KPMG

Better days ahead?

M&A trends in private equity

Q4'23

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Introduction

Lean times

The decline in private equity (PE) mergers-and-acquisitions (M&A) activity that began in H2’22 extended all through 2023. In the face of persistent recession fears and volatile financial markets, deal volume fell 28.9 percent year over year while deal value declined 45.2 percent. However, as 2024 approached, the PE deal market showed signs of improvement buoyed by a growing investor expectation that the Federal Reserve’s rate hiking cycle is not only over but will reverse in the coming months in line with rapidly cooling inflation.

Despite the headwinds, PE deal makers inked significant deals in 2023. Notable transactions included the $12.5 billion bid for software developer Qualtrics by Silver Lake and CCP Investments, and the planned $9.6 billion acquisition of sandwich chain Subway by Roark Capital Group. The most active sectors were technology, media, and telecom (TMT), which led in deal value with 29.1 percent of the final tally, and industrial manufacturing (IM), which did so in deal count with 44.3 percent of the total. Overall, small deals dominated, with 77.3 percent of transactions having enterprise value less than $500 million.

The slowly lifting fog of macroeconomic uncertainty should help boost deal makers’ confidence heading into 2024. We expect the PE M&A market to bounce back, fueled by a record $2.6 trillion in global dry powder.[1] Financing conditions should also ease and provide added momentum, although disagreement on valuations may pose a challenge in aligning buyers and sellers. Nevertheless, we believe PE deal makers are likely to find 2024 a much busier year than the previous one.

Joseph Hartman
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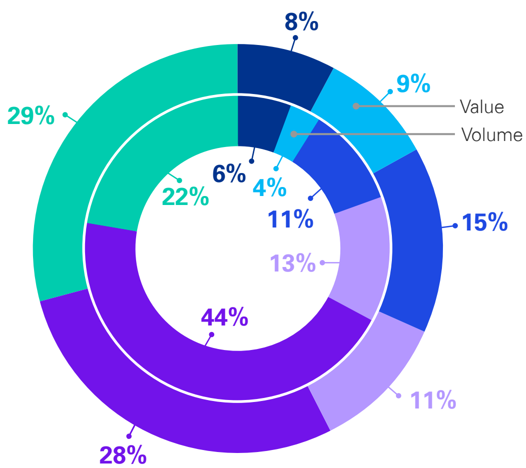
2023 highlights

7,790 deals ▼ **-29%** decrease YoY

$425 billion deal value ▼ **-45%** decrease YoY

2023 PE sector mix

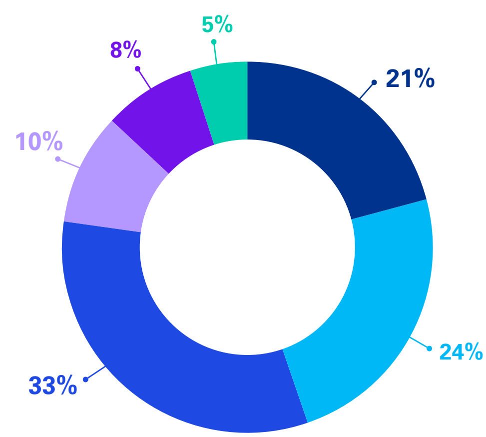
Outer ring represents value. Inner ring represents volume.



■ C&R ■ ENRC ■ FS ■ HCLS ■ IM ■ TMT

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

2023 PE deal size mix



■ < $25M ■ $25M–$99M ■ $100M–$499M ■ $500M–$999M ■ $1B–$2.49B ■ $2.5B

Percentages may not add up to 100 due to rounding.

[1] Muhammad Hammad Asif and Annie Sabater, “Private equity firms face pressure as dry powder hits record $2.59 trillion,” S&P Global Market Intelligence, December 13, 2023

