Opportunities for Private Equity: Finding Growth in a Downturn

AlphaSense

What's Inside

Introduction

The last decade has been one of unprecedented growth for private equity (PE). Assets managed by the industry have more than doubled since the global financial crisis (GFC), with firms now managing more than $3.8 trillion in assets. During this period, long-established funds have become significantly larger and a wide range of new entrants have joined the market.

Undoubtedly, PE has been an undisputed beneficiary of 10-plus years of monetary easing as ultra-low interest rates have led institutional investors to reach for yield. However, we now enter a period where the outlook is uncertain.

On one hand, we have robust (albeit slowing) global GDP growth. On the other hand, there are mounting concerns over an economic downturn driven by geopolitical instability (Russia-Ukraine war, etc.), changing societal expectations (COVID-19, etc), pockets of market excess and sector disruption, and the overall length of the current economic expansion. In aggregate, it's a picture of increasing volatility.

But as economic uncertainty spreads, growth slows down, and capital becomes more scarce, there is opportunity for firms to streamline operations and mitigate risk in order to seize on opportunities.

The bottom line: **There's still opportunity for PE in a downturn.**

However, managers must act decisively with speed and agility. The quality of your firm's relationships and how you leverage them impacts your ability to source, analyze, and close even bigger, better deals.

Historically, private equity has shown to perform well during periods of market volatility. By understanding the risks and opportunities and having the right technologies in place, your firm can deliver high-quality returns to its LPs with ease.

CHAPTER 1

Deal Sourcing in a Downturn

Even in the midst of the COVID-19 pandemic, middle market PEs within the US experienced high activity levels of deal-making in 2021—closing over 4,000 deals totaling around $600 billion.

While profits soared for PE during one of the most economically uncertain times in recent years, rising inflation, geopolitical risks, and competition from thousands of private equity funds have made forecasting a future for the industry much more difficult.

In short, PE managers must identify more potential investment opportunities or proprietary deals that other buyers have not yet seen, which means deal sourcing will be critical to a firm's success. You can no longer rely on old-fashioned techniques like pouring over the latest trade publications and cold-calling companies in today's crowded markets.

The firms with the most success find that leveraging relationships, in conjunction with the power of an AI-based market intelligence platform, is the latest and greatest way of creating a consistent pipeline of potential deals.

The deal-sourcing process differentiates from venture capital, as PE firms invest in private companies that aren't part of the public stock exchange list, making it harder to find new opportunities. For venture capitalists, they tend to invest in public startups that show signs of growth or stealth startups, but most opportunities occur within the publicly available area of startups.

For private equity deal sourcing, a firm analyzes 80 investment opportunities on average before making a single investment. The top PE firms follow a handful of practices to ensure that they'll see a return on where they funnel their funds.

Monitoring growth allows PE managers to observe and evaluate a startup or company's growth using headcount data, social media presence, market fragmentation, and revenue performance as metrics. These indicators can help with deal origination by filtering out certain companies that don't fit the required criteria based on levels of success reached.

Further, taking note of a company's liquidity is a smart way to decipher if a company is not just suitable for investment but is open to opportunities from a PE firm. Making note of the number of C-level employees nearing retirement, the company's success or failure to embrace technology, the rise of greater competition, and industry consolidation will provide the context for beneficial deal-sourcing.

Using data revealed in aftermarket research, company documents, and expert calls will also help you identify industry trends, monitor potential deals, target companies, and establish high-quality relationships. With this information, you can filter companies by data points and get a list of the businesses that fit into your area of interest and, ultimately, streamline the PE deal sourcing process by making it less time-consuming to find potential deals.

