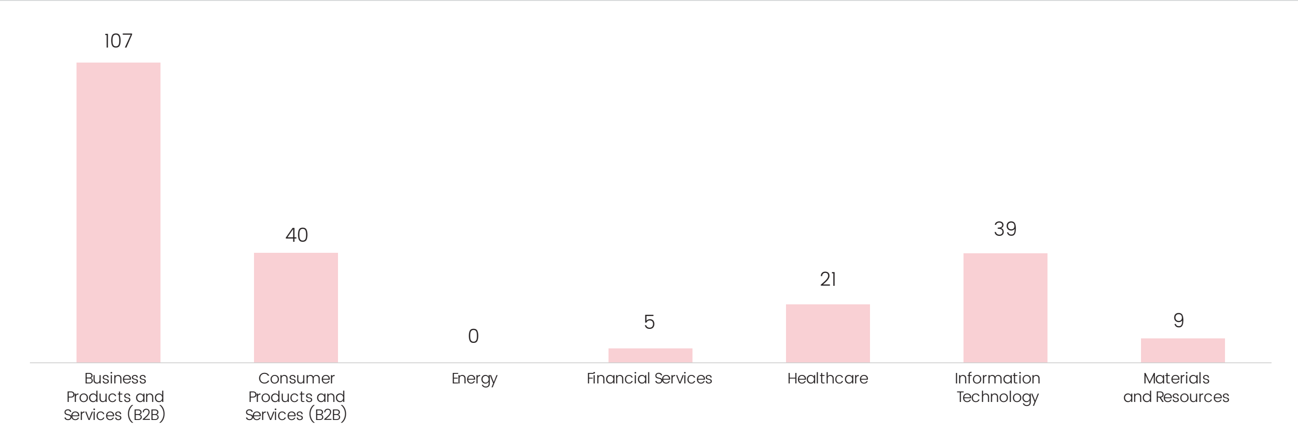


Figure 7: Consumer Products and Services

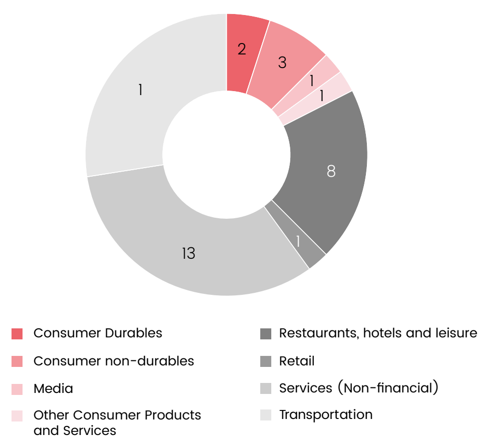
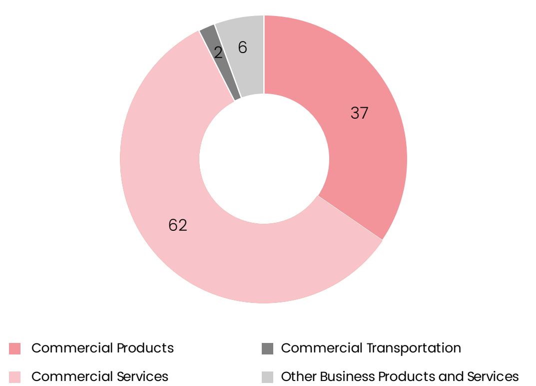


Figure 8: Business Products and Services



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 focuses solely on these investor preferences and does not include details related to deal sizes.

