Moving forward, looking inward

M&A trends in private equity

2022

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Introduction

Record deal making cools down

Historically high deal making levels for private equity (PE) firms continued well into 2022 before economic, structural, and geopolitical headwinds created a drag.

Plenty of leverage, low rates, and a reasonably strong economy fueled the PE market through the first half of 2022. Annual deal activity declined from unprecedented levels, but the strong start pushed total volume to the second-highest on record, after 2021. Meanwhile, total deal value increased 8 percent, driven by several mega deals, breaking the prior-year's record.

Eventually, rising interest rates and falling valuations impacted performance and purchasing power. In its effort to reduce inflation, the Federal Reserve increased the fed funds rate seven times in 2022.[1]

Debt grew more costly and harder to access. Some PE firms looked for alternatives, like all-cash or 100 percent equity deals.[2] Even with financing, buyers became less willing to pay the high prices sellers continued to expect.

PE sponsors globally dealt with the added challenge of geopolitical tension emanating from the Russia-Ukraine war. European economies continue to bear the brunt of the conflict's impact, with peak gas and electricity costs not seen for two decades before the COVID-19 pandemic.[3]

Global PE fundraising was 21.5 percent lower in 2022 than the record $695.6 billion raised globally in 2021.[4] While fundraising slowed throughout the year, firms still reached the second-highest annual fundraising level in history.

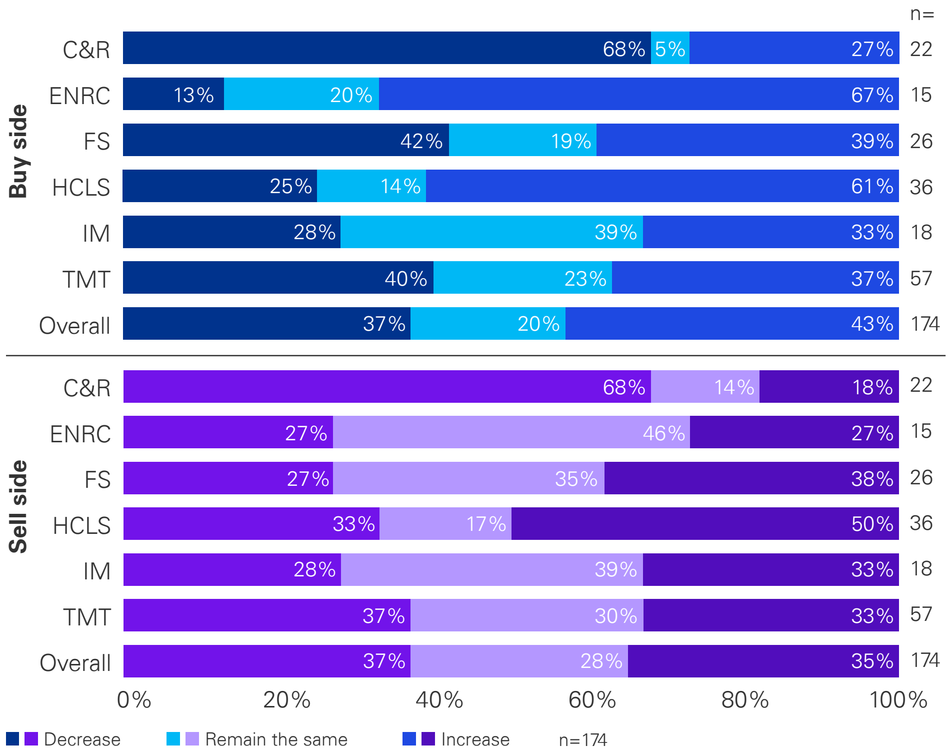
Key statistics

-22% decrease in PE volume from 11,339 in 2021 to 8,845 in 2022.

8% increase in total PE deal value from $849.4 billion in 2021 to $920.2 billion in 2022, a new record.

