TresVista
Catalyzing Your Impact

TresVista Investor Confidence Index Report

April 2024

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Executive Summary

If the U.S. Middle-Market Private Equities (PE) sentiment in 2023 were to be defined in a phrase, it would be **speculative hope.** The narrative of 'what goes up, must come down' drove discussions of many dealmakers, as an anticipated curb on inflation and subsequent fall in interest rates gripped the attention of all PE participants. Anticipated buyers and sellers alike were hopeful of things improving in H2 2023. However, in TICI H1 2024, respondents conveyed that most things remained the same when compared to H1 2023. As inflation remains sticky, a rate-cut rethink has led to several participants pushing their expectations further to H1 2024. However, all is not lost. As PE participants continued to adjust with the macro conditions, settling in the not-so-comfortable deal environment, they have continued to spend more time on portfolio management in anticipation of exit opportunities. The spread in valuation has continued to converge further as buyers sit on dry capital, eager to do more deals, and sellers, with their cash-starved LPs, looking forward to making distributions. Access to capital might improve as LPs adjust their portfolio due to the denominator effect in light of the recent bull run of public equity. In H1 2024, PE firms expect to have all hands on deck, as they anticipate more time being spent on deal origination and deal diligence and more deal flow coming in from bankers. As the competition level increases, timelines to close deals are also expected to shrink. Healthcare and software continue to be primary areas of interest, as cyclical businesses are still less preferred. While talks of political uncertainty in the latter half of 2024 prevail, investors expect 2024 to be the year of recovery.

Index Methodology

The TresVista Investor Confidence Index is an initiative to capture the evolving investor sentiments in the U.S. Middle-Market PE industry. We spoke to PE professionals to assess changes in activity levels in key business functions and overall investor sentiments for U.S. Middle-Market PEs over the last six months (H2 2023 vs. H1 2023) and their outlook for these over the next six months (H1 2024 vs. H2 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 (1)	Slightly Less (2)	Same (3)	Slightly More (4)	Significantly More (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

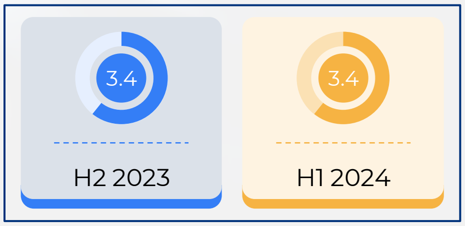
3.0
H2 2023

TICI Index Value:

3.5
H1 2024

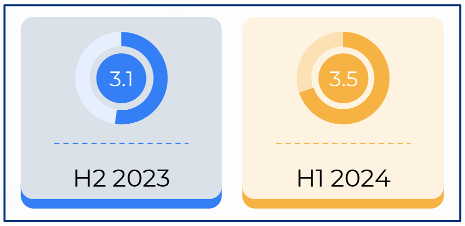
Time Allocation

There was a slight increase in the time allocated by U.S. Middle-Market PEs toward fundraising, new deal diligence, and deal origination activities in H2 2023, compared with H1 2023. In parlance, there was a proportionately larger emphasis on portfolio management activities due to the challenging economic conditions. The time allocated to fundraising activities is expected to subside slightly, whereas efforts towards deal diligence and origination activities are expected to increase.



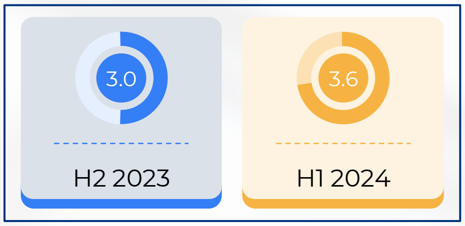
Access to Capital and Financing

The apprehension of recession diminished as the interest rate stabilized in Q3 2023, resulting in a more relaxed financing environment. Access to capital and financing from LPs around new fund-raising activities edged up marginally in H2 2023 compared to H1 2023. Investors anticipate a further ease in financing in H1 2024 as LPs would start getting more comfortable with the macro-economic environment.



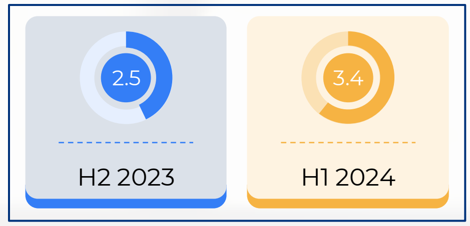
Deal Pipeline and Origination

There was a marginal increase in the number of total opportunities at the top of the funnel and inbound opportunities available in H2 2023 compared to H1 2023. The anticipated level of competition for new opportunities remained at a similar level in H2 2023 relative to the first half of the year. The average size of transactions dwindled in H2 2023, whereas a surge was observed in the quality of inbound opportunities and the timelines for deal closure. The situation is expected to meliorate and witness a moderate increase in the deal opportunities available in H1 2024. The quality of these opportunities, the average size of transactions, and the anticipated level of competition are also expected to improve marginally, but the timelines for deal closure are anticipated to decline further.



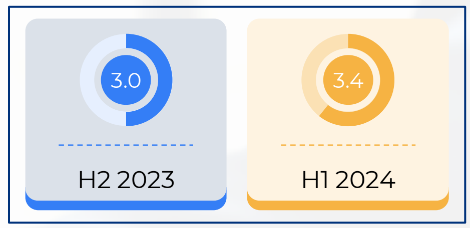
Portfolio Management

Amidst the abrasive macroeconomic environment, the holding period of portfolio investments increased moderately, and the quality of distressed assets witnessed a mild decrease in H2 2023 compared to H1 2023. 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 H2 2023.



