



The Evolving PE Firm Valuation Landscape

HIGHER INTEREST RATES AND COST OF CAPITAL

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Valuation is no longer just an accounting exercise for private equity firms. It is now central to portfolio management, investor relations, fund governance, audit readiness, fundraising credibility, and transaction execution.

Valuation has always been at the center of the private equity business model. It drives investment decisions, portfolio monitoring, investor reporting, compensation structures, fundraising, and exit outcomes. However, the valuation environment facing private equity firms today is more complex than at any point in the last decade.

Following a prolonged period of higher interest rates, slower exits, increased regulatory scrutiny, and greater investor focus on transparency, private equity firms are being forced to reevaluate traditional valuation methodologies and assumptions. At the same time, the growth of continuation vehicles, GP-led secondaries, private credit, and structured capital solutions has introduced new challenges in determining fair value.

The result is a valuation environment where rigor, consistency, and defensibility have become just as important as technical accuracy.

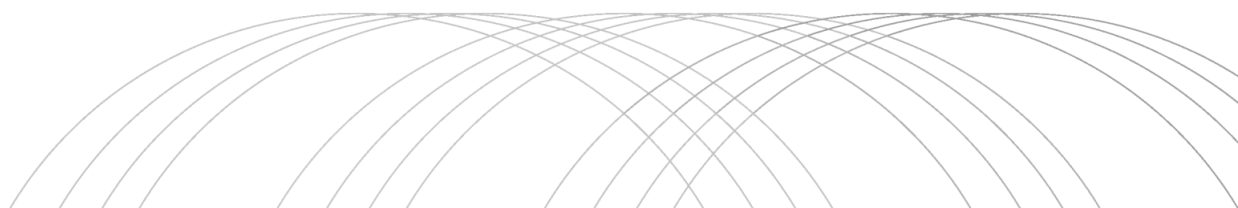
Higher Interest Rates and the Cost of Capital

Perhaps the most significant valuation challenge facing private equity firms is the impact of higher interest rates on portfolio company values. This interest rate risk is not expected to change quickly with the impact of geopolitical issues on the near-term increase in inflation which has heightened the likelihood that the next move by the Federal Reserve is an increase in interest rates rather than a decrease.

Valuations are fundamentally driven by expected future cash flows and the rate at which those cash flows are discounted. As risk-free rates and borrowing costs increase, discount rates also rise, reducing present values and putting downward pressure on enterprise values.

Higher rates affect valuations through several channels: increased weighted average cost of capital, reduced debt capacity for leveraged transactions, lower acquisition multiples, greater sensitivity to forecast assumptions, and increased refinancing risk.

Assets acquired during the low interest rate environment of 2020 to 2022 often face the greatest pressure. Many were purchased at historically high EBITDA multiples supported by inexpensive leverage. Maintaining those valuations in today's environment requires strong operating performance and credible growth expectations.



The Challenge of Stale Market Comparables

Private equity firms rely heavily on market evidence when valuing portfolio companies. However, market data can become difficult to interpret during periods of volatility.

Key questions include which public company multiples remain relevant, whether recent transaction multiples are reflective of current market conditions, how firms should account for changing sector sentiment, and whether observed transactions are truly comparable.

The valuation challenge becomes especially acute when public markets and private market valuations diverge significantly. In many sectors, public market multiples adjust rapidly to changing conditions, while private market valuations tend to lag. This creates tension between historical transaction evidence and current market reality.

Valuation committees, auditors, and investors are increasingly focused on whether firms are appropriately calibrating values to evolving market conditions rather than relying solely on historical precedents.

The Growing Importance of Discounted Cash Flow Analysis

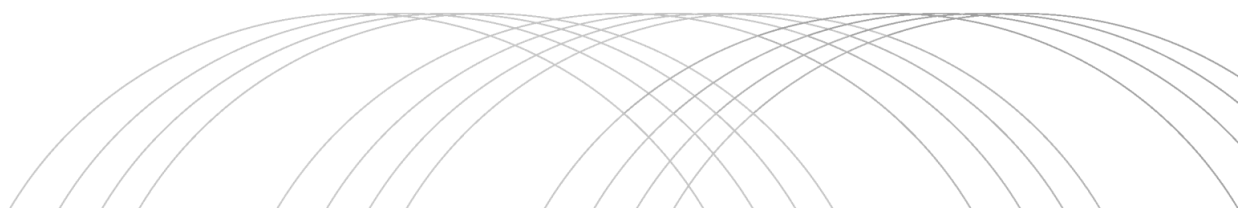
As private equity firms navigate a period of reduced transaction activity and increased volatility in public market multiples, the Discounted Cash Flow methodology has become more important than ever.

