BUY, SELL OR HOLD?

IS IT A GOOD TIME TO INVEST IN PRIVATE EQUITY?

October 2024

Executive Summary

Private equity valuations are under scrutiny as investors cope with macro uncertainty, increasing regulatory pressure for accuracy and transparency, and limited partners' growing need for liquidity. Using privateMetrics data, which covers more than 1 million companies globally across 150 countries, this report provides a detailed analysis of valuation metrics – including EV/Sales, Price/Book, and EBITDA multiples – the latest valuation trends, strategic opportunities for investors, and a deep-dive into the valuation drivers in the private equity market. Using the PECCS® classification system, this analysis offers a granular look at various industries, allowing for more accurate peer comparisons.

Key Insights

- **Valuation Trends Across Industries:** privateMetrics reveals significant variation in valuation trends across different sectors. While most industries have seen their valuation multiples expand or remain stable in the past year, the Hospitality and entertainment sector stands out with a notable contraction in profit multiples. This divergence highlights the importance of industry-specific analysis when evaluating private equity investments.
- **Top-Valued Industries:** Based on a comparative analysis of median multiples derived from sales, book value, and EBITDA, the Information and Communication and Health industries emerge as the most highly valued. Notably, their (unadjusted) EBITDA multiples stand at 20.24x and 24.12x, respectively. In contrast, industries such as Retail, with an EBITDA multiple of 14.43x, exhibit lower valuations across all three metrics.
- **Dispersion and Risk:** The data emphasizes that the range of multiples within each industry segment—a measure of dispersion—offers insights into the risk profile of the sector. For instance, the Retail sector demonstrates the widest range of EBITDA multiples, spanning almost 18x, suggesting a higher degree of risk compared to other sectors. Notably, subscription-based businesses and those with a strong B2B focus, which tend to command higher valuations and potentially exhibit lower risk.
- **The Health Industry: A Closer Look:** The Health industry claims the title of the most expensive sector based on its current valuation, with a median unadjusted profit multiple of 24.12x. Despite a modest increase in valuation over the past year, this sector has experienced above-average sales and profitability growth. However, the size of companies and profit levels remain low relative to other sectors, indicating potential for further profit expansion. Importantly, the Health industry exhibits lower valuation dispersion compared to other sectors, which may translate into broader strategic opportunities for investors seeking to acquire assets.
- **Information and Communication - Opportunities Amidst Risks:** The Information and Communication sector boasts high valuations, with a median sales multiple of 2.19x and an EBITDA multiple of 20.24x. However, this sector has not witnessed robust sales or profit growth. The prevailing high-interest-rate environment further dampens prospects for future growth, and the observed front-running of valuations without corresponding improvements in fundamentals may signal potential downside risks. Nevertheless, the wide dispersion of valuations within this industry suggests that attractive investment opportunities could exist for discerning investors.

Market Multiples

Since 2023, private equity valuations have been impacted by higher rates, a slower exit environment, fewer distributions, longer fundraising periods, etc., but is now a good time to buy?

Three important elements are necessary to index private equity, including:

i) a robust method to estimate the valuation of assets.
ii) a taxonomy that can organise assets into groups with similar risk and return characteristics; and
iii) a formal method to define a relevant and representative universe of assets.

privateMetrics addresses all these requirements scientifically and objectively to produce products that solve the problems of appraised, smoothed, infrequent, and biased data.