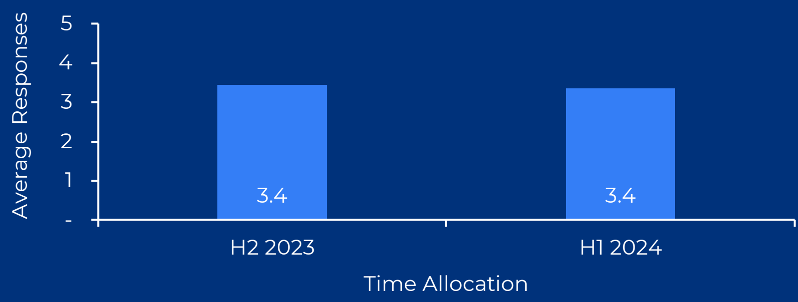
Valuation and Exit Opportunities

Multiples decreased moderately in H1 2023 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

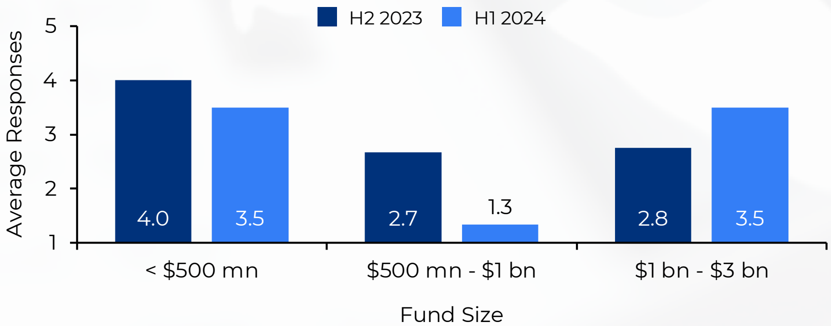
Time spent on deal activity increased slightly in H2 2023 vs. H1 2023, backed by increased portfolio management. PE firms have spent resources managing the controllable, increasing inward focus on optimizing their portfolio companies' performance. Reinforcing companies to sustain the prolonged macroeconomic storm has been a priority. Marginal improvements were observed in time spent on fundraising and deal origination as well, albeit the reasons are firm-specific. Going into H1 2024, time allocation is expected to further increase. However, a categorical shift is expected, with more time being spent on deal origination and deal diligence driven by heightened expectations of deal flow originating in H1 2024.



> It's strange because you feel like you have to really focus on the portfolio, but you also have to do more sourcing because not as many people are raising.

Fundraising

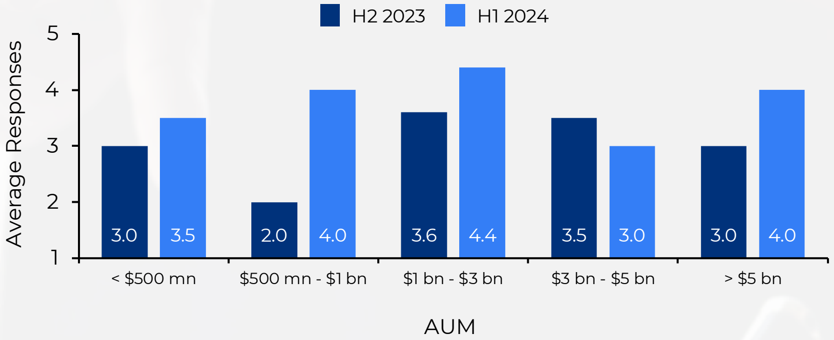
Fundraising as a function continues to garner attention from most PE firms, with time spent on fundraising consecutively increasing in H2 2023 as well. LP allocation continues to be a struggle, as GPs are unable to meet the increasing demand for returns. Subsequently, LPs remain hesitant to deploy additional capital. GPs have turned to other sources of liquidity, including NAV financing, secondaries, and continuation funds needing additional time and effort. Time is also being spent to compensate for H1 2023, where access to capital was low. The time spent was not significantly higher, as was expected, as opportunities to invest funds were relatively poor. Going into H1 2024, fundraising efforts are expected to slow down slightly as several interviewees sit on dry capital. Excluding outlier firms that have closed new funds, investors believe that fundraising efforts will increase marginally compared to H2 2023, as new opportunities to invest come in and capital deployment picks up.



> "In the second half, I'd say we had a broader approach to the market and just started spending a lot more time with other potential lenders and investors to source capital. It was really trying to make up for the lack of productivity from the first half of the year."

Deal Origination

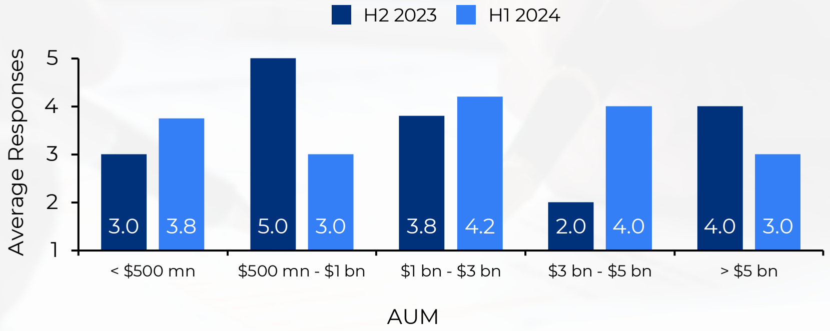
Deal Origination saw a very nominal increase in time spent in H2 2023 compared to H1 2023. In H1 2023, U.S. Middle Market PEs scaled up their efforts to raise funds and find potential deals as they adjusted to the macro environment. Going into H2, while a full-scale recovery is yet to be seen on the horizon, there have been equal efforts, as were in H1, to find investment opportunities. As more funds become available in H1 2024, PE firms want to be on the offensive and thus have started scaling their origination activities in preparation for the market acceleration. As the market anticipates lower interest rates in the second half of 2024, time spent on deal origination is expected to increase going into H1 2024 as well. Many investors favored portfolio management over new deal origination.