S&P Listed Private Equity Index

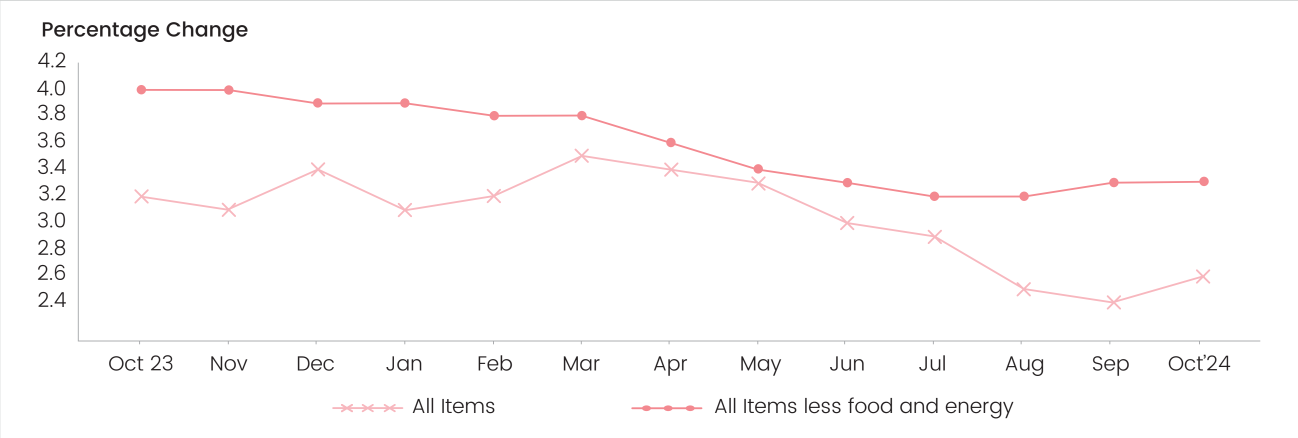
Figure 9: S&P Listed Private Equity Index

S&P Listed Private Equity Index	260.24	+79.52	44.00%
S&P 500	5,995.54	+1,583.99	35.91%
Nasdaq Composite	19,286.78	+5,519.04	40.09%
Dow Jones Industrial Average	43,988.99	+9,651.12	28.11%

Data as of November 11, 2024

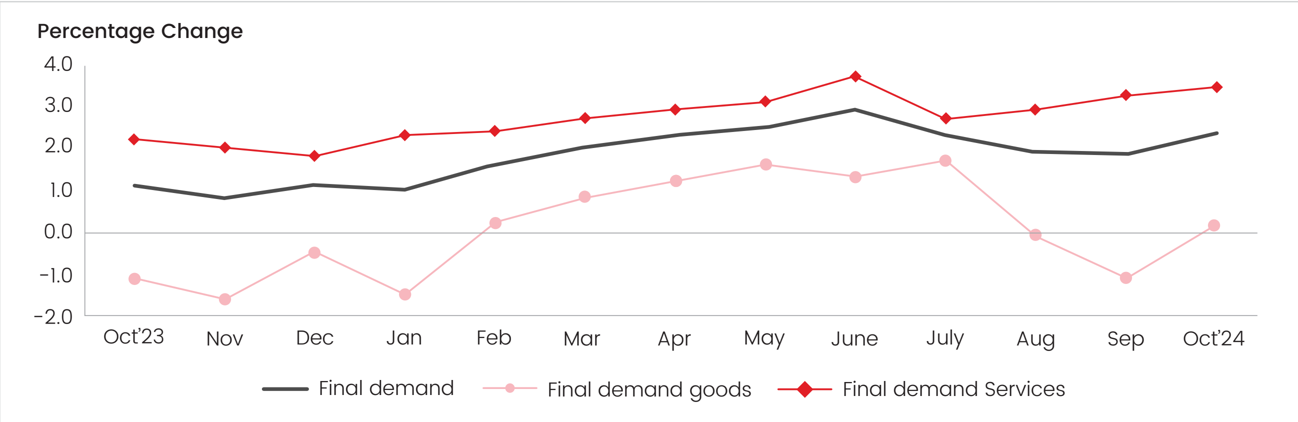
Index	Month-over-Month	YTD
Consumer Price Index	0.2%	2.6%
Producer Price Index	0.2%	2.4%

Figure 10: 12-month Percent Change in CPI for All Urban Consumers, Not Seasonally Adjusted



Source: US Bureau of Labor Statistics

Figure 11: 12-month Percent Change in Selected PPI Final Demand Price Indexes, Not Seasonally Adjusted



Source: US Bureau of Labor Statistics

Upcoming Events

Responsible Investor USA 2024	**December 03–04, 2024**	**Convene, New York**
Independent Sponsors & Capital Providers Dealmakers Meeting	**December 04, 2024**	**New York**
Infrastructure Investor America Forum 2024	**December 04–05, 2024**	**Convene, New York**

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