By the numbers

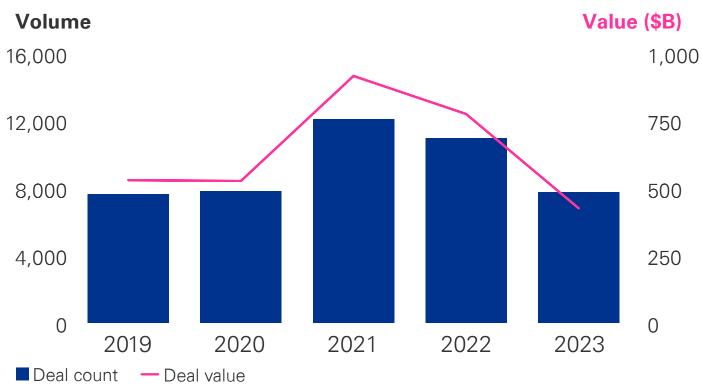
An extended slide

Elevated inflation and high interest rates contributed to making 2023 a worse year for PE deals than the pandemic year of 2020. Deal count slid from 10,960 in 2022 to 7,790, while deal value dropped from $775.3 billion to $425.2 billion. The declines were across the board. Domestic deals fell 30.8 percent by volume and 44.6 percent by value, while cross-border transactions decreased 23.7 percent and 46 percent, respectively.

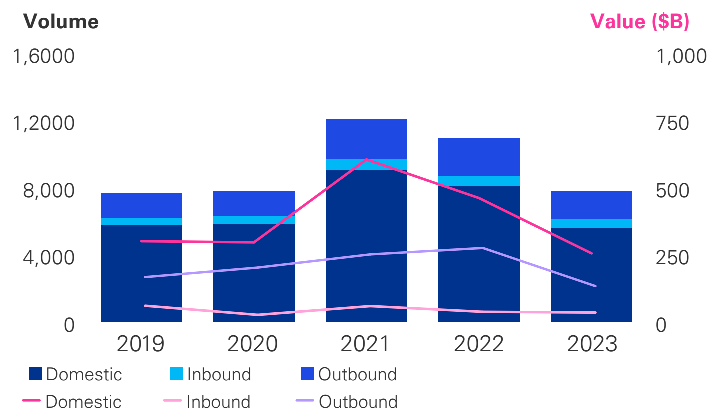
Neither were any industries spared. The TMT sector suffered the worst retreat, with deal value plunging 61.7 percent to $123.9 billion—even though this sum still led all sectors. Meanwhile, the consumer and retail sector held up best with an 11.9 percent increase in deal value to $33.1 billion, thanks partly to the $9.6 billion Subway-Roark Capital Group deal. IM registered the highest deal count with 3,449 transactions, which was a 29.7 percent decrease from 2022.

The largest PE deal of the year was the $12.5 billion Silver Lake and CCP Investments takeover of Qualtrics, a software developer. The next biggest was GTCR's $11.7 billion bid for Worldpay, a payments technology firm, followed by Roark Capital Group's $9.6 billion acquisition of Subway.

PE deal volume and value



Cross-border and domestic deal activity



Top PE deals in 2023

Acquirer	Target	Rationale	Value (billions)
Silver Lake, CPP Investments	Qualtrics	Take-private transaction	$12.5
GTCR	Worldpay	Accelerate growth through strategic acquisitions	$11.7
Roark Capital Group	Subway	Expand the PE firm's existing portfolio of restaurant chains	$9.6

Deal data has been sourced from Pitchbook and KPMG analysis. The values and volumes data cited are for U.S. deals announced between 1/1/2023 and 12/31/2023. 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 any changes.

How PE firms kept busy

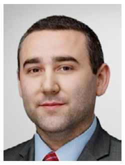
PE deal activity in 2023 may have been underwhelming, but it hardly meant PE deal makers were idle. A sharp rise in interest rates, a lackluster market for initial public offerings, and the persistent gap between sellers and buyers on valuation all conspired to make the year a tough one for PE firms. Even so, many kept busy with diverse approaches.

Given the high cost of capital to fund transactions, in 2023 PE deal makers focused more on taking minority stakes than acquiring companies outright.[2] That way, a deal could be done on less financially onerous terms while both buyer and seller placed themselves in a position to benefit when the company's value rises—a mutually enticing incentive to enter into a transaction. There were 665 minority-stake PE deals globally through mid-December, according to Preqin. For example, in August, Carlyle reportedly invested $500 million for a 28 percent stake in the Singapore-based Quest Global, an engineering services firm.[3]

> **The M&A market had an uptick in carve-outs as corporate entities looked to divest non-core assets to shore up balance sheets.**

Another active area for PE firms was the secondary market, driven by prolonged ownership periods due to delayed exits. PE firms increasingly engaged in continuation funds and the like in an effort to return capital to investors.[4] In such transactions, the seller can free up liquidity while the buyer often gains an interest in assets at a discount and shorter investment duration. Inflows into secondary funds which invest in PE secondary deals were $68.1 billion in the first three quarters of 2023, an 18 percent uptick from a year ago, PitchBook Data shows.[5] In a related development, the M&A market had an uptick in carve-outs as corporate entities looked to divest non-core assets to shore up balance sheets ahead of uncertain economic conditions, while PE firms themselves renewed focus on value preservation and creation of their portfolio companies.