- First, the prices in privateMetrics are updated every month, based on a dynamic factor model that can very precisely explain observed transactions on average, in aggregate and at industry level. The estimated valuation of companies is driven by the factors of each company (e.g., its size, leverage, etc.) and by each factor prices inferred from observed transactions. To find out more about this approach, please refer to this publication.
- Second, the PECCS® or PrivatE Company Classification Standard, created by the EDHEC Infra and Private Assets Research Institute, is a multi-dimensional classification scheme for private companies, comprising five independent pillars: the industrial activity, lifecycle phase, revenue model, customer model, and value chain type. These pillars help create peer groups of companies exposed to similar systematic factors, thus maximising the insights one can draw about private companies while dealing with limited data availability in private markets. (Find out more about PECCS® here.)
- Third, privateMetrics curates a Private Equity-backed Universe (or PEU) of private companies, which matches the characteristics of PE-held companies.[1]

Using privateMetrics data, it becomes possible to understand the price dynamics in private markets. Tables 1 and 2 present the quartiles of the valuation multiples of each PECCS® industry class, using the privateMetrics universe of companies valued at the end of August 2024.

EV/Sales and Price/Book Valuation Multiples

Table 1 shows the EV/Sales and Price/Book metrics by PECCS® industries, compared against the global private equity market which represents more than 111k observations for Sept. 2024.

The Financials, Transportation, and Natural Resources sectors have **strong multiples**, specifically in EV/Sales, whereas Information and Communication exhibits strong Price/Book multiples. This can be attributed to several things:

- Financials, Transportation, and Natural Resources: These sectors typically exhibit **higher leverage and profitability**, which supports stronger EV/Sales multiples. These sectors

[1] The PEU is constructed from a Broad private Market Universe (BMU) by filtering for size and profits that matches the characteristics of known PE portfolio companies. The BMU comprises over 1.2 million eligible private companies from over 150 countries that are for-profit, not publicly listed, not majority government-owned, not part of infraMetrics®, and have at least USD1 million in revenue. The PEU includes 80k+ companies and represents USD13.4T of market capitalisation in mid 2024. Find out more about the PEU here.

also exhibit similar levels when considering valuation as a ratio of book value, with the notable exception of Financials, which exhibits distinct accounting procedures.

- Information and Communication: These sectors are characterized by a prevalence of smaller and younger companies, as well as have higher amounts of intangible capital that may not be included in the book value, leading to higher book value multiples.

Interquartile Range (IQR) Analysis

The Interquartile Range (IQR) provides valuable insights into the dispersion of valuations within a particular industry. A larger IQR suggests a wider range of valuations, indicating:

- Increased Opportunities and Risks: Identifying suitable investment targets becomes more complex, as the spread between the top and bottom quartile companies is significant.
- Significant Value Drivers: The choice of comparable companies (comps) for valuation becomes crucial, as the presence of significant value differentiators within the industry necessitates careful selection.

Health, Hospitality and Entertainment, and Education and public exhibit lower interquartile ranges (IQR) for both EV/Sales and Price/Book metrics. Conversely, Natural resources has higher IQR on both the metrics. Notably, Real estate and construction, Retail, and Transportation have higher IQRs on Price/Book.

Table 1: Quartiles of EV/Sales and Price/Book valuation ratios by PECCS® Industrial Activity – September 2024

	EV/Sales			**Price/Book**			
PECCS Activity	25th Percentile	50th Percentile	75th Percentile	25th Percentile	50th Percentile	75th Percentile	**Obs. (000s)**
Education and public	1.47	1.77	2.18	1.52	1.87	2.39	5.3
Financials	2.30	3.87	5.16	0.25	0.54	3.88	11.4
Health	1.56	1.79	2.08	3.34	3.92	4.62	13.0
Hospitality and entertainment	1.74	2.13	2.81	2.87	3.85	5.35	12.6
Information and communication	1.73	2.19	2.79	4.91	6.72	9.09	13.9
Manufacturing	1.69	2.19	2.94	2.02	3.73	6.10	11.6
Natural resources	2.36	3.51	5.06	1.76	4.48	8.54	5.7
Professional and other services	1.70	2.17	2.98	2.78	4.38	6.41	20.8
Real estate and construction	1.50	1.99	2.92	1.64	3.41	6.98	6.1
Retail	0.97	1.25	1.65	1.89	3.54	7.36	10.2
Transportation	1.78	2.23	3.39	1.93	5.42	7.51	1.5
Global Private Equity	**1.59**	**2.07**	**2.95**	**2.10**	**3.96**	**6.29**	**111.9**

Source: privateMetrics, as of 31/8/2024

EBITDA Multiples: A Deeper Dive

privateMetrics multiples represent a robust market price average (or systematic component) that can be used as the starting point to gauge market prices at the individual asset level.

