TresVista
Catalyzing Your Impact

TresVista Investor Confidence Index Report

H1 2023

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Executive Summary

The U.S. Middle-Market Private Equities (PE) witnessed a multitude of deals in the market coupled with record-breaking valuations in the last few years. The immediate future of PE, however, appears to be in flux as our survey participants believe the economy may continue to be impacted by rising interest rates, inflation, and the possibility of a recession.

The fund managers whom we surveyed indicated an overall bearish sentiment for H2 2022 with a slight decline as compared to H1 2022. They believe that macroeconomic factors such as public market drawdown, the rising interest rate coupled with fear of recession, and disruptions to the supply chain are behind this consensus. Hence, in H2 2022, the investors spent most of their time and efforts on portfolio management activities to navigate their portfolio companies smoothly through challenging macroeconomic conditions. They also focused on finding ways to increase the value of potential investments by targeting struggling businesses that could be acquired at a bargain. SPACs, which were in trend in the M&A market during the last couple of years, were noticeably absent in 2022.

In H1 2023, respondents expect the quality of distressed assets to improve and hope that the valuation multiples may decrease. This is, however, shadowed by expectations around increasing deal closing timelines and constrained access to capital and financing around new initiatives. From an overall perspective, the sentiment remains similar to H2 2022. As per the survey, healthcare and technology may continue to be favorable investments in 2023.

> H2 2022 had an unwavering slim outlook characterized by weak economic activity coupled with tight credit markets, and H1 2023 is expected to follow suit.

Index Methodology

The TresVista Investor Confidence Index is an initiative to capture the changing investor sentiments in the U.S. Middle-Market PE industry. We spoke to PE professionals to measure changes in activity levels in key business functions and overall investor sentiments for U.S. Middle-Market PEs over the last six months (H2 2022 vs. H1 2022) and their outlook for these over the next six months (H1 2023 vs. H2 2022).

The responses to the questions under these sections are captured using a 5-point Likert Scale and are assigned numerical values from 1-5. The score of the preceding period serves as the Investor Confidence Baseline Score for the current period. An aggregate score of 3 (Investor Confidence Baseline Score) implies no change in investor sentiment for the period under consideration compared with the preceding period. An aggregate score above 3 means a boost or positive change in confidence. Similarly, a score of less than 3 implies a decline or negative shift in confidence. The sectional questions are coalesced in proportion to their weights and correlation to arrive at an index value for the respective section. The final Index value calculated reflects all the sections' weighted average value and indicates the overall shift in investor confidence compared to the preceding period.

Significantly Less	Slightly Less	Same	Slightly More	Significantly More
(1)	(2)	(3)	(4)	(5)

Qualitative questions were used to delve further into the index value, gain deeper insights behind the score's rationale, and highlight the larger trends driving the current investor sentiments.

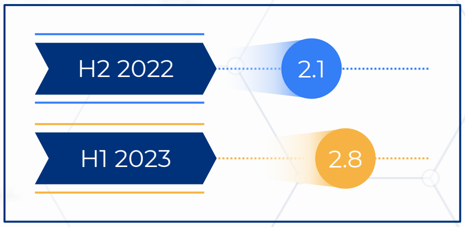
Key Takeaways

Time Allocation

The total time allocated by U.S. Middle-Market PEs toward new deal diligence and deal origination activities in H2 2022 trended in line with H1 2022. In parlance, there was a slightly increased focus on fund-raising and portfolio management activities in the six months leading to 2023. The time allocated toward fundraising, new deal diligence, and portfolio management activities is expected to rise marginally in H1 2023 as compared to H2 2022. The respondents expect to spend more time on deal origination activities, as PEs further adapt to macro-level uncertainties.

Access to Capital and Financing

The equity market was less bankable in H2 2022 due to rising interest rates and operating costs. Access to capital and financing from LPs around new fund-raising activities declined moderately in H2 2022 as compared to H1 2022. Investors do not anticipate the ease of financing to change much in H1 2023 albeit a marginal decline as they expect the uncertainties in the market to persist and LPs may continue to be reluctant to deploy capital.

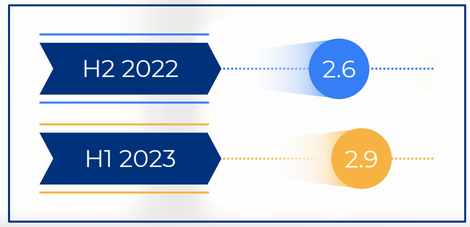


Deal Pipeline and Origination

H2 2022 marked a slight slump in the number of total opportunities at the top of the funnel and average size of transactions as compared to H1 2022. The number of inbound opportunities along with their quality deteriorated moderately during the period whereas the timelines for closing a deal increased marginally. However, the level of competition for new deal opportunities trended in line with that in H1 2022. In H1 2023, the number of total opportunities as well as the number of inbound opportunities are expected to decrease marginally as compared to H2 2022 whereas, the quality of these opportunities, timelines for closing a deal, and the anticipated level of competition are expected to increase marginally. The average size of transactions is anticipated to remain at a similar level.