"I think maybe managers were focused on their own portfolios and less focused on doing something strategic at the GP level (leading to low deal origination efforts)."

New Deal Diligence

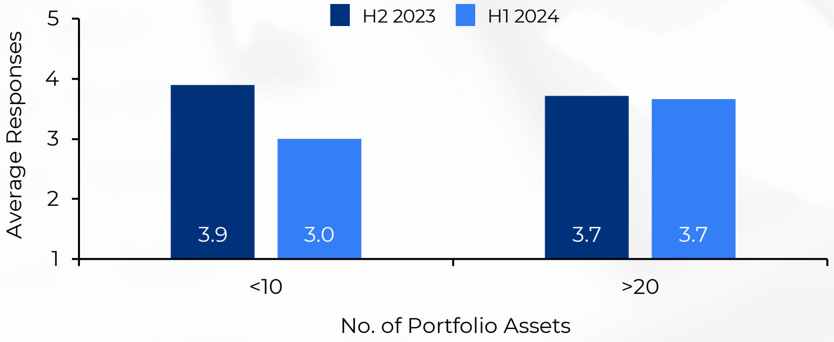
In line with the increased deal origination activities, deal diligence efforts saw a slight increase in H2 2023. The broader narrative remained the same - increased macro volatility led to investors holding potential investments under heightened scrutiny. Going into H1 2024, as more deals are expected to flow in, time spent on deal diligence is expected to increase.



Respondents with AUM size between $1 bn and $3 bn expect a surge in new deal diligence activities more than other sizes.

Portfolio Management

The shift in trend towards increased time spent on portfolio management in H1 2023 continued in H2 2023, with even more time being dedicated. The general sentiment behind continued portfolio management has shifted from avoidance – where in H1 2023, investors were focusing on keeping companies afloat against rising debt burden and macro uncertainty, to assertiveness – where in H2 2023, investors want to focus on preparing portcos for exit opportunities in H1 2024. Expectations for H1 2024 vs. H2 2023 remain the same, as continued effort towards finding the right exit opportunities is paramount.

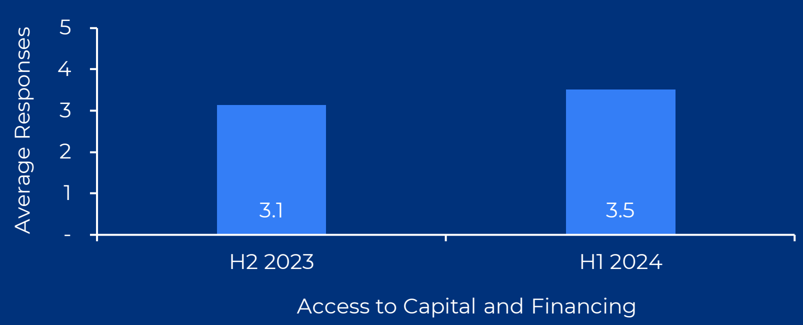


"Hike in rates (has made us) reassess how to look into the current portfolio. I would say it's more about trying to position the companies for exits."

Access to Capital and Financing

LPs showed a slightly higher interest related to capital allocation to new funds in H2 2023 compared to H1 2023. The improvement in predictability related to interest rates and the subsiding risk of recession in the second half of 2023 has instilled confidence among LPs. Although largely hesitant, LPs are willing to redeploy capital into the market if the new deals meet their valuation expectations. As the conditions in the M&A market improve and GPs exit holdings, LPs' capital is expected to replenish, and the fundraising market is likely to show signs of improvement as LPs move to redeploy their capital into the market.

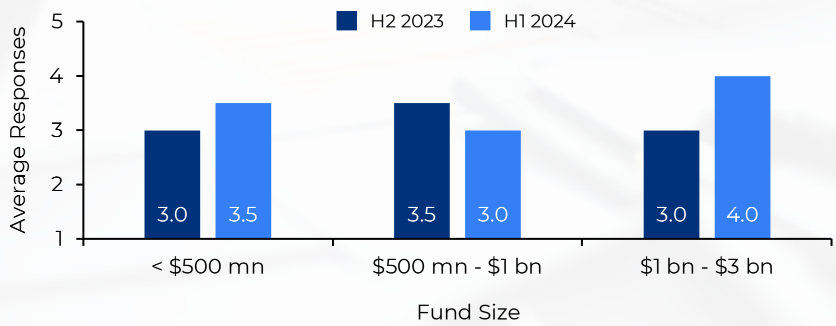
For H1 2024, improvement in the conditions related to ease of access to capital and financing are expected. It is anticipated that as GPs find exits, due to interest rates stabilizing and market sentiment improving, funds will flow back to the LPs, increasing their dry powder and hence improving access to capital in the market. Debt availability should also improve as GPs negotiate favorable term sheets.