In what follows, we consider EBITDA multiples based on reported EBITDA, averaged at the level of the market segment i.e. *unadjusted*, and do not use adjusted EBITDA, as such adjustments are made on a case-by-case basis and preclude any like-for-like comparisons between assets and segments of the level of multiples. In effect, such adjustments correspond to the asset-specific component of individual asset prices.

Moreover, over the medium term, unadjusted and adjusted EBITDA can be considered to follow similar trends.

Analysing **unadjusted EBITDA multiples** across various industries, as shown in Table 2, reveals noteworthy valuation trends that differ from those observed using Sales or Book Value multiples. This divergence stems from the inherent variations in profitability across sectors.

- **Information and Communication, Health, and Education and Public** command **higher valuations** when assessed through the lens of profit multiples. This contrasts with their rankings based on EV/Sales, where they secure the 4th from last and the last two positions, respectively.
- The **reason for this inversion** lies in their **lower-than-average profitability**. These sectors operate with median EBITDA margins of 10.7%, 7.4% and 9.8%, respectively, trailing the global private equity median of 12.5%. Consequently, their profit multiples experience an upward push, while sales or book value multiples remain relatively unaffected.
- **Information and Communication** consistently maintains a **high ranking across multiple valuation metrics.** For instance, it has the best average rank across the three metrics, signalling a robust investor preference for companies within this sector and a willingness to pay a premium.
- **Retail** stands out with the widest IQR, showcasing an almost 18x difference between the top and bottom quartile companies. This substantial variation underscores the importance of meticulous comp selection within this sector. In contrast, **Hospitality and entertainment** displays the least dispersion in its IQR.
- **Retail's** IQR based on book value is also high, while its sales-based IQR is among the lowest. This difference is understandable, as retail businesses typically generate high gross revenues, but not all of this revenue directly reflects the value added by the business.

Table 2: Quartiles of EBITDA multiples by PECCS® Industrial Activity – September 2024

PECCS Activity	25th Percentile	50th Percentile	75th Percentile	Inter-quartile range	Obs. (000's)
Education and public	17.49	21.58	28.19	10.70	5.3
Financials	12.81	17.23	23.05	10.24	11.4
Health	20.91	24.12	28.06	7.15	13.0
Hospitality and entertainment	11.22	13.96	18.20	6.98	12.6
Information and communication	16.33	20.24	25.52	9.20	13.9
Manufacturing	9.45	14.14	22.57	13.12	11.6
Natural resources	9.33	13.25	23.46	14.12	5.7
Professional and other services	10.11	13.77	20.09	9.98	20.8
Real estate and construction	10.34	16.63	28.03	17.69	6.1
Retail	8.38	14.43	26.25	17.87	10.2
Transportation	10.12	16.43	21.72	11.60	1.5
Global Private Equity	**11.66**	**17.32**	**24.61**	**12.96**	**111.9**

