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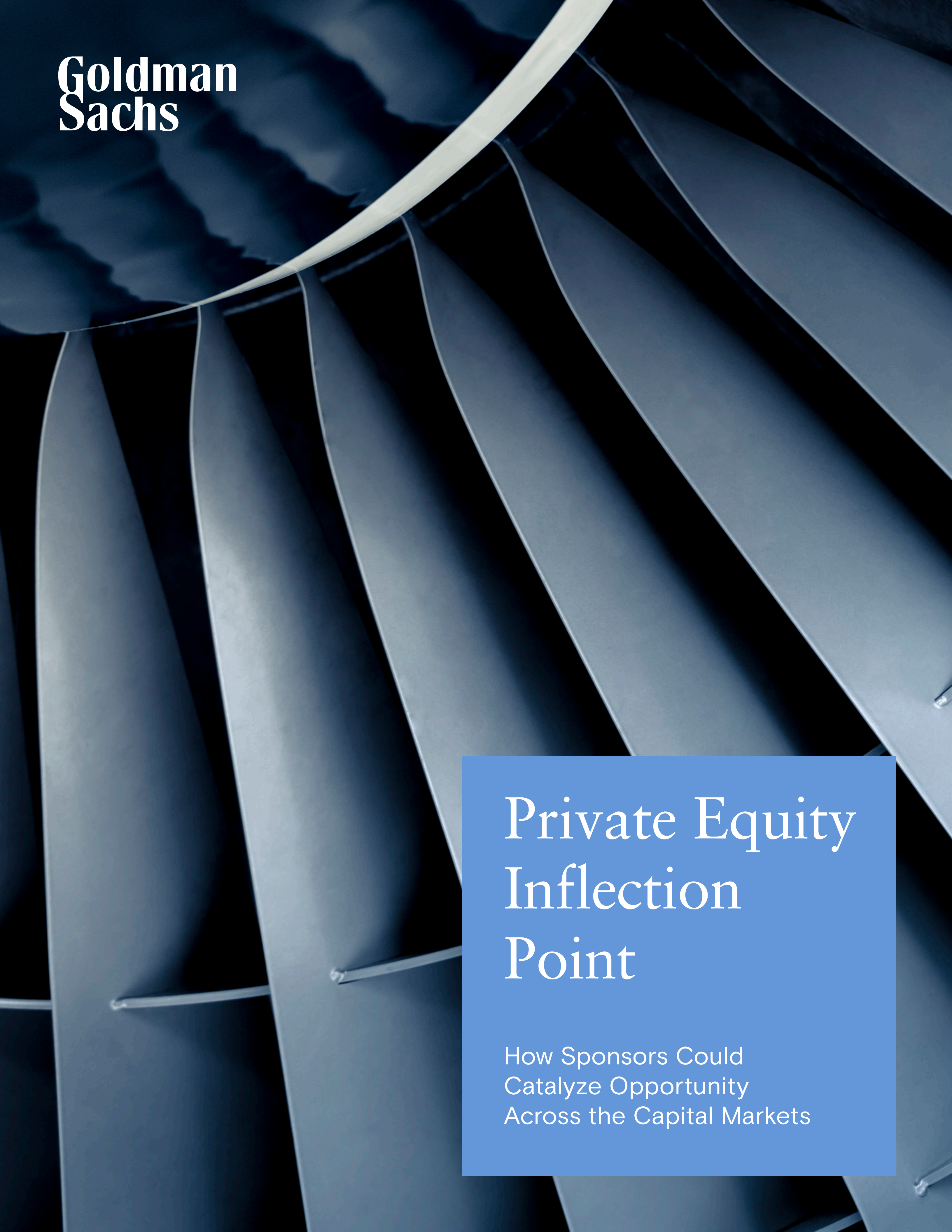


Private Equity Inflection Point

How Sponsors Could Catalyze Opportunity Across the Capital Markets

Introduction

As the markets continue to heal and sentiment improves, we expect 2024 to be a year of rebalancing, bolstered by renewed optimism, fresh pools of capital, and pent-up demand. Capital has historically been expensive, and while this truth momentarily faded during the low-interest-rate era, issuers and sponsors began to acquiesce to a “higher for longer” rate environment as we moved through 2023. A recalibration of markets and alignment of valuations, aided by multiple liquid pools of capital, have given way to a unique set of opportunities.

