DC advisory

European Private Equity Mid-Market Monitor: Q4 2023 & Outlook

Coming out of hibernation, poised for recovery

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European Private Equity Mid-Market Monitor: Q4 2023

DC Advisory presents our latest European Private Equity Mid-Market Monitor, discussing the latest trends and themes impacting deal flow, further to our Global M&A Outlook published in December.

European top trends and themes

Outlook for 2024 and beyond

Country by country review

GP-led secondary solutions

Michael Wieczorek
Managing Director

Sabina Sammartino
Managing Director

Ludovic Douge
Managing Director

Asia and Europe cross-border activity

Tosh Kojima
Managing Director

Endong Zhai
Managing Director

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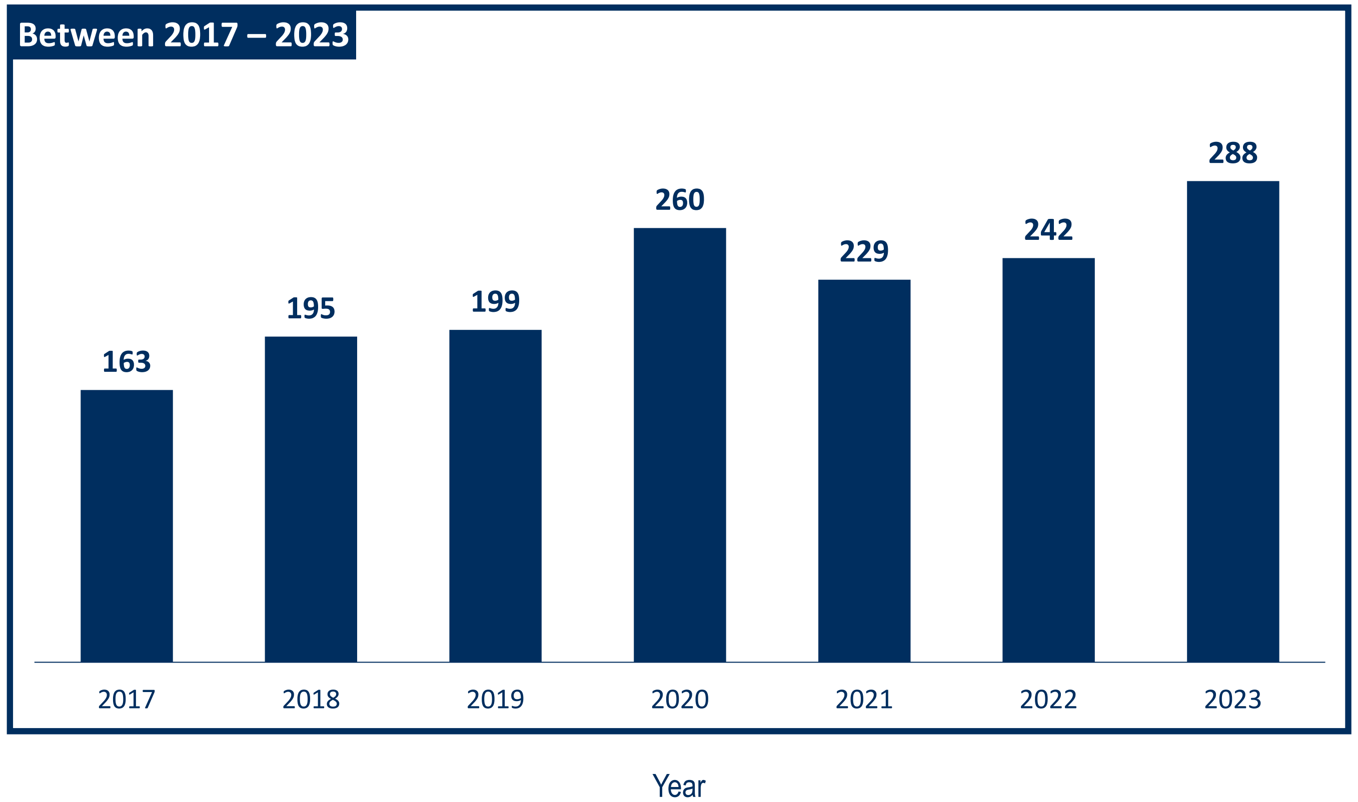
European overview