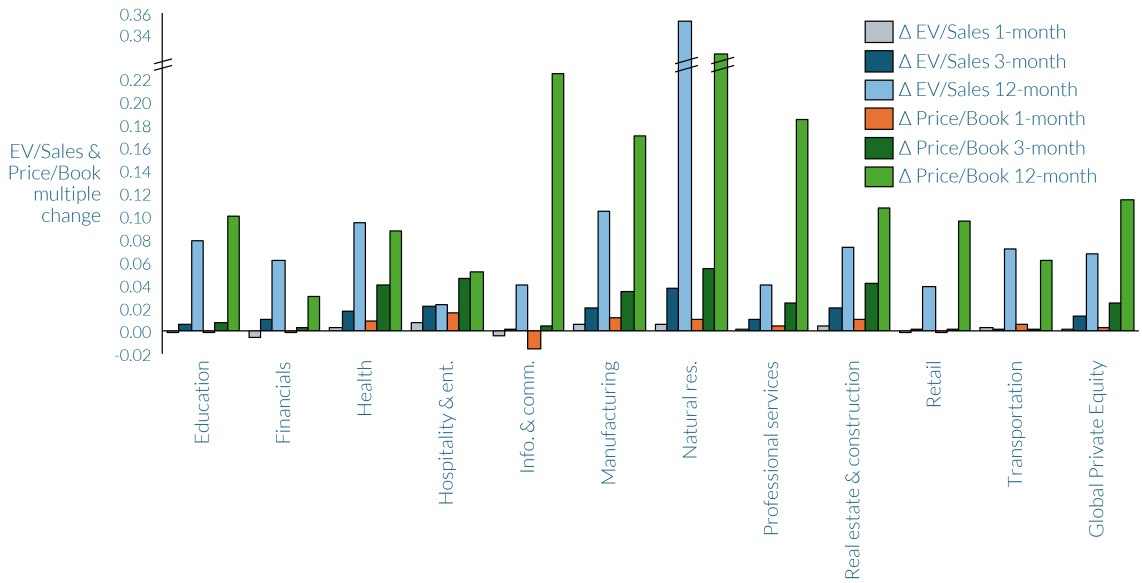
Relying on a single valuation multiple can lead to inaccurate conclusions about the private market. Discrepancies in valuation rankings across industries, depending on whether sales, book value, or profits are used, highlight inherent differences in these financial metrics. This emphasizes the importance of accessing granular data and precise segment definitions to paint a clearer picture of the market landscape.

Valuation Changes

Valuation Multiple Changes: A Sectoral Analysis

Figure 1 shows the one-, three-, and 12-month changes in sales and book multiples across different sectors. On average, the sales multiples expanded by 0.07x over the past year but have remained relatively stable in the last quarter. Likewise, the book multiple has expanded by 0.11x over the past year, with recent changes being much smaller. However, in both metrics, significant variations exist among sectors.

Figure 1: Changes in sales and book value multiples in Global Private Equity by PECCS® Industrial Activity – September 2024



Source: privateMetrics, as of 31/8/2024. Changes are computed as the median of same company differences in each group.

The Natural Resources and Manufacturing sectors lead the pack with the most substantial increases in both multiples, while Hospitality and entertainment lags behind. Price/Book multiples generally follow a similar pattern as EV/Sales, except for Information and Communication, that exhibits a faster growth in equity valuation compared to its book value. This suggests that sales within the Information and Communication sector have kept pace with valuations, explaining the lack of significant expansion in its EV/Sales multiple.

Shifting focus to unadjusted EBITDA multiples, Figure 2 reveals that Hospitality and entertainment is the only sector experiencing a contraction in profit multiples over the past year. All other sectors have witnessed an expansion, with Health and Education and public demonstrating the most pronounced growth. EBITDA multiples display greater volatility compared to sales or book value multiples, highlighting the variability of profits in comparison to sales or book value.

