WAITING WITH CONVICTION

Private equity discipline in uncertain conditions

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Introduction

Over the last three years, slower exits and persistent questions around valuations have tested private equity. In 2025, the world has seen a surge in geopolitical, macroeconomic, and trade uncertainty. Because of the current market backdrop, this paper turns to the data to find evidence behind how private equity creates and sustains value. This paper offers quantification on exits, valuations and the drivers that may influence private equity's future outcomes.

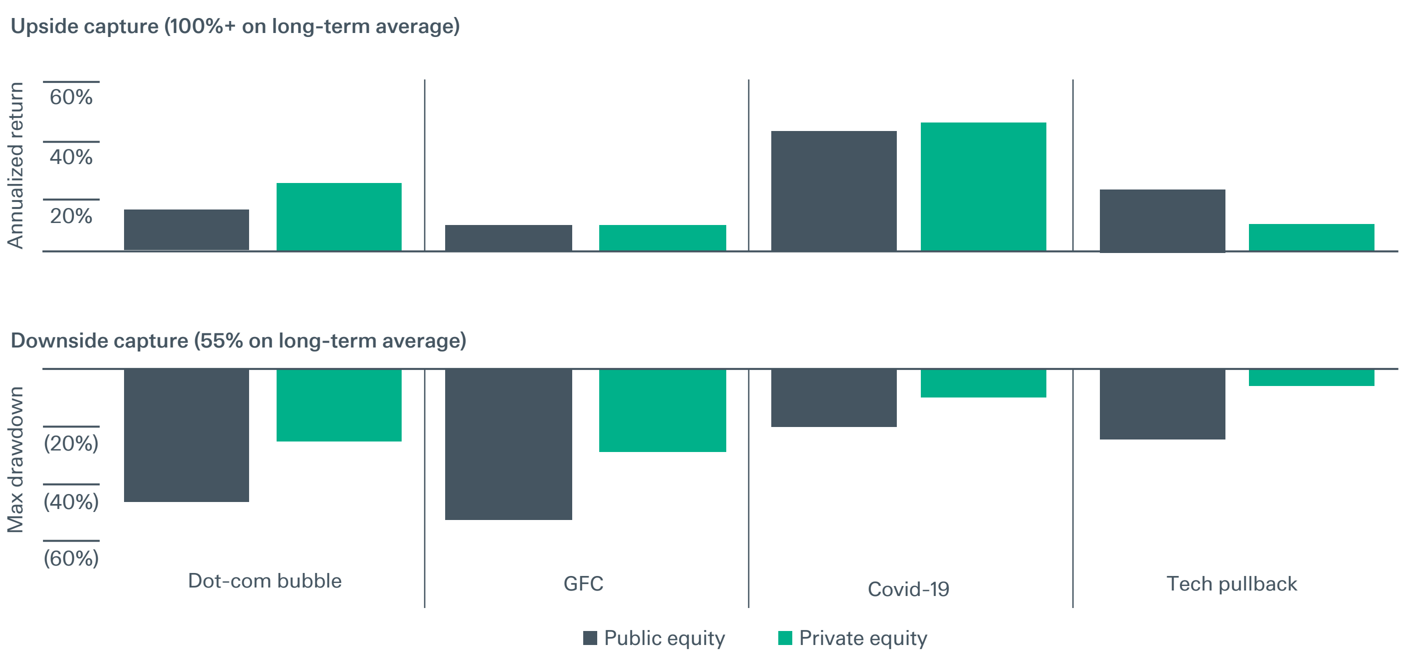
Before we dive into the current market cycle, it's worth stepping back over the last 25 years to highlight a theme that has defined private equity across crises. From the dot-com bust to the Global Financial Crisis to the Covid-19 shock, private equity has consistently shown it can adapt and endure.

As **Figure 1** illustrates, the asset class has historically absorbed only about 55% of public market drawdowns while capturing 100%+ of the recovery. This asymmetry underscores private equity's resilience.