A resilient and adaptable European mid-market is poised for a gradual recovery

- Q4 2023 marked the highest number of insolvencies in a quarter since the pandemic, as the mid-market faced high debt costs, weak economic growth and rising energy prices. Insolvencies in the UK reached 30,199[i] by the end of 2023, with sectors including Construction, Retail, and Hospitality contributing significantly
- We believe a lack of distributions has led to a rise in continuation fund processes across the market, allowing sponsors to hold onto star assets for longer with the aim of prolonging value creation, as well as generating liquidity from underperforming portfolios
- In Q4 2023, the volume of private equity exits was the lowest in over a decade[ii], resulting in a build-up of investments within portfolios, driving funds to seek alternative exit paths and deferring asset sales until more favorable market conditions and improved valuations emerge
- Challenging market conditions, a focus on decarbonization, recycling, and digitization has led to increased private equity interest in the Infrastructure sector. Demographic growth and circular economy initiatives present opportunities in renewable energy, waste reduction, and digital infrastructure[iii]
- European private equity transactions were dominated by the Industrials and Technology & Software sectors in 2023, whilst the Business & Tech-Enabled Services sector saw an increase in M&A activity
- The UK remained the most active private equity investment region, with a 28.1% share[iv] of the total volume of deals in Q4 2023 – the highest for a decade
- The European private equity market has demonstrated resilience and adaptability, and it is poised for a gradual recovery, driven by strategic investments, resilient sectors, pointing to a potential rebound in M&A activity over the course of 2024

European financial sponsor dry powder to be invested ($BN)

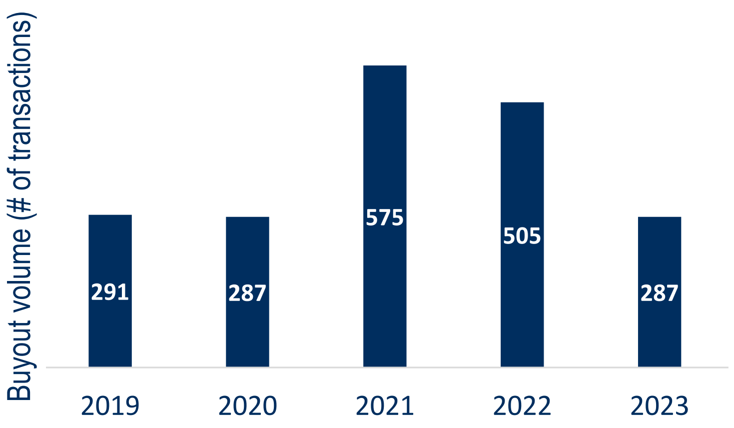


Source: Preqin: Europe, buyout strategy, dry powder, classification between 1-1-2017 to 31-12-2023 – as of January 31 2024

European overview

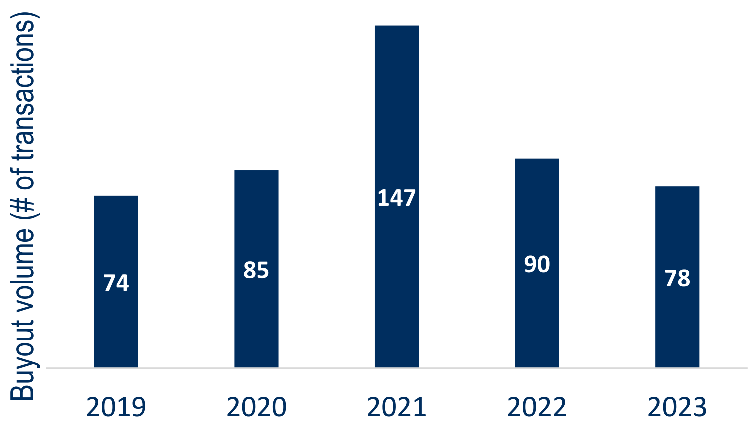
Buyout activity in the European mid-market