A key driver? The growth and diversification of alternatives, which continue to rapidly accelerate. Alternatives dry powder is estimated at approximately $3.9T, with private equity (PE) and private credit hovering at $1.2T and $443B respectively.[1] As the broader universe of alternatives — which also includes venture capital, infrastructure, growth equity, and secondaries — continues to expand, we expect that activity among financial sponsors broadly, and PE in particular, will become a catalyst for activity across many markets.

This growing dry powder surplus — amid expectations of central bank cutting cycles around the globe — is fueling momentum that has already begun to bolster M&A volumes (Q1 activity was up 34% YoY)[2] and financing markets, as an overall reopening takes hold. Last year, the S&P 500 index returned 26% including dividends, more than two times the average annual return since 1986.[3] The S&P has already made new all-time highs several times in 2024, and the continued desire by sponsors to monetize their portfolios and return capital to limited partners (LPs) is generating both urgency and risk appetite. In the US, there is also an eagerness to complete deals ahead of the presidential election.

Recovery globally is following suit. Momentum in Europe is reflected in both a strengthening of M&A and a reopening of the capital markets. While appetite in China continues to be muted, India and Japan (followed closely by Korea, Australia, and New Zealand) are increasingly attracting greater attention from investors, driven primarily by more stable geopolitics and a conducive growth environment for the medium-long term.

In this report, we explore how these macro drivers, coupled with unprecedented dry powder and an estimated $6T[4] in PE assets under management, have primed the capital markets for what we expect to be a **robust ripple effect of both strategic and financing opportunities** throughout 2024 and beyond.

“Financial sponsors have been relatively quiet the last two years, with most of them focused on raising new capital, returning capital to LPs, or a combination of both. We are starting to see that dynamic change with more constructive markets.”

Vivek Bantwal
Head of the Global Financing Group

[1] Source: Preqin as of 3/28/24
[2] Source: Dealogic as of 3/28/24
[3] Source: Goldman Sachs Global Investment Research as of 1/2/24
[4] Source: Preqin as of 4/9/24

Key Opportunities in 2024

Expanding Possibilities: Sponsor M&A

As M&A volumes normalize and sponsor-backed activity in particular rebalances, there will be greater opportunity for a “meeting of the minds” between buyers and sellers. CEO confidence, strong balance sheets, and more favorable debt financing markets, coupled with the need for sponsors to return capital to LPs and raise new funds, are creating a healthy environment for stronger transaction activity. With 2023’s higher borrowing costs and operational risks subsiding, there is potential for a meaningful bounce-back in 2024.

Staying Private Longer: The Mainstreaming of Secondaries

Despite an increasingly active IPO market, the mainstreaming of the secondaries market and a more muted exit environment have ushered in a new era for private markets, which remain a viable option for corporates with pragmatic valuation outlooks. In particular, we anticipate the growth of the secondaries market to continue, thereby allowing GPs to improve distribution to paid-in capital (DPI) performance.

A Key Liquidity Alternative: Public Equity Markets

As sponsors monetize via public equity markets, the next several quarters should see increased deal count, volume, and industry breadth. Barring the exceptional peak in 2021, global equity capital market (ECM) issuance in Q1 saw the fastest start to the year since 2018 and the fastest start in the US since 2015. With this improved sentiment, we’re seeing investors shift to the offensive. We expect not only IPOs but also secondary public offerings to accelerate in the form of follow-ons and block trades. Sponsors will also likely look at derivatives and margin lending to return incremental capital to LPs.

Leveraged Finance: Refinancing and Dividend Recaps

The leveraged loan market is strengthening, and we expect it to become increasingly supportive of M&A financing throughout 2024 and 2025 as normalized loan trading levels spur lenders to seek new opportunities and support more aggressive underwriting structures. Within this environment, dividend recaps have reemerged as a tool for healthy companies to take advantage of lender demand and create avenues for cash return to sponsors. Both companies and sponsors are looking for ways to deploy capital with large-scale deals.