> I think the equity side is going to be tight but should loosen just because of the run up in the equity markets. And so, the denominator effect there should impact LPs and create more commitment availability.

Sector Trends

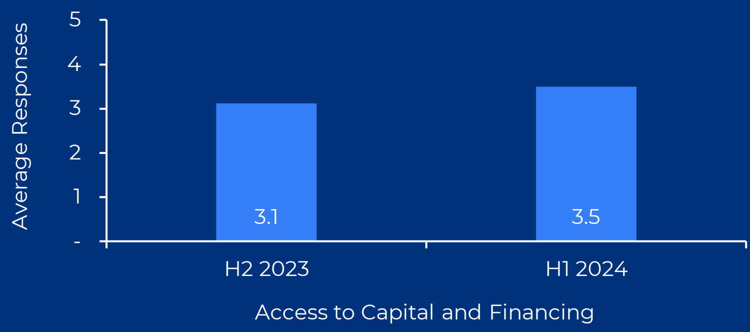
As economic uncertainty has increased, investors have continued to shift their focus towards counter-cyclical and recession-proof sectors that are less dependent on the performance of the economy. Many respondents suggested their interest in the healthcare and software sectors due to their potential resistance to recessionary conditions. The respondents also remained doubtful of the ability of cyclical sectors to perform with apprehension to the consumer and real-estate sector due to their sensitivity to the macro-economic factors.



Firms with fund size between $1 bn - $3 bn are expected to witness a significant rise in securing allocations from LPs toward new funds in H1 2024 compared to H2 2023

Deal Pipeline and Origination

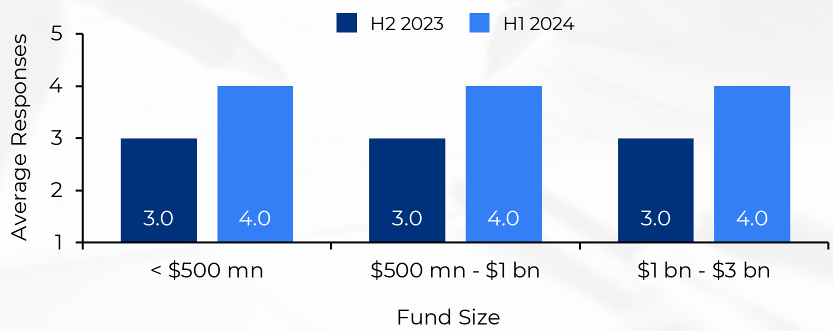
In H2 2023 deal pipeline and origination activities continue to remain the same as were in H1 2023. While there has been some improvement in the number of opportunities both at the top of the funnel and through inbound opportunities, deals have taken longer to close, and the size of transactions have also gone down. Investors expect the deal pipeline and origination activities to improve in H1 2024 compared to H2 2023, with shorter deal timelines, increased competition, and more opportunities coming in.



> Deals are sitting on the shelf with investment bankers and they're ready to pull the trigger. And when banks pull the trigger on those deals, it could be an absolute avalanche of deal flow.

Number of Opportunities

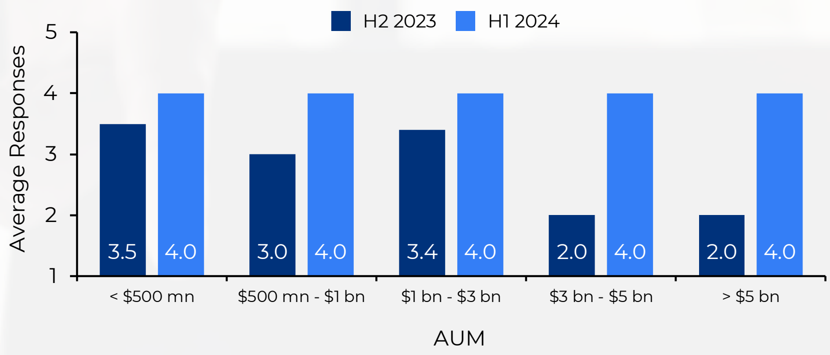
The number of opportunities witnessed at the top of the funnel was marginally higher in H2 2023, as was anticipated by survey participants in H1 2023. As macro conditions improve, there has been a gradual surge in the number of opportunities as sellers begin to get comfortable about getting the right valuation. Going into H1 2024, a surge in deal flow is expected due to lower interest rates and an overall positive expected environment. Respondents are preparing to sieve through the expected clutter of deals to find the right opportunities. Murmurs about the impact of the US Elections on deal flow in H2 2024 have begun but are relatively tame. We expect a lot more speculation to come in H2 2024.



> "The top of the funnel is tough because a lot of it is just spam. I don't spend a ton of time on that total top of the funnel because a lot of it is just stuff, it's way too small."

