Will Private Equity Activity in 2022 be as Robust as 2021?

Private equity (PE) has proven to be both stable and even resilient, despite economic uncertainty, as illustrated during the 2008 global financial crisis and the COVID-19 pandemic. During both events, PE-backed companies provided greater growth opportunities than many public company competitors, delivering the returns asset managers sought.

Mergers and acquisitions activity in 2021 has reached new levels, with deal value in the U.S. reaching $787 billion at the end of Q3, surpassing the annual record set in 2019. This upsurge in activity isn't only a U.S. phenomenon, it can be found across the globe.

The 2021 uptick was driven in part by a backlog of deals that paused to ride out the uncertainty of 2020. There is an assumption that there will be a pullback in 2022, though we expect activity to remain robust given the large sums of dry powder amassed that still need to be put to work. In fact, according to a recent Lincoln International survey of nearly 400 PE investors, 62% expect deal activity to be up slightly or remain flat year-over-year, a 2022 that is flat to 2021 would continue a pace of transactions that is unprecedented.

As the competition for quality assets continues, there is a concern about overpaying just to deploy capital. This concern is not new, it has been present for the last three to four years. It is important that investors pay close attention to the lender response to this issue to determine if they will continue lending at high multiples or pull back. One difference from 2008 that we have observed is that lenders have displayed high levels of patience during the COVID-19 pandemic. As lenders learned from the past that those who were patient saw greater returns in the years following 2008. Today, lenders and PE are generally working in true partnership, avoiding rash reactions that could deter long-term growth. This collaboration has generated greater returns.

This past year, the world acclimated to living and working in the new environment spurred by the pandemic. As we approach 2022, items General Partners (GPs) and Limited Partners (LPs) should pay attention to include:

Inflation. With the government pumping large amounts of liquidity into the market and ongoing supply shortages, the risk of inflation is high. The vast majority of government leaders and business executives have not contended with inflation as high as the 1970s or early 1980s in their professional careers. If there is a spike, costs will be increased in the short term and, depending on how business performance fares, investors might need to alter their approach. However, there might not be a long-term impact on PE.

GP-Led Secondary Transactions. Traditionally, PE-owned businesses could pursue three paths: go public, be sold or stay with the PE firm through a dividend recapitalization (which drove activity to reach an all-time high in 2021). A fourth option has now emerged as a compelling alternative; when a GP wants to hold onto a strong performing portfolio company, but LPs need liquidity, a GP-led secondary transaction allows both groups to achieve their goals. A secondary vehicle is created where LPs can choose to accept their liquidity or continue investing in the company and be rolled into the new vehicle. This process is growing rapidly in the U.S. and is becoming increasingly attractive in Europe.

China's Economy. As China nears the end of a large real estate boom, concerns abound as developers carry $5 trillion in debt, which is more than the entire economic output of Japan in 2020. Evergrande, one of the largest developers, is on the brink of default, and the question remains if others will follow. Depending on how the events unfold, there could be a potential ripple effect around the world. This is in addition to slowing economic growth in China.

As we approach the end of the year, investors are wondering: will a potential cloud like inflation cause a storm or dissipate in 2022? Will an unexpected event rock the private market? Looking ahead to 2022, Lincoln International remains bullish about the opportunities in the new year. Across products and industries, our bankers expect and are prepared for continued strong performance in the private capital markets.

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