Annual buyout volume 2019-2023



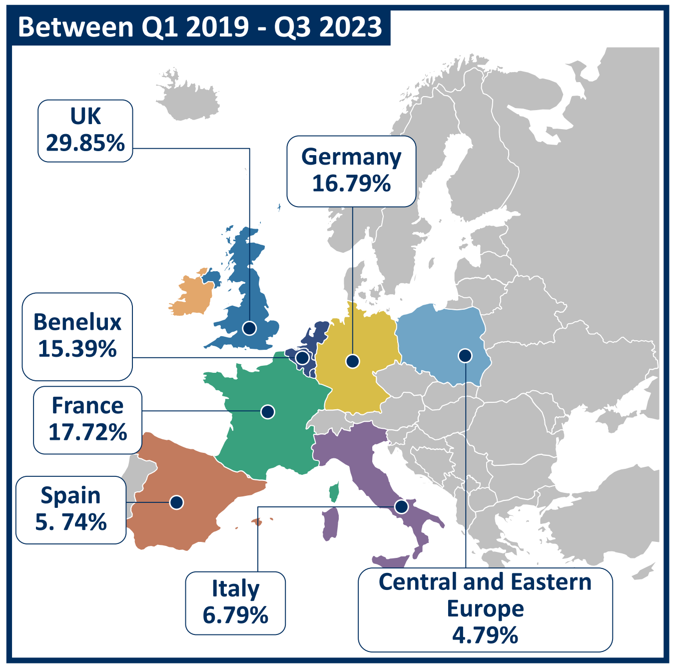
Source: Mergermarket, European mid-market deal data[v]

Q4 buyout volume 2019-2023

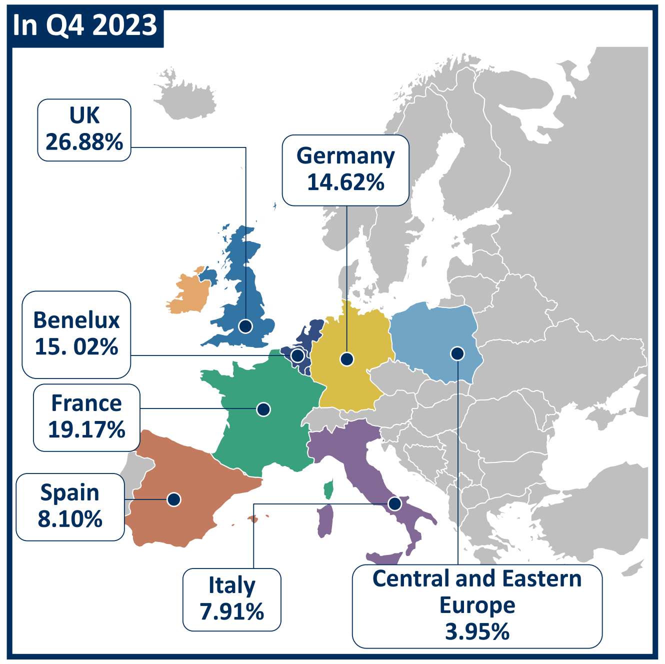


Source: Mergermarket, Q4 2023 European mid-market deal data[v]

Buyout volumes split by region (%)