Portfolio Management

Amidst the unfavorable macroeconomic scenario, the holding period of portfolio investments increased moderately in H2 2022 as compared to H1 2022, and the quality of distressed assets remained at a similar level. Our survey participants expect a slight improvement in the quality of distressed assets and a slightly longer holding period of portfolio investments in H1 2023 as compared to H2 2022.



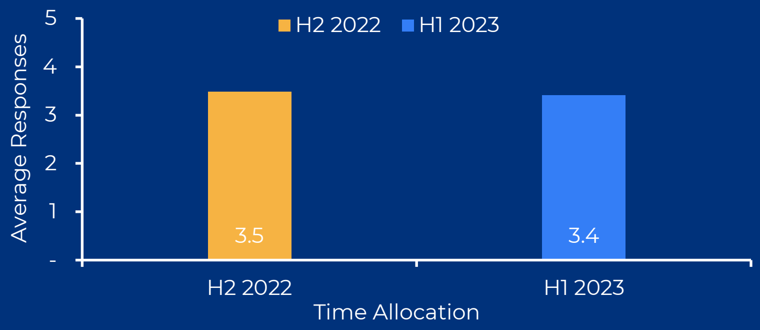
Valuation and Exit Opportunities

Multiples decreased moderately in H2 2022 as compared to H1 2022, and the gap between buyers' and sellers' valuation expectations increased slightly. The respondents anticipate the valuation multiples and the gap between buyers' and sellers' valuation expectations to decrease slightly as compared to H2 2022, as they expect volatility may continue to persist in the market and sellers become realistic in terms of the valuation. The investors also found it challenging to exit their investments as an IPO exit was not a feasible choice in the volatile market.

Time Allocation

With inflation topping nine percent, interest rates continuing to rise, and a slump in the stock market, the U.S. Middle-Market PEs continued to spend similar time on new deal diligence and deal origination activities, with a slightly increased focus on fund-raising and portfolio management activities in H2 2022 as compared to H1 2022.

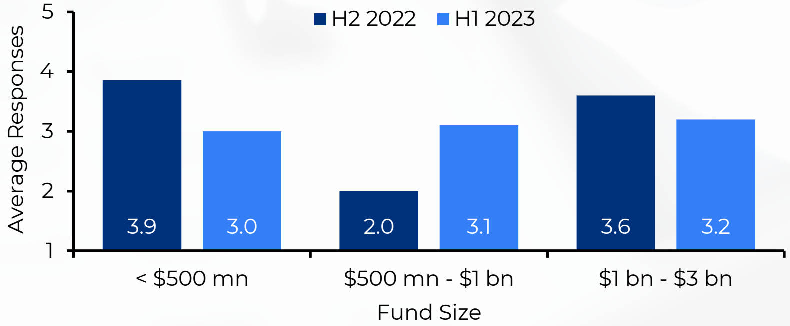
Our respondents do not anticipate the macro environment to improve drastically in H1 2023 and thereby expect the time spent on these activities to display a very marginal increase as compared to H2 2022.



> I believe that during periods of high volatility, it becomes more difficult for buyers to conduct proper valuations, resulting in an increase in time and effort.

Fundraising

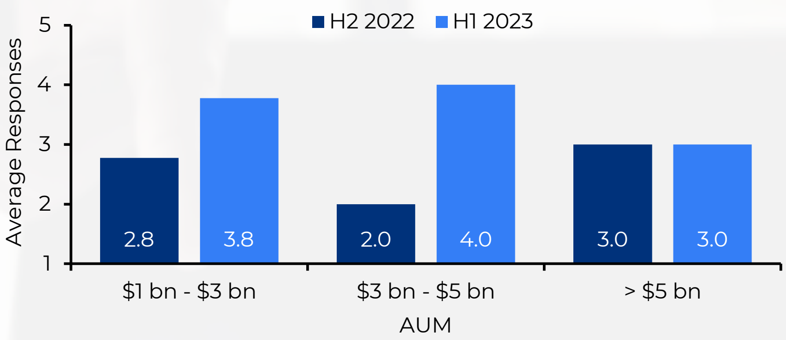
Time spent on fundraising activities in H2 2022 increased slightly when compared to H1 2022. The dip in the stock markets and the uncertainty surrounding it caused private assets to make up a larger portion of many LP's alternative buckets. The denominator effect alongside the tumble in the credit markets, is likely to cause a reduction in the rate at which they would make commitments to private equity funds over the next one or two years.



Given the challenging market conditions, investors expect the fundraising activities to remain in line with the trend witnessed during H2 2022 in H1 2023.

