TresVista
Catalyzing Your Impact

# TresVista Investor Confidence Index Report

September 2023

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# Executive Summary

The U.S. Middle-Market Private Equities (PE) witnessed more deal activity in the last two years than in any single year of the past decade. However, in H2 2022, PEs started preparing to brace for the impact of high inflation, geopolitical pressure, and a recessionary H1 2023. As we arrived in H1 2023, the looming threat of a delayed impact of geopolitical and credit risk has taken the investors on the back foot.

PEs expect the total deal activity to go back to the lesser pre-pandemic levels driven by lower inbound opportunities in the first half of the year, exhausted deal pipelines of many participants, extended timelines to close deals, and lower favorable exit opportunities. Like H2 2022, participants spent more time on portfolio management, making sure that portcos do not breach covenants and meet budgeted targets. One upside identified by survey participants in the current market has been a correction in the seller's expectations on valuation, with lower bids due to a larger equity component and public comps materially reducing in value. Prima facie, the situation is expected to slightly improve in H2 2023, with survey respondents expecting increased opportunities, improved access to capital financing, a larger deal pipeline, and improved valuations. However, the consistently volatile developments in the credit space, along with inflationary tailwinds, have kept the PE players with bated breath toward shorter-term stability. The next six months should largely dictate how the survey respondents and subsequently, the larger market adjust their long-term expectations. Survey participants expect the non-cyclical businesses to be an attractive source of investments.

> "H1 2023 witnessed credit tightening coupled with muted exit activities due to economic turbulence. The reactionary movements of the market are awaited as they would largely dictate the decision making going forward."

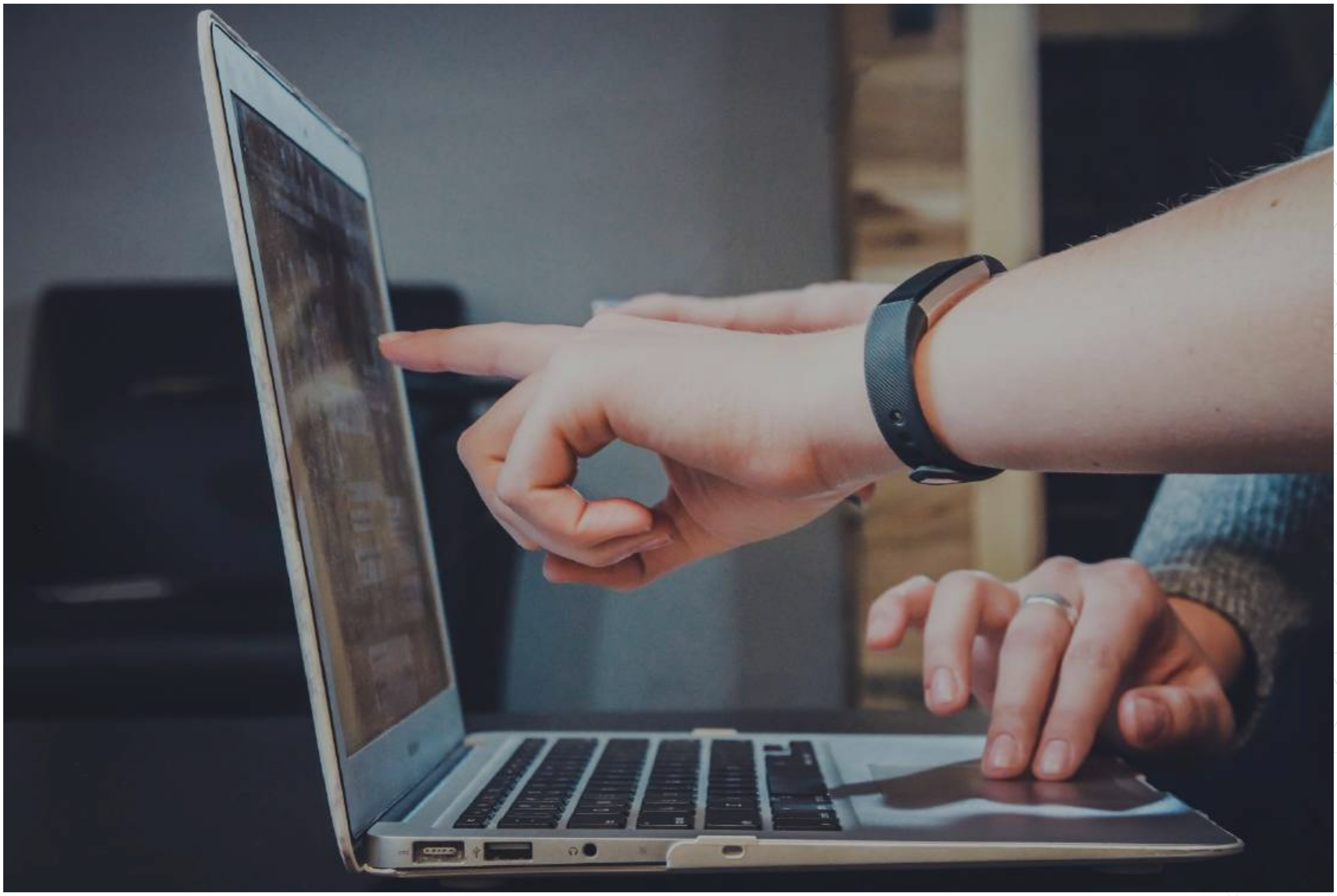
# Index Methodology

The TresVista Investor Confidence Index (TICI) 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 (H1 2023 vs. H2 2022) and their outlook for these over the next six months (H2 2023 vs. H1 2023).