Background

In 2021, low interest rates, fiscal support and strong earnings drove a surge in exits and market performance. The next year, however, the environment shifted as inflation reached multi-decade highs, and central banks aggressively hiked rates. Between the 4Q21 peak and the 3Q22 trough, the S&P 500 declined 24% versus 6% for private equity. However, the S&P 500 has since rallied 80% through 2Q25, while private equity has gained 26%. Adding to the performance concerns, we also saw private equity distributions drop amid slower deal activity.

FIGURE 1: PRIVATE EQUITY MARKET CAPTURE

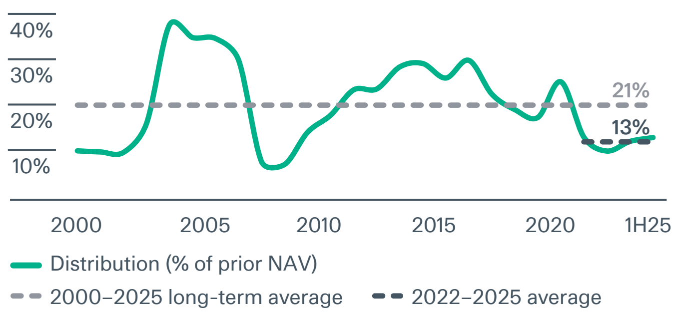


Source: CapIQ, Burgiss, S&P 500, MSCI Index and StepStone analysis, as of August 2025.

Notes: Public equity here is defined as an average of S&P 500 and MSCI World indices. Upside capture is the annualized return from the prior market trough to the next cycle's peak. Downside is defined as the max drawdown between the peak and trough during a crisis. For downside capture, Dot-com period is 1Q00–3Q02; GFC period is 3Q07–1Q09; Covid-19 period is 4Q19–1Q20; tech pullback is 4Q21–3Q22. For upside capture, Dot-com period is 3Q02–3Q07; GFC period is 1Q09–4Q19; Covid-19 period is 1Q20–4Q21; tech pullback is 3Q22–2Q25. Long term averages exclude the tech pullback period.

Historically, mature private equity portfolios have distributed 20–25% of NAV annually; yet, in recent years that number has dropped to 10–15%—a level not seen since the GFC (**Figure 2**). These metrics have fueled criticism—namely, that private equity, composed of smaller, more leveraged businesses, shouldn't have fared better during the downturn, and the dampened exits point to high valuations. This paper offers a different perspective. Looking past the headlines and focusing on the data, we see a nuanced picture: Overall exit activity has slowed, but quality assets continue to find buyers, and valuations remain grounded in fundamentals.

FIGURE 2: ANNUAL DISTRIBUTION ACTIVITY



Source: Source: SPI by StepStone, as of June 2025. Sample consists of only PE Buyouts.

How have companies been exiting?

Although exit activity has slowed, it has by no means come to a halt. That prompts two key questions:

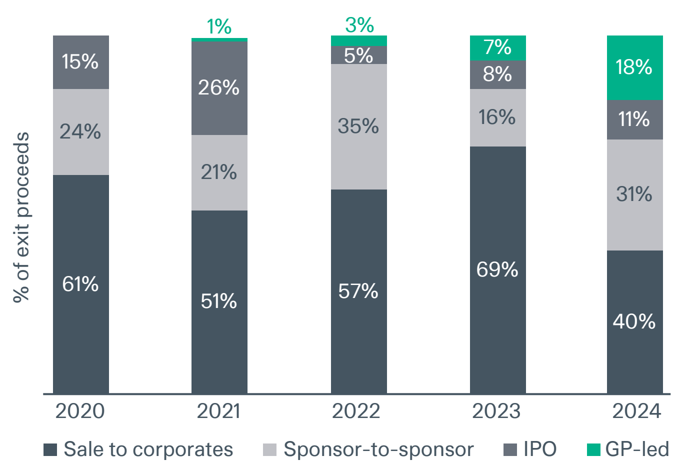
1. Which exit paths have been driving realizations?
2. What types of companies are most likely to exit over the next 12–18 months?