Expanding Possibilities:
Sponsor M&A

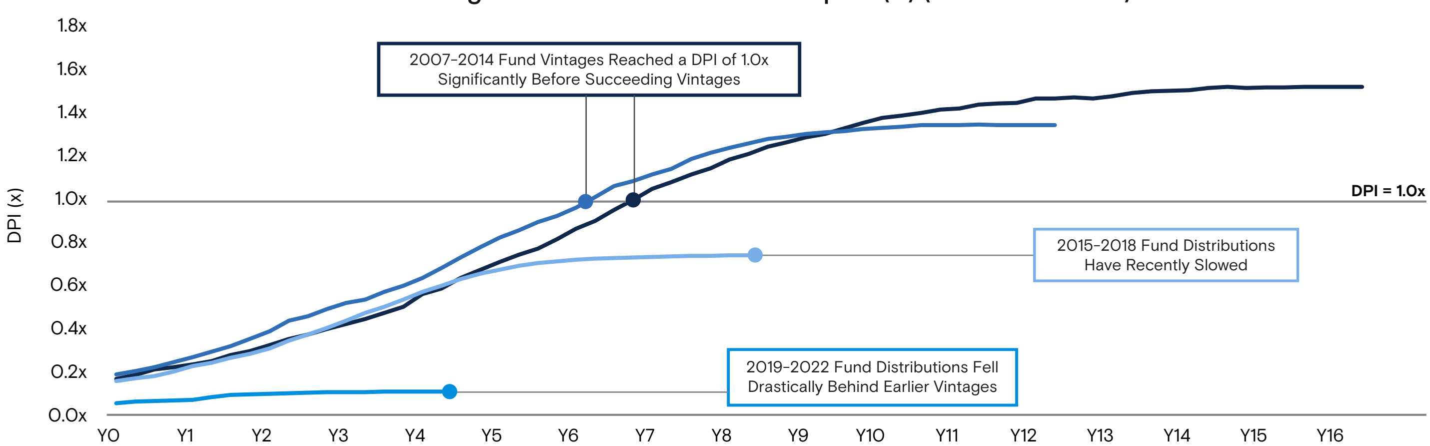
A more subdued dealmaking environment in 2023 was underscored by sponsors' conservative posture, forcing PE M&A volumes to a 10-year low (28% of total activity, down from nearly 40% in 2022) amid increased borrowing costs, heightened macro and operational risks, and a challenged institutional loan market. Sponsor exit activity saw a 15-year low.[5]

As the rate environment becomes more constructive and the institutional leveraged loan market increasingly supports M&A financing, sponsor M&A is primed to strengthen. DPI has been very low over the last four years, and investors have experienced net drawdowns since 2018 with limited capital return. LPs are more focused on DPI from prior funds as a key metric for evaluating capital deployment opportunities, creating a persistent headwind for fundraising. As a result, we expect to see continued pressure on sponsors to monetize their portfolio companies through full or partial sales, dividend recaps, and continuation vehicles. The growing dry powder surplus has only added to that pressure to deploy capital as interest rates hold steady and the gradual reopening of the IPO market fuels momentum for sponsors to act on opportunities.

As activity has contracted over the last two years, nontraditional deal structures and flexible financing solutions have also become strategic avenues for realizations. As M&A continues to rebound, we expect there will be more opportunity for bespoke structured transactions. In addition, emerging technologies around energy transition and GenAI have provided companies in certain sectors incentive to rethink strategic growth plans and move quickly as opportunities materialize.

> "In Q1, we saw a series of interesting sponsor M&A transactions including public-to-private, sponsor-to-sponsor, and strategic acquisitions of portfolio companies. The breadth of activity sets the scene for a very robust 2024."
>
> **Rob Pulford**
> Head of Americas Financial and Strategic Investors Group

Global Average Distributions to Paid-In Capital (X) (Rebased at T=0)[6]



[5] Source: Dealogic as of 11/30/23
[6] Source: Preqin as of 4/3/24, most recent reporting date available
Note: Date of first non-zero DPI defined as T=0 for each fund in given vintage (i.e., Y1 represents ~2017 for 2016 vintage funds, but ~2019 for 2018 vintage funds). Slight variations in values relative to the "Current Fund Performance Metrics" page are the result of rebasing the analysis to T=0 on a fund-by-fund basis.