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

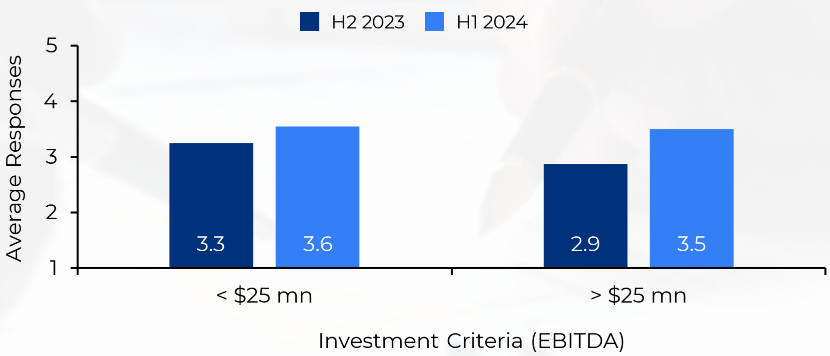
The number of inbound opportunities from bankers and brokers has largely remained the same in H2 2023 compared to H1 2023. Anticipation in the last survey was towards an increased deal flow coming from bankers. However, due to sticky inflation and uncertainty about valuations, it seems that bankers are being conservative about conducting deals. Going into H1 2024, there is a significant increase in deal flow expected from bankers in anticipation of a favorable deal-making environment.



"You know they're (bankers) saying they expect a much stronger year than last year. So not exactly sure on the timing of it but if feels like their pipelines are in a lot better shape."

Quality of Inbound Opportunities

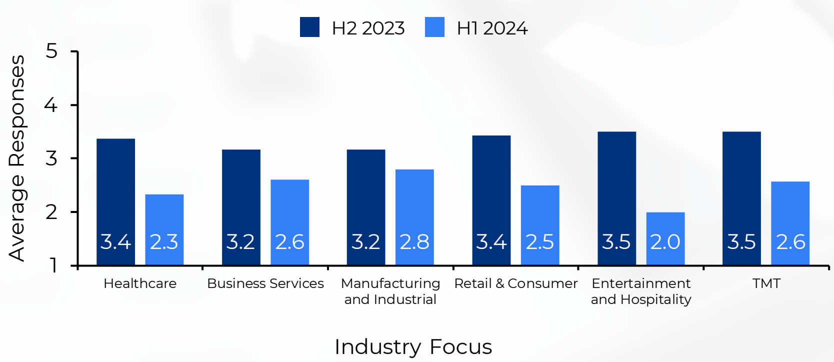
One of the most highly anticipated improvements by PE respondents in the H1 2023 report was the improvement in the quality of inbound opportunities. However, respondents in H2 2023 experienced deal quality that had remained largely similar compared to H1 2023. The most widely agreed upon reason is that as the divide in valuation expectations goes down further, bankers will be more willing to bring better opportunities to the table. In line with the increased number of opportunities in H1 2024, the quality is also expected to improve.



A significant improvement in the quality of inbound opportunities is expected for the fund size of $5 mn - $50 mn, whereas firms with fund size > $50 mn are expected to witness a decline in quality.

Timelines for Closing a Deal

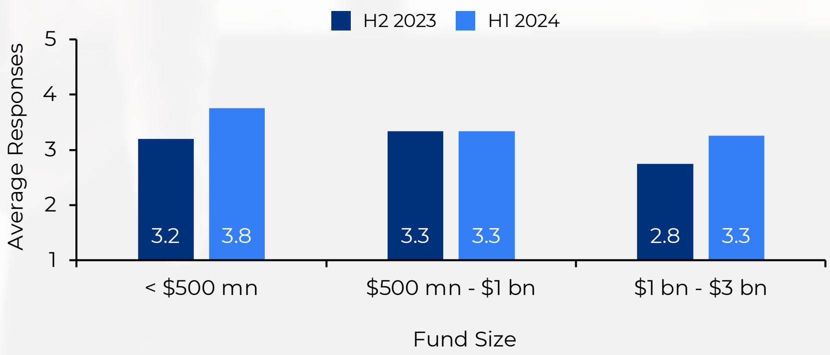
Timelines for closing deals were slightly longer in H2 2023 vs. H1 2023. Lower competition and less willing buyers made it so that select buyers had the leverage to dictate timelines – with increasing time spent on diligence. Unless the transaction was extremely high quality with a lot of competition, buyers took more time to close deals, focusing on optimizing return on dollars spent. However, in H1 2024, as the level of competition increases and more deals will need attention, timelines are expected to shrink.



"I think buyers will be more aggressive with getting deals done, whereas before, I think buyers were taking their time and being very critical of the business."

Level of Competition

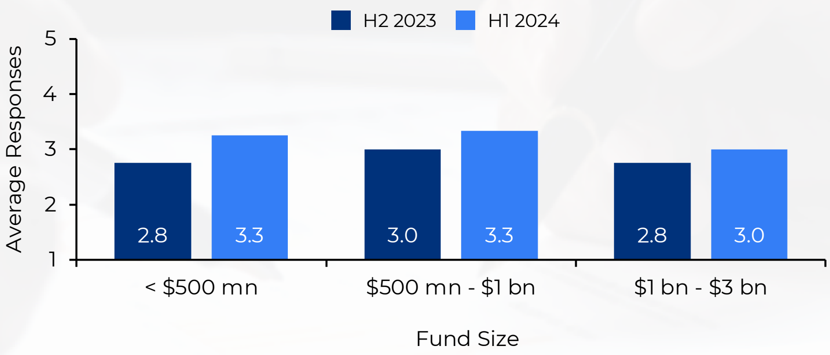
In H2 2023, the level of competition remained at the same level as H1 2023. Most firms decided to stay on the sidelines, focusing largely on existing assets in 2023. The focus was inward, as portfolio management activities saw increased time dedicated to them. Going forward into H1 2024, as the interest rates cool down, a lot of these firms are going to be eager to start taking a hard run at assets that are coming out, especially firms that have been tracking opportunities for some time and have been sitting on dry capital. Competition is expected to increase in H1 2024.