Historically, many private market valuations relied heavily on market approaches, including guideline public company multiples and precedent transactions. While these methodologies remain important, they are inherently dependent on market conditions and comparable transactions. During periods when M&A activity slows, financing markets tighten, or public markets experience significant volatility, comparable market data can become less reliable or less representative of a portfolio company's intrinsic value.

A well-constructed DCF analysis helps anchor value to the company's expected future cash flows. By analyzing projected revenue growth, profitability, capital expenditures, working capital requirements, and long-term cash generation, investors can assess value based on economic fundamentals rather than short-term market sentiment.

This is particularly important for private equity-owned businesses that have significant value creation initiatives underway. Operational improvements, pricing strategies, technology investments, and acquisition synergies may not yet be reflected in current earnings multiples but can be captured through a forward-looking cash flow analysis.

DCF analyses also allow valuation professionals to explicitly consider company-specific risks through assumptions regarding future cash flows and discount rates. Rather than applying a



generic market multiple, the valuation can more accurately reflect customer concentration, integration risk, end-market exposure, capital intensity, customer retention, margin sustainability, and other investment-specific considerations.

In periods of market dislocation, the DCF approach provides a useful anchor to fundamental value. When public market multiples move rapidly or transaction markets become inactive, reliance on market multiples alone can produce conclusions that may not fully reflect an asset's underlying economic performance. For illiquid investments and Level 3 assets, a DCF analysis can supplement market-based valuation methods and improve the overall support for fair value conclusions.

A proper DCF analysis also strengthens audit defensibility. It creates a transparent framework linking valuation conclusions to management forecasts, market participant assumptions, discount rates, terminal value assumptions, and observable economic data. This documentation is increasingly important as investors, auditors, and regulators examine subjective valuation assumptions more closely.

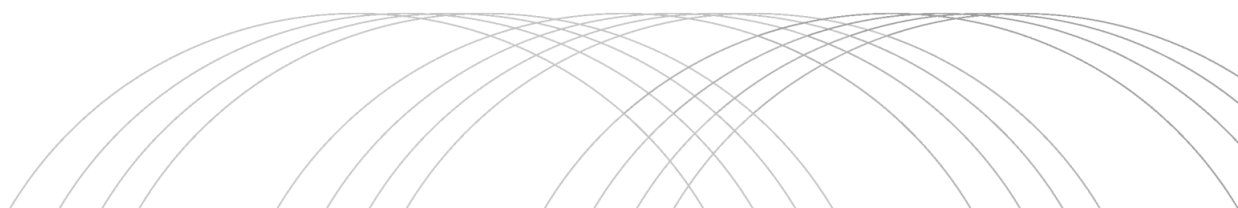
Even when the market approach remains the primary valuation methodology, leading firms increasingly use DCF analyses as an independent reasonableness test. If the implied value from market multiples differs materially from the DCF indication, valuation committees gain insight into whether the difference is driven by market dislocation, forecasting assumptions, company-specific risk, or a change in the broader cost of capital.

Liquidity Discounts and Secondary Market Signals

The growth of the secondary market has provided a new source of pricing information, but it has also created valuation challenges.

Many secondary transactions occur at discounts to reported net asset value. The existence of those discounts raises important questions: are reported NAVs fully reflective of market value, do secondary discounts reflect liquidity constraints rather than underlying value, and how should observed secondary pricing influence portfolio valuations?

Investors are increasingly examining secondary market activity as an independent validation point when assessing fund-reported values. For private equity firms, the challenge lies in distinguishing between temporary liquidity discounts and fundamental changes in portfolio value.



Longer Holding Periods and Exit Uncertainty

Private equity holding periods have expanded in recent years. Many firms now own assets well beyond traditional investment horizons due to reduced M&A activity, delayed IPO markets, financing constraints, and valuation gaps between buyers and sellers.

Longer holding periods introduce additional valuation complexity. Management forecasts often extend beyond original investment cases, requiring greater reliance on long-term assumptions. Revenue growth projections, margin expansion initiatives, and capital expenditure requirements become increasingly uncertain as forecast periods lengthen.

Valuation professionals must carefully assess whether historical underwriting assumptions remain realistic given changing market conditions.

Valuing Private Credit and Complex Capital Structures

The rapid growth of private credit has introduced new valuation challenges across private equity portfolios.

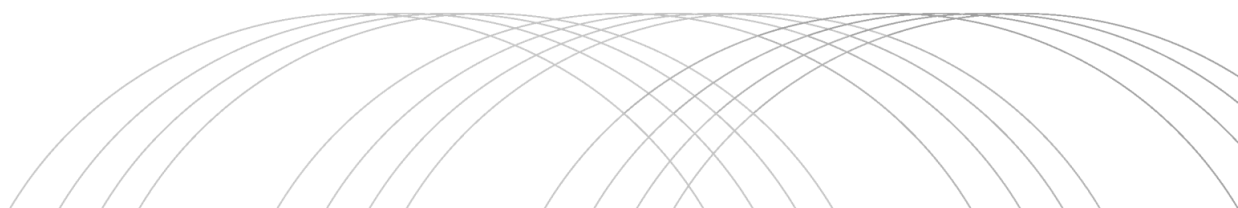
Many capital structures now include unitranche facilities, preferred equity, convertible instruments, structured financing arrangements, warrants, and contingent payment rights. These instruments often lack readily observable market prices, requiring sophisticated modeling techniques.

