EXPERT COMMENTARY

Following a drought in distributions, private equity dealmaking is showing signs of awakening in 2024, writes Yann Robard, managing partner at Dawson Partners

Liquidity on the horizon?

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A dire year of distributions

2023 was the year when distributions dried up in private equity. Driven by markets that were largely shut over the past two years, transactions stalled. There was much confusion due to a lack of clarity in the markets broadly and little consensus in the direction of inflation and interest rates. For two years many GPs have created limited liquidity for their LPs, for themselves and for the market.

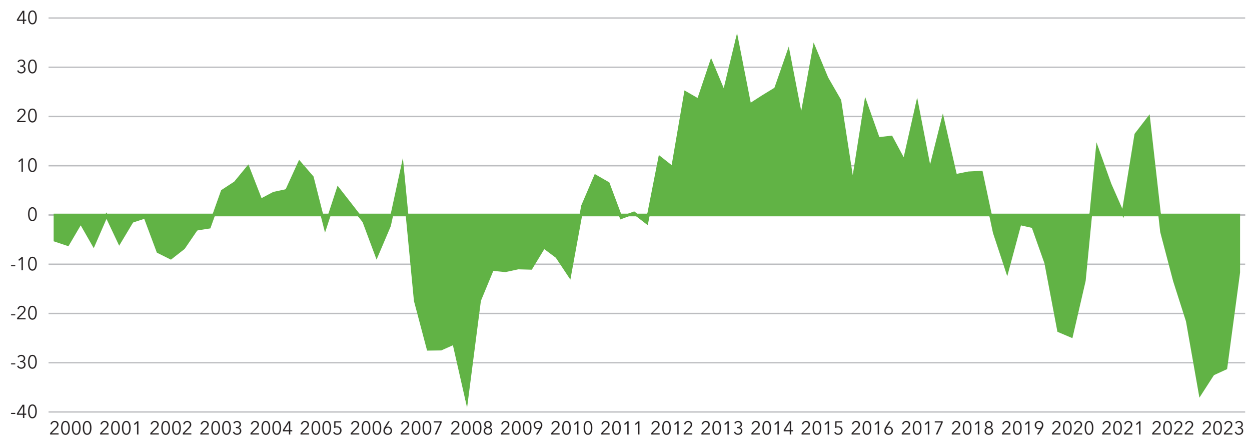
In fact, according to S&P Capital IQ, M&A volume was down 70 percent in 2023 compared with 2021, while IPO activity was down 90 percent during that same period. Essentially, GPs chose to hold assets through the market volatility, not sell in the eye of the storm, and that resulted in limited distributions to their LPs.

For most private equity investors, this refrain will not come as a surprise. Many have felt a drought in distributions. Many have seen their allocations to private equity impacted by this muted activity. So, we asked ourselves… how bad has it been? The answer was striking.

We looked at the net cashflows of private equity LPs to get better context. Said differently, did LPs receive more calls or more distributions in a given year? The answer can be seen in chart 1. From January 1, 2022, to September 30, 2023, buyout private equity portfolios generated significant negative net cashflows (ie, more capital calls than distributions). In fact, it was nearly identical to lows seen during the global financial crisis (GFC).

Let us say this again: private equity cashflow levels over the last two years have replicated what LPs and GPs experienced in 2008 and 2009 during the worst of the GFC, when Lehman Brothers collapsed and when the

Chart 1: Private equity net cashflows to LPs ($bn)



Source: MSCI Private Capital Solutions data as of September 30, 2023. (Data set excludes venture capital and reflects 4,031 funds with a capitalization of $4,935bn. Data since September 30, 2023 not yet available on MSCI Private Capital Solutions)

markets crashed. That is how bad it has been.

What's ahead for 2024?

Fast forward to today, we certainly feel like market sentiment is shifting. While there remains concern that inflation may persist, and that there may be higher rates for longer, there is more clarity in the market today on the path forward. The economy has surprised to the upside over the past year. Fears of a hard landing have largely tempered. Today, in short, there seems to be less confusion, more clarity and broader consensus in the markets.

And the public markets have responded. From September 30, 2023, to March 31, 2024, the S&P 500 and Russell 2000 were up 23 percent and 21 percent, respectively. However, that enthusiasm seen in the public markets does not yet appear to be reflected in private equity.

In fact, according to MSCI Private Capital Solutions, buyout private equity valuations were only up 3.4 percent in Q4 2023 while the S&P 500 and Russell 2000 were up 11 percent and 14 percent, respectively. We believe the private equity recovery is lagging that of the public markets and the tides may be turning.

Now let us be clear. The broader markets generally seem to agree that we are not out of the woods yet. There is increasing consensus that interest rates will be higher for longer and that inflation will be sticky. But for markets to open and transactions to get completed, we believe clarity on the direction of the economy is as important as the direction itself.