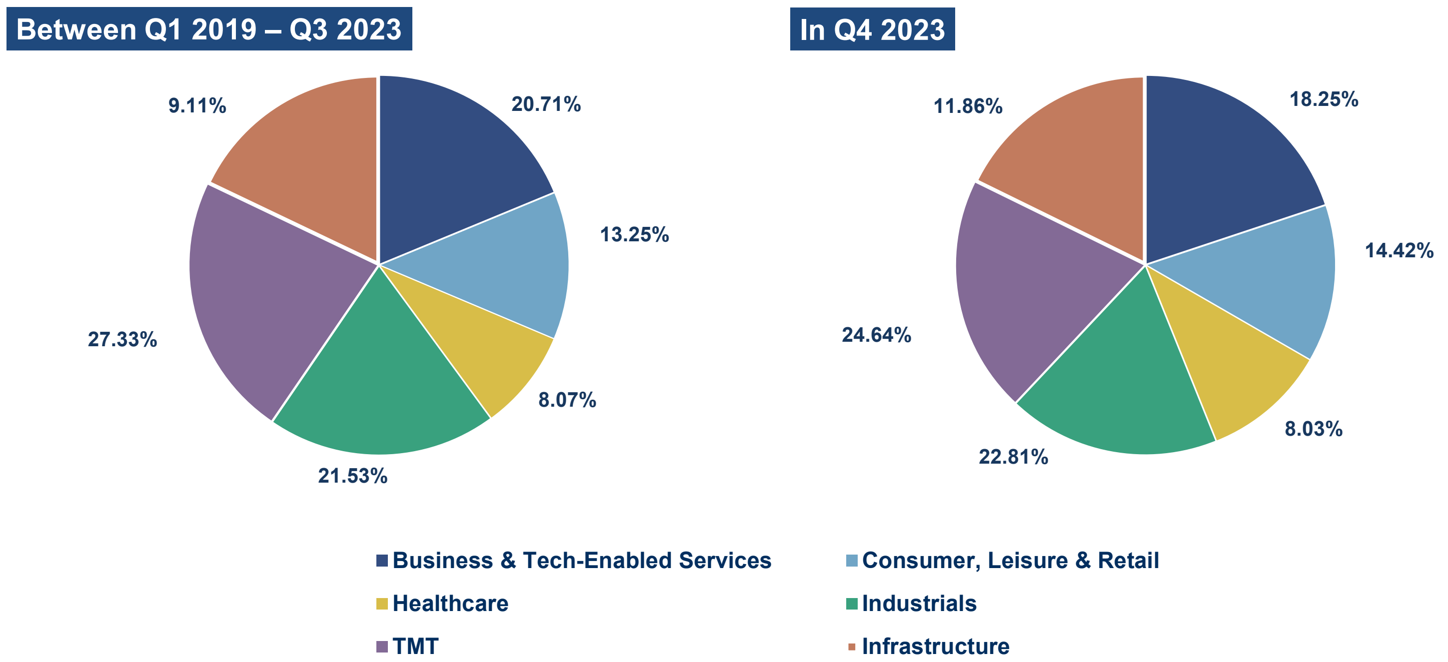


Source: Mergermarket, European mid-market deal data[vii]



Source: Mergermarket, Q4 2023 European mid-market deal data[vii]

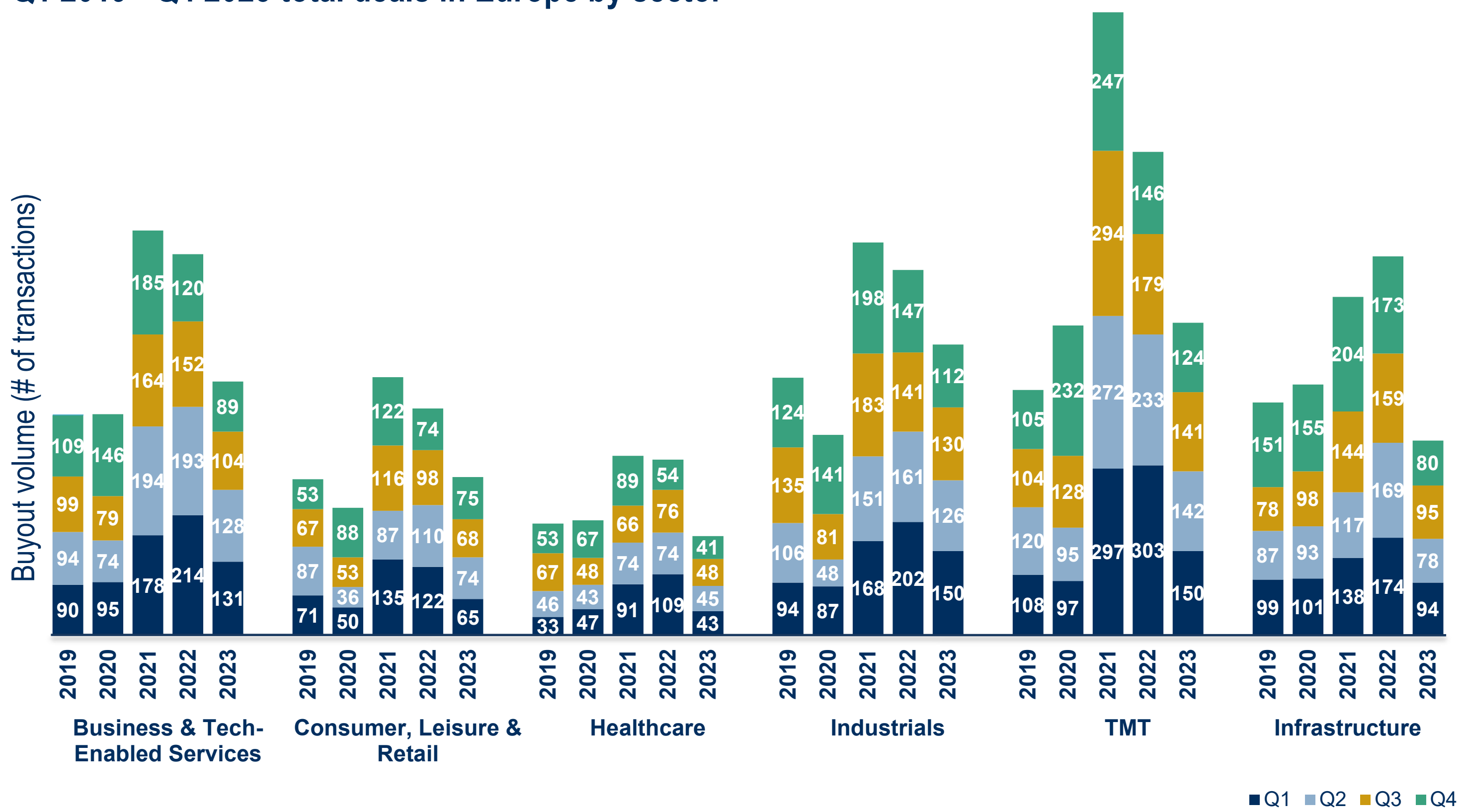
European buyout volumes split by sector (%)



