2022 US Private Equity Outlook: H1 Follow-Up

A midyear assessment of our PE predictions

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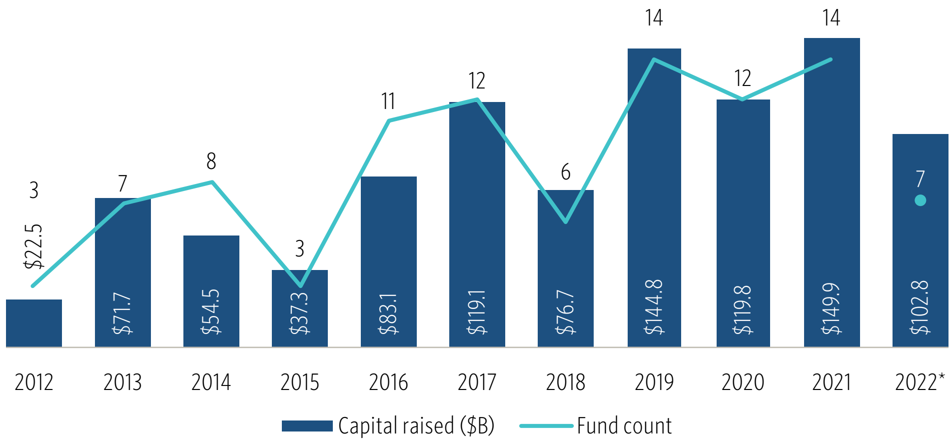
2022 predictions

Introduction

Many of our predictions were made amid several tailwinds at the end of 2021: US private equity (PE) dealmaking had eclipsed $1 trillion in total deal value and set several new high-water marks; exit activity soared as sponsors listed companies at a record rate and at high valuations; and the fervent exit environment led to capital quickly flowing back into newly launched PE funds. The global macroeconomic backdrop in 2022 has experienced a sharp turn. Inflation is raging as supply chains adjust to pandemic-related shocks, and Russia's invasion of Ukraine escalated supply chain disruptions and further lifted inflationary pressures. The US Federal Reserve's (Fed's) aggressive and numerous interest rate hikes battered the public markets, putting pressure on valuations in private markets as well. The significant market volatility has dampened PE's previously fervent pace. We will observe how the PE industry will be affected in 2022's remaining six months.

Prediction: Mega-funds will raise $250 billion in 2022, including the three largest-ever buyout funds.

PE mega-fund fundraising activity



Source: PitchBook | Geography: US
*As of June 30, 2022

Rationale: At the end of November 2021, 12 mega-funds, defined as funds larger than $5 billion, raised $138.4 billion in aggregate, as large GPs sought to aggressively raise and deploy capital into attractive investment opportunities in a record-setting year of deal activity. During 2021, significant revenue growth and an uptick in multiples led to faster investment monetization for many funds, whose distributions were then recycled into new, larger funds. Additionally, many of the largest LPs are increasingly looking to consolidate and deepen relationships with large investment managers to ease portfolio management. The Carlyle Group (NASDAQ: CG), Apollo Global Management (NYSE: APO), and Blackstone (NYSE: BX) are expected to lead the mega-fund fundraising activity in 2022, with over $80 billion anticipated between those three firms alone.

Caveat: The market is at risk from continued volatility from COVID-19, which could cause GPs to delay their fund launches as their existing funds and portfolio companies struggle and market downturn decreases capital availability and investor appetite. Not wanting to lock up additional capital in private investments, LPs could take a more defensive approach in their investments. A bear market in public equity markets could lead to the denominator effect,[1] thus pushing buyouts above internal limits. On the other hand, in a bull PE market, LPs could also reach an internal allocation limit from outstanding reported returns and become unable to provide the additional capital for which GPs are asking.

1: The denominator effect is when a private equity portfolio value exceeds its target allocation due to the decline in value of other asset classes in the investment portfolio.

H1 2022 update: It is not yet clear whether this prediction will come true.