Deal Origination

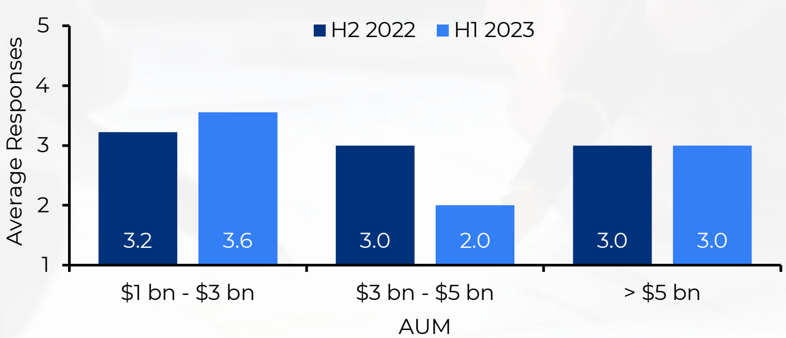
The focus of respondents on deal origination activities remained very similar to H1 2022 in H2 2022. The slightly downward trajectory of deals was largely attributed to uncertain macroeconomic conditions and rising capital costs coupled with staffing expenses. Investors remain cautiously optimistic about the opportunities for H1 2023. They continue to look forward to new ways to deploy capital and expect slightly better guidance in H1 2023.



Deal origination activities are expected to moderately increase for the firms with AUM between $1 bn - $5 bn in H1 2023 as compared to H2 2022.

New Deal Diligence

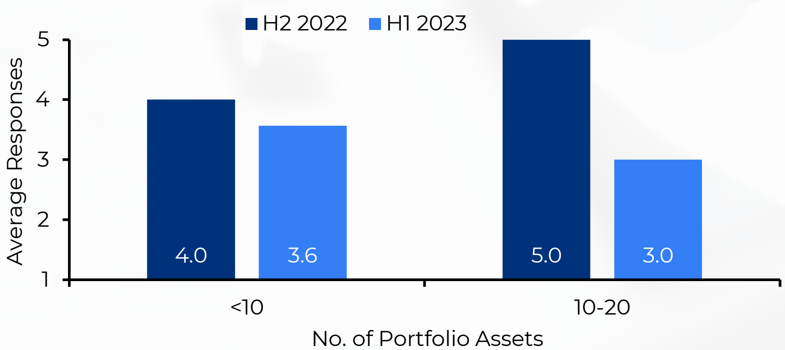
The survey participants spent almost similar time on new deal diligence activities in H2 2022 as compared to H1 2022 as they primarily focused on their current portfolio than on new deals amidst a cooling deals market. Our survey participants believed the public markets were more volatile than their expectations. The focus on new deal diligence is expected to marginally rise owing to the optimistic view of increased deals in H1 2023 as compared to H2 2022.



Firms with an AUM between $3 bn - $5 bn are expected to spend and allocate moderately lesser time toward new deal diligence in H1 2023 as compared to H2 2022.

Portfolio Management

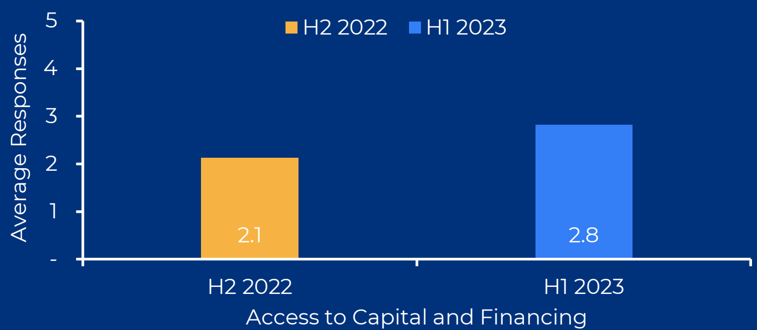
Time spent on portfolio management activities was slightly higher in H2 2022 as compared to H1 2022. Investors believe that the lack of competitive deals in the market and the challenging operating environment are the primary reasons behind this. Moreover, with increasing inflation, input costs rose sharply, causing the already worse situation to worsen. Though investors believe to have some confidence with respect to newer deals in the market, the time and effort on portfolio management are expected to marginally increase in H1 2023 as compared to H2 2022.



Amidst the macroeconomic factors which may continue to impact the broader economy unfavorably, the investors expect to spend similar time on portfolio management activities in H1 2023 as compared to H2 2022, which was considerably more than in H1 2022.

Access to Capital and Financing

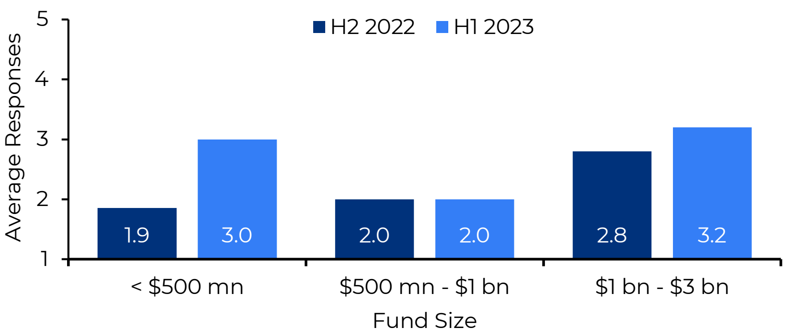
LPs showed slightly less interest in capital allocation to new funds in H2 2022 as compared to H1 2022. The equity market remained less lucrative in H2 2022 because of rising interest rates and operating costs (e.g., labor costs) which made it difficult for the companies to make concrete projections. Our respondents expect that quality assets with a strong market position may continue to be attractive in H1 2023, and people are likely to shy away from businesses with a huge consumer spending element. The investors do not expect the ease of financing to change significantly, albeit a very marginal decline in H1 2023, as they believe uncertainty to continue to prevail in the market and LPs continue to remain reluctant to deploy capital. Lower-quality deals would probably not get support from external investors and may need funding from internal investors.