Let's start with a historical view on realizations over the last five years. To drill down into granular exit pathways, we used AI to summarize data from over 240 GPs contained in SPI by StepStone. Our analysis covers more than 700 buyout funds with realizations between 2020 and 2024.

Using a hybrid methodology that combines AI with human-led data validation, we were able to successfully map exit paths for approximately 75% of the sample. We focused on the four most common categories: GP-leds, IPOs, sales to corporates and sponsor-to-sponsor transactions (**Figure 3**). From this analysis, three key themes emerged:

1. **GP-leds rising**: GP-led transactions have become a viable path to offer LPs liquidity and generate DPI. Demand is focused on blue-chip assets with strong TVM. GP-led transactions reached $75 billion in 2024 from $35 billion in 2020, reflecting rapidly building momentum. In 1H25 alone, volumes have already reached $47 billion.[1]
2. **Exit blueprint**: Corporate sales dominated, but 2024 saw a jump in sponsor-to-sponsor deals, signaling a healthier exit market and tighter GP pricing alignment.
3. **IPO freeze**: Strong volumes in 2020 and 2021, but IPOs stalled in 2022 and remain sluggish.

FIGURE 3: BUYOUT RETURN ATTRIBUTION



Source: StepStone analysis, SPI by StepStone, as of December 2024. Notes: Sample consists of PE Buyouts. Sponsor-to-sponsor includes some exits to sponsor-owned corporates. The analysis leverages a hybrid approach, utilizing application of artificial intelligence to enhance data processing and identify potential insights, while our team provides in-depth qualitative analysis and validation. Analyses generated by large language models (LLMs) may contain inaccuracies or hallucinations and should be verified independently for accuracy and reliability. Coverage is defined as the ratio of funds with exits identified by the AI to the total number of unique funds with exits highlighted. IPOs represent distributions generated from share sales.

Past performance is not indicative of future results and there can be no assurance that the investment will achieve comparable results or avoid substantial losses.

[1] Jefferies 1H25 Global Secondary Market Review, as of July 2025.

AI case study

We developed a forward-looking view of where exit opportunities are likely to emerge over the next 12–18 months. We used AI to analyze forward exit indicators within a diversified private equity portfolio. The sample included over 100 buyout funds spanning multiple vintages.

From this dataset, our LLM identified over 100 companies for which GPs have started discussing exit trajectories.

- **Top performers ready to exit:** 80% of the identified companies share a compelling profile—robust earnings growth and limited reliance on multiple expansion. They appear well positioned for exit in the near term.
- **Slow growers run out of steam:** The remainder had been held for over five years, with earnings growth that—while positive—lags expectations and peer benchmarks.

This case study revealed two key takeaways:

1. Earnings growth remains the central driver of exit readiness. GPs consistently mark assets with stronger growth trajectories more confidently, regardless of market volatility.
2. AI, when combined with proprietary datasets and skilled interpreters, can uncover early signals that are both actionable yet otherwise difficult to detect—especially in uncertain times.

Exits and valuations are two sides of the same coin: Realizations are only possible when buyers and sellers agree on a price. Therefore, understanding valuations is key to making sense of go-forward exit activity.

With that perspective in mind, we turn our focus to valuations and examine three core questions:

1. How do private equity valuations hold up at exit?
2. How do private equity valuations compare and evolve relative to listed markets?
3. How are returns generated in private equity?

Taken together, they turn debate into data and uncertainty into clarity on GP valuation practices.

Valuations at exit

Pop or pain?

In private equity, exit readiness marks the end of a successful value creation plan—it's when valuations, earnings growth and asset maturity converge. With scrutiny around whether GPs have marked assets too aggressively, we consider whether private equity valuations hold up as companies approach exit.