"Today there seems to be less confusion, more clarity and broader consensus in the markets"

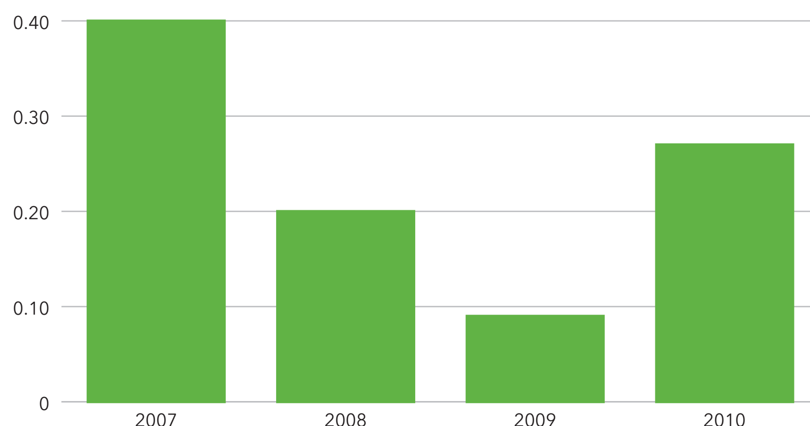
And now that we have more clarity on the direction of inflation and interest rates, bid/ask spreads are starting to narrow. Many, including Dawson, believe the market is awakening. Deals are returning. We believe things are shifting. We are seeing deal activity ramping up. As spring has sprung, private equity seems to have sprung into action.

Looking back at the GFC

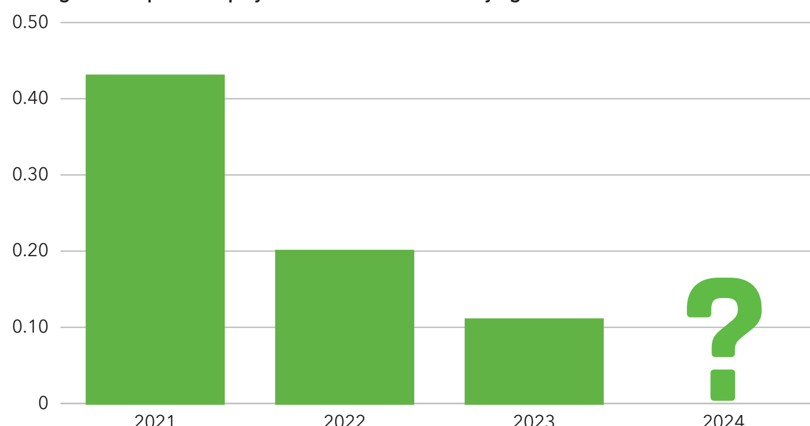
So, we thought it would be interesting to look at GFC distributions by buyout private equity portfolios to help provide perspective. We looked at three periods: pre-GFC, during the GFC and post-GFC.

Prior to the GFC, in 2007, on average, for every dollar of net asset value in a private equity portfolio, 40 percent of it was returned that year. It was a big year for liquidity. The peak before the crisis. In 2008, that number declined by half to 20 percent. And in 2009, that declined again by half to 9 percent. In fact, 2009 was the worst year of distributions over the past 20 years.

Chart 2: Distribution profile (GFC)
Average annual private equity net distributions over carrying value



Distribution profile (recent)
Average annual private equity net distributions over carrying value



Source: MSCI Private Capital Solutions data as of February 29, 2024. (Reflects data for 50th percentile North American buyout funds greater than $250m and represents annual average of fund vintages that are 3-10 years old. Selection criteria based on Dawson views. Different criteria would have yielded different results)

We then examined liquidity levels over the past three years and saw something shockingly similar – private equity distributions have largely replicated the distribution levels experienced during the GFC.

Like 2007, 2021 was a big year for liquidity. As markets peaked, so did distributions. For every dollar in net asset value at the beginning of the year, 43 percent of it was returned in distributions that year. Then 2022 replicated 2008, with 20 percent of net asset value coming back in distributions. And if we look at 2023 – with markets worried about high inflation and climbing interest rates – distribution levels nearly replicated that of 2009, at 11 percent.

"Over the past three years LPs and GPs have experienced distributions similar to the GFC"

Said differently, over the past three years LPs and GPs have experienced distributions similar to the GFC.

The natural question we had was: what happened in 2010 after the GFC came to an end? And the answer: distributions came back. In fact, in chart 2 you can see that investors received three times more distributions in 2010 than they received in 2009. The market rebounded quickly after a dire year of distributions.

Which leads us to our next question: could history repeat itself? Will 2024 be a big liquidity year? With more clarity in the direction of the economy, market and interest rates, has the bid/ask spread sufficiently narrowed for the pace of deals to accelerate?

We believe, absent a material geopolitical event, that the private equity dealmaking market is awakening. After two years of many GPs holding steady and waiting for the storm to pass, they are starting to act and bringing assets to market. And while the flood gates have not opened just yet, the momentum is building.

Remember, there is generally a three-to-six-month lag between when deals are announced and when they close. On that basis, distributions may not pick up until the second half of the year despite the feeling of momentum. Nevertheless, an increasing number of recent deal announcements could suggest a return to a more normalized level of distribution in the second half of the year.

To conclude, we at Dawson predict that the second half of 2024 will see a return of distributions to a more normalized historical level. Said differently, we expect 2024 full-year distributions to be somewhere between 2009 and 2010 activity. We believe there will be a bounce back from the trough, but not necessarily as quick a rebound as in 2010. We also believe, when we look back over time, that 2023 will have been the trough year for distributions as a result of this recent market volatility. Time will tell. You be the judge. ■