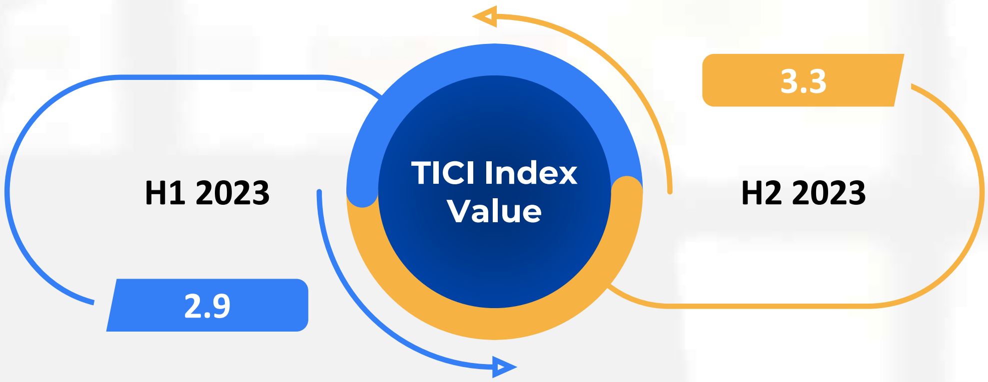
The responses to the questions under these sections are captured using a 5-point Likert Scale and are assigned numerical values from 1-5. The score of the preceding period serves as the Investor Confidence Baseline Score for the current period. An aggregate score of 3 (Investor Confidence Baseline Score) 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 values 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 into the score's rationale, and highlight the larger trends driving the current investor sentiments.

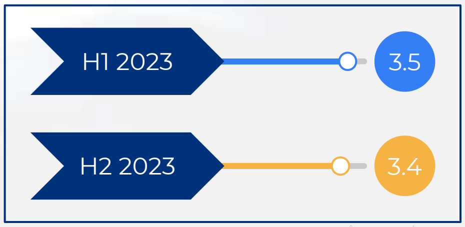


# Key Takeaways



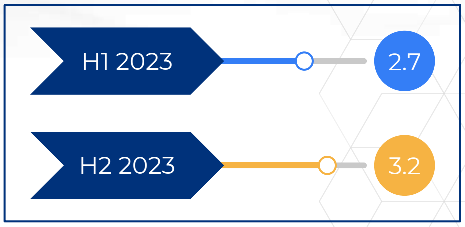

## Time Allocation

The total time allocated by U.S. Middle-Market PEs toward fundraising, new deal diligence, and deal origination activities increased in H1 2023, compared with H2 2022. In parlance, there was a proportionately larger emphasis on portfolio management activities due to the challenging operating environment. The time allocated to all four activities is expected to rise marginally in H2 2023 as PEs adapt to macro-level uncertainties, including the geopolitical and interest rate risks.



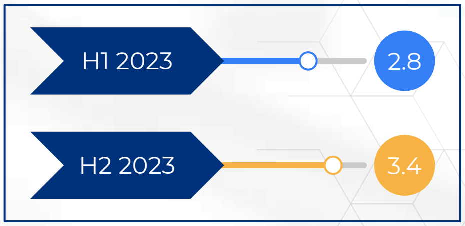

## Access to Capital and Financing

Investors continued to detect negative sentiments in the market in terms of recession. The denominator effect has caused investors to pause and reassess deployment plans. Access to capital and financing from LPs around new fund-raising activities declined marginally in H1 2023 as compared to H2 2022. Investors anticipate an ease in financing in H2 2023 as LPs start getting comfortable with the macroeconomic environment.




## Deal Pipeline and Origination

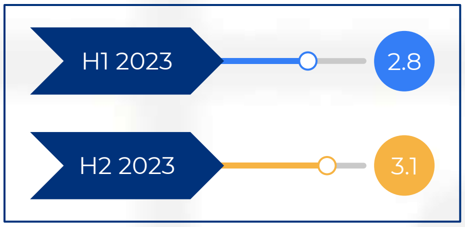
There was a slight increase in the number of total opportunities at the top of the funnel and inbound opportunities available in H1 2023 as compared to H2 2022. The quality of inbound opportunities, along with the anticipated competition for new deal opportunities, deteriorated moderately during the period, whereas a surge was observed in the timelines for closing a deal. A slight slump was observed in the average size of transactions due to difficulties in raising capital. The situation is expected to improve and witness a moderate increase in the deal opportunities available in H2 2023. The quality of these opportunities, the average size of transactions, and the anticipated level of competition are also expected to increase marginally, but the timelines for deal closure are anticipated to decrease.



# Key Takeaways

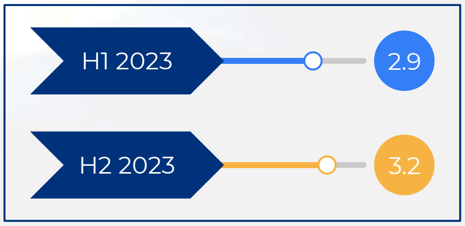
## Portfolio Management

Amidst the hostile macroeconomic scenario, the holding period of portfolio investments increased moderately, and the quality of distressed assets witnessed no change in H1 2023 as compared to H2 2022. As the economy heads towards 2024, our survey participants expect the holding period of portfolio investments to decline marginally and the quality of distressed assets to improve compared to H1 2023.