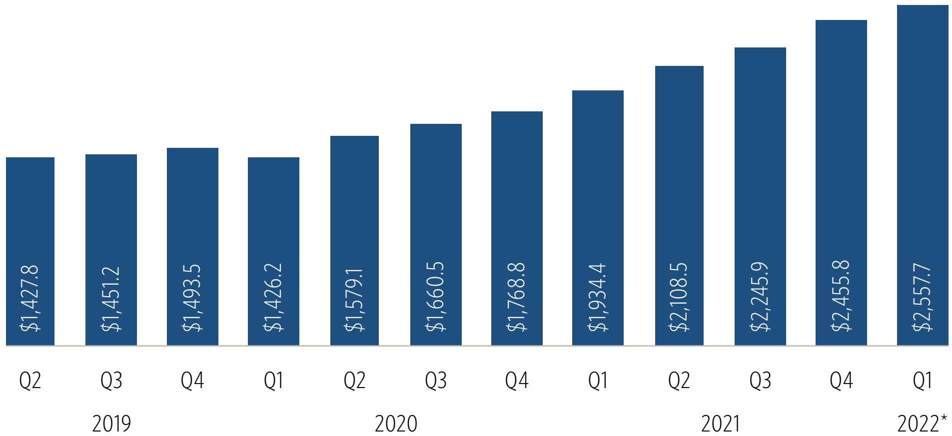
While the overall fundraising environment remains favorable for PE, individual GPs are battling for limited resources as myriad managers are currently raising capital. Firms are coming back to market at a faster pace and are often seeking sizable step-ups, overwhelming institutional investors' funding abilities. Nevertheless, seven mega-funds raised $102.8 billion in aggregate in H1 2022, led by flagship funds of PE giants such as KKR (NYSE: KKR), Clearlake Capital, and Advent International, to name a few. Other mega-funds, such as Thoma Bravo's 15th flagship software fund, which already raised over $20 billion, are likely to close in H2. While fundraising has been smooth for large firms, it is difficult to say if mega-funds are on track to raise $250 billion by the end of the year.

Apollo, which had planned on raising $25 billion for its next flagship fund by year-end, is now preparing to raise half of the original goal in Q3, shifting the timetable for the final close.[2] Carlyle also signaled similar difficulties in raising capital, with around $15 billion committed so far for a fund that was targeting up to $27 billion—short of the $17 billion it had anticipated collecting by the end of H1.[3] With so many gargantuan vehicles in the market and a slowing exit environment reducing capital flow back to LPs, it could become more difficult for GPs to find LPs willing to commit large amounts of capital with ease, or raise mega-funds as smoothly or as quickly as they used to.

2: "Apollo, Carlyle See Buyout Fundraising Slow with Markets on Edge," *Bloomberg*, Dawn Lim and Allison McNeely, June 10, 2022.
3: Ibid.

Prediction: The big five US public alternatives managers' AUMs will eclipse $3 trillion in 2022.

Combined AUM value ($M) for the five largest public US private capital managers



Source: PitchBook | Geography: US
*As of March 31, 2022

Rationale: At the end of Q3 2021, the big five public alternatives managers—Blackstone, KKR, Apollo, Carlyle, and Ares—managed nearly $2.25 trillion combined. These behemoths are continuing to scale by expanding existing product lines and launching new ones. There is a constant demand to deliver outperformance to equity holders by scaling management fees and revenues, all of which starts with higher AUM figures. This prediction requires an acceleration of growth by the largest managers. Over the past two years, these managers have grown AUM by approximately 5.6% per quarter. In order to hit $3 trillion by year-end 2022, they will have to lift AUM by just under 6% per quarter.

Caveat: This prediction is predicated on everything going right, and a lot could go wrong. Much of the growth in AUM in 2021 came from insurance M&A transactions. KKR alone added over $100 billion in AUM after acquiring Global Atlantic in mid-2021. These blocks could be absent for several reasons in 2022 and thus dry up a critical source of growth. LPs may also be reaching the top of their allocation ranges, thereby limiting the amount of capital they can pour into these GPs' strategies. On the flip side, an economic downturn or a lack of liquidity may also hamper LPs' ability to swell their private markets allocations.

H1 2022 update: This prediction is not on pace to come true.

The big five public alternatives managers ended 2021 with a combined total of $2.45 trillion in AUM. After Q1 2022, the five firms had amassed a total AUM of $2.56 trillion, a 4.5% increase, which is lower than the near 6% increase required per quarter to hit the mark. As the prediction stated, a lot would have to go well to reach $3 trillion, and so far, little has gone well.