CHAPTER 2

PE Expectations for the Next Downturn

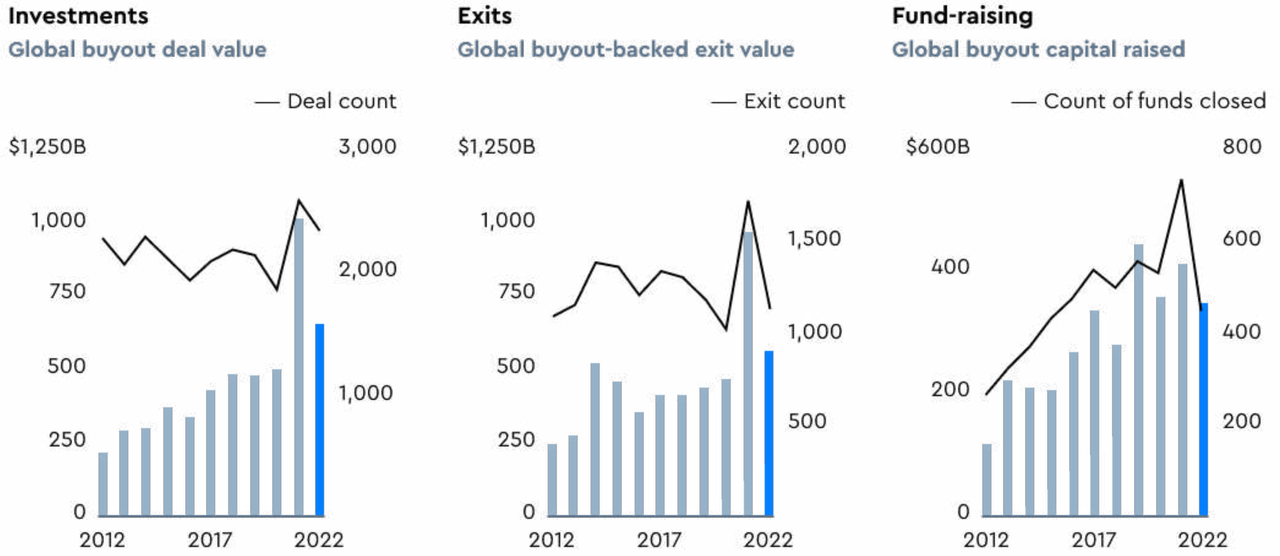
While PE performance throughout and post-COVID-19 yielded impressive stats, ultimately, they were no match for the Fed.

For the first half of last year, the industry saw a record-shattering burst of deal activity similar to the kind seen in 2021—even with inflation, the Russia-Ukraine war, and growing tensions with China playing to its detriment.

But in June, US central bankers issued the first in a series of three-quarter-point interest rate hikes, with global competitors following their footsteps. Banks pulled back from funding leveraged transactions, and deal-making fell off a cliff, pulling exit and fund-raising totals down with it.

According to Bain & Company, "given the heights from which they fell, buyout deal value ($654 billion), exits ($565 billion), and fund-raising ($347 billion) all finished 2022 with respectable totals in a historical context. But the sudden reversal marked the end of an upcycle that has endured (with a brief Covid brake tap) since 2010 when the industry emerged from the global financial crisis and produced a 12-year run of stunning performance."

Investments, exits, and fund-raising all declined in 2022 as macro forces took their toll



Charts sourced from Bain & Company

Even as the PE industry shifts gears from accommodating investments to tightening budgets, the full effects of the forecasted "recession" last year have unfolded in the market—this being primarily due to a tight labor market and lingering Covid-related stimulus. But what about the rest of 2023 and 2024?

There's no shortage of macroeconomic forces hindering growth and have resulted in rising rates that have siphoned access to cheap, obtainable debt financing. Consequently, future global economic activity is precarious and likely to cast a shadow over the PE industry through Q3 and Q4 of 2023 and likely beyond.

With buyers, sellers, and lenders waiting to see how economic forces will affect cash flows, this ambiguity will slow, if not halt, most deal activity, especially large transactions that require leverage. While dealmakers are discovering new ways to finance smaller transactions with private credit and larger equity infusions, 2023 will be marked with an overall decline in new deals and exits that produce a cumulative effect for fund-raising.

In the immediate time, limited partners will have to maintain balanced portfolios (and rectify any blunders that unbalance them) that can survive market swings and a slowdown in cash back from previous commitments. With a short-term cash squeeze, LPs will face challenges in extending new commitments—especially after several years of record-breaking allocations to private equity.