45% increase in PE deal value for technology, media, and telecommunications (TMT) in 2022.

"Compared to the last 12 months, do you expect deal activity in your industry will increase or decrease over the next 12 months?"



KPMG 2022 Year-End M&A Survey, December 2022

Note: n= number of PE responses

C&R: Consumer, retail
ENRC: Energy, natural resources, chemicals
FS: Financial services
HCLS: Healthcare, life sciences
IM: Industrial manufacturing
TMT: Technology, media, telecommunications

[1] KPMG Economics, "Won't Stop Until the Job is Done," December 2022
[2] Allison McNeely, "Private Equity's Tough Year Shows No Signs of Letting Up," Bloomberg, December 20, 2022
[3] The Economist, "Russia is using energy as a weapon," November 26, 2022
[4] Preqin Global Report 2023: Private Equity

The largest publicly traded PE firms acknowledged the impact of changing economic conditions on portfolio valuation and total returns during their third-quarter conference calls, and indicated a dimmer future, at least temporarily.[5] The same challenges that debuted in 2022 will extend into at least the first half of 2023.

According to the KPMG 2022 Year-End M&A survey, PE executives expect lower or stagnant deal activity across most sectors compared to the previous year, with the most negative outlook around consumer and retail (C&R).

However, PE firms started to adapt as conditions declined, including increasing their focus on squeezing greater profitability and efficiency out of their existing portfolios.

The global PE industry is still sitting on a record level of dry powder, approaching $2 trillion in cash reserves—21 percent more than at the end of 2021.[6] We believe that deal activity will begin to pick up in the second half of 2023 with greater certainty that the Fed will have backed off interest rate hikes and the consumer price index will have stabilized.

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[5] S&P Global Market Intelligence, "Sentiment indicators dip as performance of private equity's 'Big 4' slows," November 17, 2022
[6] Dylan Thomas, "Global private equity dry powder approaches $2 trillion," S&P Global Market Intelligence, December 21, 2022

By the numbers

Deal value increased as transactions fell

PE transactions dropped 22 percent from a record-breaking 11,339 in 2021 to 8,845, still the second-most active year in history. Total PE deal value of $920.2 billion set a record, topping 2021's $849.4 billion.

Total deal value got a boost from the $63 billion acquisition of Italy-based infrastructure and transport company Atlantia by Blackstone and Edizione, the largest-ever take-private deal for a European-listed company.[7] Blackstone also led the second-largest PE deal by value and the largest private real estate transaction on record with its $23.8 billion recapitalization of pan-European logistics firm Mileway.[8]

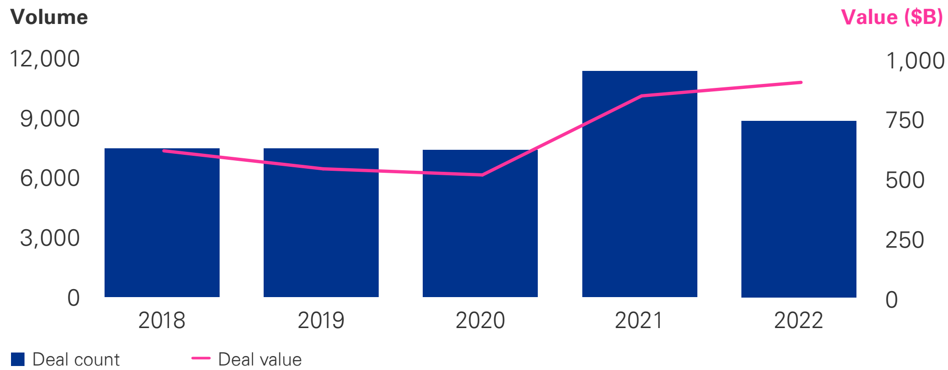
Transactions were down across all key sectors year over year, but deal value increased significantly in several industries. Technology, media, and telecommunications (TMT) deal value grew 45 percent to $345.4 billion, boosted by two of the year's larger PE transactions: Citrix Systems, acquired by Vista Equity Partners and Evergreen Coast Capital for $16.5 billion to create the Cloud Software Group through a merger with TIBCO Software[9]; and another Evergreen deal, a consortium co-led with Brookfield Business Partners to acquire The Nielsen Company for $16 billion.[10]