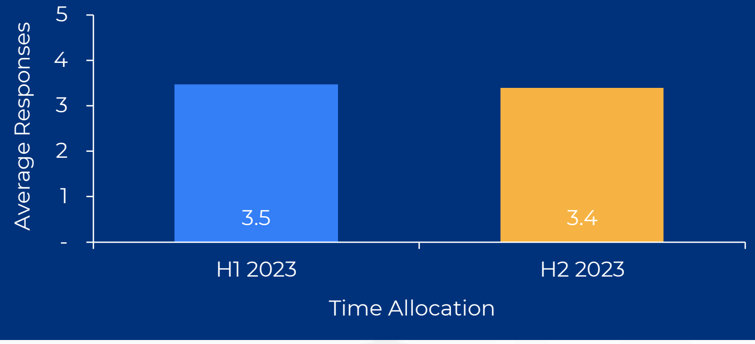

## Valuation and Exit Opportunities

Multiples decreased moderately in H1 2023 as compared to H2 2022 due to lag in public markets. The gap between buyers' and sellers' valuation expectations also witnessed a slight decline during the period since sellers are becoming more realistic in terms of valuation expectations. The respondents anticipate a further decline in the gap between buyers' and sellers' valuation expectations, while the valuation multiples in H2 2023 are expected to remain in line with the multiples in H1 2023. The investors find it challenging to exit their investments as an IPO exit was not a lucrative option in the turbulent market.




# Time Allocation

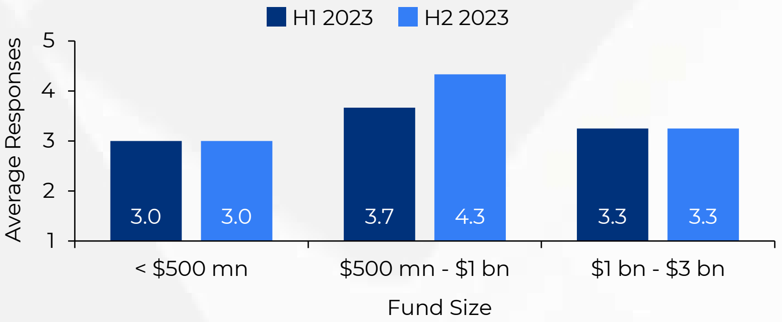
As quality opportunities in the PE space have been scarce, the U.S. Middle-Market PEs have spent more time in portfolio management and extensive due diligence of companies. We observe a positive adjustment toward fundraising activities as PEs make peace with the rising rates in the economy. The overall score in time allocation increased in comparison to H2 2022, indicating the market is adjusting to the rising rates but has not yet overcome speculative fear. 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 marginal increase as compared to H1 2023.




> "Generally, everybody is taking a step back and waiting to see what will happen in the economy, spending more time dealing with rising uncertainty."

## Fundraising

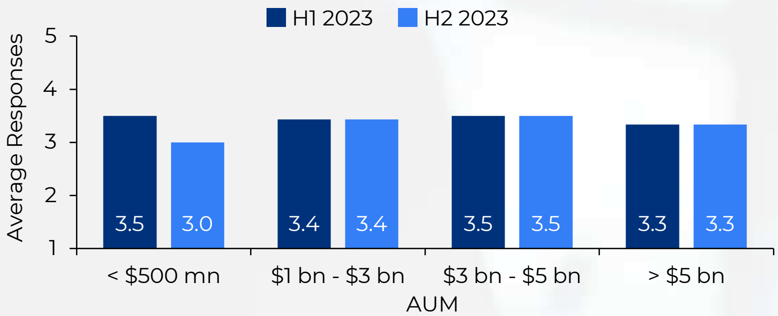
Time spent on fundraising activities in H1 2023 has slightly increased when compared to H2 2022, driven by increased challenges in matching funding valuation expectations with existing market instruments. With increased quantitative tightening by the Federal Reserve, PEs have observed a risk-reward imbalance in the market, with the opportunity cost of PE funding rising significantly. This has led to more time being spent on fundraising to find the right fit for the opportunity. The outlook for H2 2023 seems to be positive. With the Fed closing in on the end of a rate-rising cycle in H2 2023, cheaper money could catalyze the closing of a pipeline of opportunities that have been developed in H1 2023.




Fundraising activities have found a new status quo in the increased rate environment, and funding activities are expected to get back on track.

## Deal Origination

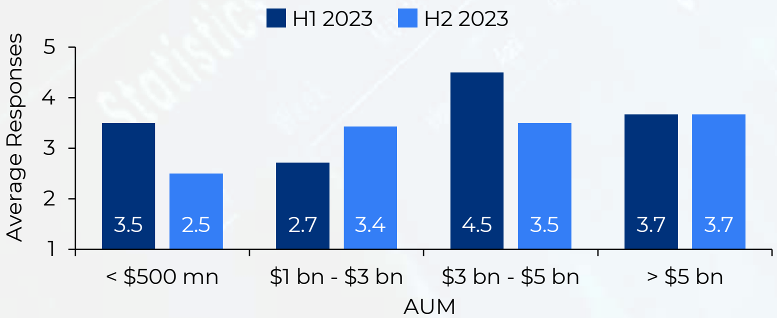
Time spent on deal origination activities increased moderately in H1 2023 compared to H2 2022. With the markets digesting high-rate environments, deal origination has slightly picked up, with many resources chasing few lucrative value opportunities in a rising competitive market. Time spent on deal origination will continue to increase in the latter half of 2023 but at a slightly slower pace.




Firms that had a prebuilt pipeline in H1 2023 will be less likely to pursue deal-sourcing activities, while firms with exhausted pipelines will likely expand their deal horizon, leading to a net neutral position, tilting in a slightly positive direction.