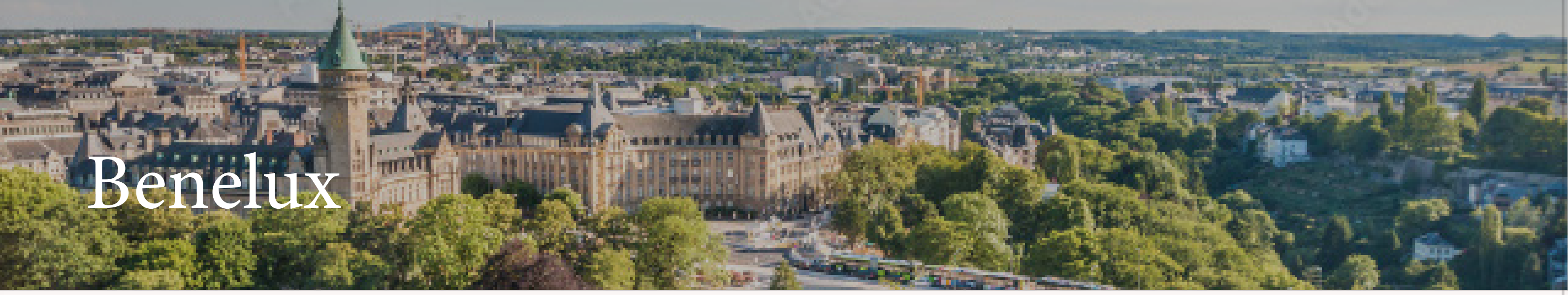
Source: Mergermarket, European mid-market deal data[vi]

Source: Mergermarket, Q4 2023 European mid-market deal data[vi]

Q1 2019 - Q4 2023 total deals in Europe by sector



Source: Mergermarket, European mid-market deal data[viii]