A Key Liquidity Alternative:
Public Equity Markets

Improving macro conditions in 2023 resulted in a notable uptick in global sponsor-backed ECM issuance (up 62% YoY), but activity was still muted relative to historical averages. A total of $47B in global issuance across global sponsor-backed IPOs, blocks, and follow-ons was still under 50% of the 2018–2019 average of $110B. This year has proven to be much more constructive for broader ECM issuance as the IPO market has reopened, with over $17B of global IPO proceeds raised in Q1 (up 90% YoY).[7]

Looking ahead, issuers will have longer open windows to access markets via IPOs, alongside improved investor confidence, bringing valuations that align more closely with issuer objectives.

The IPO Issuance Barometer, tracked by Goldman Sachs Research, monitors five key macro inputs to gauge how conducive the environment is for IPOs: S&P 500 drawdown, CEO confidence, the ISM Manufacturing Index, the six-month change in the nominal two-year Treasury note yield, and S&P 500 trailing enterprise value-to-sales. In March, the barometer rose to 137 (scaled at 100 as the typical IPO frequency), the highest level since February 2022. Although outlier risks remain, baseline macro forecasts suggest this momentum will only continue.

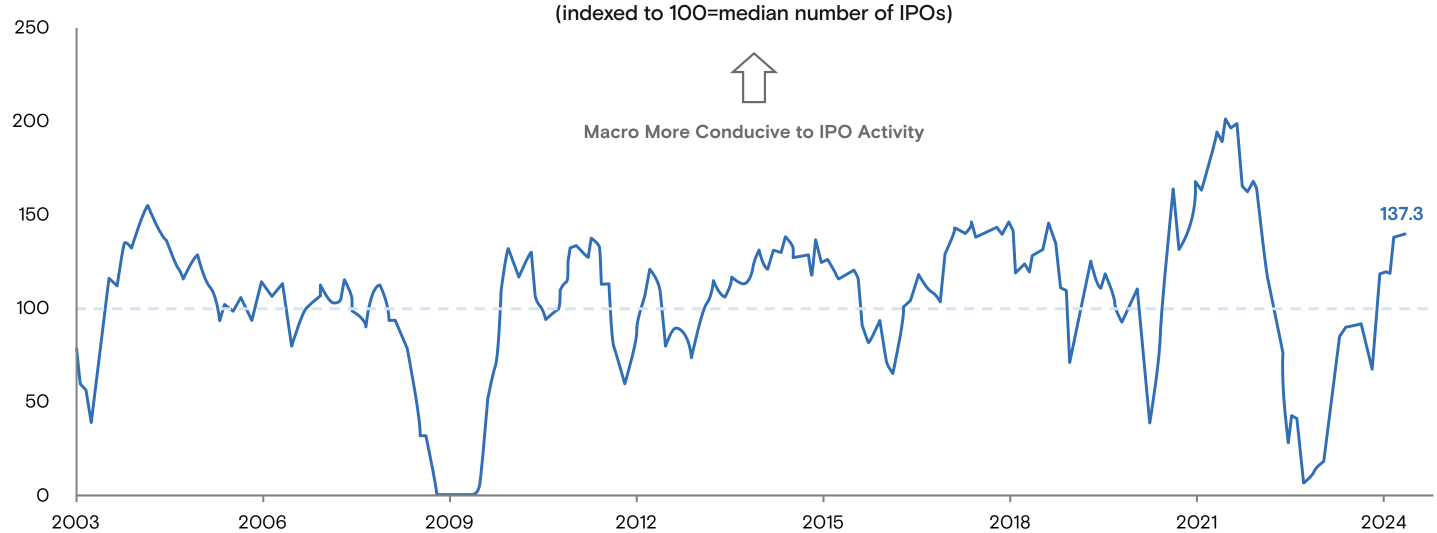
Secondary sponsor activity has also improved, with over 50 global monetizations returning $20B of capital to LPs so far this year (up 200% YoY). With asset valuations recovering, secondary pricing dynamics improving for sellers, and stronger aftermarket performance playing out, we anticipate the appetite for these issuances will only increase.[7]

“We’re already seeing issuers across more sectors looking to go public, but the depth and demand for growth-oriented assets has notably shifted.”

Elizabeth Reed
Global Head of the Equity Syndicate Desk

GS IPO Issuance Barometer[8]

(indexed to 100=median number of IPOs)



[7] Source: Dealogic as of 3/31/24
[8] Source: FactSet, Goldman Sachs Global Investment Research

Staying Private Longer:
The Mainstreaming of Secondaries

When public markets began to wobble in 2022, the secondary markets remained resilient. As secondaries rapidly evolved into a mainstream asset class, their relative undercapitalization created a buyer's market. Value stabilization in the latter half of 2023 began to create a duration mismatch: while LPs are eager to monetize their investments and find an avenue for liquidity, some GPs want to hold on to their best-performing assets longer.