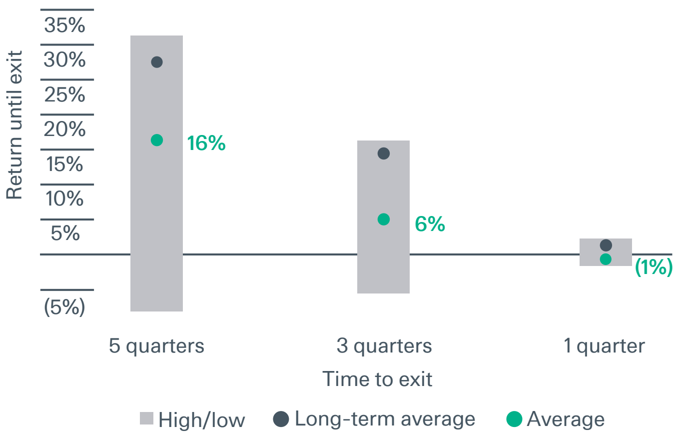
There are concerns in today's market that GPs have inflated valuations to avoid markdowns. In this case, we would expect to see valuations flatten or decline as companies near realization. Indeed, if GPs had delayed marking assets down in 2022 when private equity captured 25–30% of the public equity downturn, the gap should be visible by now.

To test this theory, we analyzed over 1,800 fund-investment pairs that exited between 2022 and 2Q25, tracking how valuations moved in the quarters leading up to each exit.

Despite an environment of rising rates and volatility, the results were clear: On average, valuations were not inflated.

- **Three quarters before exit:** Realized exits were 6% higher than their reported values 3Q prior, on average.
- **Five quarters before exit:** The return at exit increased to 16%, suggesting conservative marks ahead of monetization (**Figure 4**).

FIGURE 4: BUYOUT REALIZATION VALUE UPLIFT



Source: SPI by StepStone, as of June 2025.
Notes: Long-term average period is 2015–2025; Average is 2022–2025; High/low is 2022–2025.

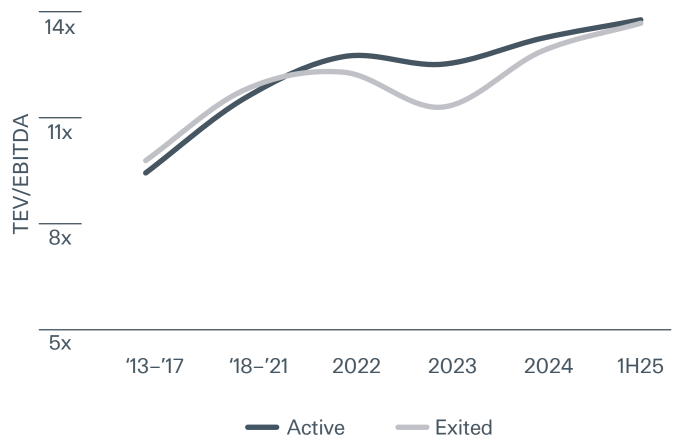
Historically, private equity assets have exited at a 27% premium relative to marks 5Q prior, on average. While realized uplifts since 2022 are lower than historical norms, the premium on exit remains meaningful.

True value is realized only when buyer and seller converge, and during times of uncertainty, bid-ask spreads widen. At such times, GPs can court uncertain buyers at prices that do not reflect the underlying company fundamentals and growth outlook, or they can exercise discipline that protects value. The data-driven view is clear: Assets are selling at prices that validate prior marks.

Marks in motion

Another way to determine if assets are overvalued is to compare the broad universe of unrealized and exited investments. To assess whether valuation practices differ meaningfully between active and exited investments, we compared TEV/EBITDA multiples across a broad dataset of companies that were held from 2013 to 2Q25 (**Figure 5**). For the period from 2013 to 2021, exited multiples trended at or above unrealized investments, indicating reasonable marks for unrealized assets. This is consistent with the evidence that assets typically exit at a premium to prior valuations.

FIGURE 5: ACTIVE VS EXITED INVESTMENTS



Source: SPI by StepStone, as of June 2025.