Lastly, PE firms became bigger players in offering private credit. In early 2023 when the collapse of several regional lenders slowed bank lending, cash-rich PE firms swooped in as an alternative funding source for corporate borrowers. Being a provider of "direct lending" is attractive for PE firms because they can charge higher interest rates than market rates. They can also cater to investors who may want other options than PE investments since private credit can be less risky in an uncertain market environment. Some of the most high-profile PE firms were the biggest players in private credit. For example, KKR, Carlyle Group, and Warburg Pincus all raised private credit funds last year.[6]



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[2] Kristin Broughton, "What Happened in M&A in 2023, and What's Ahead, in Five Charts," Wall Street Journal, December 29, 2023
[3] Reghu Balakrishnan, "Carlyle buys into Quest Global, invests $500 million," The Economic Times, August 9, 2023
[4] Jessica Hamlin, "The pipeline is full for secondary deals in 2024," Pitchbook, December 12, 2023
[5] Yuliya Chernova, "Secondary Fund Deals Surge as Investors Seek Exits," Wall Street Journal, December 13, 2023
[6] Michael Flaherty, "In down year, private credit greases M&A wheels," Axios, December 28, 2023

Outlook

Cautious optimism

Entering 2024, the U.S. economy has begun to slow from the torrid 4.9 percent pace of growth in Q3'23, but it is unlikely to slip into a recession in the coming months. KPMG Economics forecasts that GDP growth will decline from 2.5 percent in 2023 to 1.7 percent in 2024, especially on account of slowing consumption. This will cause unemployment to rise modestly to 4 percent by end-2024 mostly due to slower hiring rather than layoffs.

We believe a soft landing—lowering of inflation without a spike in the jobless—is likely. The rapidly improving inflation outlook has allowed the Fed to pause rate hikes with policymakers projecting three cuts in 2024[7]. But they are unlikely to do so before the core personal consumption expenditures (PCE) index, which excludes food and energy, stays below 3 percent. We expect the first rate cut in May.

All this bodes well for PE deal makers. Steady inflation and interest rates should allow them to put together transactions with more stable capital and cost structures at a time when PE funds also face increasing pressure to deploy their huge pile of dry powder or return the money to limited partners. In a KPMG survey of 200 U.S. M&A executives in November 2023, 40 percent of PE respondents said they plan on completing 3-5 deals in 2024 and another 28 percent expect to ink 1-2 deals, with 33 percent saying their next deal will likely take place in H1'24. As for the deal size, 80 percent expect it will be greater than $1 billion. The most favored industries are healthcare followed by infrastructure, drawing interest from 64 percent and 53 percent of PE respondents, respectively.

A key to more deal making in 2024 will be closing significant valuation gaps that kept many buyers and sellers apart last year.[8] But as deal multiples undergo a correction from recent highs due to interest rates, the seller's expectation on asset prices should moderate.

For PE deal makers, much uncertainty still remains. A rebound in deals may arrive only slowly and not pick up steam until H2'24. However, we are cautiously optimistic that the PE M&A market will turn the corner this year and that better days are ahead.

Key considerations

In anticipation of a more active M&A market, PE deal makers should focus on:

1 Value creation in portfolio companies

Improve performance by reviewing capital structures and cash flow management.

2 Tap the power of data

Understand where new markets are and how they fit with existing core offerings with help of data analytics.

3 Take another look at carve-outs

Corporate carve-outs should remain an active area for deal makers in 2024 as companies continue to streamline and focus on core businesses.

[7] Nick Timiraos, "Fed Begins Pivot Toward Lowering Rates as Inflation Declines," Wall Street Journal, December 13, 2023.
[8] Broughton

How we can help you

At the KPMG Private Equity practice, we understand the unique requirements of private equity. Our team works with your fund, operating partners, and portfolio companies to help you realize your ambition to buy, sell, finance, and drive performance, on both the buy side and sell side.

KPMG helps its clients overcome deal obstacles by taking a truly integrated approach to delivering value, leveraging its depth in the PE industry, data-supported and tools-led insights, and full M&A capabilities across the deal lifecycle.

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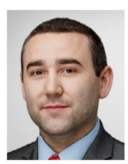

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