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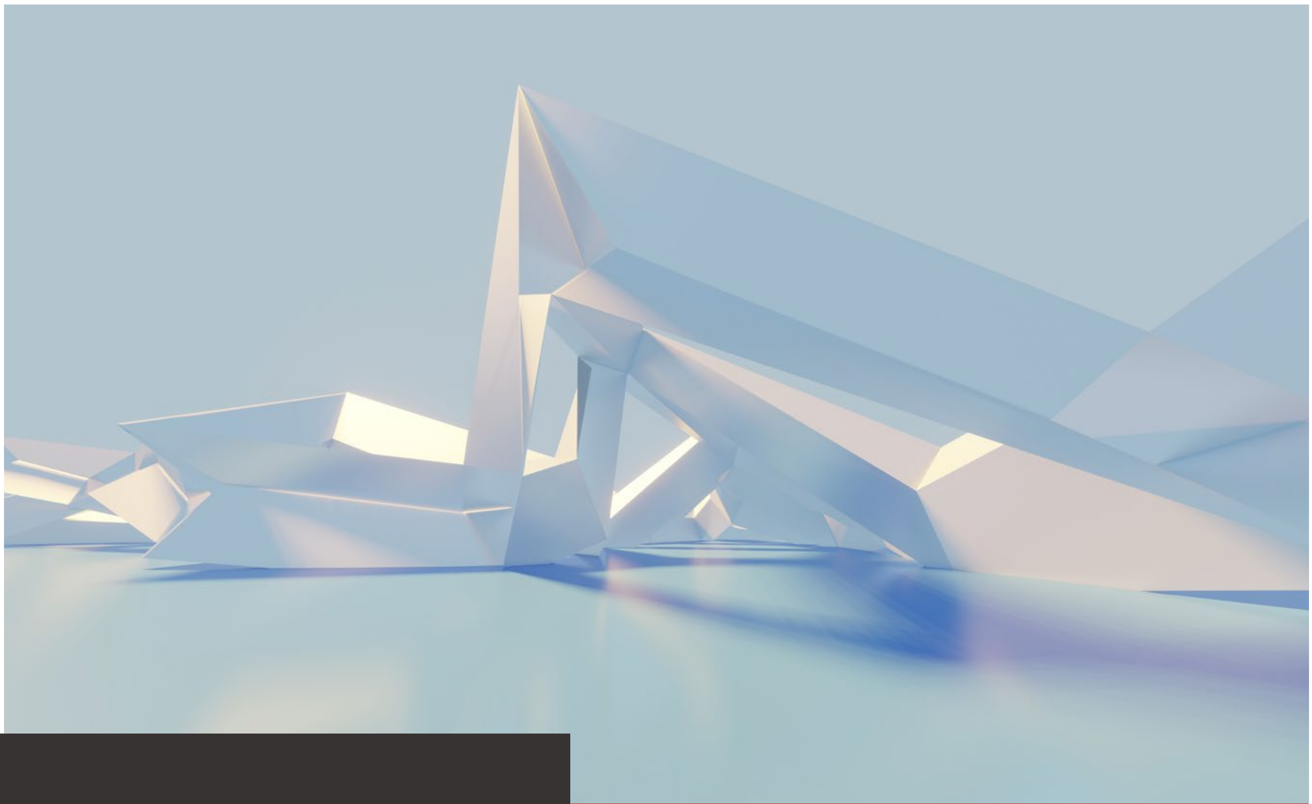
AXIA

Issue 04 / May 2024



Private Equity Newsletter

SG Analytics' premier private equity monthly newsletter and your window to the latest trends, deals, and strategies reshaping the industry. Each edition of Axia will bring you an exclusive feature article and topical news developments with our experts dissecting critical topics, offering insights and commentary that go beyond the headlines.

Contents

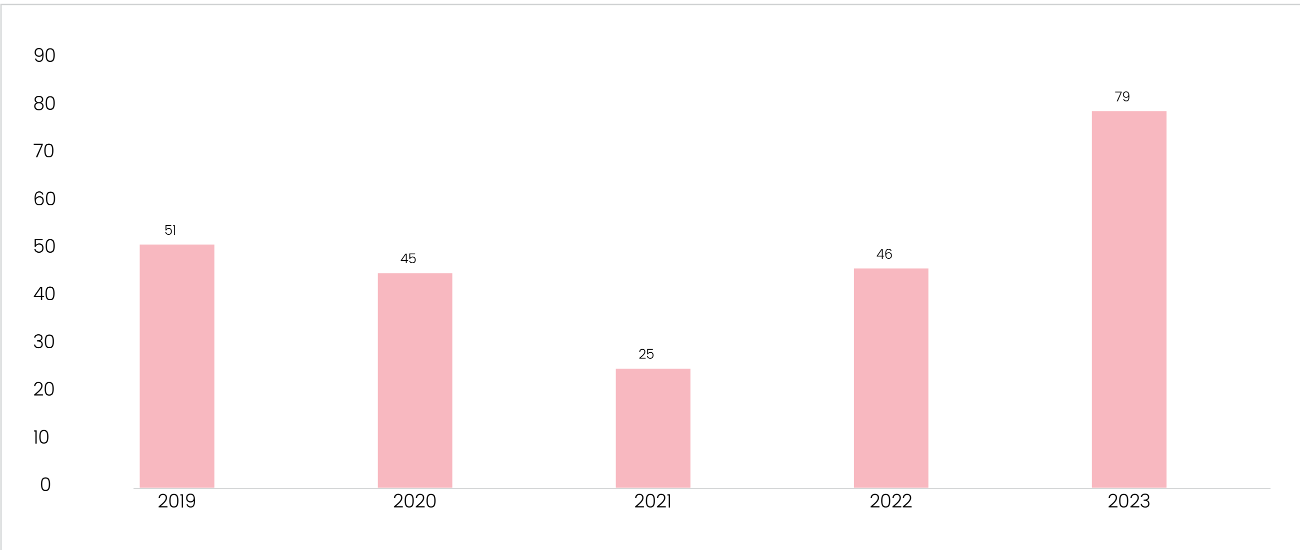
Private Equity Prognosis: Navigating the Evolving Healthcare Landscape