## New Deal Diligence

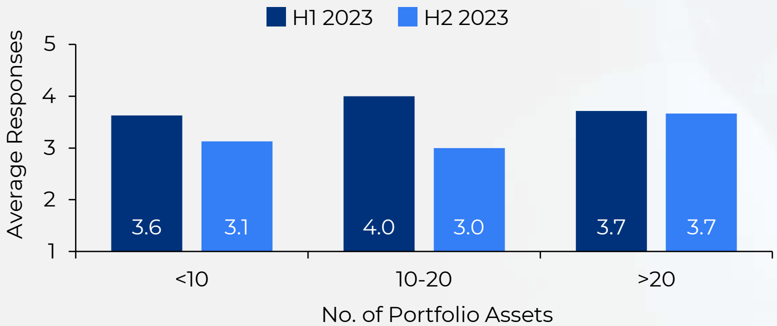
Time spent on new deal diligence activities witnessed a slight increase in H1 2023 compared to H2 2022. Increased deal flow with discounted valuations to meet liquidity requirements for credit commitments has led to a larger pipeline of deals requiring increased deal diligence. The quality of deals has also demanded increasing diligence. The outlook for H2 2023 remains equally positive, with a larger expected deal flow.




With prevailing higher rates acting as headwinds for company solvency, time spent on due diligence is trending upwards.

## Portfolio Management

Time spent on portfolio management activities was slightly higher in H1 2023 as compared to H2 2022. The active intervention of private equity managers in upholding the operations and solvency of portfolio companies has been a leading driver of time spent on portfolio management. Increased acquisition activity due to opportunities being available at massive discounts due to liquidity crunches has also added to the time spent on portfolio management. In H2 2023, the time spent on portfolio management activities is going to follow the ongoing upward trend. More time will be spent on selling, capitalizing, and liquidating assets. However, as the markets move towards stability, we expect the operational involvement of sponsors in portfolio companies to reduce.

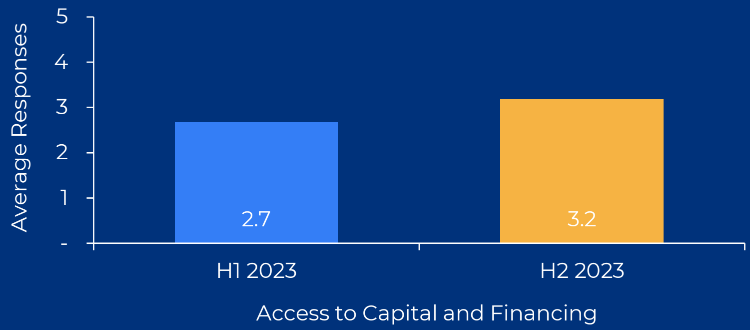



Operational activities are a priority. The focus on budget, business plan, and debt has been given attention.

# Access to Capital and Financing

LPs showed slightly less interest in capital allocation to new funds in H1 2023 as compared to H2 2022. The rising interest rates and macroeconomic and geopolitical volatility have caused a slowdown in fundraising for the private equity market as a whole. While older firms had the benefit of leveraging existing LPs, newer and older funds alike faced difficulty in attempting to onboard new LPs. There is a credit slowdown in the economy due to banking turmoil. Banks are tightening lending standards amid fears of regulatory crackdowns following the lender collapses. This has led to funds altering their deal structure and becoming more flexible on the sources for funding the transaction.

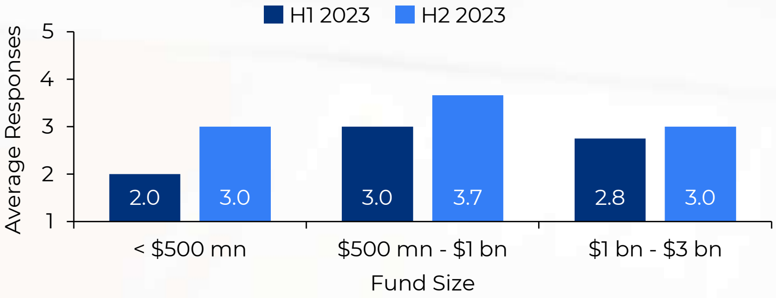
The expectations for H2 2023, however, seem to be slightly on the brighter side. It is expected that LPs, considering the large amount of dry powder in the market, will adapt to the environment, which would lead to an increase in fund flow. Though the macroeconomic situations are not expected to change significantly during H2 2023, the debt market would be showing signs of improvement as the Fed rates are easing slowly.




> "I detect a much more negative sentiment towards recession, with it being harder to raise money from a debt perspective, but from an equity perspective, there is more money out there. In my opinion, 2024 is going to be the year when we can start expecting a more stable environment."

## Sector Trends

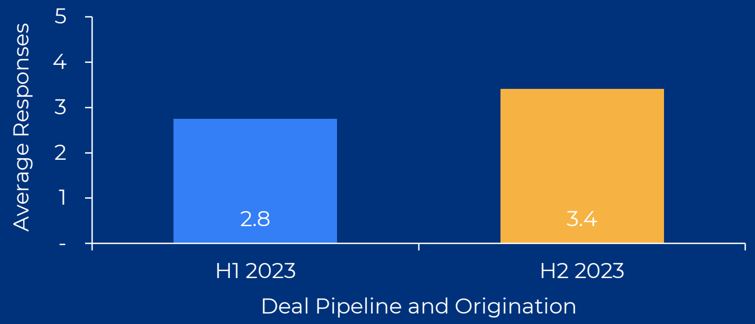
Investors preferred to invest in non-cyclical businesses due to the hovering fear of recession in the economy. Our respondents found the healthcare and technology sectors to be most attractive as these have remained relatively more resilient to the macroeconomic uncertainties. However, there is a separate school of thought that looks at the economic slowdown as an opportunity to obtain a better price for fundamentally strong cyclical businesses. This opportunity, however, could be considered riskier by the LPs and thus could be opted only by funds with existing LPs with whom they have built a trust relationship, as LPs are reluctant to back a new fund in an uncertain market.