> I think new funds continue to be more of a challenge, than re-ups to existing funds.

Sector trends

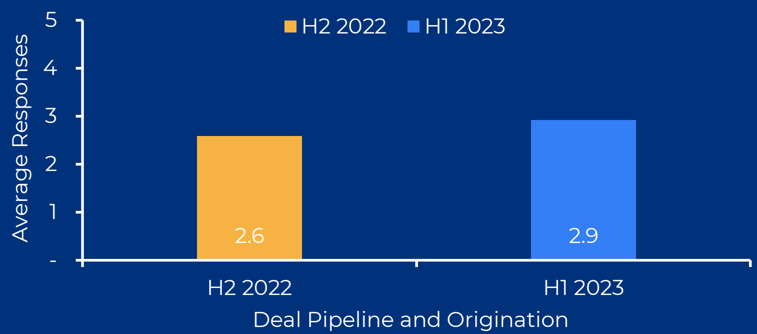
Investors considered the energy segment to be a difficult sector to raise funds for due to unfavorable macroeconomic and geo-political scenarios, and M&A and SPAC deals in the energy segment were also relatively less resilient than the H1 2022. Our respondents found the consumer segment to be less attractive as it is subjected to macroeconomic headwinds. There was an increased investment in general tech and healthcare as the investors expected to generate outsized returns over time.



Firms with fund size between $500 mn - $1 bn are expected to witness a moderate decline in securing allocations from LPs toward new funds in H1 2023 as compared to H2 2022.

Deal Pipeline and Origination

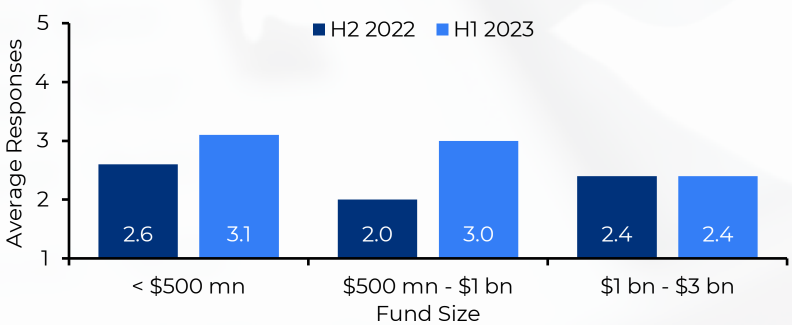
H2 2022 saw a slight decline in the deal pipeline and origination activities as compared to H1 2022 since few of our respondents believe that directors and key decision-makers were comparatively more hesitant and had a risk-averse mindset keeping in mind the volatile markets. Additionally, heightened and less predictable regulation also tampered with M&A activity. The investors expect the deal pipeline and origination activities to marginally decline in H1 2023 as compared to H2 2022.



> In 2022, the entire year was more or less the same from a deal flow perspective. I think a lot of folks started seeing the impact of macro factors in the fourth quarter.

Number of Opportunities

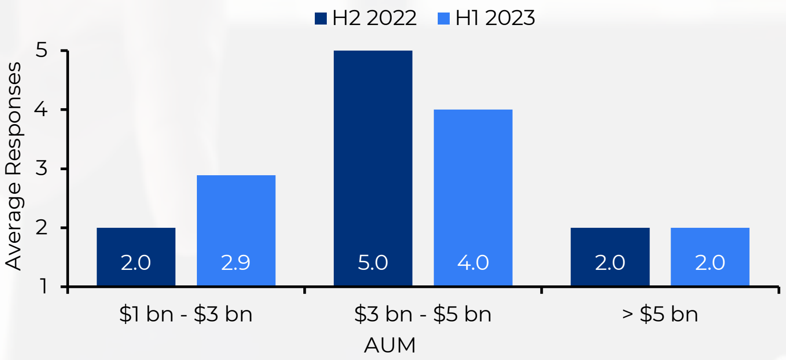
The number of opportunities saw a marginal decline in H2 2022 as compared to H1 2022 since PE firms were trying harder to source more deals as they had the capital to deploy but there were fewer deals coming from bankers leading to lesser volume. In early 2022 and 2021, the firms had a lot of deals, whereas the situation was the complete opposite in H2 2022, when there were not enough deals in the market. H1 2023 is expected to witness a very similar trend as was the case in H2 2022.



The number of top-of-the-funnel opportunities for firms with fund size < $1 bn are likely to trend in line, while firms with fund size between $1 bn - $3 bn may see slightly lesser opportunities in H1 2023 as compared to H2 2022.