Recently, there has been increased regulatory scrutiny of the role that private equity (PE) plays in the healthcare sector. These inquiries, driven by concerns about antitrust practices, declining care standards, and increased prices, have the potential to significantly alter the healthcare landscape for PE firms.

PE investment in healthcare within the US has experienced a surge over the past decade, reaching $79.9 billion in 2023 from $45.3 billion in 2014, at a CAGR of 7%, according to Pitchbook Data. The sector's growth rates, acyclical nature, and resilience against economic downturns have positioned it as one of the most attractive investment opportunities. However, the sector faces financial challenges due to narrow profit margins, inflationary pressures, and increasing wages. Gibbins Advisors reported that healthcare bankruptcies reached a five-year peak in 2023, highlighting the urgent demand for capital infusion and managerial expertise, an opportunity for PE firms to leverage.

Healthcare sector faces financial challenges due to narrow profit margins, inflationary pressures, and increasing wages.

Figure 1: Increase in Healthcare Bankruptcy Filings in 2023



Source: Gibbins Advisors

However, the resilience of PE in the healthcare sector has had some unintended consequences. PE-backed firms have experienced facility closures, mass layoffs, decline in care quality, and notable cost hikes for patients, prompting the wave of probes in this space. According to New York University, short-term mortality rates were 10% higher in facilities under PE ownership, while adherence to Medicare care standards dwindled and taxpayer spending surged by 11%. Bloomberg reported a sharp rise in bankruptcies among PE-owned healthcare entities in 2023, accounting for 21% of all healthcare company bankruptcies. These issues primarily stem from PE's approach to financing buyout deals, often burdening acquired companies with debt and subsequently slashing operational expenses to bolster earnings, as per the Harvard Medical School.

Recently, the Federal Trade Commission (FTC), alongside the Department of Justice Antitrust Division and the Department of Health and Human Services, launched an inquiry into the increasing control of PE firms within the healthcare sector. The FTC believes that while some PE investments might be beneficial, the majority of buyout firms prioritize profits at the expense of healthcare quality. Additionally, the Biden administration has intensified its scrutiny of PE transactions, particularly roll-ups. In 2023, the FTC filed a lawsuit against US Anesthesia Partners and its PE partner, Welsh Carson Anderson & Stowe, alleging their involvement in monopolizing the market for anesthesiologists in Texas through the roll-up strategy.

The Senate has also witnessed a surge in activity. In December 2023, Senators Sheldon Whitehouse and Charles Grassley initiated an investigation into the complex financial arrangements and transactions between healthcare facilities and PE firms. The investigation sought to examine whether such agreements spelled harm to patients and staff. Letters of inquiry were dispatched to Prospect Medical, Leonard Green and Partners, and Medical Properties Trust. In April 2024, Senator Ed Markey drafted the Health Over Wealth Act, aiming to mandate increased transparency in the ownership of healthcare entities. The bill, if passed, would significantly broaden the authority of the Department of Health and Human Services by authorizing them to approve PE investments in healthcare firms.

Moreover, regulators at the state level are also pushing back against the consolidation of medical businesses backed by PE. According to the Wall Street Journal, over a dozen states have enacted legislations requiring corporate buyers to inform states of planned healthcare acquisitions. In certain instances, these laws empower state authorities to intervene and block deals if they are deemed detrimental to the public interest.

Multiple organizations, including the American Investment Council (AIC), have pushed back, a trend that is likely to continue as these probes surge. The AIC argues that investment firms foster competition and contribute to expanding access to healthcare. Additionally, doctors have more time to dedicate to patient care and benefit from experienced management teams, advanced technology, and broader networks. The AIC maintains that PE currently plays a crucial but relatively minor role in the healthcare system, with only 4.5% of physicians employed in PE-owned practices according to 2022 data from the American Medical Association. It asserts that the challenges faced by the healthcare sector are more systemic in nature.

Amid the changing landscape and increased scrutiny, healthcare mergers continue to thrive, as highlighted by Axios. This momentum is anticipated to maintain its course until decisive measures, such as the enactment of Ed Markey's bill or the introduction of stronger FTC regulations take effect post-investigations. Although it is early to fully gauge the long-term effects, these measures will at least necessitate enhanced disclosure practices and compel firms to demonstrate the public benefits of their investments. The private equity sector in healthcare should view this as a signal to gear up for impending regulatory hurdles, while also seizing the opportunities that come with navigating this dynamic environment.