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However, the long-term outlook for private equity is not doomed for gloom but rather is in a position to be just as remarkable as 2021. Generating $10.7 trillion in capital over the past ten years, the PE industry is gaining traction with investors who reached the boundaries of the public markets.

Over the past quarter-century, about a third of US public companies have dissolved, leaving a handful of large tech firms to hold authority over the indexes—making it challenging to find adequate diversification in the public markets. Concurrently, private market returns are outpacing public returns due to alternative funds, which allow investors to access a broader global economy and the fullest range of asset classes. It's these advantages that make private markets more desirable than the public markets.

GPs are fostering growth through product innovation by consistently developing new types of fund structures across asset classes and, ultimately, making the industry increasingly attractive to LPs with highly specific allocation requirements.

While buyout remains the industry's largest asset class, a variety of others have been growing at double-digit rates. GPs are also diversifying their sources of growth by structuring products for massive pools of capital like sovereign wealth funds and wealthy individual investors.

History suggests that clear sight lines, rather than ideal economic conditions, will bring the energy back to dealmaking.

GPs can work around high-interest rates, but if uncertainty persists, so will the hesitancy to commit. The PE industry ended 2022 with a record $3.7 trillion in dry powder, so GPs will be eager to put it to work as soon as possible. But buyers, sellers, and lenders are all looking for more precise signals about where GDP is headed and how much further the rate hikes have to go.

The last downturn revealed that the winners didn't panic—firms that properly assessed their risk scenarios created mitigation plans and set themselves up to accelerate out of the downturn. This has implications for both dealmaking and portfolio management. Deal teams have become increasingly specialized over the past cycle and may need a keen understanding of how to evaluate the micro forces impacting a target company.

CHAPTER 3

AI to Sharpen Sourcing Strategy

Staying abreast of potential opportunities today requires more than having a pulse on market movements. You need to be privy to market-moving industry trends and predictions, corporate and sector performances, and the commentary being shared about these developments. Together, these streams of intel inform better decision-making and, consequently, lucrative investments. But even the most seasoned GPs and LPs can't complete this work without a tool that streamlines the process of collection and acting on insights.

Market intelligence platforms that leverage AI are widely becoming adopted by leading PE firms to cut through the noise and find the answers they need to seize on fleeting opportunities. With AlphaSense, professionals waste less time searching for information from multiple sources by relying on our platform to aggregate information from over 10,000 trusted resources—making sure you never miss an important piece of information.

In tandem with our AI search technology, AlphaSense makes it easier for you to surface insights across historical documents, industry reports, expert calls, and broker research—all in seconds.

By leveraging these capabilities, a market intelligence platform ensures you are prepared to answer any question at any moment. No one wants to go in front of the investment committee and find out something was missed. With AlphaSense, you'll be fully confident in your due diligence by using a single platform that compiles company documents, aftermarket research, expert transcripts, and news from a wide range of industries.

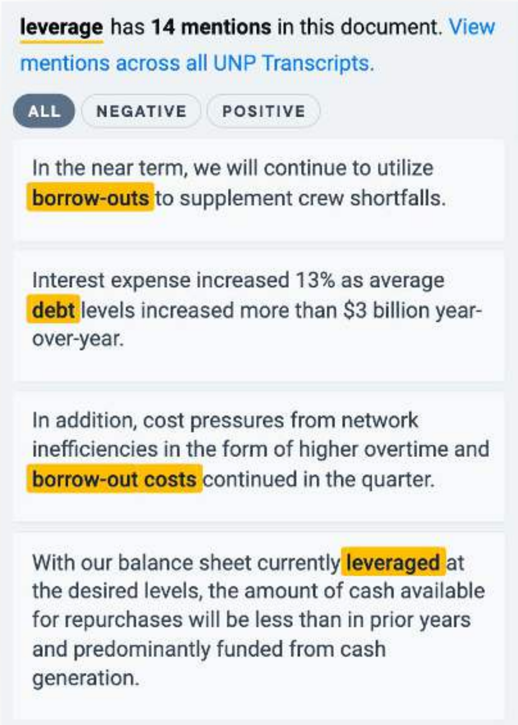
And with an expansive universe of content and cutting edge AI search technology, you can seek out niche investment quicker and move faster than your competition. AlphaSense will allow you to discover undervalued companies in blackbox industries with our extensive collection of expert calls, regulatory docs, and company data.