Determining appropriate discount rates, default assumptions, recovery values, and market participant inputs requires significant judgment and expertise. As portfolios increasingly incorporate hybrid securities, the valuation process becomes substantially more complex than traditional common equity valuation.

How Private Equity Firms Are Creating Liquidity in a Slower Exit Environment

Liquidity has become a central strategic issue for private equity firms. With traditional exits taking longer and many portfolio companies approaching or exceeding original hold-period expectations, sponsors are increasingly using a broader set of tools to generate distributions, manage fund duration, and provide optionality to limited partners.

GP-led secondaries and continuation vehicles have become two of the most important tools. In these transactions, a sponsor typically moves one or more assets into a new vehicle, allowing existing investors to sell, roll, or sometimes do both. This structure can create liquidity for investors that need cash while giving the sponsor more time and capital to execute the remaining value creation plan.



LP-led secondary sales also remain an important source of liquidity. In these transactions, limited partners sell fund interests to secondary buyers, often to rebalance portfolios, manage vintage exposure, address denominator-effect pressures, or accelerate cash realization. These transactions can provide a market-clearing signal, but they also raise valuation questions when pricing differs materially from reported NAV.

Tender offers and structured liquidity windows are increasingly used to provide selective liquidity without forcing a full fund liquidation or asset sale. These processes can be useful where only some investors want liquidity, although they require careful process design, clear disclosure, and transparent price discovery.

NAV-based financing has also become a more common fund-level liquidity tool. Rather than borrowing against unfunded commitments or a single portfolio asset, a fund borrows against the net asset value of its existing investment portfolio. Proceeds may be used to support portfolio companies, bridge timing gaps, finance follow-on investments, or, in some cases, fund distributions to investors.

Preferred equity, asset-level financings, refinancings, and dividend recapitalizations are additional tools sponsors may use to create liquidity without selling a portfolio company outright. These structures can be attractive when the underlying company is performing well but exit markets are less favorable. However, they also increase the importance of solvency analysis, capital adequacy review, and post-transaction cash flow testing.

Traditional M&A sales, sponsor-to-sponsor transactions, and IPOs remain important liquidity paths when market conditions allow. However, in a slower exit environment, private equity firms are increasingly managing liquidity as a portfolio-level discipline rather than relying solely on conventional exits. This makes valuation, fairness and solvency opinions, process integrity, and governance especially important when liquidity is generated through related-party, leveraged, or structured transactions.

Practical Implications for Private Equity Firms

In the current valuation environment, private equity firms should consider the following priorities:

Priority	Why It Matters
Use DCF analysis as a core valuation tool	Provides a fundamental view of value when market multiples are volatile, stale, or inconclusive.
Calibrate market multiples carefully	Helps ensure market approaches reflect current economic conditions rather than outdated transaction evidence.
Document assumptions thoroughly	Improves audit readiness and gives valuation committees a clear basis for reviewing subjective inputs.
Evaluate liquidity and secondary market evidence	Provides an independent reference point for investor expectations and market-clearing prices.
Strengthen valuation governance	Reduces perceived conflicts and improves investor confidence in reported NAVs.

Conclusion

The private equity valuation landscape has entered a new era. Higher interest rates, longer holding periods, liquidity constraints, complex capital structures, and increased stakeholder scrutiny have elevated both the importance and difficulty of fair value measurement.

Successful private equity firms will distinguish themselves not simply through superior investment selection, but through the credibility, consistency, and defensibility of their valuation processes. In an environment where investors increasingly demand transparency and regulators continue to focus on valuation practices, robust valuation governance has become a strategic advantage rather than merely a compliance requirement.

Given today's challenging valuation environment, private equity firms should view DCF analysis not as a secondary valuation technique, but as a critical tool for establishing and defending fair value. As market comparables become less reliable, exit timelines lengthen, and stakeholders demand greater transparency, valuations grounded in fundamental cash flow analysis provide a more durable and defensible assessment of portfolio value. Firms that combine rigorous DCF analysis with market-based methodologies and strong valuation governance will be best positioned to withstand investor, audit, and regulatory scrutiny while maintaining confidence in reported asset values.

Ultimately, valuation is no longer just an accounting exercise. It has become a core component of portfolio management, investor relations, fund governance, and value creation itself.

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