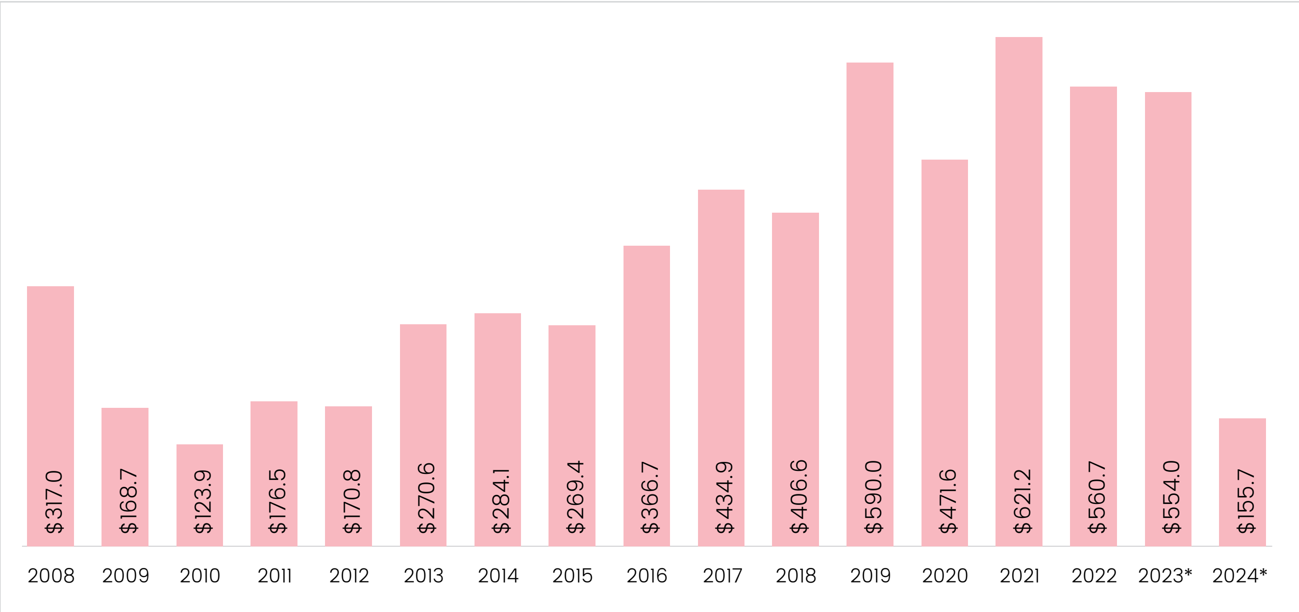
In conclusion, the intersection of PE and the healthcare sector is undergoing intense scrutiny. While PE investment in healthcare has surged, it has also brought unintended consequences. Regulatory bodies, at both federal and state levels, are actively investigating these issues, with proposed legislation aiming to increase transparency and oversight. Amid these challenges, there are opportunities for PE firms to adapt to evolving regulations and demonstrate the public benefits of their investments. As the healthcare landscape continues to shift, all stakeholders must navigate this dynamic environment with a focus on improving patient outcomes and ensuring the sustainability of the sector.

Monthly News and Analysis

PE Fundraising Rebounds Slightly in 1Q24

PE fundraising gained momentum in the start of the year, as funds globally secured $155.7 billion in 1Q24, marking an increase from the $97.1 billion raised in 1Q23, according to Pitchbook. Buyout funds dominated the fundraising landscape, constituting approximately 90% of the total in 1Q24, a historic high compared to 76% in 2022. Meanwhile, the share of growth funds, typically thriving in a robust economy, declined from nearly 25% to below 10% during the same period.

Figure 2: PE Capital Raised from 2008 to 1Q24



Source: Pitchbook

2023 witnessed an overall slowdown in fundraising amid challenging macroeconomic and geopolitical conditions. The subdued exit market, despite ample LP capital, constrained commitments to new funds. The combined exit deal value for 2022 and 2023 totaled about $992 billion marking a 34% decrease compared to 2021 alone, as per PitchBook. While public markets, fixed income, and inflation have stabilized, aiding greater deal financing, it is premature to declare a full recovery in PE activity after two challenging years. A closer analysis of 1Q24 reveals a steady increase in the time it takes firms to close their funds, reflecting the challenge of securing investors. The median fund closure duration rose from 11 months in 2022 to 14.5 months in 2023 and further to 16.8 months in the first three months of 2024, according to PitchBook. Additionally, a revival of the exit market is imperative to reduce holding periods, which reached a 20-year high of 7.1 years for North American PE, according to S&P Global, and to restore LP confidence.

CVC Raises $2.15B in Long-awaited IPO

CVC Capital Partners launched an IPO in Amsterdam, raising €2 billion or $2.15 billion, representing the largest IPO by market cap for a European PE firm. The company's stock jumped 24% at the start of its first day of trading. This move comes after the firm withdrew its previous IPO attempt in November 2023 due to market turbulence exacerbated by the outbreak of conflict in the Middle East.

IPO activity experienced a deceleration in 1Q24, furthering the trend from last year, which recorded the fewest new market debuts since 2019, as reported by S&P Global. In 1Q24, IPOs raised a total of $23.19 billion, down from $24.92 billion in 4Q23, marking the lowest amount since 1Q19 when approximately $19 billion was raised. Since CVC's initial plan to launch an IPO, global stocks have experienced a rally, fueled by signals from central banks indicating a halt to interest rate hikes. Peer firm EQT, for instance, has surged nearly 50% over the past six months. This positive market sentiment, coupled with successful listings in both Europe and the US — including notable companies such as social-media platform Reddit and Swiss skincare specialist Galderma — set the stage for CVC's record performance. The firm's strong debut will help further bolster Europe's market for IPOs, which is showing signs of revival after a period of dormancy over the last two years. So far in 2024, companies have raised approximately $8.6 billion through IPOs, surpassing the amount raised during the same period in 2023 by more than double, according to Bloomberg.