Industrial manufacturing (IM), the sector with the highest deal value, was surpassed by TMT even though Atlantia was by far the largest PE deal by value. Another top-10 deal was Emerson Electric's agreement to sell a majority stake in Climate Technologies for $14 billion to Blackstone and co-investors Abu Dhabi Investment Authority and GIC. However, most individual deals continue to be in IM, which led the count with 3,849 transactions.

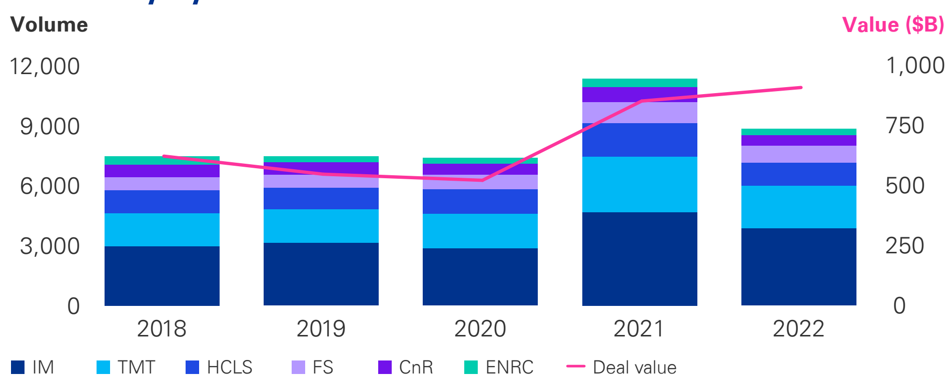
Top PE deals in 2022

Acquirer	Target	Value (billions)
Blackstone, Edizione	Atlantia	$63.0
Blackstone	Mileway	$23.8
Vista Equity Partners, Evergreen Coast Capital	Citrix Systems	$16.5
Evergreen Coast Capital, Brookfield Business Partners	The Nielsen Company	$16.0

PE deal value and volume



PE activity by sector



Data was sourced from Pitchbook and KPMG analysis. The values and volumes data cited are for U.S. deals announced between 1/1/2022 and 12/10/2022. Deal values are only presented based on publicly available deal data and are not exhaustive. Previously published statistics may be restated to incorporate new data and/or changes in deal outcomes.

[7] PitchBook, "Blackstone, Benetton eye Europe's largest take-private ever with Atlantia bid," April 14, 2022

[8] Blackstone, "Blackstone Announces €21 Billion Recapitalization of Mileway," February 15, 2022

[9] "Vista Equity Partners and Evergreen Coast Capital Announce the Completion of the Transaction to Acquire Citrix Systems and Combine it with TIBCO Software," Cloud Software Group press release, September 30, 2022

[10] "Nielsen announces closing of transaction with Evergreen- and Brookfield-led consortium," Nielsen press release, October 2022