The Importance of Industry Context in Valuation

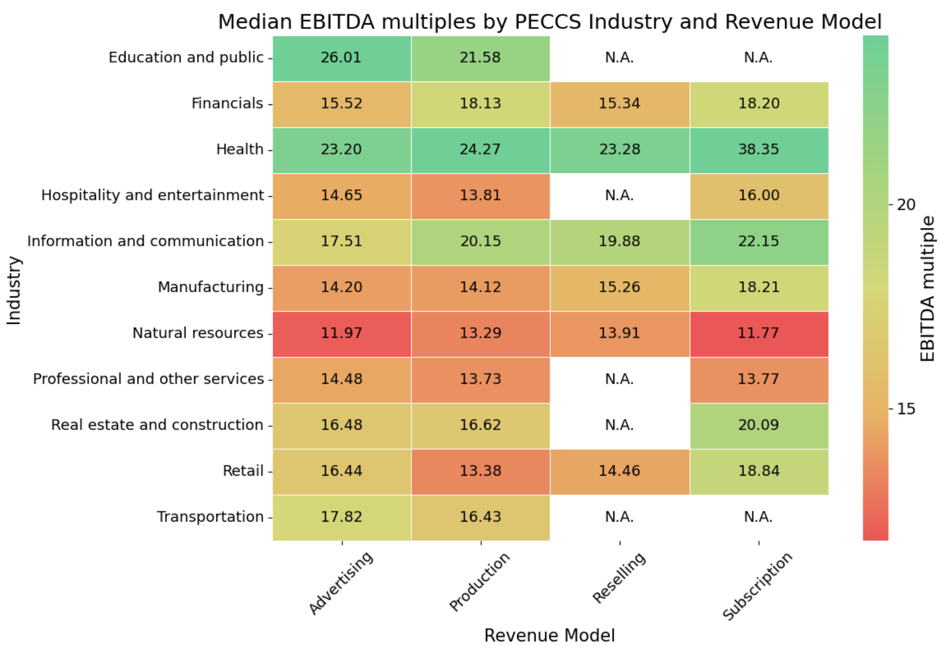
While certain revenue and customer models might generally command higher valuations, their perceived value can significantly vary depending on the specific segment. This underscores the importance of considering segment-specific nuances when evaluating private equity investments. In this context, the PECCS taxonomy provides a multi-dimensional framework to understand valuations.

- **Revenue Models:** While **subscription-based revenue models often receive higher valuations due to their recurring revenue streams**, this trend is not universally applicable across all industries as shown on figure 3. For instance, a subscription model might be highly valued in a rapidly growing technology sector but less so in a mature industry with limited growth potential.

- **Customer Models:** Similarly, while **business-to-business (B2B) models are generally favoured by investors, Figure 4 shows that this is more the case in industries like Education, Hospitality and entertainment, and Retail**. But in sectors that typically cater to individual consumers, B2C models may be more valuable. For example, in the retail industry, direct consumer relationships and brand loyalty play a crucial role, making B2C models more relevant and potentially more valuable than B2B models.

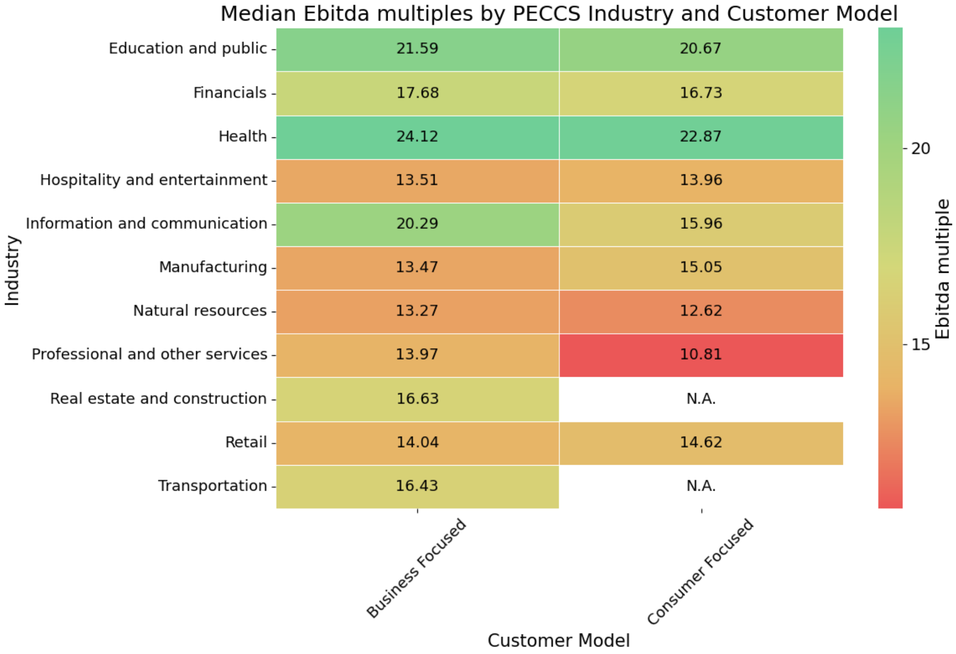
The varying importance of different revenue and customer models across industries highlights the need for a nuanced and context-aware approach to valuation. Investors should not rely solely on generalized trends but must consider the specific characteristics and dynamics of each industry when assessing the potential value of different business models.