Blue Owl Expands into Insurance with KAM Acquisition

Blue Owl Capital is set to acquire Kuvare Asset Management (KAM), a Chicago-based asset management firm specializing in the insurance industry, for $750 million. This acquisition will be financed through a blend of $325 million in cash and $425 million in Blue Owl Class A common stock. Additionally, Blue Owl has also committed to a long-term investment in KAM, acquiring $250 million worth of preferred equity.

Over the past year, approximately one-fifth of the funds raised by seven of the largest publicly traded PE firms have originated from the insurance industry, according to Pitchbook. Mergers, acquisitions, and partnerships with insurance companies have emerged as a crucial source of funding due to a shift in PE strategies to focus on expanding perpetual capital. As of 2Q23, large PE firms collectively owned nearly 9%, or $774 billion, of the total assets within the US life insurance industry, a substantial increase from the mere 1% share in 2012. Insurance companies' balance sheets present an appealing proposition for PE firms by providing a source of enduring capital and dependable revenue streams for long-term investments. PE firms tap into their vast asset reserves which yield returns greater than the costs of servicing liabilities until future payout. According to McKinsey, life and annuity insurers in the US collectively manage assets worth $4.5 trillion. Despite numerous acquisitions in recent times, there remains a considerable pool of underutilized assets within the insurance industry, presenting ample opportunities for PE managers to capitalize on.

Infrastructure Products Winner for Blackstone in 1Q24

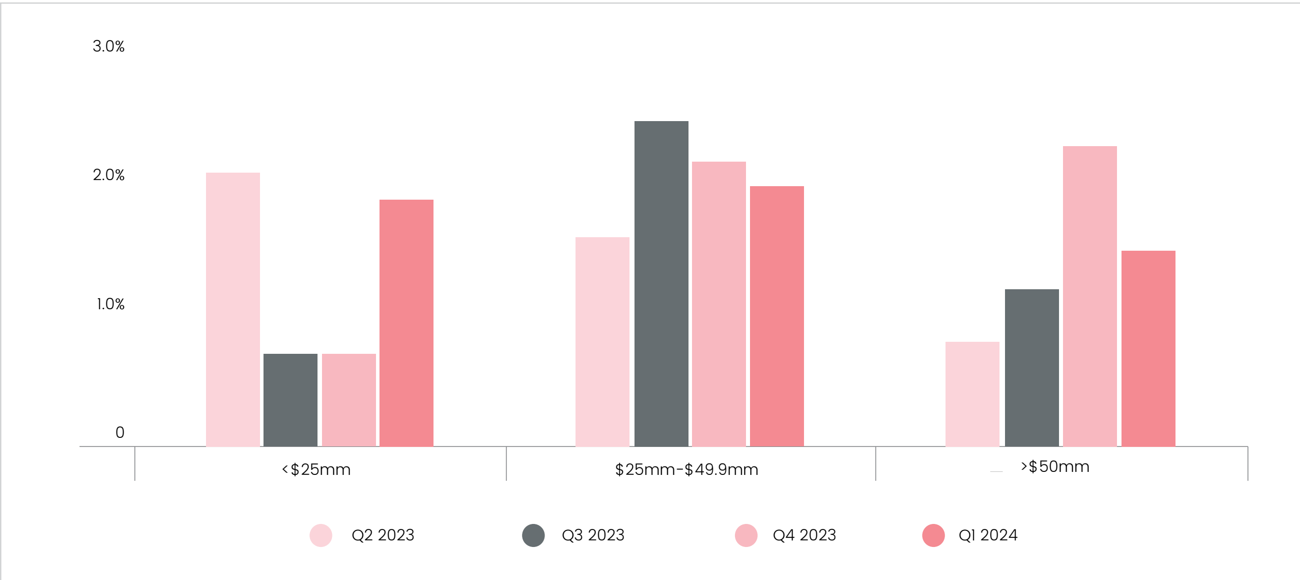
In Q1 2024, Blackstone's infrastructure vehicles achieved a 4.8% appreciation, marking the highest gross return rate among all of the firm's strategies, according to Pitchbook. Blackstone attributes the strategy's strong performance to the substantial scale of its $44 billion infrastructure platform, which has consistently delivered 15% net returns since its establishment, approximately six years ago.

Infrastructure investment has experienced a resurgence in interest owing to its long-term, stable, and uncorrelated returns amid challenging macroeconomic conditions. In 2023, when traditional private market funds struggled, real assets outperformed all other strategies. Infrastructure funds, comprising the majority of real assets, achieved a commendable one-year IRR of 10.7% in 2Q23. This renewed interest in infrastructure is further propelled by several factors, including the global shift toward cleaner energy sources, the increasing data demands of technologies such as artificial intelligence (AI), and the necessity for resilient domestic supply chains. Moreover, legislative initiatives such as the US Inflation Reduction Act and the Chips and Science Act, have stimulated investment and heightened demand for infrastructure related to transportation, energy, and waste management across the US. Major asset management firms have demonstrated confidence in this sector. In 2023, for example, Brookfield closed the largest-ever infrastructure fund on $28 billion. BlackRock, in a record-breaking deal in the alternatives space, acquired Global Infrastructure Partners for $12.5 billion.