Number of Inbound Opportunities (Opportunities Sourced from Bankers and Brokers)

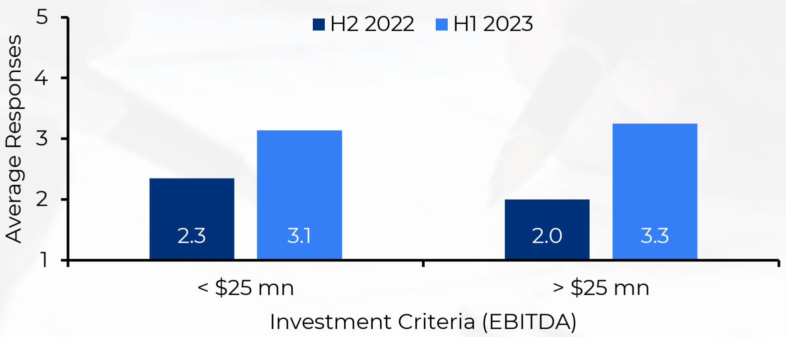
The number of overall inbound opportunities sourced from banks and brokers saw a slight decline in H2 2022 as compared to H1 2022. A clear demarcation between the strategy adopted by banks and brokers was that the banks were holding deals while brokers were still coming to market with deals in Q4 2022 as per some of our survey participants. H1 2023 is expected to mirror the trend that was witnessed in H2 2022.



60 % of our respondents believe that the number of inbound opportunities may be slightly lesser in H1 2023 as compared to H2 2022, however overall sentiment remain similar to H2 2022.

Quality of Inbound Opportunities

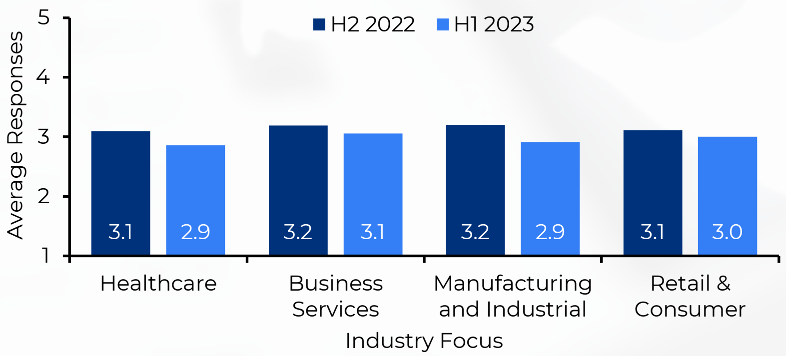
The quality of inbound opportunities in H2 2022 declined slightly in comparison to H1 2022. Those sellers who were in the possession of good quality assets withheld from selling as they were aware that this would not be a lucrative time to sell. Investors are expecting the quality to improve in H1 2023 very marginally.



Investors expect the quality of inbound deals to marginally increase based on factors like the funnel being steep and an increase in cash constraints in H1 2023 as compared to H2 2022.

Timelines for Closing a Deal

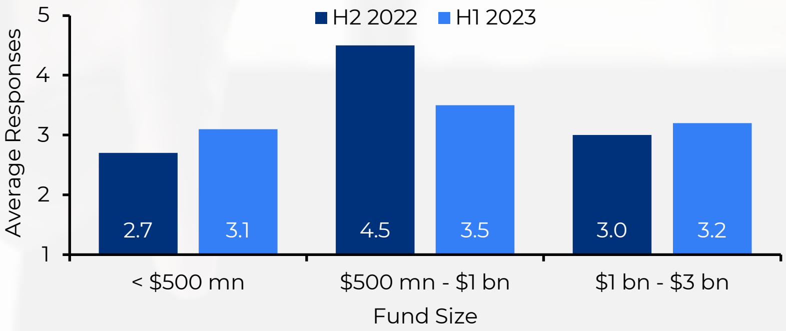
Timelines for closing a deal rose moderately in H2 2022 as compared to those in H1 2022 as the investors spent more time on diligence. They now expect the deal close timelines to tread steadily, albeit a very marginal increase on account of increased due diligence in H1 2023 as compared to H2 2022.



Timelines for closing deals are expected to remain inline with the trend witnessed during H2 2022 in H1 2023 across all industries except TMT for which the timelines are expected to slightly decrease.

Level of Competition

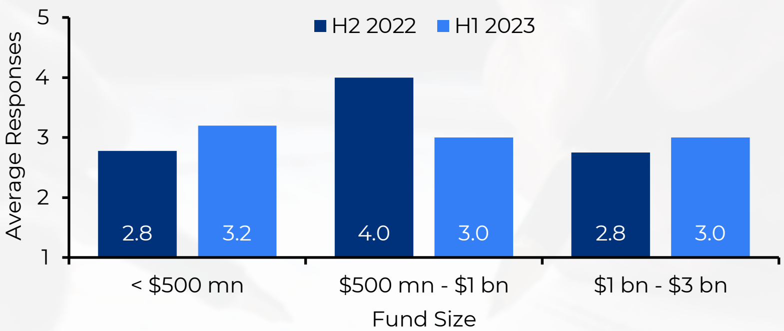
The deal market remained competitive, and the level of competition mirrored the trend that was witnessed during H1 2022 in H2 2022 as well. PE professionals anticipate that the level of competition will rise marginally in H1 2023 in comparison to H2 2022 as they expect better quality deals coming to the market in the first six months of 2023.