"There's still a lot of capital to put to work and I think people's optimism and enthusiasm to put capital to work is greater."

Average Size of Transactions

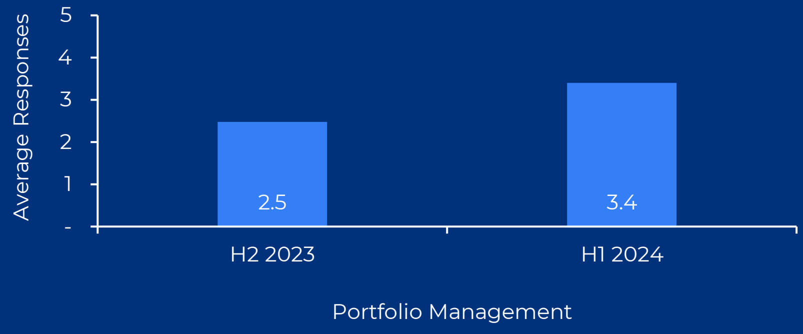
The average size of transactions has slightly reduced in H2 2023 compared to H1 2023. As debt continues to be expensive, funding large transactions has become difficult. The risk-return profiles have stayed relatively high. While some funds expect their sizes to inflate as they deploy dry capital, most firms expect only a moderate increase in the average size of transactions in H1 2024.



Firms with fund size < $1 bn are expected to witness an increase in transaction size, owing to quality opportunities coming in.

Portfolio Management

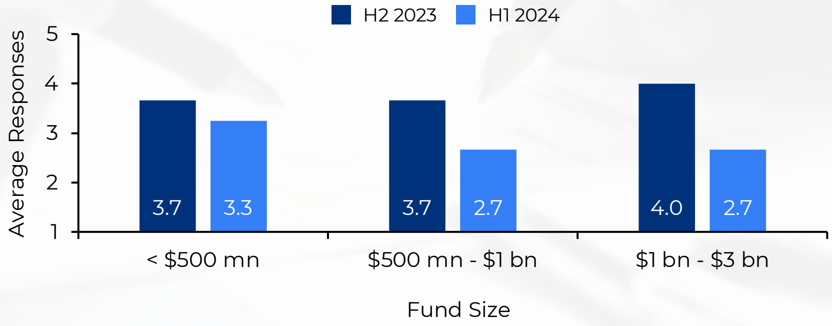
The backdrop of macro-economic uncertainty and the decreasing quality of distressed assets resulted in a liquidity squeeze in the market, which caused many PE firms to extend their runway by establishing continuation funds. The holding period of assets increased slightly in H2 2023 compared to H1 2023. However, H1 2024 is expected to see an increase in liquidity due to a narrower bid-ask spread, reduced holding periods, and improvement in the quality of distressed assets.



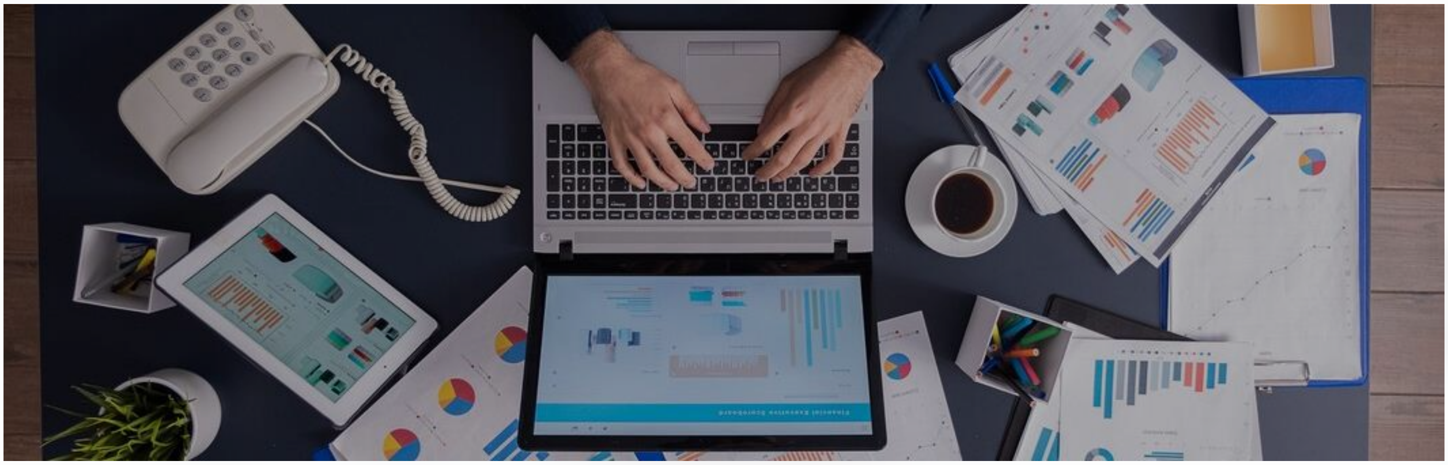
> The one thing we've seen is other funds that have been doing like continuation vehicles and things like that to extend their runway for companies that they haven't been able to sell.

Holding Period of Portfolio Investments

The holding period of investments has become significantly longer during H2 2023 compared to H1 2023 due to economic uncertainty, which was evidenced by lower distribution being made to LPs and the establishment of continuation funds to extend the runway for the portfolio companies. For H1 2024, the holding period is expected to shrink as GPs are seeking exit opportunities in the market in which liquidity is expected to rise with a narrower bid-ask spread, which is indicated by the expectation of convergence of buyer's and seller's valuation and expected increase in the valuation multiples in H1 2024.