Private Credit Default Rates Continue to Rise in 1Q24

Private credit default rates increased for the second consecutive quarter, reaching 1.84% according to Proskauer's Private Credit Default Index. This rise was driven by growing defaults in the lower middle market, despite improvements observed in other market segments. The index monitors 980 US-based senior secured and unitranche loans, totaling approximately $150 billion in original principal.

Figure 3: Default Rate by EBITDA



Source: Proskauer

According to the IMF, the global private credit market surpassed $2.1 trillion in assets and committed capital in 2023, with approximately three-quarters of this concentrated in the US. Fitch projects that the severity of default within its portfolio of privately monitored ratings for middle market companies will remain elevated in 2024, with expected default rates ranging from low to mid-single digits for the second consecutive year. However, the default rate for this portfolio is anticipated to rise as sponsors opt to abandon companies with compromised business models and unsustainable capital structures, rather than continuing to provide support amid a landscape of significantly increased capital costs. Fitch also anticipates a rise in the volume of US private credit origination in 2024, driven by stabilized rates and growing pressure from limited partners for capital returns from private equity funds, although at higher levels. These fluctuations in default rates from quarter to quarter are considered normal, and according to Proskauer, the overall private credit market remains dynamic and resilient, particularly when compared to other markets such as leveraged loans, where lenders have faced notably higher instances of payment defaults and bankruptcies.

Deals Flash

Blackstone Acquires AIR Communities

Blackstone Real Estate acquired Apartment Income REIT, also known as AIR Communities, a Denver-based rental housing company, in a take-private transaction valued at $39.12 per share, totaling approximately $10 billion. This acquisition represents a 25% premium over AIR Communities' closing share price on the NYSE as of April 5, 2024. AIR Communities' portfolio comprises 76 upscale rental housing communities, encompassing 27,010 apartment homes primarily located in key coastal markets such as Miami, Los Angeles, Boston, and Washington D.C. Blackstone intends to allocate over $400 million toward maintaining and enhancing the existing communities within the portfolio, with potential additional investments for future expansion.

Peak Rock to Buy HuFriedyGroup from STERIS

Peak Rock Capital, a Texas-based PE firm, will acquire HuFriedyGroup, the dental segment of Steris, an Irish medical equipment company, in an LBO valued at $787.5 million. An additional $12.5 million will be paid by Peak Rock if certain performance targets are met. Established in 1908, HuFriedyGroup, headquartered in Chicago, has a global presence, serving customers in approximately 100 countries. The company is supported by a workforce of around 1,500 employees spread across more than 20 manufacturing facilities and locations worldwide. Renowned for its exceptional quality, extensive product range, efficient workflow solutions, and innovative ergonomic instrument designs, HuFriedyGroup has earned a solid reputation within the dental industry.

Bain to Sell Zellis Group to Apax

Apax Partners, a British PE firm, will acquire Zallis Group, a British payroll and HR software provider, from Bain Capital. Bain initially acquired the company in 2018, ushering in a new and highly experienced leadership team aimed at bolstering capabilities across all sectors, with a particular focus on software innovation and customer service excellence. Apax's acquisition values Zellis at $1.55 billion. Established in 1963, Zellis Group comprises three distinct businesses: Zellis, which delivers award-winning payroll and HR software and services to organizations with over 1,000 employees; Moorepay, which provides payroll and HR software and services to small and medium-sized enterprises, ranging from 50 to 1,000 employees; and Benefex, a specialized provider of employee benefits solutions.

Big 7 Acquires Bowtex

Big 7 Ventures Management, a California-based PE firm, acquired Bowtex LP, a Texas-based manufacturer of high-quality survey stakes and other specialty grading products. This strategic acquisition marks a significant milestone in Big 7 Ventures' ongoing efforts to broaden its footprint and diversify its portfolio within the industrial and construction sectors. Bowtex has earned recognition for its commitment to delivering top-notch consumable products to clients across Texas and beyond. Following the change in ownership, Bowtex will continue its operations. Additionally, the company plans to extend its reach into new geographic markets as part of its growth strategy.

One Equity Acquires Ballymore Safety

One Equity Partners, a New York-based PE firm, acquired Ballymore Safety Products, a Pennsylvania-based manufacturer specializing in safety-related products. Ballymore is known for its innovative safety solutions tailored to vertical access and heavy material handling challenges in both retail and industrial settings across North America. With six operational facilities in the US and a workforce of around 270 employees, the company serves a network of over 1,800 distributors. Benefiting from favorable industry tailwinds such as the resurgence of industrial activity in the US and heightened emphasis on employee safety, Ballymore is positioned for substantial growth under its new ownership.

Blackstone Nears Deal with L'Occitane

Blackstone is close to finalizing a deal to take L'Occitane, a French skincare company, private, according to Bloomberg. L'Occitane, valued at $5.55 billion, suspended trading in anticipation of a likely announcement regarding the specifics of the takeover. L'Occitane, which debuted on the Hong Kong stock exchange in 2010, raised HKD 5.49 billion, or $704 million, marking one of the earliest instances of a Western firm offering its primary shares in the Asian financial center. L'Occitane has established itself as a prominent manufacturer and retailer of premium and sustainable beauty and wellness products, boasting a global presence across 90 countries. The company operates a robust network of 3,000 retail outlets, comprising over 1,300 proprietary stores, solidifying its position as a leader in the industry.