To provide LPs with a dynamic set of liquidity alternatives, GPs have turned to secondary capital solutions such as continuation funds, which are unconstrained by the life cycle of a traditional fund. This approach allows GPs to compensate for a dearth of high-quality assets for sale by controlling exit strategy and retaining assets they know well during high periods of market volatility.

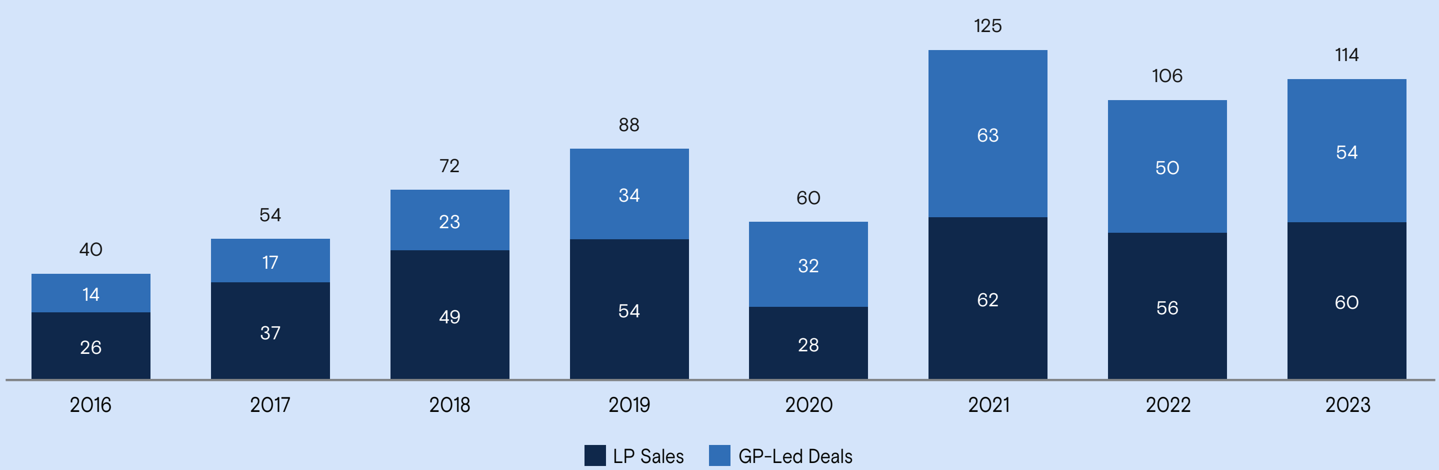
The largest secondary funds are well capitalized to take more risk-on approaches to high-quality deals as conditions improve. With the pipeline building, both incumbents and new entrants have gained momentum.

We anticipate large transactions to close this year, drawing on several pools of capital to fund "mega continuation" vehicles. A reduction in bid-ask spreads, along with ongoing pressures to generate DPI, will lead GPs to finally launch processes, potentially increasing the volume in the GP-led market to around $60B. Meanwhile, as discounts abate, LP volumes should normalize.

"The secondary market continues to grow and serve as a valuable form of exit or recapitalization for GPs that want to hold on to trophy assets for longer, "clean up" older assets and funds, or buy more time to harvest in the right environment."

David Kamo
Global Head of Financial Sponsor M&A

Overall Secondary Transaction Volume Since 2016 ($B)[9]



[9] GS transaction database, gathered from various sources including Secondaries Investor, Preqin, SecondaryLink, and others

Staying Private Longer:
The Opportunities and Upside

For sponsor-backed private companies, the growth of secondary capital solutions, coupled with a more muted exit environment, has created new openings for private capital transactions. Even with the IPO market reopening, the number of private companies seeking capital has spurred a new era for private market opportunities that we expect will expand and persist. Last year, US private deal volumes finished ~32% higher than the five-year average pre-COVID,[10] with ~$53B capital invested in Q1.[11]

We expect additional employee, institutional, and sponsor liquidity opportunities to arise this year as IPO candidates weigh their options and as DPI-driven dialogue continues to increase. While traditional M&A processes are regaining steam, structured capital proposals from investors — driven less by market sentiment than by a shift in strategy for financial sponsors — are becoming increasingly common. A few strategic themes emerge:

"Private IPO"-like Capital Raises and Other Structured Equity Alternatives

"Private IPO"-like capital raises can provide liquidity for existing shareholders and employees, some of whom may have expected an exit event already. The appetite for secondary shares continues to grow across investor types, providing a tailwind for successful outcomes. When finding alignment on price proves too challenging, some companies pivot to structured capital raises (convertibles, preferred securities, and warrant securities) to bridge the gap.

