

## KEYNOTE INTERVIEW

AI readiness now  
key to investment theses

*Tech companies are well placed to answer PE sponsors' growing questions about AI readiness, helping to buoy appetite for the sector, say KPMG's **Anuj Bahal**, **Patrick Carpenter** and **Greg Sward***

**Q** Fundraising in the tech sector has slowed in recent years. What trends are you observing around capital raising in this space?

**Patrick Carpenter:** We have seen a slowdown in fundraising over the last two years. But tech is still a primary focus for capital deployment, with a lot of continued investor confidence and resilience around the sector. Actually, deal activity has rebounded to some extent in Q3, which illustrates this confidence. Historically there has been a close correlation between deal activity and fundraising momentum in a sector.

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We see artificial intelligence readiness as a key part of investment theses – it is increasingly important for attracting capital and is now pervasive throughout tech. There is still over a trillion dollars of dry powder in US private equity and a lot of the caution around deployment has related to questions about AI readiness and the impact of that, with the tech sector positioned better than most to provide answers.

Continued fundraising is the lifeblood of private equity and we are

seeing a split emerge between the fortunes of the more mature mega-funds and those of the smaller, newer managers. That relates to market presence, historic traction and success in past transactions, all of which underpin successful fundraising.

**Greg Sward:** Deal activity is a proxy for fundraising at some level and tech transactions ran up the fastest against other verticals in the busy times and came off the fastest in 2022 and 2023.

Now the question is whether the upswing will be technology-led or more general. There are some signs that technology may be slightly ahead

of the pack, though right now tech numbers are skewed somewhat by a few large, landmark transactions that may be masking a more cautious recovery. Where deals are getting done, they tend to be more sizeable, whereas volume is fairly flat.

**Anuj Bahal:** The bar to raise money is also much higher today than it has been in the past. Capital has become a commodity, and track record, sector depth and operational value creation are now differentiators that LPs look for when deciding who to deploy capital with.

We could witness some industry contraction where big firms get bigger and small firms merge or disappear.

### **Q Given challenges around deal sourcing, where are the attractive opportunities today?**

**AB:** We see a lot of folks trying to think ahead. Companies that have gone through a lot of acquisitions historically are now going through a period of digestion and certain deals that haven't worked out may present opportunities for acquirers.

Most assets are sold through processes today, so funds are trying to think about which corporates are going to go through a level of portfolio reshaping and getting ahead of those sales. Likewise, on the private equity side, longer hold periods have an impact on IRR and so funds are all looking at what they want to sell when the market unlocks.

**GS:** For private equity, the ability to drive a deal depends on the strength of your position. In other words, if you have a lot of traction, a lot of expertise in a sector, the ability to run a complex carve-out and a network of operating executives, you are at an advantage when it comes to sourcing a deal. One implication of a return to more normal dealmaking conditions is that we are going to see a separation of the strong and the less strong. Not everyone can do those big, complex deals.

**PC:** Even at the smaller end of the market, we are not seeing much in the way of proprietary/unbanked deals. The dominant theme on value potential in the market is moving from growth to profitable growth. Does a company have its sales force going after the most strategic opportunities, is R&D focused, is the back office fully streamlined, and so on. That theme goes across all the different subsectors of tech.

### **Q Why does the tech sector continue to dominate private equity investment and deal activity?**

**GS:** First, the tech sector has a lot of different facets to it and is more complex relative to other industries, which means there are a lot of opportunities for investors to create value. Second, PE firms in particular like scalable businesses that are information-based. That means tech has always been a bit of a beacon for investors. AI has also helped the tech sector first, more than any other sector, with many businesses leveraging it as part of their value proposition. All those things mean tech probably has some natural advantage versus other places where an LP could put their dollar.

**PC:** It's worth adding that people like predictable cashflows, highly recurring revenues and strong margins, all of which are key tenets of tech investing and have been for years.

**AB:** There are also intersections with other industries, whether it is fintech, healthtech, aerospace and defence, mobility tech, robotics or even infrastructure. Technology is literally impacting every end market and that creates tremendous deal opportunities.



### **Q How can funds accurately assess the potential of AI-focused companies?**

**GS:** At least a year ago our clients moved beyond 'what is AI?' to placing much more emphasis on tangible use cases.

Now, funds need to look at how well companies have built use cases that are showing clear returns on investment. That probably shows up in R&D and code development, any kind of content creation and customer service – those tend to be the lead use cases out of the gate. Over time, that list will expand

into areas such as finance and business processes.

Governance is also critical for AI. The proliferation of agents, for example, requires companies to really focus on governance and managing downside risk.

**PC:** For existing platform companies that are looking to add capabilities and remain competitive, we are seeing not just acquisitions but also hires being key. There are even funds buying businesses and shelving the technology to take the core code and the talent forward.

**AB:** There has also been a proliferation of experimentation going on, but now people are realising they might have too many sub-scale experiments that aren't becoming anything meaningful. The next stage is getting behind two or three elements that will have meaningful scale and leaning into those.

### **Q What challenges and opportunities are presented by the regulatory landscape today?**

**AB:** There is a mixed reality on the regulatory side. On the one hand, the current US administration is talking about deregulation, which is good for faster approval processes and fewer deal delays.

But on the other hand, you have the US/China dynamics around whether US companies can sell chips into China and whether overseas businesses can really invest cross-border into the US. That general trade and policy debate going on globally means there are headwinds as well as tailwinds for the sector.

**PC:** Big tech companies continue to be under the microscope on both sides of the Atlantic, with more scrutiny on several fronts. And whenever a deal is getting done, the Hart-Scott-Rodino filing and merger review process in the US is taking longer and impacting

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timelines between signing and closing deals.

### **Q Where do you see PE funds focusing their value creation efforts in tech businesses?**

**GS:** There is much more intensity to those efforts. When you have extended hold periods and an environment where demand is a bit softer, it is harder to grow the top line, so you need to ensure you make a deep investment in value creation as a PE fund.

Some funds continue to invest in very sizeable operating teams, while others have chosen to build their operating structures through networks or by being investor-only and leaving value creation to the portfolio company management team. Our view is that those in the latter category are probably not getting this right. You need to have that operating support covered.

There is a reason why some of the leading names are investing heavily in operations and that is because it is such a key part of the value proposition, both for investors and management teams. With exits taking longer, funds need to go into value creation theses at a deep level.

### **Q The last few years have seen a drop-off in IPO activity. What has this meant for exit strategies?**

**PC:** We are seeing longer PE hold periods, over six years on average now, because funds don't want to exit at lower valuations. However, there is an expectation that private equity will drive more IPO activity, with predictions that it will be a fair bit above historical levels, which were in the low teens.

We are going to see quite a lot of aged assets coming to market, and the key is going to be not missing the IPO window when it opens. That means that, during the hold period, owners need to do everything they can to prepare to be a public company, which looks very different from being a private company. That is a multi-year journey.

Being very specific early in the hold period, conducting periodic IPO-readiness assessments and then deciding which gaps to address is key.

**GS:** The focus needs to be on making sure a business is operationally ready for an IPO. There have been times over the last 25 years in tech where that bar has been too low. Now, we are in more normalised conditions, so companies need predictable EBITDA and profitability along with growth that they can report in a responsible way. The bar is higher, but for the right companies we can expect more IPOs looking forward. ■

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