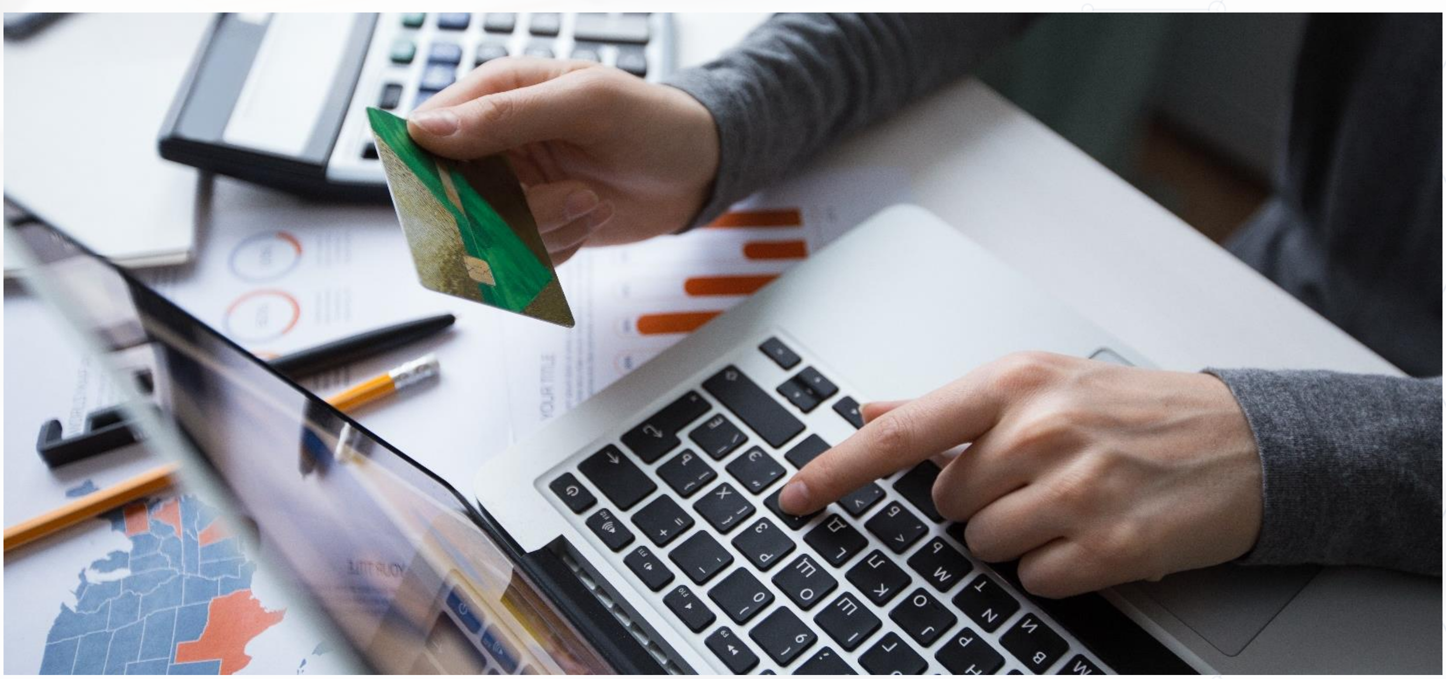
Firms with fund-size between $500 mn - $1 bn expect a slightly higher increase in the level of competition for new deal opportunities in H1 2023 while it remains in line for the firms with other fund-sizes as compared to H2 2022.

Average Size of Transactions

The average size of transactions decreased very slightly due to the unfavorable situation in the debt markets in H2 2022 as compared to H1 2022. Smaller deal sizes were easier for firms to close as funding became harder to secure. The average transaction size is expected to display the same trend in H1 2023 as it did in H2 2022.

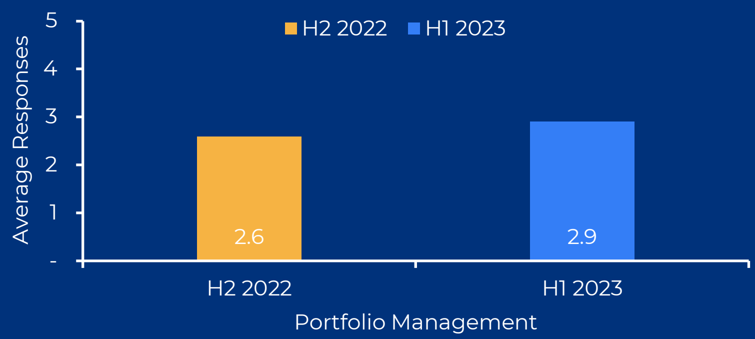


Firms with fund-size < $500 mn expect the average size of transactions to marginally increase while it remains in line for firms with other fund sizes in H1 2023 as compared to H2 2022.