Reemergence of Traditional Crossover Rounds

For certain assets, traditional pre-IPO rounds are expected to reemerge as companies prepare for the public markets. These transactions offer an opportunity for public crossover investors to establish a toehold position in a private asset that can grow upon a subsequent public listing. While price and timeline to IPO remain key considerations for these investors, the improved equity market backdrop and uptick in IPO transactions globally will help catalyze transactions.

Flexibility and Customization Through Refinancing Solutions

Refinancing with structured equity remains a persistent approach. The "higher for longer" rate environment and maturity wall through 2028 have prompted many companies to focus on both refinancing and, in some cases, deleveraging to increase exit optionality around a subsequent sale, IPO, and/or secondary transaction. Structured appropriately, these transactions can also help facilitate a refinancing of other debt that is more senior in a company's capital structure. These securities provide multiple levers for flexibility and can address considerations around leverage, interest expense, and valuation. For example, certain preferred securities include a conversion into equity at IPO and allow for interest to be paid-in-kind. The deep pockets of available capital for these solutions continue to grow.

"Creative financing solutions exist across the private markets to meet the needs of key stakeholders — issuers, existing investors, founders, and employees."

Michael Voris
Head of Structured Equity and Alternative Capital Solutions

[10] Source: Pitchbook; compares average VC / growth deal volumes >$100M in deal size from 2015-2019 to 2023 volumes globally
[11] Source: Pitchbook; VC / growth deal volumes >$100M in deal size globally for Q1 2024

Leveraged Finance:
Refinancing and Dividend Recaps Open for Business

With over $500B of leveraged finance maturities coming due by 2028 — a debt maturation peak — and significant loans maturing in the interim, high-yield issuers are looking for refinancing solutions to their debt loads. We're seeing many of them tap the market in 2024 to address 2025 and 2026 maturities, with the upcoming US election creating dealmaking urgency now and in the upcoming months.

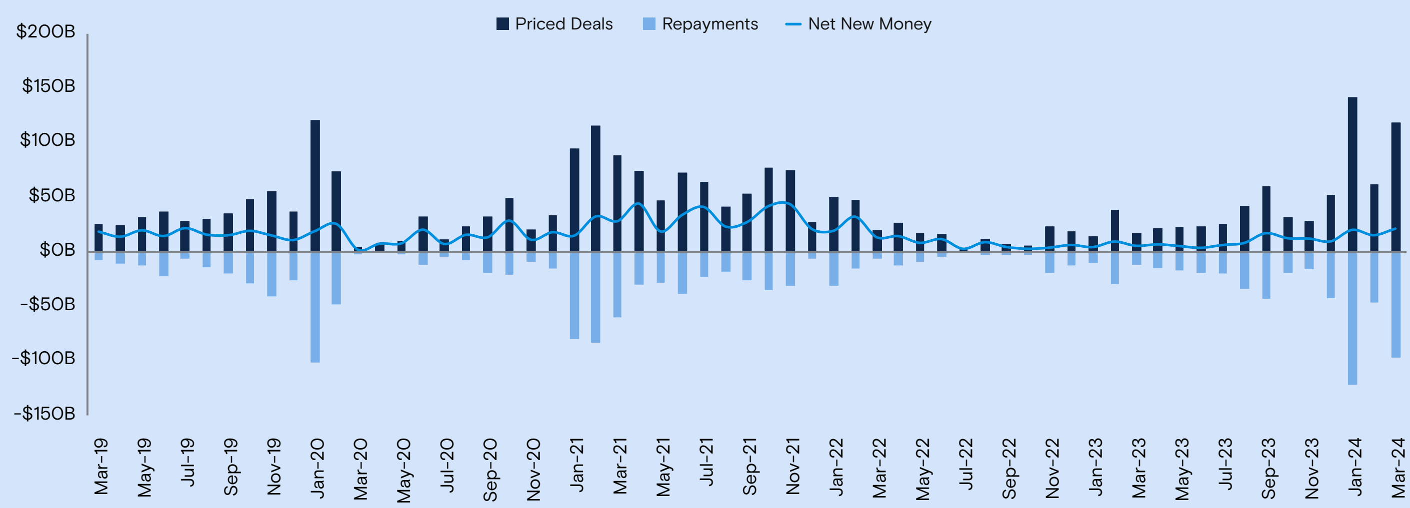
Although the cost of capital is high based on recent history, it is not high on a long-term basis, and sizable transactions are coming back to the market. Despite high interest rates, there has been a recalibration in expectations for both sponsors and issuers, resulting in some of the highest-ever quarterly volumes of syndicated market dividend issuance at $24B[12] in Q1 2024.