General Atlantic to Buy Majority Share in GRESB from Summit

General Atlantic will acquire a majority share in GRESB, a Dutch sustainability standards and benchmark provider for real assets, from Summit Partners, a Boston-based investment firm. This investment will be facilitated through General Atlantic's BeyondNetZero climate growth fund. The infusion of capital aims to propel GRESB into its next growth phase by strategically expanding its initiatives in transition finance, fixed income, and other product innovations. The goal is to enhance GRESB's impact across financial markets. Currently, GRESB's annual benchmarks encompass over 2,000 real estate portfolios and funds, along with over 170 infrastructure funds and nearly 700 infrastructure assets, collectively representing $8.8 trillion in gross asset value.

EQT to Sell Rimes to Five Arrows

EQT will sell Rimes, a New York-based technology company specializing in enterprise data management solutions for the investment industry, to Five Arrows, the alternative assets arm of Rothschild & Co., at an estimated value of $2.17 billion. Established in 1996, Rimes boasts a diverse customer base representing over $75 trillion in global AUM. Leveraging its proprietary multi-tenant cloud technology platform, Rimes' data management solutions empower clients to make informed investment decisions and tackle complex data challenges, supported by over 800 data partnerships. During EQT's ownership, Rimes underwent a significant transformation, expanding its services to cater to 60 of the world's top 100 asset managers and the 10 largest asset servicers globally.

Blackstone to Acquire Tropical Smoothie Cafe

Blackstone is set to acquire Tropical Smoothie Cafe, an Atlanta-based franchisor of fast-casual restaurants, from Levine Leichtman Capital Partners, a California-based PE firm, at a valuation of $2 billion. This acquisition represents the inaugural deal from Blackstone's latest vintage and aims to expedite Tropical's ongoing growth by bolstering investment in menu innovation, operational excellence, and top-tier marketing. Established in 1997, Tropical has evolved into a widely recognized brand boasting over 1,400 establishments across 44 states in the US. The company has unveiled more than 175 new locations in 2023 alone, with 70% of them launched by existing franchisees. In 2023, the company disclosed that its top 50% franchises averaged $1.2 billion in net revenue, while the system-wide average net revenue amounted to $979,491.

KKR Acquires Nexeye from 3i

KKR acquired Nexeye, a Dutch eyewear company, from 3i Group, a UK-based PE firm through its $8 billion European Fund VI. This acquisition aims to facilitate Nexeye's expansion efforts, positioning it uniquely to address the growing prevalence of vision correction needs. Under the brands Hans Anders, eyes + more, and Direkt Optik, Nexeye offers eye and hearing care across 719 stores across the Netherlands, Belgium, Germany, Austria, and Sweden. 3i values Nexeye at $489 million, with a reported turnover of $380 million in 2022. Following 3i's investment in 2017, Nexeye successfully ventured into new markets, notably acquiring eyes + more in 2019, resulting in a twofold increase in sales and EBITDA since then. 3i estimates Nexeye's value at $489 million. Its turnover in 2022 was $380 million.

Upcoming Events

2024 ACG Atlanta Spring Summit	May 7, 2024	Atlanta History Center, Northwest Atlanta, Georgia
Private Credit Industry Conference on Direct Lending and Middle Market Finance	May 9, 2024	The Diplomat Beach Resort Fort Lauderdale, Florida
12th Annual Private Equity New York Forum	May 15, 2024	Convene 225 Liberty Street, New York

TRENDS AND STATS

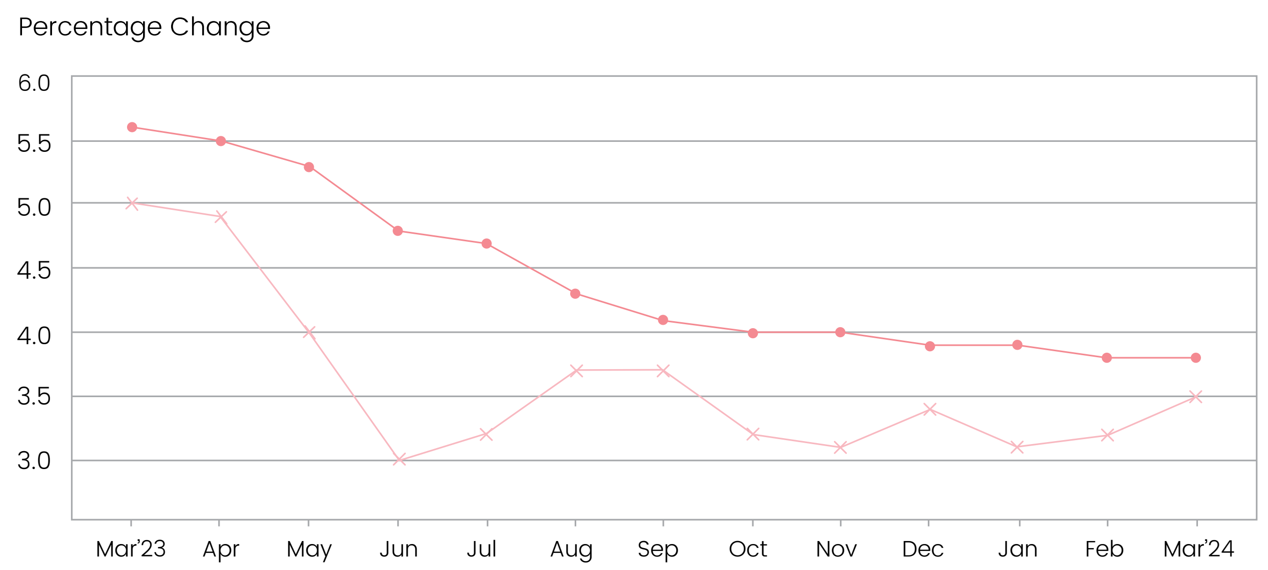
Data as of April 28, 2023

Thomson Reuters Private Equity Buyout Index

Thomson Reuters P...	4,346.73	+756.96	↑ 21.09%	
S&P 500	5,099.96	+932.06	↑ 22.36%	✕
Nasdaq Composite	15,927.90	+3,715.30	↑ 30.42%	✕
DOw Jones Industries...	38,239.66	+4,187.96	↑ 12.30%	✕