Portfolio Management

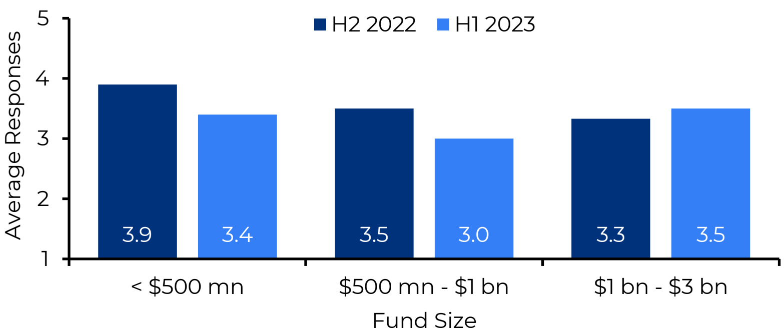
In an environment where interest rates had been soaring to keep a check on rising inflation coupled with arrested growth, and elevated volatility, investors believed it was the right time for active management and bottom-up portfolio construction. However, with the holding period increasing, overall portfolio management activities dropped slightly in H2 2022 and is expected to show a similar trend in H1 2023.



> The holding period is slightly longer as the sellers are always waiting for the right time or they are not getting the best results in the market.

Holding Period of Portfolio Investments

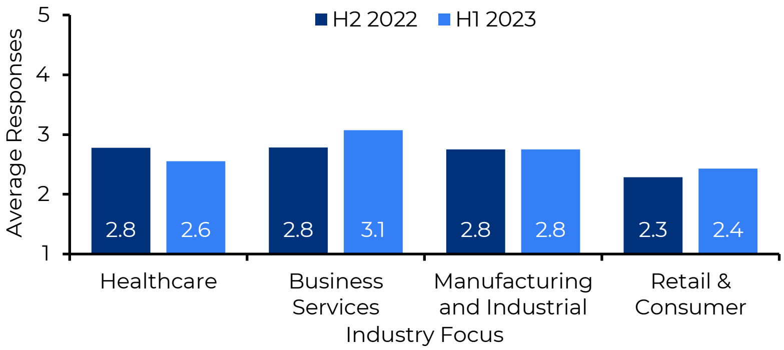
The holding period has become slightly longer given the tough economic environment in H2 2022 as compared to H1 2022. Many PE firms were in possession of assets that would have otherwise been a lucrative sale in a similar period and believed that it was better to hold on to these assets. Our respondents expect that companies may continue to hold on to these assets and the holding period in H1 2023 is expected to marginally rise as compared to H2 2022.



Holding period for firms with fund size between $500 mn - $1 bn is expected to remain in line while it may increase slightly for firms with other fund sizes in H1 2023 as compared to H2 2022.

Quality of Distressed Assets

The market condition in H2 2022 was challenging and there were cuts in businesses and people became quite attuned to it. However, the quality of distressed assets displayed a trend very similar to H1 2022 in H2 2022. Investors are now confident that the quality of distressed assets in the portfolio will bounce back a little bit in H1 2023 as compared to H2 2022.



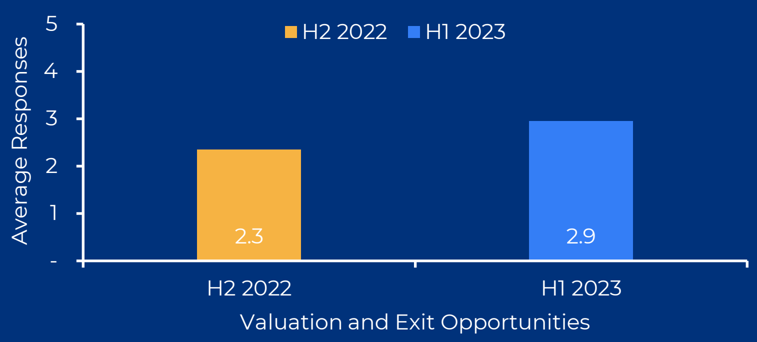
Retail and Consumer business may witness a moderate decline in the quality of distressed assets in H1 2023 as compared to H2 2022 on account of supply chain issues and soaring inflation.

ESG

PEs continued to allocate their focus on ESG in H2 2022. A significant proportion of our respondents have an active ESG framework for shortlisting deals, with the depth varying between different investors. A few respondents haven't incorporated the framework wholly, although they have shown interest in the same.