Meanwhile, limited announced new commitments at year-end 2023 may prompt investors to look for dividend opportunities or leveraged buyouts (LBO) with cash-generating businesses carrying limited debt. Sponsors structuring large-scale M&A deals also took note when large LBO financings for public insurance and healthcare companies cleared the syndicated market at attractive levels in Q1.

However, the reality of an elevated cost of capital means transactions might be composed of more equity, more cash, and less debt than the debt-heavy transactions of cycles in recent history. This scenario could lead to investors targeting cash-rich, high-growth businesses rather than slow-growth prospects. As financing markets strengthen and collateralized loan obligation formation shows signs of improvement, financial sponsors will find opportunities to secure more aggressive financing packages for M&A and LBOs across both the public syndicated and private credit markets.

> "What's most encouraging is watching the broadly syndicated markets and private credit market start to coexist and do transactions together in ways we haven't seen before."
>
> **Christina Minnis**
> Global Head of Credit Finance and Acquisition Finance

Supply of New Money[13]



[12] Source: PitchBook
[13] Source: LevFin Insights; represents gross institutional loan issuance and associated repayments

Spotlight on Private Credit:
Customizing Risk and Return

Private credit is increasingly becoming an attractive option for investors as a distinct and scalable asset class that is generating flexible financing opportunities for companies. Private credit and capital solutions strategies are participating in junior capital to help facilitate M&A and recapitalizations for DPI, and to replace cash-pay debt with payment-in-kind (PIK) alongside an amend-and-extend. Flexible pools of capital allow the form of these instruments to take shape across holding company PIK, preferred equity, and convertible instruments, tailored to bespoke needs.

Our colleagues within Goldman Sachs Asset Management are actively engaging in structured equity and preferred equity financings via hybrid capital and mezzanine strategies, allowing us a unique position to provide differentiated solutions to clients through our OneGS platform. We also see our dedicated private vehicles actively collaborating with the public markets to help optimize financing solutions for clients.

"The partnership across our Leveraged Finance and Private Credit businesses is unique in the market, and allows us to deliver bespoke solutions for clients at a time when dynamic market shifts demand it."

Greg Olafson
Head of Private Credit,
Asset & Wealth Management

The PE Effect:
Accessing Capital in 2024

From our seat at the nexus of global industry and capital markets, we believe we are at an inflection point for financial sponsor activity to become a material catalyst across markets. With interest rates expected to stabilize and the pipeline building on both the sell-side and buy-side, there is increased synchrony in pricing expectations and demands. The dry powder surplus and strong company balance sheets are also creating an attractive window for opportunities to deploy capital, negotiate terms, and maximize investment returns in ways we haven't seen for nearly two years.

We encourage clients to stay grounded in fundamentals — but also to recognize the opportunity to be bold, nimble, and proactive.

"As the alternatives markets continue to scale and mature, nearly every aspect of our franchises in Global Banking & Markets and Asset & Wealth Management is deeply immersed in the global alternatives ecosystem. As the world's markets cure and activity rebounds, we are intently focused on offering our clients bespoke solutions across that continuum."

Pete Lyon
Global Head of Financial Institutions Group, the Financial and Strategic Investors Group and Firmwide Alternative Asset Managers Solutions

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We welcome the opportunity to discuss these themes and market dynamics at your convenience.

Please contact our team at IBMarketing@gs.com

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