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

# Deal Pipeline and Origination

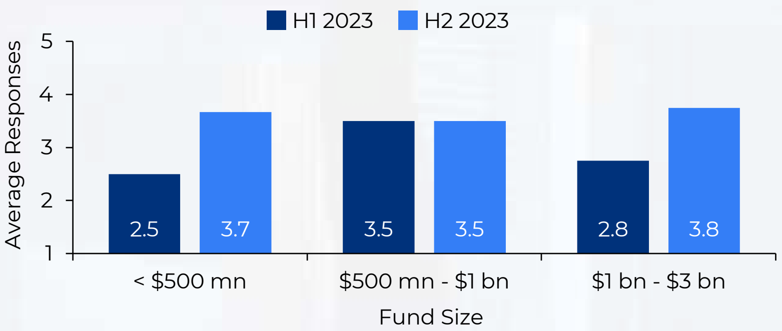
H1 2023 saw a slight decline in the deal pipeline and origination activities as compared to H2 2022. The drivers towards the decline include lower pursuable opportunities, a neutral inflow of deals from bankers, and deteriorated quality of opportunities. Competition is expected to increase in the latter half of the year. Investors expect the deal pipeline and origination activities to improve marginally in H2 2023 as compared to H1 2023.



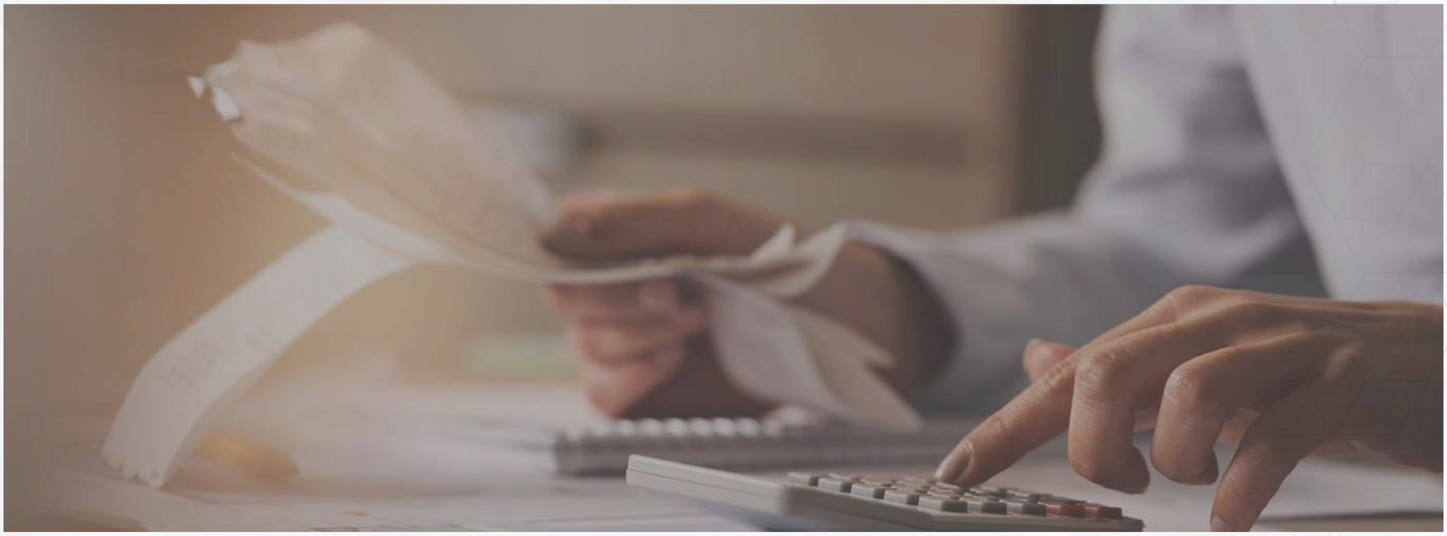

"Large transaction size has become rare due to the unavailability of debt. The only way a big deal could happen without debt would be if the assets were sold at discounts."

## Number of Opportunities

The number of opportunities witnessed a slight increase in H1 2023, as compared to H2 2022. Though there is an increased amount of time being spent on deal origination activities, the actual deals that have been initiated for H1 2023 were slightly less compared to H2 2022. The quality of said opportunities has been a driving factor toward the same. As macroeconomic conditions improve in H1 2023, PEs expect a surge in the number of pursuable opportunities as compared to H1 2023.

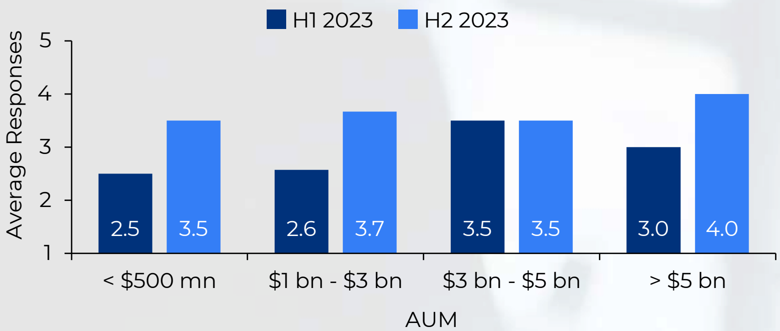



The number of top-of-the-funnel opportunities for firms with fund size $500 mn - $1 bn are expected to trend in line, while firms with <$500 mn and $1 bn - $3 bn are expecting to see much more pursuable opportunities in H2 2023.