By the numbers

Cross-border deal trends

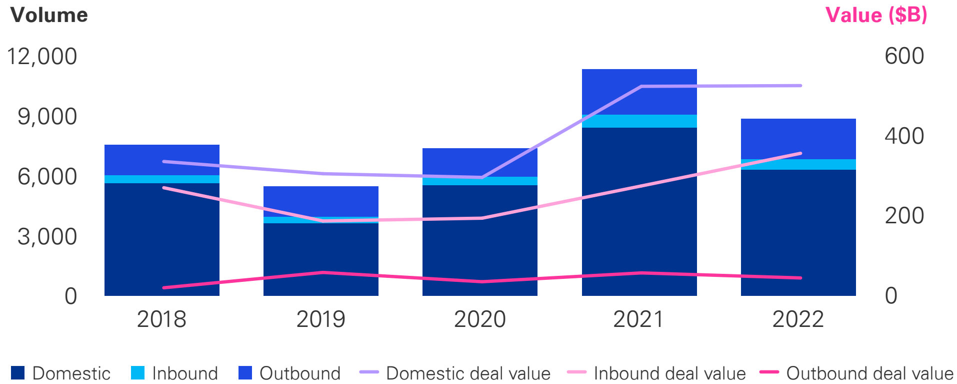
Higher outbound deal value in 2022 compared to the previous year reflects two significant cross-border deals, both involving Blackstone as an acquirer.

The two largest PE deals of the year overall were Blackstone-Edizione's acquisition of Atlantia, based in Italy, and Blackstone's acquisition of Mileway, based in Netherlands. The acquisition of business management software provider Grupo Primavera in Spain by France's Cegid was the third-largest outbound PE deal of 2022, although valued at $6.9 billion was multiples smaller than Atlantia, $63 billion, and Mileway, $23.8 billion. Cegid, a cloud-based business solutions provider, was backed by Silver Lake, KKR, and AltaOne Capital.[11]

Domestic PE deal value has been flat since 2021, and inbound deal value has been relatively flat for five years. In 2022, Canada-based Brookfield Business Partners, together with institutional partners acquired CDK Global, a provider of technology and software-as-a-service solutions to auto dealers and manufacturers.[12] Valued at $8.3 billion, CDK Global was the largest inbound PE deal for the year.

Despite the sluggish global economy, there is a strong appetite for cross-border deals in 2023, given the strength of the dollar. Almost half (43 percent) of PE professionals we surveyed said they will consider international deals in 2023, and 25 percent believe they could and intend to fully leverage the strong dollar.[13]

Cross-border and domestic deal activity



Top cross-border PE deals 2022

Acquirer	Target	Inbound/ outbound	Value (billions)
Blackstone, Edizione	Atlantia	Outbound	$63.0
Blackstone	Mileway	Outbound	$23.8
Brookfield Business Partners	CDK Global	Inbound	$8.3
Cegid (backed by Silver Lake, KKR, and AltaOne Capital)	Grupo Primavera	Outbound	$6.9

The deal landscape in 2023 may look somewhat different than in 2022. Even if deal volume bounces back, deal value may drop, with many executives saying they will focus on smaller deals. For 2023, 63 percent said they will look at deals valued under $500 million. Only 4 percent said they will target larger deals (over $1 billion), whereas 12 percent of the deals were over $1 billion in 2022.

[11] Cegid, "Cegid closes the acquisition of Grupo Primavera and now holds the position of cloud business management solutions leader in the Iberian Peninsula," September 5, 2022

[12] Automotive News, "CDK completes sale to investment firm Brookfield Business Partners," July 7, 2022

[13] KPMG 2022 Year-End M&A Survey, December 2022

Deep dive

PE pivots to portfolio value creation

The PE industry has increased its focus on portfolio value creation in recent years, while still leveraging M&A. But in 2023, without market conditions to support robust dealmaking, PE portfolio performance will now be top of mind.

Cost reduction is key, but growth is an even higher priority in the coming months, according to our survey and our conversations with global PE executives.

PE firms with more sophisticated data analytics have the insights across their portfolios to identify growth opportunities during the downturn.[14] They are considering long-term levers such as new business models, product and service offerings, and go-to-market approaches.

These moves will complement the more tactical performance improvement levers we expect to see used this year, such as noncore headcount reduction, vendor consolidation and contract renegotiation, facilities rationalization, and working capital optimization.

Among the value drivers are several emerging themes:

Automation and offshoring strategies against the labor shortage. The postpandemic labor shortage is expected to continue through and after the current economic challenges, which is unique compared to historical economic downturns. Necessary jobs will remain unfilled, and high employment costs will eat into margins as talent commands a premium.