When paired with our proprietary AI, AlphaSense provides you with an even deeper industry and company analysis for your clients. From Smart Synonyms™ to Sentiment Analysis, our AI capabilities will give you a better understanding of when to buy, hold, or sell investments for your clients—and why.

Smart Synonyms™

Often, there is a natural variance in the language we use for a specific word. For example, the word "equities" is interchangeable with assets, securities, shares, or holdings in a search. Because of this variance, it is impossible to capture every relevant data source with a single keyword search.

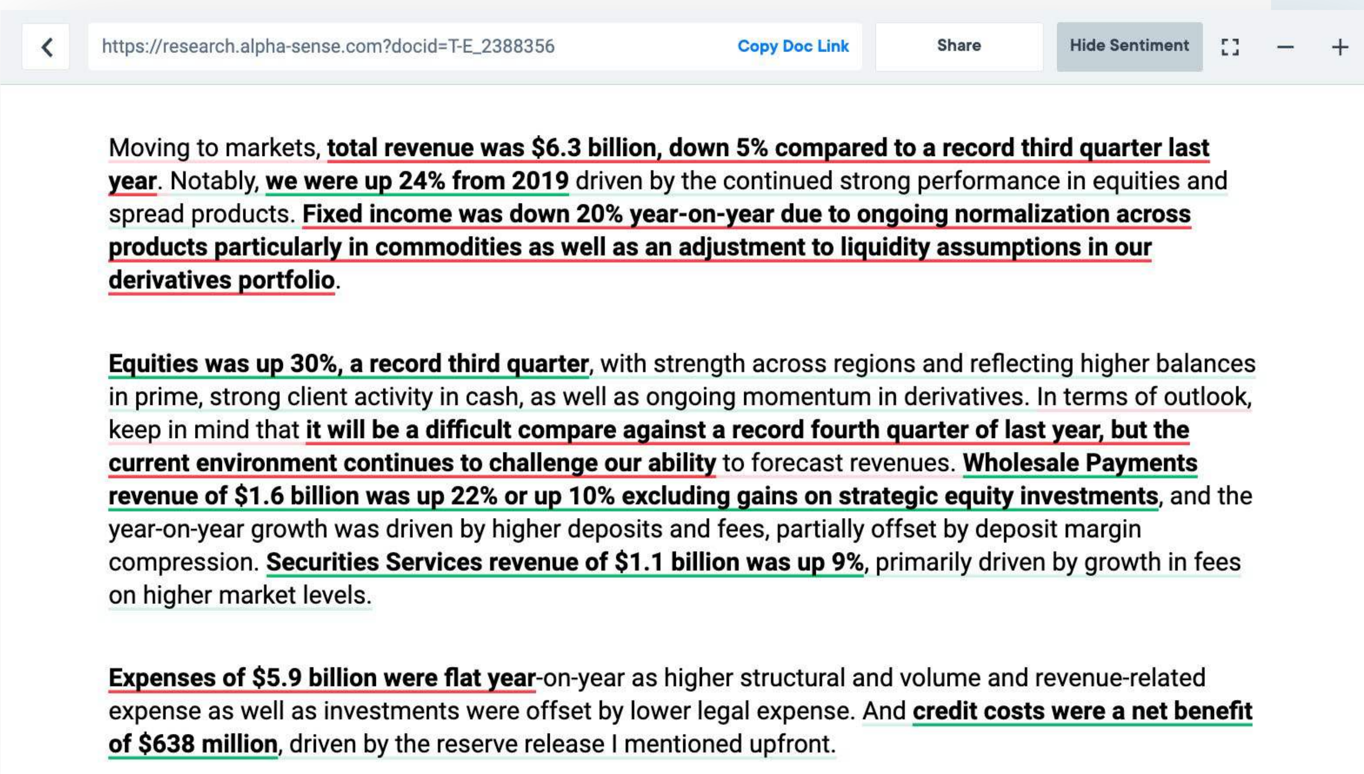
Smart Synonyms™ technology, powered by [Natural Language Processing (NLP)], automatically expands searches to include synonyms for the search terms used. This significantly cuts down research time by [eliminating repetitive searching] and decreasing the possibility of missing important information because a particular keyword was left out.