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

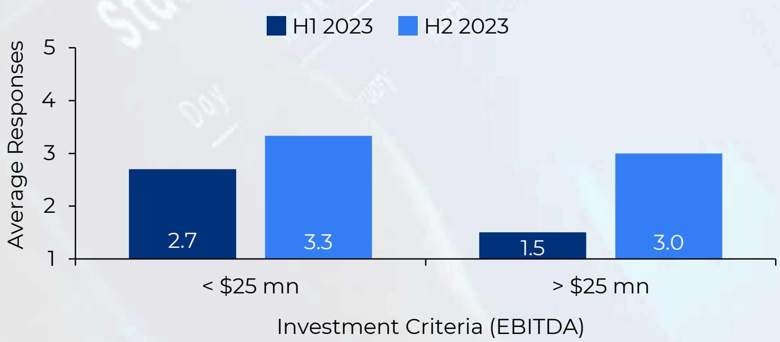
The number of inbound opportunities from bankers and brokers has largely remained the same in H1 2023 as compared to H2 2022. In line with discounted valuations, there has been a shift towards proprietary sourcing over banker opportunities. However, inbound opportunities are expected to elevate in the latter half of 2023 with an extended pipeline of backlog entering the market.




While the $3 bn - $5 bn funds expect similar trends in the second half of the year, respondents with other AUM sizes expect an increase in inbound opportunities, with >$5 bn funds expecting the most significant increase in opportunities from bankers and brokers.

## Quality of Inbound Opportunities

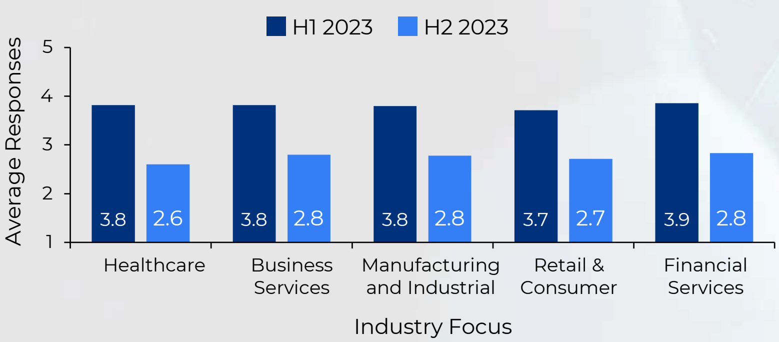
There has been a slight decline in the quality of inbound opportunities in H1 2023 as compared to H2 2022. The quality can be divided into two aspects, the valuation and the operational strength of the business. There has been an improvement in the expectations of sellers due to turmoiled markets which has led to fair valuations of operationally sound businesses. But there has also been an influx of operationally weaker businesses, doubled down with inflation eating away the thin margins. This, combined with fewer deals coming in, has led to a deterioration in the rating. However, PEs expect the quality of inbound opportunities to improve significantly in H2 2023, with more non-cyclical businesses being recognized and a general improvement in the market expectations for the economy.




Quality of inbound opportunities is expected to increase in H2 2023, with operationally sound businesses showing grit in tougher times, and weaker opportunities being weeded out.

## Timelines for Closing a Deal

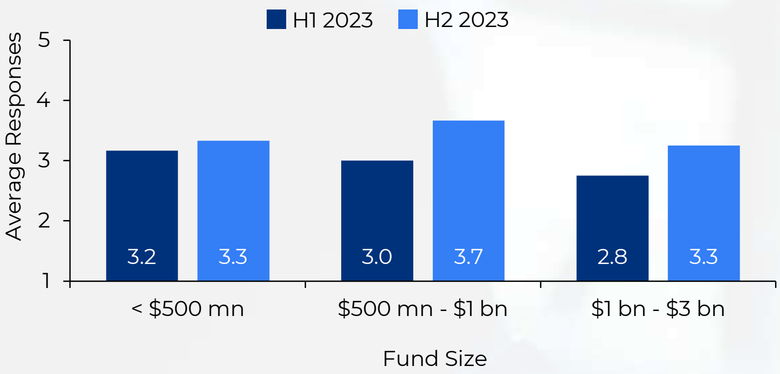
In line with the increased time spent on due diligence, the timelines for closing deals have also been extended in H1 2023 as compared to H2 2022. Slowdowns due to delays in debt financing have also pushed timelines with borrowers looking for more floating rate deals. Timelines in H2 2023 are expected to reduce due to the ease of financing that comes with better Federal guidance regarding interest rates, along with an increase in competition.




Timelines are expected to get shorter across the board, primarily due to easier funding and competition inadvertently pushing for PE proactiveness.

## Level of Competition

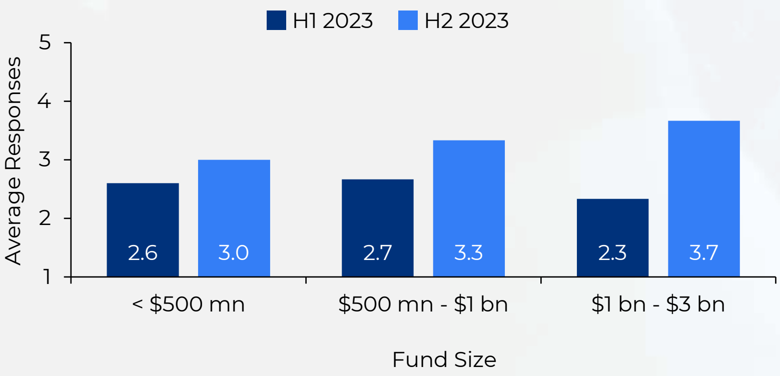
The level of competition for deals in H1 2023 is close to the levels of H2 2022. With a decrease in inbound opportunities from banks, the opportunities that do come have increased competition due to too many resources chasing too few goods. There is not a surge in competition due to lack of financing. The level of competition should increase slightly in H2 2023 after improved quality of inbound opportunities and improved access to financing opportunities.




