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A new day? A 2024 U.S. private equity outlook

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2023 was a challenging year for U.S. private equity (PE) fund sponsors and their limited partners. Instability in the broader markets and their influences – geopolitical crises, inflation and continuing recovery from Covid-related dynamics, among other things – were and remain prevalent heading into the new year.

Last year's PE data was underwhelming to say the least. *S&P Global* reported a 45% year-over-year (2023 vs. 2022) decline in global PE deals by value and a close to 40% decline in the number of deals transacted. European deal activity suffered worse – a decline of 60% by some accounts – while take privates were down roughly 40%. This is incredibly stark considering that the total amount under management (AUM) for U.S. PE firms was nearly $3 trillion at the beginning of 2023, according to *Pitchbook*. Despite this significant figure, capital returns were few and far between as sponsors divested only roughly $182.9 billion in exit value as of mid-December 2023.

Financial metrics that formed the basis for valuations changed dynamically. Multiples themselves were, unsurprisingly, substantially down. Metrics deployed also adapted. Valuations tied to revenue in the recent up-market were displaced by less forgiving EBITDA (profit) multiples or, at least, a blending of revenue and EBITDA metrics. As a result, emerging companies that have not yet achieved the stable, sustainable and scalable financial performance required by PE sponsors were, by and large, left without a market of interested acquisition partners.

Last year also witnessed a change in the capital raising environment. Throughout 2023, a continuing divide persisted between strong companies that raised capital at the height of the private markets and their less recognized and celebrated counterparts. Prominent companies remained poised to delay M&A exits as well as further capital raising (growth equity) to wait out the market. Closed capital markets precluded any meaningful IPO prospects. Less successful companies were in a stalemate with market conditions as they retrenched to avoid a suboptimal, or even distressed, M&A exit or a death spiral, capital raise. To keep afloat, companies in need of capital predominantly focused on inside rounds and, worse for some, outside downrounds. Growth equity financings that did get done were often structured with usual down-turn structure such as liquidation preference multiples, earn-outs and more Draconian governance.

Credit markets remained challenged in 2023, further impacting leveraged buyout opportunities. Some PE funds responded with a variety of creative solutions. Notably, a key strategy was diversification. By in-

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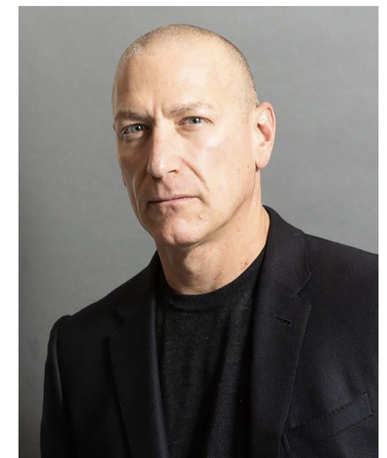

corporating ABS/structured products alongside structured preferred capital and recurring revenue loans, U.S. PE funds that previously were not in the lending business have turned to private credit solutions as a means of delivering superior risk-adjusted returns to their investors.

So, what next?

There are undoubtedly some continued headwinds. Market dynamics remain unchanged as we enter the new year. We are also heading into a presidential election cycle that could add another layer of market volatility or at least uncertainty. Anecdotally, sponsors continue to extend their "best guess" date as of which deal activity could uptick meaningfully – early spring for some, June for others.

But there is plenty of room for optimism. The Fed is poised to reduce interest rates, which, most likely, should stoke deal activity both by calming deal makers' nerves and by opening up the debt markets that are necessary to support leveraged buyouts. Broader domestic economic trends should improve as interest rates drop – enterprises and consumers alike are likely to invest and spend more in that environment than they were in 2023. Sponsors are sitting on an unprecedented amount of "dry powder" that, at some point, they will need to deploy. According to *Prequin*, uncalled capital commitments at December 2023 were up 10% from December 2022 and 20% from December 2021. And the lack of predictability – perhaps a stronger influence on negative deal flow than valuation – is settling into a "new normal" that should portend capitulation from PE sponsor counterparties. While only a small data set, capital calls in December and heading into January appear to be picking up albeit slightly.

It's a new day. Deals will come back. They always do. And when, not if, the markets pick up, they will do so non-linearly. Many in the industry might then look back at the downturn with a bit of a soft spot as they inevitably will be working around the clock to make up for lost time.

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