

Four for '24 (Third of a Series)

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2. *Winners and Losers: Continued dispersion from multiple dimensions of the market.*

The current brew of macro pressures and broader uncertainty have combined to fuel an intriguing effect across multiple dimensions. In 2024, we expect to see continued dispersion across three key market participants: private capital asset managers, private equity firms and portfolio companies. As we navigate slowing economic growth, volatility, and geopolitical shocks, it is even more critical to identify the attributes of winners and losers.

The winners have distinct attributes. Asset managers with scale, diverse investment capabilities, multiple sources of dry powder, and sustainable deal-sourcing advantages, will thrive. These firms will continue to secure the highest quality deal flow, build the most resilient portfolios and attract the broadest capital base, fostering resilience in any market cycle.

Ample cash for deployment is also key for the best private equity firms. Having as well a proven track record of valuation discipline will allow them to prevail as the “buyer of choice” for the best platform opportunities. They will adapt more quickly to the new normal for rates, developing multi-dimensional value creation plans that don’t rely on leverage for growth.

For portfolio companies, those with prudent balance sheets or bifurcated financings that offer payment-in-kind (“PIK”) flexibility will be best suited to pursue organic and add-on growth. They can diversify platforms to protect and enhance profitability and cash flow generation.

No clearer example from 2023 is the private equity allocator active in both primary LP commitments and equity co-investments. The stark correlation between smaller distributions from one’s primary portfolio and diminished co-investment dry powder became evident last year. Those managers with multiples sources of capital experienced significantly less competition for equity opportunities as single-sourced institutions were sidelined.

Conversely, asset managers lacking scale, comprehensive capabilities, and uncertain deal origination will face significant hurdles in an already challenged deal environment. PE sponsors lacking sufficient dry powder, ability to raise new or larger funds, or valuation discipline will fall short in auctions where value-added partnerships count most. Portfolio companies with aggressive capital structures and higher interest burdens will be disadvantaged, shifting available cash to debt service, compromising growth initiatives with little cushion to weather economic turbulence.

The dispersion effect across these key market participants will be a pivotal investment aspect in 2024. Gone are the days of hiding in the middle. Mediocre performers over time are at risk of falling into the loser camp. The strategies adopted by winners – embracing scale, cultivating diverse capabilities, leading with true sourcing advantages, exercising valuation discipline, and maintaining conservative and flexible balance sheet structures – will prove to be a brighter path for success in the year ahead.