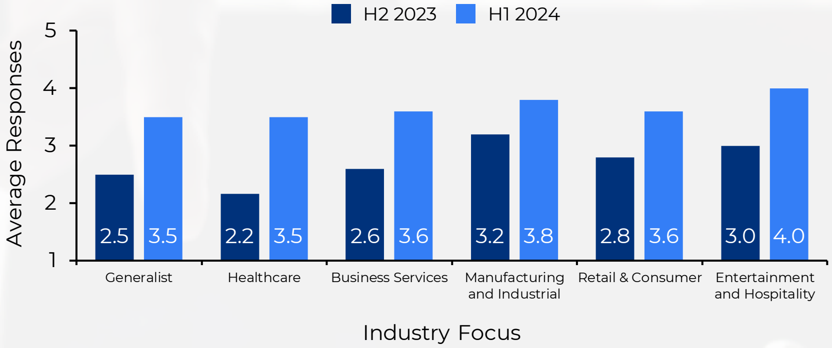


The holding period for fund size between $500 mn and $3 bn is expected to decline, whereas an increase is anticipated for the fund size < $500 mn.



Quality of Distressed Assets

The quality of distressed assets continued to worsen in H2 2023 compared to H1 2023. The stability that was expected in the quality of the distressed assets did not occur due to stickiness of the macro-economic conditions. PE firms were forced to take on NAV loans pledged against the value of the wider portfolio to keep their distressed assets afloat, in turn increasing the risk and reducing the risk-adjusted return or making a debt-for-equity swap, giving private credit the ownership, shifting their focus on companies that are performing well. However, the quality is expected to improve in H1 2024 vis-à-vis H2 2023.



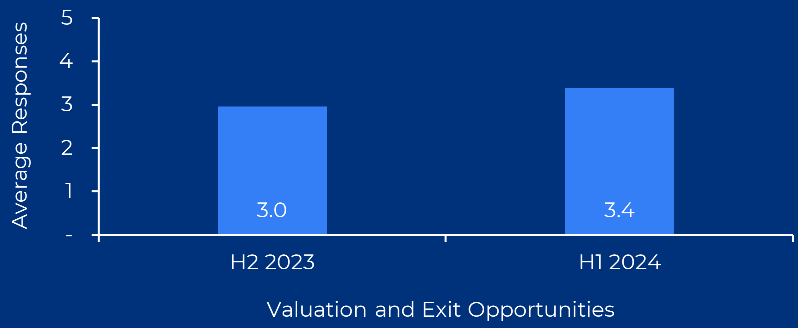
The quality of assets is expected to moderately improve for the Financial Services sector in H1 2024 as compared to H2 2023.

ESG

Most of our respondents follow an active ESG framework, but not all fully incorporate it into their decision-making process. The respondents acknowledge the importance of the ESG framework, but most wouldn't look away from a well-performing asset just because it fails to meet ESG criteria. The participants agree that a strong ESG proposition helps to boost the liquidity of the company as the ones that do not fit into the ESG criteria are more difficult to sell.

Valuation and Exit Opportunities

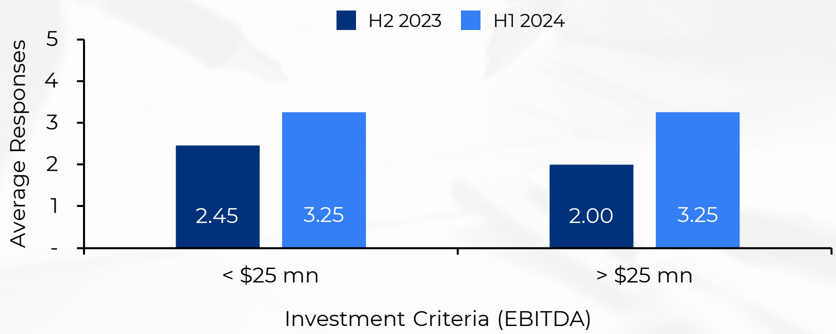
The valuation and exit opportunity conditions remain the same in H2 2023 compared to H1 2023. A two-pronged correction has led to a fall in valuation expectations. On the buy side, LP pressure for liquidity leads to GPs searching for exits, and on the sell side, realistic multiple expectations from sellers with the backdrop of macro uncertainty have led to a narrower bid-ask spread. Respondents expect market conditions to improve in H1 2024 compared to H2 2023, leading to a rebound in exits. PE firms have thus shifted focus on value creation at the portco level, in an attempt to bag higher valuation multiples in the event of an exit, which is also reflected in the increased time allocated to portfolio management as well.