Benelux



Paul de Hek
Co-CEO

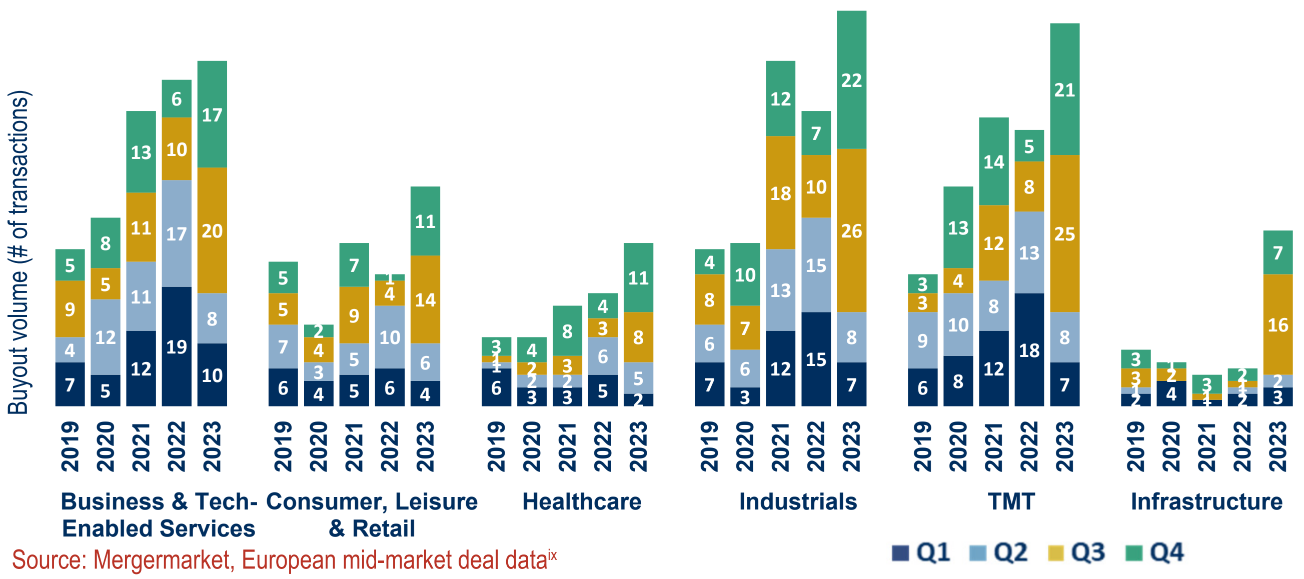
Robert Ruiter
Co-CEO

Verner Uiterwijk
Vice President

> ***"Trade buyers inbounding continue to be an attractive route for sellers where a formal auction process can be avoided"***

- We have observed a general liquidity overhang, driven by both equity and debt funds with abundant dry powder to deploy, however, the financing market continued to stretch out processes in Q4 2023 due to debt funds selectivity, limited competition for financing on a deal-by-deal basis, whilst larger club deals and syndicated loans were scarce
- Trade buyers, most of whom have also aggregated cash positions during and post Covid-19, inbounding will be an attractive route for sellers where a formal auction process and implied deal rumors can be avoided, although such deals can take 2 months more of due diligence and negotiation time
- While the outcome of the Dutch elections brought some short-term political and regulatory uncertainty, it did not directly impact deal flow
- Deal activity varied across sectors in Q4 2023; a difficult environment for consumer deals and businesses particularly exposed to discretionary spending, whilst Technology & Software and Infrastructure remained attractive sectors, due to macro, geopolitical and consumer trends, and areas boosted by sustainability and digitalization
- Deal activity for Industrial and Industrial Services companies was strong in Q4 2023, driven by stable trading and steady valuation multiples in the sector
- We expect unexceptional trading to continue into 2024, with macro uncertainty that may pressure the M&A pipeline and increase the risk of aborted deals, exacerbated by a risk averse and perceived expensive debt financing environment, as local banks continue to shy away from buyouts
- We see sustainability continuing to drive niche deals where strong amounts of dry powder will flow towards. The pile up of private equity portfolios will drive a willingness to exit and provide liquidity to limited partnerships (LPs)

Q1 2019 - Q4 2023 total deals in Benelux, by sector



Source: Mergermarket, European mid-market deal data[ix]

Central and Eastern Europe (CEE)