$500 mn - $1 bn funds expect more competition in coming months, driven by the increased time engaging in funding activities, thus having more resources chasing fewer opportunities.

## Average Size of Transactions

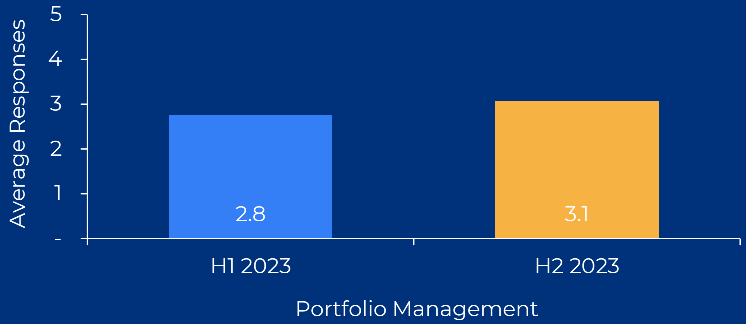
The average size of transactions has slightly reduced in H1 2023 compared to H2 2022. It has become more difficult to fund large ticket opportunities due to rising debt financing costs. In the coming six months, investors expect the size of transactions to normalize as and when rates start to go down.




$1 bn - $3 bn funds expect the largest jump in the size of transactions, led by the improved quality of opportunities justifying ticket size.

# Portfolio Management

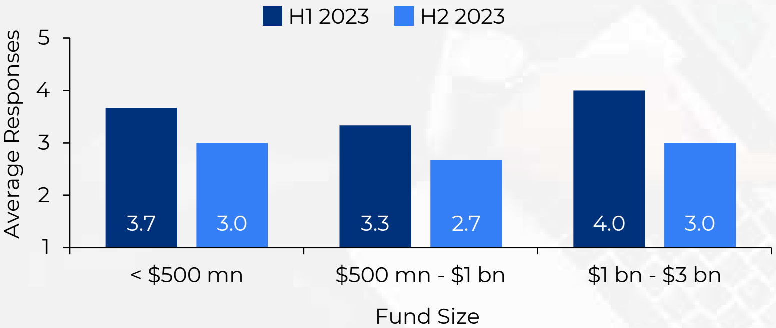
Due to discounted prices caused by the liquidity crunch, the economic instability and increased acquisition activity reported by a few respondents have demanded increased attention toward portfolio management. The holding period of assets increased slightly in H1 2023 as compared to H2 2022. However, H2 2023 is expected to see a slight stabilization in the economy, reducing the holding periods and improving the quality of distressed assets.




> "Deals that were supposed to be exited this year or next year have been extended further to see how the markets adjust, extending the holding periods."

## Holding Period of Portfolio Investments

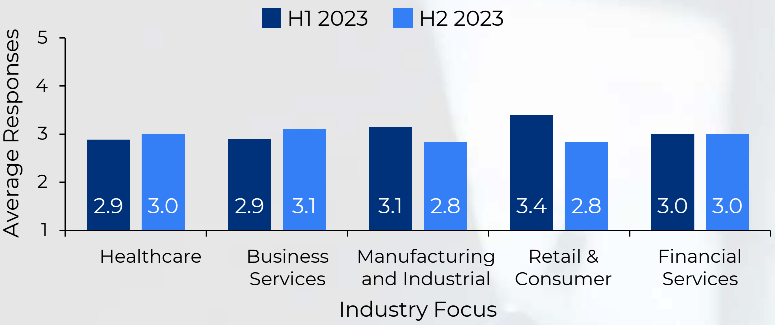
The holding period of investments has become slightly longer during H1 2023 as compared to H2 2022 due to economic turbulence. Many PE firms were in possession of assets that would have otherwise been a lucrative sale in a similar period and believed that it was better to hold on to these assets since they would have to settle for lower multiples in currently distressed economic situations. For H2 2023, the expectations for change are minimal. Our survey participants expect that the holding period might decline in H2 2023, but marginally.




In line with other metrics, the holding period is expected to normalize for most fund sizes as they expect the portcos to receive fair valuations as markets improve. Respondents also expect to readjust the currently extended pipelines in H2 2023.

## Quality of Distressed Assets

The market conditions for assets have become more troubling. Companies with underperforming assets are facing trouble in raising more capital to improve the quality of assets. This is causing underperforming assets to come out to market prematurely for sale, and assets that were set to come out now are having their exit dates prolonged by the sellers. However, the quality of distressed assets displayed a trend very similar to H2 2022 in H1 2023 on average. The quality is expected to bounce back a little in H2 2023 vis-à-vis H1 2023.



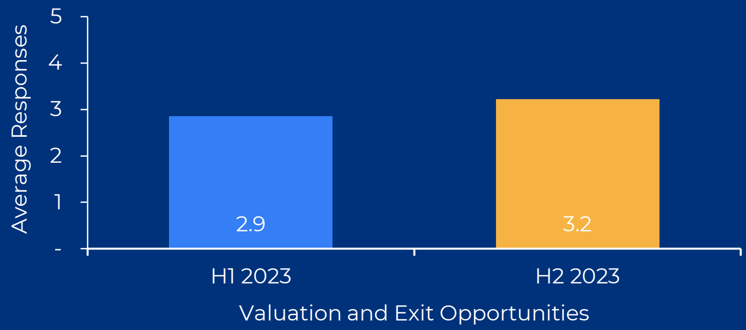

Looking at sector-wise spread of distressed assets, retail and consumer assets are expected to face the brunt of rising costs, absorbing a hit on margins, leading to lower asset quality.