Sentiment Analysis

Interpreting unstructured data at scale is difficult for human cognition and an exciting challenge for AI. Analyzing inflection points in tone in earnings transcripts (regarded as a proxy signal anticipating stock movement and an indicator of shifting corporate strategy) requires an AI model that can understand natural language.

With AlphaSense, you can use AI-based Sentiment analysis to identify, quantify, and analyze levels of emotion within text. Understanding sentiment can help investors and business professionals catch the subtle inflection points in language that move markets and provide early indicators of shifting corporate performance. AlphaSense's Sentiment Analysis for transcripts uses natural language processing and machine learning to parse the language in those documents, revealing the most salient language and significant changes since previous quarters, down to the sentence level.



Moving to markets, **total revenue was $6.3 billion, down 5% compared to a record third quarter last year**. Notably, **we were up 24% from 2019** driven by the continued strong performance in equities and spread products. **Fixed income was down 20% year-on-year due to ongoing normalization across products particularly in commodities as well as an adjustment to liquidity assumptions in our derivatives portfolio**.

Equities was up 30%, a record third quarter, with strength across regions and reflecting higher balances in prime, strong client activity in cash, as well as ongoing momentum in derivatives. In terms of outlook, keep in mind that **it will be a difficult compare against a record fourth quarter of last year, but the current environment continues to challenge our ability** to forecast revenues. **Wholesale Payments revenue of $1.6 billion was up 22% or up 10% excluding gains on strategic equity investments**, and the year-on-year growth was driven by higher deposits and fees, partially offset by deposit margin compression. **Securities Services revenue of $1.1 billion was up 9%**, primarily driven by growth in fees on higher market levels.

Expenses of $5.9 billion were flat year-on-year as higher structural and volume and revenue-related expense as well as investments were offset by lower legal expense. And **credit costs were a net benefit of $638 million**, driven by the reserve release I mentioned upfront.

Generative AI (genAI)

Generative AI is changing the way people generate new ideas, collect information, and go about their day-to-day lives. It also has the potential to completely revolutionize the way we work. The future is offloading mundane, repetitive, and predictable tasks onto technology and prioritizing our time on high-value strategic and creative exercises—and that future is here.