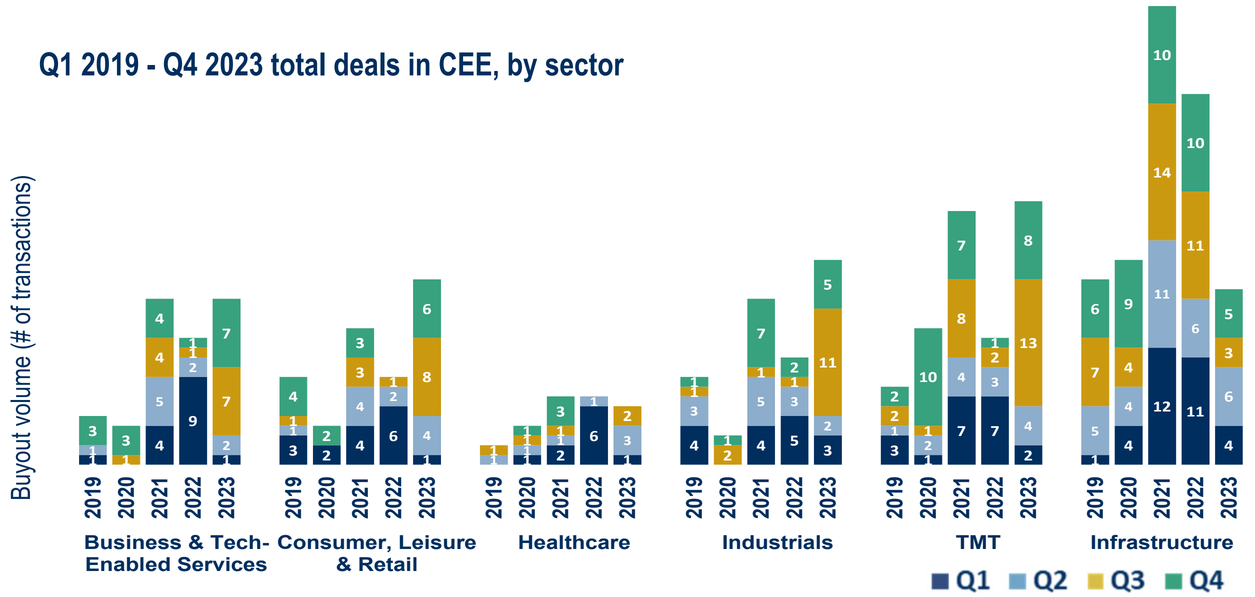

Tod Kersten
Managing Director

Mateusz Prudzynski
Vice President

> ***"Private equity investors in the CEE region, notably in Poland, should, in our view, monitor evolving debt dynamics, capitalize on emerging opportunities in restructuring, and align their strategies with the government's emphasis on sectors receiving EU funding"***

- The first signs of distressed debt are becoming visible, indicating potential for increasing numbers of debt restructurings in 2024. Private equity players may find opportunities in restructurings should companies need to sell assets to lighten financial pressure
- Debt-for-equity swaps are attractive[x] for two reasons - high interest rates make debt expensive and scarce, while equity is more easily available, and becomes an attractive alternative
- The newly formed government is expected to unlock substantial EU funding[xi], particularly benefiting industries such as Renewables, Transport & Logistics, Energy, Storage (batteries) and other sectors earmarked for increased investment through EU funds[xii]. The Infrastructure sector's focus on renewables anticipated to be the primary beneficiary of EU funding, may present attractive investment opportunities
- The political landscape is transitioning from a populist right-wing administration to a new government, which may bring stability and open doors for private investment
- In H2 2023, we saw consolidation in the Beauty sectorxiii, while Technology & Software continues to exhibit momentum, particularly in batteries. Battery technology is gaining traction[xiv] and we expect to see increased activity in the coming year
- The macroeconomic situation in Poland has stabilized, which we expect to drive increased M&A in the Retail sector. Partners Group's acquisition of Velvet Care[xv] in December 2023 demonstrates a renewed interest in cyclical businesses
- Private equity investors in the CEE region, notably in Poland, should, in our view, monitor evolving debt dynamics, capitalize on emerging opportunities in restructuring, and align their strategies with the government's emphasis on sectors receiving EU funding. Additionally, the stabilization of the macroeconomic environment and the resurgence of traditional sectors can contribute to a promising investment landscape in 2024

Q1 2019 - Q4 2023 total deals in CEE, by sector



Source: Mergermarket, European mid-market deal data[xvi]