## ESG

The existence of an active ESG framework has become a question while sourcing funds. Few of our respondents feel that it has become more of a political obligation than a social one. A few respondents haven't incorporated the framework wholly, although they have shown interest in the same. The participants agree that a strong ESG proposition helps to boost investment returns as better ESG means healthier firms which can boost the valuation of a firm.

# Valuation and Exit Opportunities

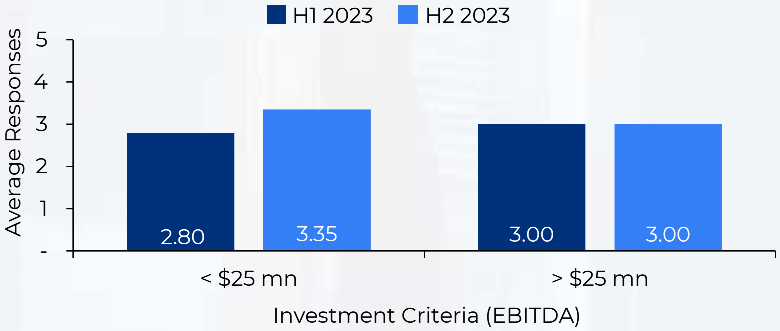
The valuation and exit opportunities declined slightly in H1 2023 as compared to H2 2022. The exit options have become more limited as the power and ability to set pricing levels in the market has significantly eroded for SPACs. The economy observed volatility in interest rates, which caused the multiples to decline further. As far as the process and preferences are concerned, there have not been many changes. Respondents expect these opportunities to increase slightly in H2 2023 as compared to H1 2023.




"There is no data to suggest that the buyers will get better multiples or that there would be better assets with a multiple that is not inflated."

## Valuation Multiples

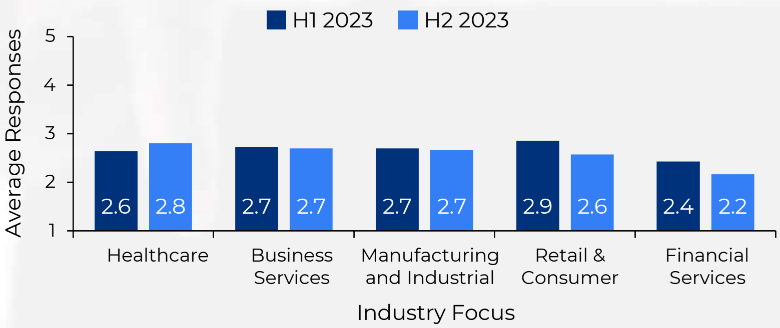
Valuation multiples have fallen significantly in H1 2023 as compared to H2 2022. This fall has been driven by the correction in expectations of sellers, as their businesses prove to be less recession-resilient than initially anticipated. However, there is some solace in the valuations of non-cyclical businesses that have proven their mettle. Valuation multiples are expected to remain at a similar level in H2 2023, with more opportunities flooding the market and with no change in the leverage and growth rates.




While H1 2023 has seen lower valuation multiples, respondents expect the valuation of lower EBITDA opportunities to improve slightly in the latter half of 2023, driven by a correction to the significantly discounted valuations received in the economy.

## The Gap Between Buyers' and Sellers' Valuation

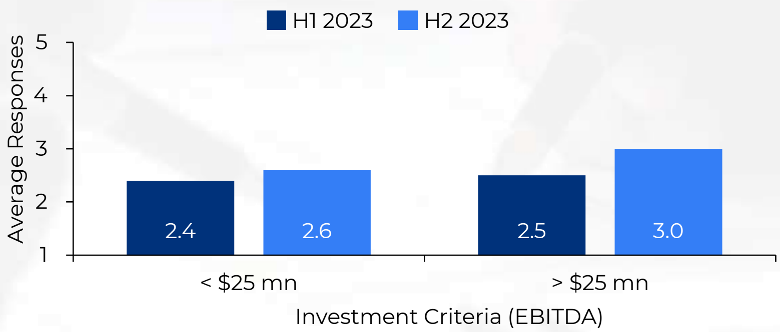
The gap between buyers' and sellers' valuations has slightly reduced in H1 2023 as compared to H2 2022. A recurring trend that has been observed by the PEs is a correction in seller expectations. The gap is expected to reduce further in H2 2023 as deal supply increases, and sellers digest the corrections in certain sectors of the public market, showing their effects in the private market. There are many sellers who quote the price to test the market rather than enter the market with a motive to sell the asset.




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

## Exits

Currently, investors do not take part in riskier investments, and thus, good assets, which are safer options, are able to bag a higher multiple due to the higher demand in the market. This trend is expected to continue into H2 2023 as well. IPO exit not being a lucrative option amidst the volatile market scenario, is expected to reopen. The companies will opt for M&A, given that the debt markets improve.




Exit opportunities are expected to remain poor in the second half of 2023, with improvements only expected if debt conditions improve.

# 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 Per Project

### Quality

- Industry-Leading Talent
- Multiple Layers of Quality Checks

### Operating Leverage

- Centralized Resource Pool
- Integration across Value Chain

### Cost Efficiencies

- Meaningful Direct Cost Savings
- Lower Indirect Costs

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# Thank You