FIGURE 3: UNADJUSTED EBITDA MULTIPLES IN THE PEU BY PECCS® INDUSTRIES AND PECCS® REVENUE MODEL



Source: privateMetrics, as of 31/8/2024

FIGURE 4: UNADJUSTED EBITDA MULTIPLES IN THE PEU BY PECCS® INDUSTRIES AND PECCS® CUSTOMER MODEL.

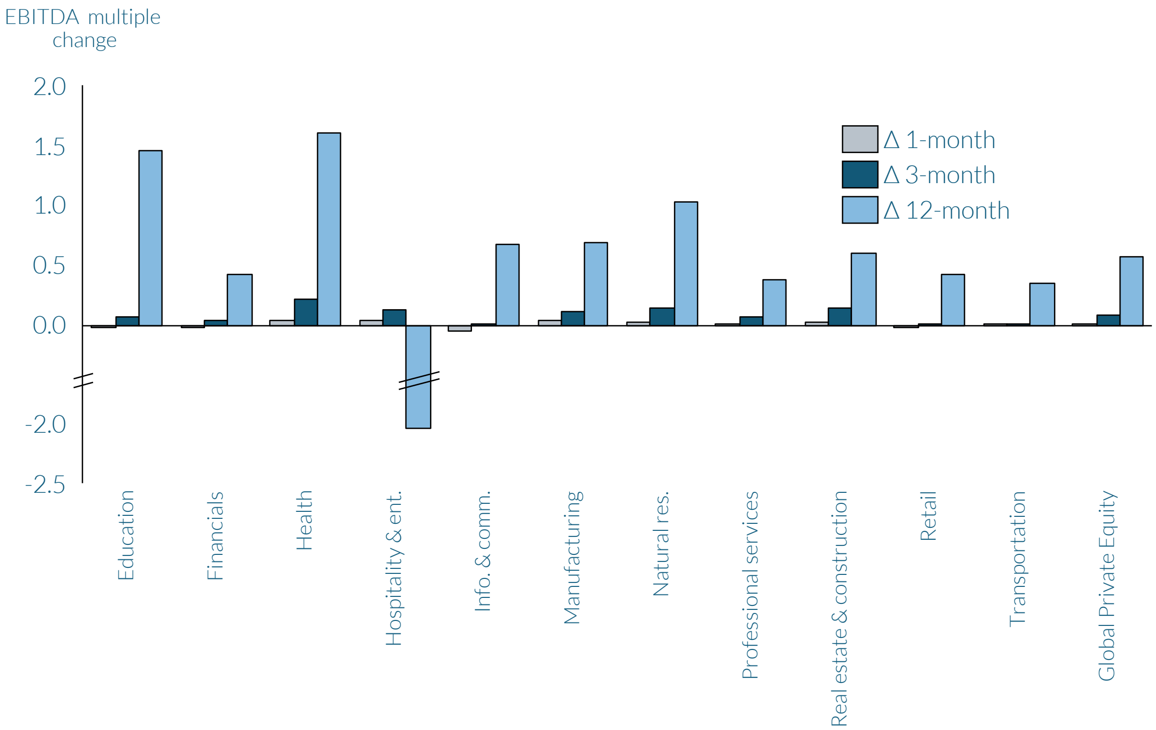


Source: privateMetrics, as of 31/8/2024

Understanding the Impact of Changes in Financial Metrics on Valuation Multiples

Valuation multiples are not static and can be significantly influenced by fluctuations in the underlying financial metrics used in their calculation. Table 3 shows the average changes in Sales, Book Value, and EBITDA and how these shifts impact different valuation multiples.

FIGURE 2: CHANGES IN UNADJUSTED EBITDA MULTIPLES IN GLOBAL PRIVATE EQUITY BY PECCS® INDUSTRIAL ACTIVITY



Source: privateMetrics, as of 31/8/2024. Changes are computed as the median of same company differences in each group.

TABLE 3: AVERAGE CHANGES IN VALUATION MULTIPLE COMPONENTS BY PECCS® INDUSTRY

PECCS Industry Class	% change in average value over 12 months			Direction of change in valuation multiples		
	Sales	Book Value	EBITDA	EV/ Sales	P/Book value	EV/ EBITDA
Education and public	0.3%	-6.4%	16.0%	+	+	+
Financials	-1.3%	-14.5%	-0.6%	+	+	+
Health	2.5%	-6.1%	3.9%	+	+	+
Hospitality and entertainment	0.1%	-12.1%	-9.6%	+	+	-
Information and communication	-0.6%	-8.3%	1.9%	+	+	+
Manufacturing	-0.8%	-12.1%	-1.2%	+	+	+
Natural resources	-0.1%	-19.9%	-1.9%	+	+	+
Professional and other services	-0.3%	-8.8%	1.6%	+	+	+
Real estate and construction	-2.0%	-11.3%	-2.9%	+	+	+
Retail	-0.8%	-9.6%	-0.9%	+	+	+
Transportation	-2.7%	-15.5%	-4.2%	+	+	+
PE Universe Total	**-0.3%**	**-10.6%**	**0.0%**	**+**	**+**	**+**

- Sales: Over the past 12 months, sales figures have decreased slightly in most industries, with the notable exception of the Health sector, which experienced a 2.5% increase. For most sectors, other things than sales growth are driving changes in valuation multiples.