The market has faced a multitude of headwinds this year, including high inflation and rising interest rates. As markets have taken a downturn, exits followed suit. PE exits struggled, causing a lack of liquidity. With fewer distributions back to LPs, they have less capital to commit back to these private capital managers that are looking to grow AUM. On their Q1 earnings calls, several firms expressed concern about fundraising in the PE space, though most managers reaffirmed bullish fundraising sentiment for flagship vehicles. However, it appears that these flagship funds are reaching a ceiling, which has pushed these firms to consider alternative methods of raising funds, including building out sector-focused and middle-market offerings. This could allow these managers to add more AUM for their firms. Though Q2 data is not yet released, we expect that it will be an uphill battle for these alternative asset managers to top the $3 trillion mark in H2.

Prediction: More private capital managers will go public in 2022 than during any previous year.

Rationale: Since the years surrounding the global financial crisis (GFC), there has never been a better time for alternative asset managers to go public. After EQT's (STO: EQT) public offering was favorably received by public markets in late 2019, the floodgates opened. In 2021 alone, Petershill Partners (LON: PHLL), Bridgepoint (LON: BPT), Antin Infrastructure (PAR: ANTIN), and Blue Owl (NYSE: OWL) have also gone public. Heading into 2022, TPG has already filed to go public; CVC, L Catterton, and Ardian are reportedly considering going public, and 2022 seems to be the target year. We have identified another 50 GPs around the world that we believe have the scale to go public.

Caveat: Going public is a one-way street, and so far, most managers have preferred to self-fund or sell a GP stake. Firms including Dyal, Petershill, and Blackstone have the financial firepower to present viable alternatives to an IPO—or to at least delay a public listing. For example, rather than go public, CVC sold a minority stake to Dyal. This capital appears to have gone toward CVC's purchase of secondaries manager Glendower Capital, though CVC seems to be preparing to go public in 2022. Several other managers have also gone this route. Additionally, any pressure on multiples, as seen more recently with KKR and Carlyle, may dissuade others from jumping into public markets.

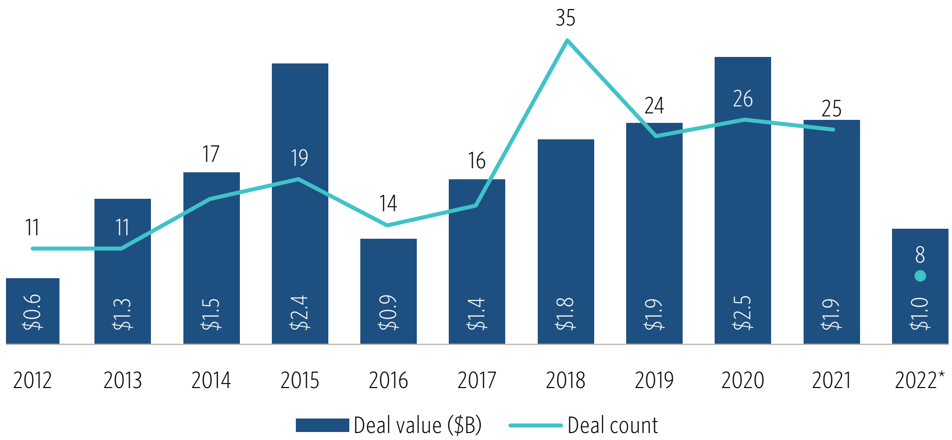
H1 2022 update: This prediction is not on pace to come true.

Going public is a tall order in the current macroeconomic backdrop. With the IPO market effectively closed due to lower valuations and sagging multiples mixed with market volatility, private capital managers have seemingly delayed potential IPO plans. Only one private capital manager, TPG (NASDAQ: TPG), has gone public in 2022. However, TPG submitted the required paperwork to IPO in late 2021, before the economic outlook shifted. Since its IPO debut, TPG's shares are down over 20%, joining the likes of other publicly listed PE managers including Blackstone, KKR, and Apollo, whose shares have suffered drop-offs of over 20% this year.

However, IPOs are not completely off the table for some private capital managers. In early July, reports came out about private capital manager General Atlantic exploring an IPO. The firm, with $79 billion in AUM, may delay a listing until next year due to the volatile equity markets. Similarly, Europe's biggest PE firm, CVC Capital Partners, was previously entertaining a London IPO for H2, but as the market shifted, it was reported to delay plans until the fall or early 2023.

Prediction: At least 30 GP stakes deals will close, thereby setting a record.