However, in 2022, valuation multiples for active investments were marked higher than those of exited investments, with the differential increasing in 2023. By 2024, the difference had nearly closed with 2025 showing no pricing gap. This distinction in 2022–2023 might suggest inflated valuations in the active book. However, three points temper that conclusion:

1. The 2022–2023 period was marked by elevated inflation, rising rates and economic uncertainty—all of which heightened volatility and put pressure on exit multiples.
2. Transaction volume dropped significantly. The mix of companies exiting naturally differs from the mix of active companies when samples are small; valuations can vary significantly by industry and TEV.
3. Lastly, assets continued to exit at a premium to holding values, highlighting that diligent value creation enables quality assets to generate meaningful gains.

Based on observed exit trends and the consistent valuations between active and realized investments, there is no strong evidence to suggest valuations are currently inflated.

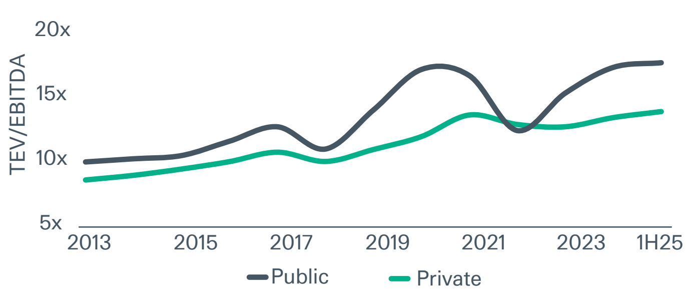
Public vs private

A closer look at TEV/EBITDA multiples of unrealized investments shows that private equity assets trade at a discount to public markets. This spread is well understood—driven primarily by smaller company size and lower liquidity on the private side. In 2025, median private equity multiples remain conservative relative to their public peers. While larger or growth-driven companies can skew averages higher, that effect is moderated in a large universe of assets.

Public market prices often move on momentum, with sharp valuation swings: Market prices will react too positively or negatively and often overcorrect before normalizing. This investor sentiment creates volatility, which often has little to do with underlying corporate health and fundamentals. In contrast, private markets tend to exhibit greater discipline in reflecting a longer-term view of a company's intrinsic worth. This contrast has been notable of late, with public market multiples materially expanding since 2022, as shown in **Figure 6**. Investors have witnessed strong public performance—and are grappling with the resulting concentration.

Private market multiples have steadily trended higher in recent years. However, the spread between private market multiples and those observed in the public markets is above the historical average. Historically, the spread between public and private multiples has averaged 2.3x (**Figure 7**). As of 2Q25, that spread is 3.8x. This spread provides important context.

FIGURE 6: CARRYING MULTIPLES COMPARISON

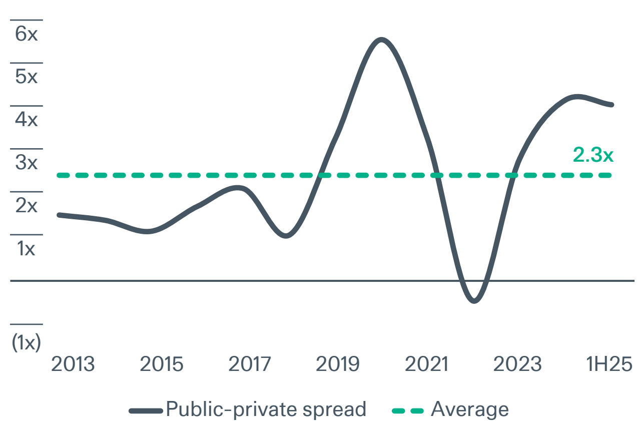


Source: SPI by StepStone, CapIQ, as of June 2025.

> We believe GPs are holding assets rather than selling under pressure at valuations that don't reflect underlying growth, consistent with what LPs should expect from managers.

- While multiples have risen, private assets are marked below their public peers, in a way that's more conservative than historical levels.
- This data shows that private equity valuations are currently pricing in a reasonable spread for differences in size and liquidity.
- Taken together, the evidence from the spread between public and private multiples, the consistency of active and exited investments and the continued premium at exit do not indicate systemic overvaluation of private equity assets.