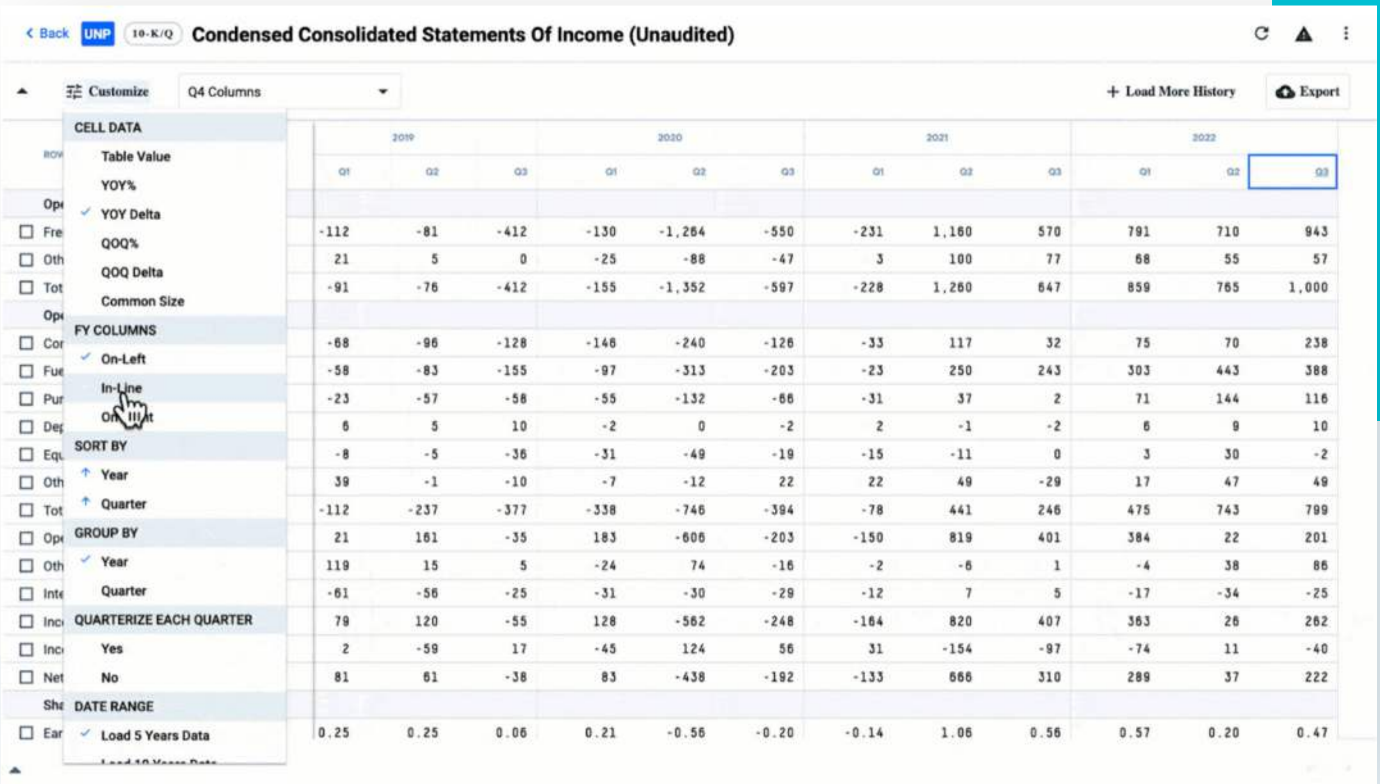
Today, professionals are spending endless hours reading and summarizing earnings calls from across their portfolios, peer sets, clients, and competitors. Whether it's scouring the Q&A of peers to prep for an earnings call, quickly understanding market-moving events for a competitive briefing, or just keeping a pulse on non-core companies that impact investment portfolios, earnings call transcripts are a key component to so many of our customers' day-to-day tasks.

With AlphaSense's Smart Summaries, customers will find every earnings call within the platform has an AI-generated summary that covers the most important topics discussed in the call. Any new calls published will automatically have summaries generated within a few hours of the call itself. Summaries access the key information from a call in concise, bulleted format—without the fluff—and cite their sources.

Financial Auditing and Modeling

For analysts, auditing financial performance or starting a financial model often means spending hours, if not a week, aggregating and validating historical performance. A surplus of time is wasted on manually aggregating or calculating historical financials and metrics. In the world of financial services, minutes are money, which is why it's critical to optimize and streamline how you get your work done.

That's where our latest feature comes in: [Table Explorer]. Table Explorer eliminates the need to manually collect data, allowing you to quickly double-check the numbers in Excel effectively, making it easier to identify quantitative insights faster. Via Table Tools, AlphaSense significantly expedites extracting valuable data from tables in SEC filings, [broker reports], and other content sets, so that you can quickly leverage your quantitative analysis and build better financial models.



Staying at the Forefront of Private Equity

Constant industry updates, new macroeconomic events, and changing investor behavior have made it seemingly impossible to stay updated as an LP or GP. That's why more firms are embracing tools to streamline the process of absorbing and acting on valuable insights. AlphaSense is the leading market intelligence platform leveraging AI for leading PE firms. Discover how our platform can elevate your research methods and pinpoint precious opportunities by starting your free trial today.

About AlphaSense

AlphaSense is a market intelligence platform used by the world's leading companies and financial institutions. Since 2011, our AI-based technology has helped professionals make smarter business decisions by delivering insights from an extensive universe of public and private content—including company filings, event transcripts, news, trade journals, and equity research.

Our platform is trusted by over 2,000 enterprise customers, including most of the S&P 500. Headquartered in New York City, AlphaSense employs over 500 people across offices in the U.S., U.K., Finland, and India.

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