Digitization and automation are needed to transform the workforce model and introduce efficiencies. At the same time, properly offshoring non-core positions can relieve the pressure of labor shortages and reduce costs. Both efforts require organizations to balance the redesign of their operating models with maintaining current operations.

> At the fund level, PE managers are taking a fresh look at their portfolios to create real value. That means finding where and how to integrate assets, develop digital platforms, leverage data analytics, achieve automation and scale, and create new offerings.

Price optimization across product and service offerings. Nearly half of U.S. deal makers we surveyed (48 percent) identified price optimization as a top area for improving revenue synergies in 2023, tied with organic customer growth strategies.[15]

Companies are still trying to make up for margin compression during the pandemic due to labor and materials costs. Now, in an inflationary environment, they need to adjust pricing strategies to share some of the anticipated high costs going forward.

Untapped value creation through ESG. Until recently, environmental, social, and governance (ESG) strategies often provided more reputational value than financial value, particularly in the U.S. market. However, there has been a sharp change in attitude toward ESG's contribution to value, such as its ability to help drive revenues through customer growth and product and service development.

Going forward, ESG principles will play a role in almost every transaction. Executives will need to consider how to unleash the value that can be created through ESG-focused strategies. That includes leveraging diversity, equality, and inclusion (DEI) to implement a better workforce model and cost structure, and controlling profitability loss through a stronger risk governance framework.

> ESG has finally been elevated from a risk management exercise to a corporate-wide strategy designed to increase value through meeting stakeholder demands.

Greater profitability and healthier portfolio companies. A possible market correction in 2023 could squeeze out underperformers. This will compel companies—many with the help of private equity—to implement a better capital structure, technologies, and operating model for improved profitability.

Top-ranked priorities for portfolio companies in 2023:

60% ranked performance improvement through **cost reductions** in the top three.

54% ranked performance improvement through **growth initiatives** in the top three.

KPMG 2022 Year-End M&A Survey, December 2022

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[14] Glenn Mincey and Carole Streicher, "KPMG: Value creation becomes a top priority," Private Equity International, December 1, 2022

[15] KPMG 2022 Year-End M&A Survey, December 2022

Outlook

On the lookout for quality at a discount

At the start of 2023, a global recession was widely anticipated but expected to be short-lived. How short and how difficult is yet unclear.

In the United States, high employment to date has contributed to stubborn inflation but provided a layer of stability to the economy. Many consumers are still tapping record savings amassed during pandemic shutdowns in addition to spending their steady paychecks. However, the jobs report released in January 2023 suggested signs the labor market was cooling.[16]

Should inflation remain high or head north, central banks may increase rates. But falling inflation could give lenders enough confidence to loosen leverage restrictions and spark reinvestment. Banks will continue to hold back until they are more comfortable with what they see.

A mismatch between lower valuations in a depressed market and continued high price expectations also will dampen activity, particularly asset sales. Nearly half of PE sponsors surveyed about their M&A plans for 2023 said they plan to both buy and sell in the next 12 months; another 43 percent said they plan to buy.[17]

Sellers will likely hold back until they believe their assets will receive what they deem to be appropriate returns. Until then, sponsors will pull back capacity before they consider lowering price, focusing instead on tweaking their portfolios for performance.

Buyers plan to be more discerning on asset quality and price, searching for opportunities created by market conditions. For example, many companies that entered the public market through a special-purpose acquisition company (SPAC) only a couple of years ago aren't performing well; average SPAC valuation declined 65 percent in 2022.[18] Management teams may look to go private again with the help of PE investors.

Companies and sectors with characteristics that help support strong performance throughout a recession will come into favor. These include assets in highly regulated industries such as healthcare, which are inherently less sensitive or exposed to consumer activity.