FIGURE 7: CARRYING MULTIPLES SPREAD (TEV/EBITDA)



Source: SPI by StepStone, CapIQ, as of June 2025.

How private equity creates value

The current dialogue around exits and valuations is rooted in a broader conversation about performance: At current valuation levels, will my private equity portfolio generate strong returns? This brings us back to a fundamental question: How does private equity create value and generate meaningful returns?

On an unlevered basis, there are three primary levers for GPs to generate performance in a portfolio company:

1. **Revenue growth**, which reflects the ability to expand market share or enter new markets;
2. **Margin expansion**, capturing operational improvements and efficiency gains; and
3. **Multiple expansion**, reflecting changes in market perception and valuation at exit.

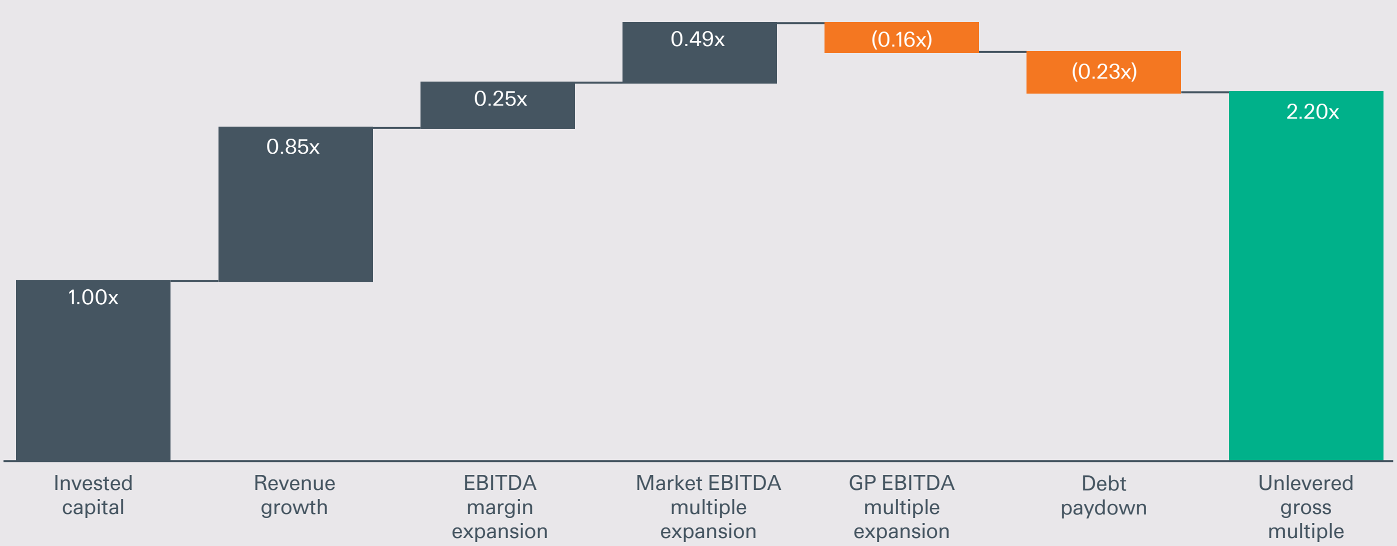
By dissecting the relative importance of each lever, we can quantify historical outperformance, contextualize realized returns, and better anticipate the potential for future value creation across different market environments.

To explore this question, we analyzed over 13,000 buyout deals from 2000 to 2Q25, spanning multiple markets. For accuracy, we focused only on deals that were at least 80% realized. This transaction-driven data shows how actual dollar value was created.