Valuation and Exit Opportunities

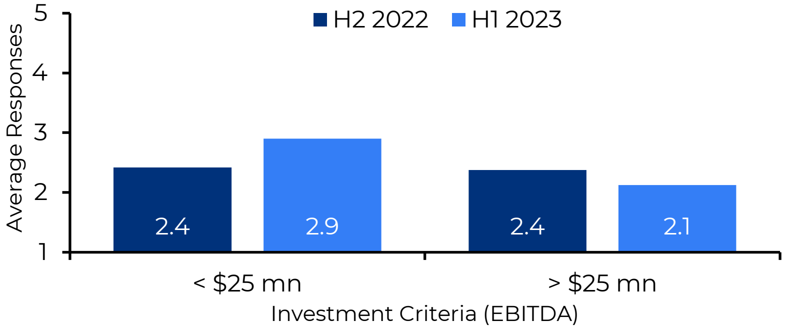
The valuation and exit opportunities declined moderately in H2 2022 as compared to H1 2022. The consensus amongst our respondents is that the SPAC market was quite inactive in H2 2022, so there weren't many buyouts in the market, and the continuation vehicles, although interesting, weren't nearly as appealing as they were in H1 2022. Our respondents expect these opportunities to marginally decline in H1 2023 as compared to H2 2022.



> Typically, the buyer definitely wants to buy at a discount while the seller is still holding on, expecting that the prices will move upward, so the gap is definitely high right now.

Valuation Multiples

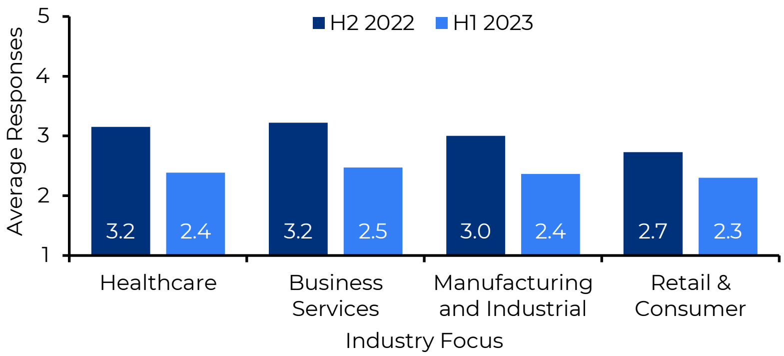
Multiples fell moderately in H2 2022 as compared to H1 2022 owing to the difficult macro environment. Investors believe that the market may further witness some volatility in H1 2023. A portion of our respondents believes that the valuation expectations are getting more realistic for the buyers as compared to the sellers. They expect the multiples to slightly decline further in H1 2023 as compared to H2 2022.



Almost 2/3rd of our respondents believed that that the valuation multiples were slightly lesser in H2 2022 as compared to H1 2022 and a major percent lean towards further decrement in H1 2023.

The Gap Between Buyers' and Sellers' Valuation Expectations

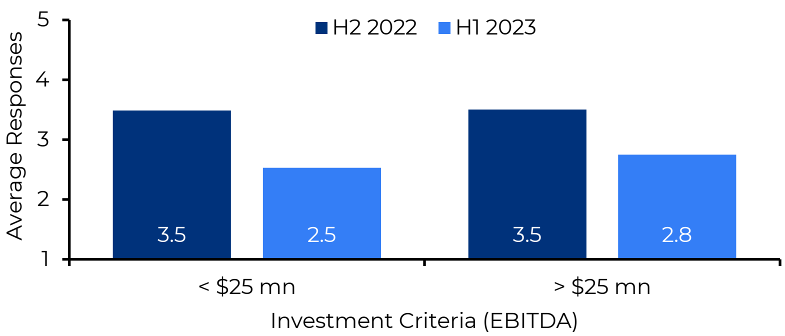
The gap between the seller and buyer valuation outlook rose slightly in H2 2022 as compared to H1 2022, as the sellers felt that the worth of their company was much more and were looking for the highest valuations, and buyers were considering the overall macroeconomic environment leading to a lower valuation. However, sellers are anticipating a drop in future expectations, thereby narrowing the gap. This trend is envisioned to last only till markets start rebounding.



Gap between buyers' and sellers' expectations is expected to moderately decline for TMT industry in H1 2023 as compared to H2 2022.

Exits

Investors found it difficult to exit their investments because of the IPO exit not being a lucrative option amidst the volatile market scenario. Parallelly, sellers were not as keen as the buyers to lock in at lower prices.



Firms with an investment criterion of EBITDA < $25 mn expect slightly higher exit opportunities on account of moderate decline in gap between the buyer's and seller's expectations in H1 2023 as compared to H2 2022.

About TresVista

Overview

TresVista is a global enterprise offering a diversified portfolio of services that enables its clients to achieve resource optimization through leveraging an offshore capacity model. TresVista's services include investment diligence, industry research, valuation, fund administration, accounting, and data analytics.

Highlights

Worked with 1,000+ Clients

From Emerging to Established Firms

Servicing Clients in 80+ Countries

Across Industries and Asset Classes

Client-Integrated Operating Strategy

Why Partner With Us

HR Solution

- Flexible Staffing Model
- Dedicated Tiered Teams Support

Quality

- Industry-Leading Talent
- Multiple Layers of Quality Checks

Operating Leverage

- Centralized Resource Pool
- Integration across Value Chain

Cost Efficiencies

- Lower Indirect Costs
- Meaningful Direct Cost Savings

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