Additionally, after a drop-off in divestitures between 2021 and 2022, we might see activity return as companies shed underperforming assets and refocus their businesses in a down market, creating more carve-out transaction opportunities. Sponsors also may consider less-common deal structures that will allow them to participate without overextending. For example, they could take a few chips off the table through coinvestment or minority deals, buying 50 percent or less of an asset while maintaining the current capital structure. Ultimately, average transaction size will shrink.

Meanwhile, institutional investor over-allocation to PE due to the denominator effect and a slower exit market have contributed to greater demand for liquidity. The secondary market, which began to take off in the latter part of 2022, is set to expand in 2023.[19]

Global PE fundraising is soft heading into 2023 and expected to decline 2.6 percent for the year. Total assets under management (AUM) has doubled every four to five years for the last three decades. While the pace is slowing, asset growth will continue assuming long-term outperformance. Total AUM, at approximately $4.2 trillion, is forecast to reach $7.6 trillion by 2027.[20]

Key considerations as we look ahead

In pursuing returns during an economic downturn, PE deal makers will need to recalibrate their focus to improve success:

1. PE managers will have to work harder to extract value from their portfolios. Improving performance through digitization and other familiar levers requires tailoring efforts to each organization and industry, or exploring untested paths to boost efficiency and profitability.
2. Take-private and carve-out opportunities are increasing as some public companies failing to thrive in current market conditions look for an exit, and others identify non-core or underperforming assets to shed.
3. Regulated industries that aren't as sensitive to consumer spending will be more attractive during the 2023 down market cycle, including healthcare, financial services (namely larger banks), and energy sectors such as power and utilities.

[16] KPMG Economics, "A Goldilocks Employment Report," January 6, 2023
[17] KPMG 2022 Year-End M&A Survey, December 2022
[18] CNBC Post SPAC Index
[19] Jessica Hamlin, "PE secondaries market set to boom in 2023," PitchBook, December 7, 2022
[20] Preqin Global Report 2023: Private Equity

2022 Year-End M&A Survey Findings

Key takeaways for 2023

1. The vast majority of PE firms expect their deal activity will remain static or decline over the next 12 months.

69% expect their firm's buy-side deal activity will stay the same (36 percent) or decrease (33 percent) and

74% think their sell-side activity will stay the same (45 percent) or decrease (29 percent).

The high cost of capital and unrealistic price expectations are the primary reasons PE firms give for holding back their buy-side deals. Low valuation and inopportune timing are behind the greater pessimism for the sell side.

Among PE respondents, healthcare and life science professionals have the most optimistic view of their companies' deal activity, as 53 percent anticipate an increase in buy-side deals. Conversely, financial services professionals have the most pessimistic deal outlook, with 46 percent projecting a decrease in buy-side deals next year.

In contrast, corporates are much more optimistic about the buy-side deal outlook, as 56 percent of the respondents project an increase. On the sell side, however, PE and corporate pessimism aligned as 71 percent of the corporate respondents say deal activity will decrease or remain the same.

2. A majority of PE executives expect valuations in their industries to decrease compared to the previous 12 months.

59% project lower valuations, primarily attributed to inflationary concerns, while only

26% project valuations will increase.

3. Given expected hurdles to deal activity, PE firms are focusing on portfolio performance.

Their top priorities to achieve strategic objectives are revenue- and cost-driven performance improvement; technology improvement and digital transformation; and operational efficiency/cost out.

44% say they plan to take a buy-and-build approach to value creation, adding more valuable add-on assets.

4. PE firms are expecting increased focus on small deals and less mega deals.

4% say they will target deals larger than $1 billion, whereas

13% of overall deals were over $1 billion in 2022.

5. PE firms expect to apply less leverage per acquisition as access to debt financing declines, prompting greater interest in all-equity deals.

65% say their leverage will decrease, with

34% expecting leverage to decrease more than 20 percent per acquisition, compared to last year.

56% say they are leaning toward 100 percent equity deals as an alternative strategy.

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