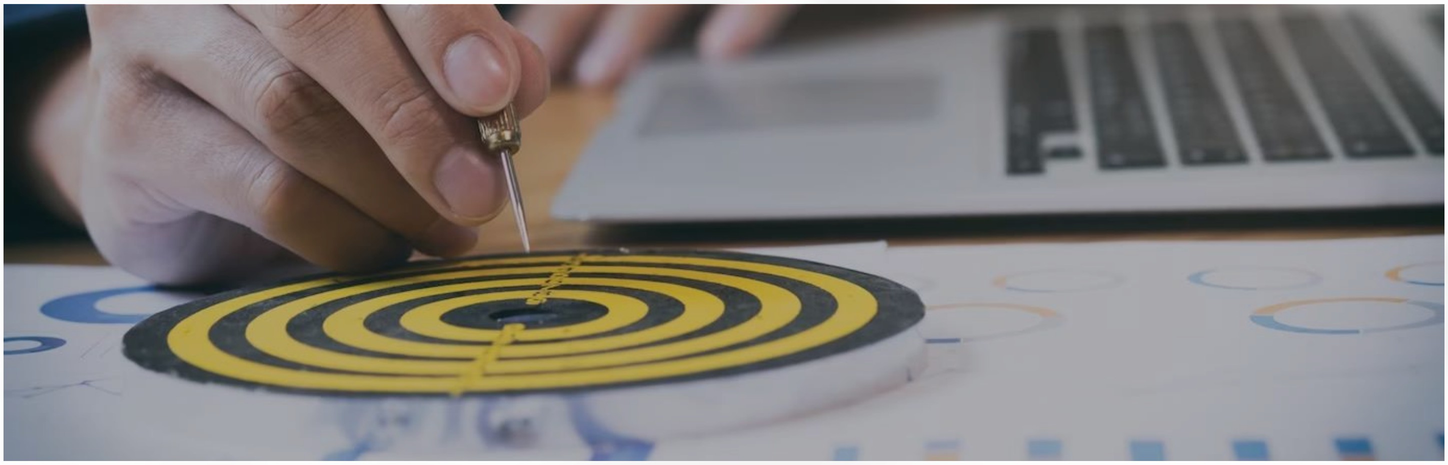
> The multiples that sellers were kind of expecting before the change in the financing environment, there's a little bit of a lag time in how it gets interpreted by sellers. So, I think that the gap's going to decrease in 2024 and make it easier to do transactions.

Valuation Multiples

Valuation multiples have declined significantly in H2 2023 compared to H1 2023. As time progressed, the sellers' expectations caught up to the macro-economic condition, resulting in more realistic valuation multiples. Valuation multiples are expected to increase slightly in H1 2024 as market conditions improve, presenting opportunities for PE firms sitting on substantial amounts of dry powder to deploy their capital or to exit their holdings.

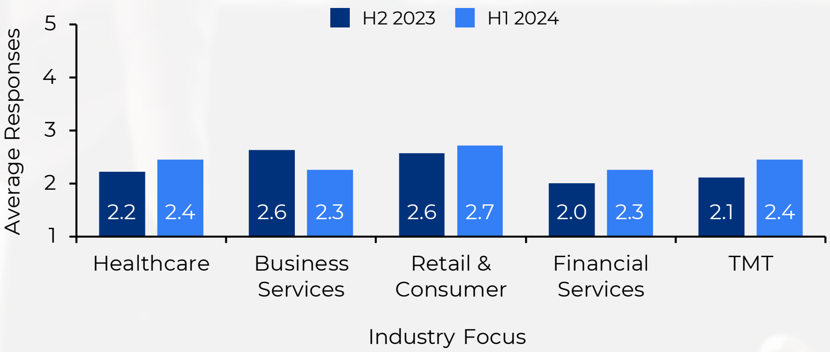


While H2 2023 has seen lower valuation multiples, respondents expect the valuation of lower EBITDA opportunities to improve slightly in 2024, driven by a correction to the significantly discounted valuations received in the economy.



The Gap Between Buyers' and Sellers' Valuation

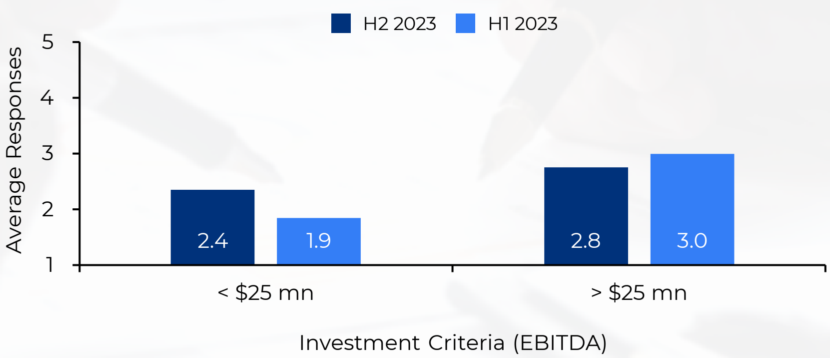
The gap between buyers' and sellers' valuations has significantly reduced in H2 2023 compared to H1 2023. The pattern that has been observed for the past few quarters was a correction in the expectation of the sellers in accordance with the macro-economic environment. The urgency and necessity of sellers to close the deal became more important than the initial valuation ask, causing the gap in expectations to decline. The gap is expected to converge further in H1 2024, as the interest rates are expected to fall, inducing confidence in market participants, bridging the valuation gap, and increasing the deal volume.



Gap between buyers and seller is expected to decline moderately for Manufacturing and Industrials industry in H1 2024 compared to H2 2023.

Exits

As more buyers flood the market and activity increases as anticipated, buyers will be more willing to negotiate with sellers on their terms. Several assets that were not marked down under the notion of temporary issues will most likely be marked down and will have to be brought at a discounted valuation. Exits will play a major role for GPs to set up for fundraising in the latter half of 2024 and early 2025, as GPs will strive to meet LPs increasing demand for liquidity. Exits through secondaries will continue to be an area of interest for GPs.



The record-high number of aging unexited companies in buyout portfolios has stanched the flow of capital back to investors.

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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