GP stakes deal activity



Source: PitchBook | Geography: US
*As of June 30, 2022

Rationale: Many GPs view the current Goldilocks environment as the perfect time to strategically invest, and balance-sheet capital has never been more important. GP stakes have become attractive as middle-market firms pursue growth capital in unprecedented ways. GP commitment has become more important, and having a partner helps navigate a private market landscape. On the supply side, a new batch of middle-market-focused GP stakes managers has emerged to finance these needs. With managers including Bonaccord and Investcorp hitting their strides in 2021, and others including Hunter Point proving their staying power, more established and well-financed GP stakes firms exist now than ever before.

Caveat: GPs have more financing options than ever, and the demand for these deals may subside. With the sky-high valuations many GPs are achieving in public markets, many of the larger firms that could sell a GP stake may opt to tap public markets instead. GPs could choose a preferred equity sale or debt financing if they are looking to raise nondilutive capital. Demand for deals could also diminish in 2022. Many founders chose to sell minority stakes in 2021 due to fears around a rising capital gains tax, thereby effectively drawing demand forward and potentially leading to fewer deals in the coming years.

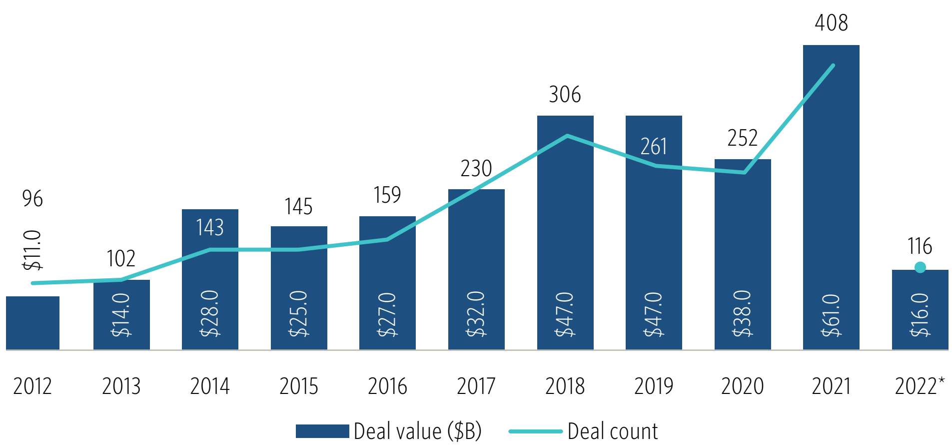
H1 2022 update: This prediction is not on pace to come true.

Only eight GP stakes deals closed in H1, with deal activity below the pace set over the past several years. High inflation and rising interest rates negatively affect buyout and growth equity managers, as higher labor and material costs and lower valuations drag down portfolio company margins, while delays in exits cause delays in incentive fees. Market prices of stakes in buyout and growth equity GPs can diminish, although firms that operate in certain sectors such as technology should hold up better. The current macroeconomic environment also pressures sponsors that have overly relied upon multiple expansion for their returns. The increasingly difficult fundraising environment means that firms can miss fundraising targets. When combined with worsening performance, incentive fee revenue can diminish and further lower market prices for fund managers.

GP stakes deals in the middle market are looking up, however, with more middle-market firms reportedly looking to sell a GP stake to help assuage fundraising difficulties. Not only can selling a stake bolster their balance sheets, but it can also open new investor networks and provide support and advice as the firm institutionalizes. A burgeoning middle-market-focused GP stakes field is also humming along, and several firms have already signed deals and continue to build out their manager development capabilities.

Prediction: PE firms will close at least 400 middle-market software deals.

Software PE middle-market deal activity



Source: PitchBook | Geography: US
*As of June 30, 2022

Rationale: Software deals in the middle market have steadily increased over the last several years. With middle-market companies recognizing the need for digitalization to improve metrics, optimize business processes, and enable integration across organizations, pandemic-accelerated trends such as e-commerce and remote work will further increase the pursuit of added technological capabilities. The middle market faces multiple avenues for software deals: from investors seeking midsized companies ready for growth, to nontech companies needing information technology (IT) acquisitions to boost their own digitalization strategies, to large PE buyouts shopping for add-ons in their large software platform builds.