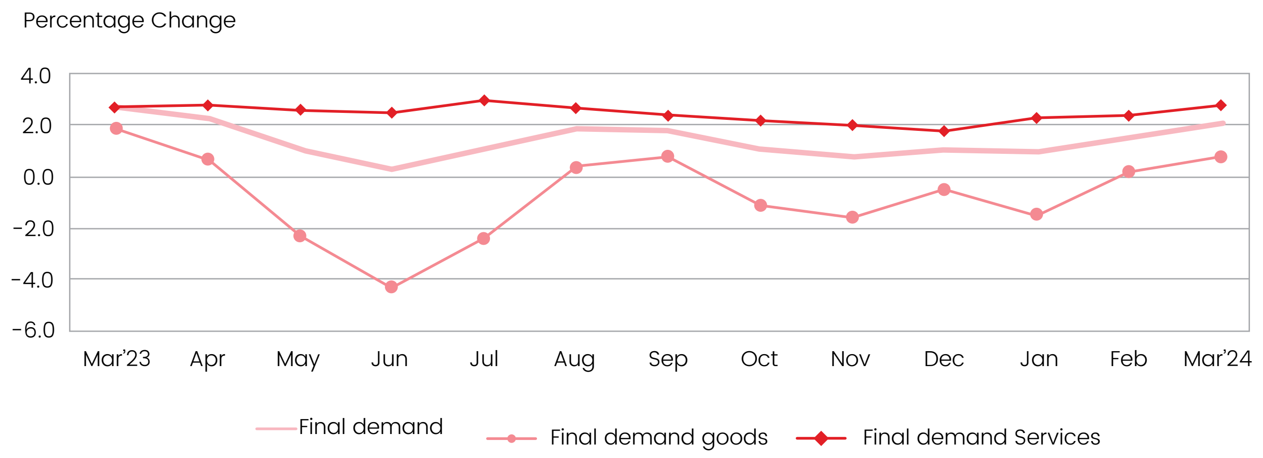
Index	Month-over-Month	YTD
Consumer Price Index	0.4%	3.5%
Producer Price Index	0.2%	2.1%

Figure 4: 12-month Percent Change in CPI For All Urban Consumers, Not Seasonally Adjusted