- Book Values: Book values have predominantly declined much more than sales across sectors. This contributes to an overall increase in the Price/Book ratio. As book values shrink, the denominator of the Price/Book ratio decreases, leading to an increase in the multiple, even if the equity valuation (the numerator) remains constant or experiences modest growth.
- EBITDA: When examining profitability, measured by EBITDA, the most substantial expansion is observed in the Education and public and Health industries. However, it's important to note that, across most industries, EBITDA growth has not matched the pace of EV expansion, resulting in a slight increase in EBITDA multiples. This indicates that, while profitability has improved in certain sectors, the market is assigning a higher value to these businesses beyond their current earnings performance.

Implications

- The consistent expansion in EV/Sales multiples across all industries, even in cases where sales have increased, highlights that Enterprise Value (EV) is growing at a faster rate than sales. This suggests a positive market sentiment and investor confidence, leading to a higher valuation being attributed to businesses relative to their revenue generation.
- The inverse relationship between shrinking book values and the rising P/Book ratio emphasizes the sensitivity of this multiple to changes in the underlying asset base of a company. Investors should carefully consider the reasons behind declining book values, as they could stem from asset write-downs, depreciation, or divestitures, which may or may not reflect negatively on the company's future prospects.
- While expanding EBITDA generally leads to higher valuations, the fact that EBITDA multiples have increased even when EBITDA growth lags behind EV expansion suggests that other drivers are contributing to company valuations.

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