Caveat: Deal activity overall could fall due to difficulties stemming from ongoing COVID-19 market disruptions. Diminishing tech multiples in public markets could also initiate lower deal activity. If the current streak of high tech multiples continues, the valuations of successful midsized private companies could surge and shoot software deals above $1 billion, which would no longer classify them as part of the middle market. Additionally, huge IT platforms could also roll out cheaper, simpler functionality accounts to smaller customers, thus preventing midsized software companies from gaining market share.

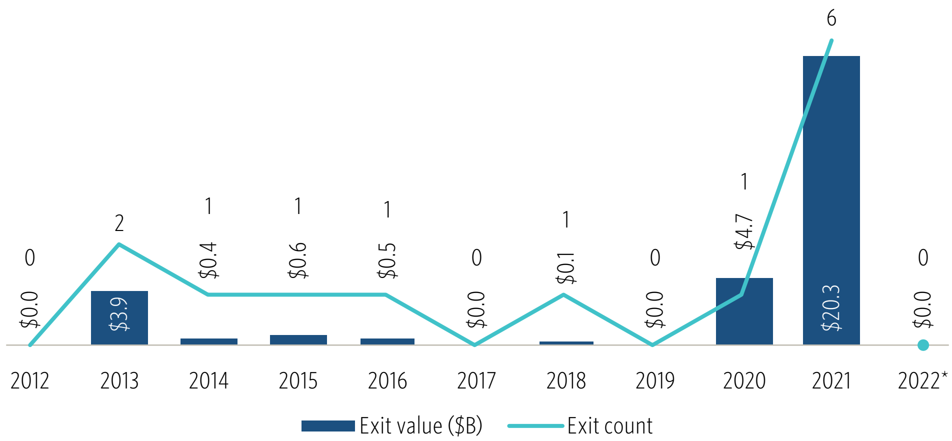
H1 2022 update: This prediction is not on pace to come true.

While middle-market software deals held on despite numerous headwinds in 2022, deal activity likely has slowed down enough to fall short of our prediction. Tech stocks tumbled throughout H1 as fears of rising interest rates pressured the high valuations at which many companies were trading. Continued market turbulence, coupled with major tech companies missing earnings targets, spurred major sell-offs in the public market, and public comparables drove down valuations in private markets, as well.

PE appetite for tech during H1 remained relatively healthy: Capital still flowed into the sector, albeit with less fervor, as investors remained focused on growth prospects of strong software companies that are cyclically—not secularly—under pressure. Middle-market PE firms even saw the market turbulence as an opportunity to secure reasonable valuations in a sector that has been pervaded by frothy valuations. While investors will continue to be drawn to opportunities in software, intense market volatility and value dislocation between buyers and sellers will cause the number of deals to fall short of the predicted amount.

Prediction: At least 10 US PE-backed healthcare provider platforms will list publicly, breaking 2021's record

PE-backed healthcare IPO activity*



Source: PitchBook | Geography: US
*As of June 30, 2022

Rationale: 2021 was a record-breaking year for PE-backed healthcare provider IPOs, and the convergence of several secular trends suggests there is more to come. First, PE firms are pursuing public listings for their portfolio companies at a historic pace across sectors. Second, the healthcare provider industry is undergoing widespread transformations on several fronts, thus making vanguard companies attractive to public investors. Another important theme is the consumerization of healthcare, in which healthcare providers are using technology to provide more convenient and patient-centric experiences—particularly in primary care.

Caveat: If the current bull run in public markets ends—perhaps due to a hawkish shift in Federal Reserve policy—firms may opt to exit via sales to other sponsors or strategics. Additionally, some of the most promising healthcare provider consolidation plays—including vision—are still relatively immature, with most platforms likely to continue for another turn or two under PE ownership before reaching the appropriate scale for a public exit.

H1 2022 update: This prediction is not on pace to come true.

The slide in public markets has created near-impossible conditions for PE-backed companies to exit into the public market. No public listings for PE-backed healthcare companies have taken place in 2022, which is a sharp decline from the records seen just last year. While sponsor-to-sponsor and strategic buyouts are proceeding at multiples similar to those in 2021, predictions that 2022 would be the year of the healthcare IPO have been shelved amid public market volatility. Healthcare companies that had previously explored going public in 2022 have abandoned those plans, and it is likely that it will take some time for healthcare IPOs to return, with some saying 2023 at the earliest.