During this period, 30-year Treasury yields ranged from 1.4% to 5.9%, with 2024 levels near 4.8%. Against this backdrop we decomposed value creation into earnings growth, margin expansion and multiple expansion (**Figure 8**). Multiple expansion has indeed contributed to private equity returns. However, the negative GP multiple expansion suggests that private equity multiples have increased less than those of like-vintage public equities. Said differently, public markets have benefitted from the exuberance in the capital markets more than private equity, especially recently. Having said that, the main driver of performance in private equity has been earnings growth and margin expansion, which accounted for 3.3x more unlevered value creation than multiple expansion.

So how does private equity generate returns? Operational improvements—and in particular top-line growth—are the driving forces that increase TEV. Ultimately, this underscores that growth, rather than market timing or multiple expansion, remains the dominant source of value creation in private equity.

FIGURE 8: BUYOUT RETURN ATTRIBUTION



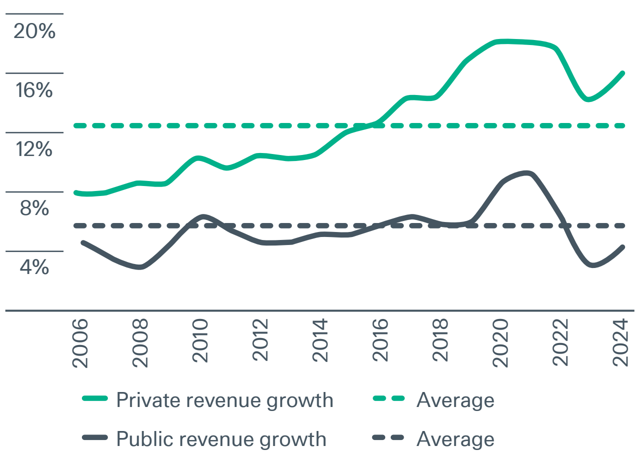
Source: SPI by StepStone, as of June 2025.

Revenue growth

Private equity fundamentally relies on driving growth, making it critical to evaluate how effectively it generates value relative to public market benchmarks. To this end, we compared revenue growth in private equity portfolio companies with sector-matched public peers over comparable holding periods. This provided a lens into the incremental impact of active ownership and strategic execution.

The analysis reveals that private equity companies delivered on average 7% higher annual revenue growth than their public counterparts. The gap has grown wider in more recent vintages (**Figure 9**). This persistent outperformance demonstrates that private equity does more than participate in market trends—it actively shapes company trajectories.

FIGURE 9: ANNUAL REVENUE GROWTH RATES



Source: SPI by StepStone, CapIQ, as of June 2025.

Understanding revenue growth is especially important in today's environment of higher interest rates. By actively driving operational improvements, private equity GPs consistently create meaningful value. Successfully executing a value-creation plan is essential for GPs to drive performance and maintain the flexibility to exit even in challenging market conditions.

Conclusion

Recent skepticism about private equity has centered on slow exits and doubts around valuations. But when we strip away sentiment and focus on the data, a different picture emerges.

- **Distributions slowed materially; however, exits did persist with assets realizing at a premium to prior quarter valuations.** GP-led deals gained traction in 2024 and 1H25. Quality assets continue to trade, even amid macro volatility.
- **Valuation concerns are overstated.** Marks on active and realized investments are aligned, reflecting disciplined pricing. Active investments remain conservatively positioned relative to public peers, and the spread between public and private multiples is in line with historical averages.
- **Revenue growth drives value creation.** Historically, operational improvements have generated 3.3x more value than multiple expansion, with private equity companies achieving 7% higher annual revenue growth than public peers. These return drivers provide essential context for valuations and future performance, reinforcing that private equity is fundamentally a value creation story.

Taken together, our findings challenge the idea that unrealistic valuations are behind the slowdown in exits. Instead, private equity values continue to be grounded in business fundamentals. Even in a complex environment, the opportunity set remains compelling. When private equity carrying multiples appear high relative to public markets, temporary swings in public market sentiment may be the culprit.

For many investors, the objective is sustained strong performance. We believe both academic research and practical experience point to the same conclusion: Maintaining a disciplined, steady investment approach tends to support long-term success.

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