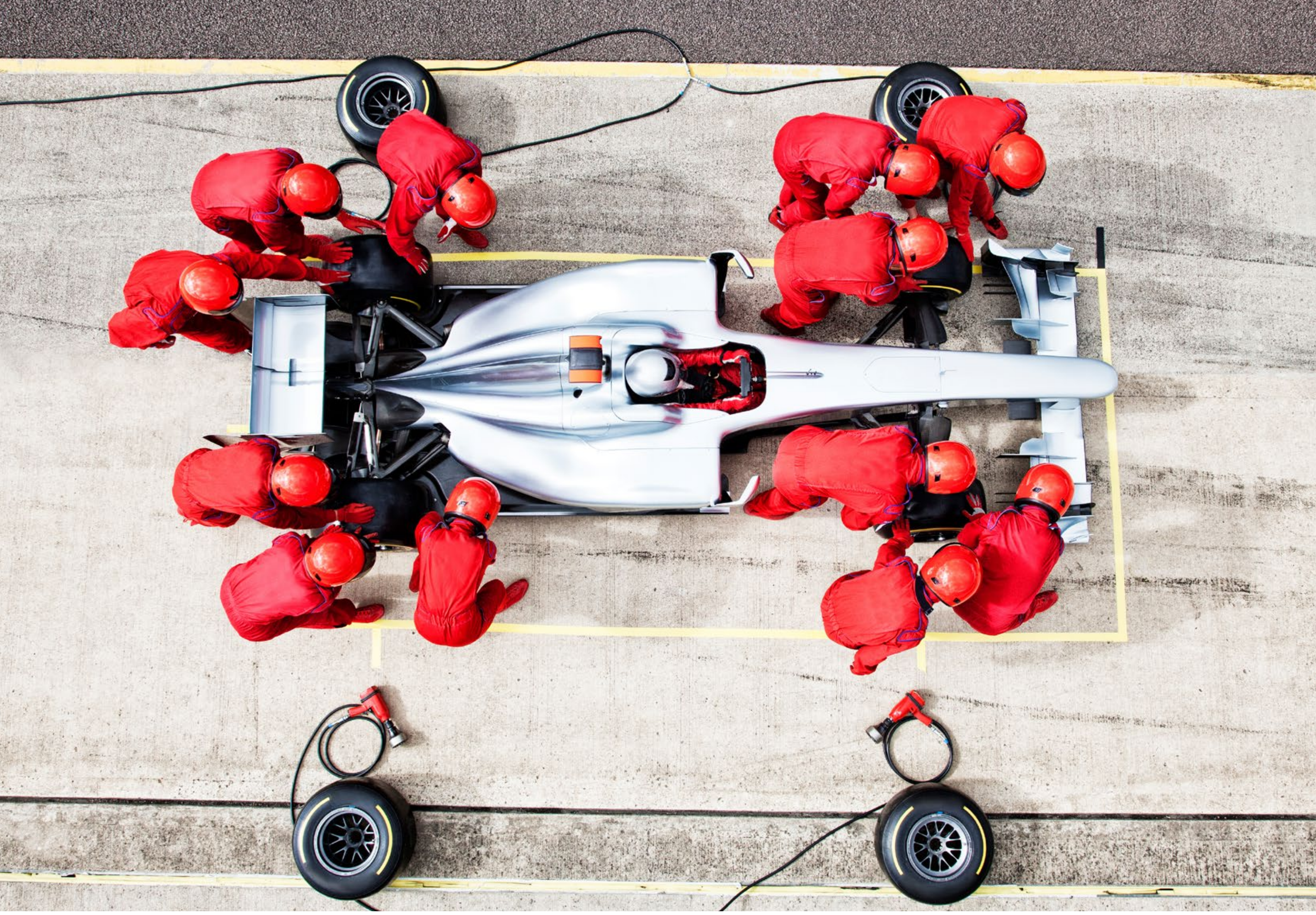


Source: US Bureau of Labor Statistics

Figure 5: 12-month Percent Change in Selected PPI Final Demand Price Indexes, Not Seasonally Adjusted



Source: US Bureau of Labor Statistics



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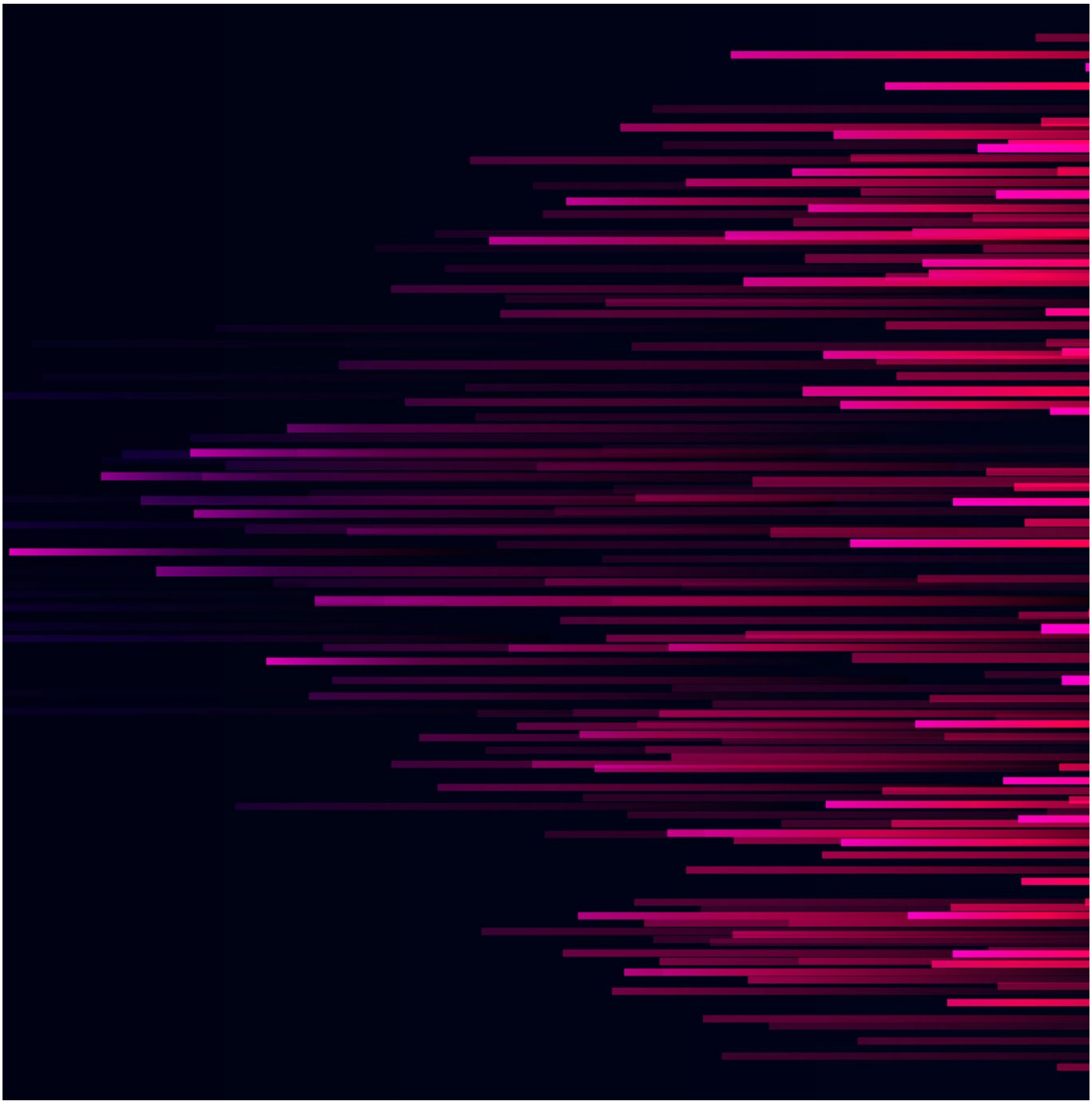

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