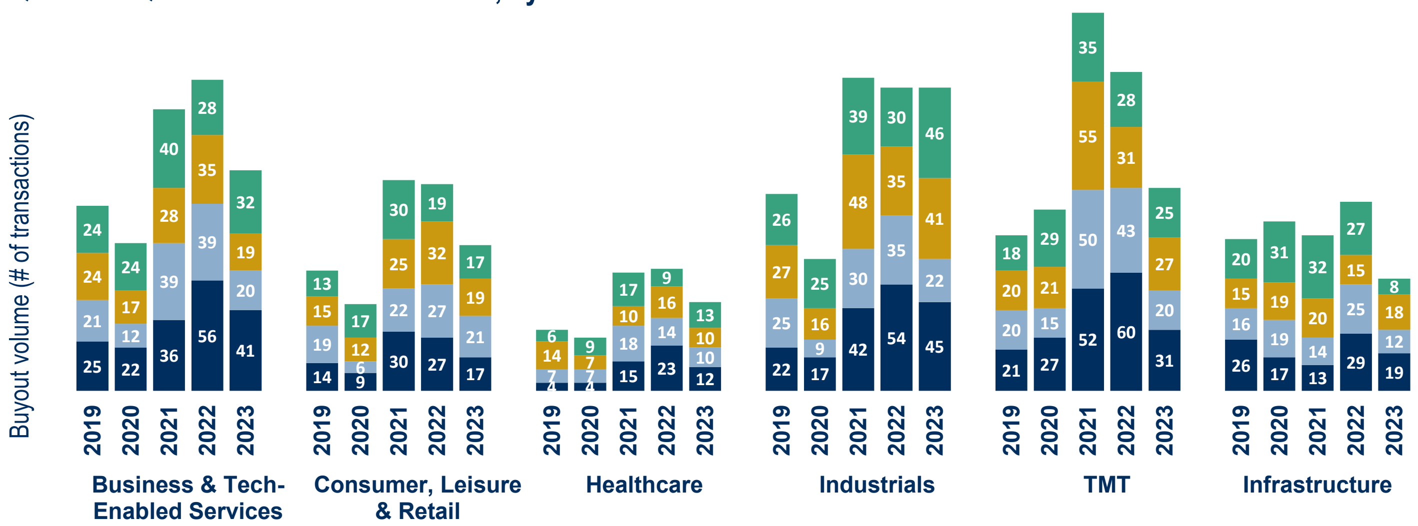
France

François Prioux
Managing Director

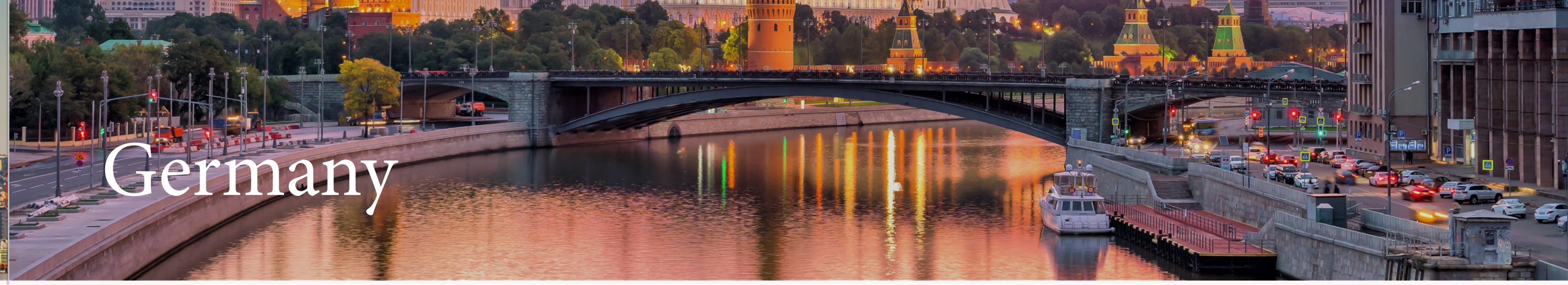
> *"The outlook for 2024 suggests a more subdued environment, where strategic investments will likely dominate the market"*

- Similarly, to the first half of 2023, in H2 we are seeing a strengthening in M&A activity, driven by improved investor sentiment and a strategic focus on growth synergies
- Geopolitical uncertainties, including conflicts in Ukraine and Gaza, have steered a shift towards domestic deals. This is further amplified by government initiatives supporting non-cyclical sectors[xvii], such as Technology & Software and Industrials, which we believe will drive consolidation
- Rising interest rates could negatively impact infrastructure assets as valuations face pressure, even as the EU Commission approved a €4.12bn French scheme to accelerate the green transition by supporting offshore wind farms[xviii]
- Economic growth is anticipated to be modest, with a projected 1.0% increase in GDP in 2024[xix]. Following persistently high inflation affecting growth, there are expectations for a gradual decrease in the inflation rate[xx]
- Private equity firms remained active, particularly in growth-oriented sectors, carve-outs and restructurings. Collaboration with corporates for larger deals has increased, leveraging complementary expertise and synergies to drive deal activity
- The private equity landscape in France is undergoing a transformation as portfolio companies struggle with slowing performance amid economic uncertainty. While deal activity is stable, valuations are experiencing pressure, and acquirers remain cautious. The outlook for 2024 suggests a more subdued environment, where strategic investments will likely dominate the market

Q1 2019 - Q4 2023 total deals in France, by sector



Source: Mergermarket, European mid-market deal data[xxi]



Germany



Stefan Jaecker
CEO

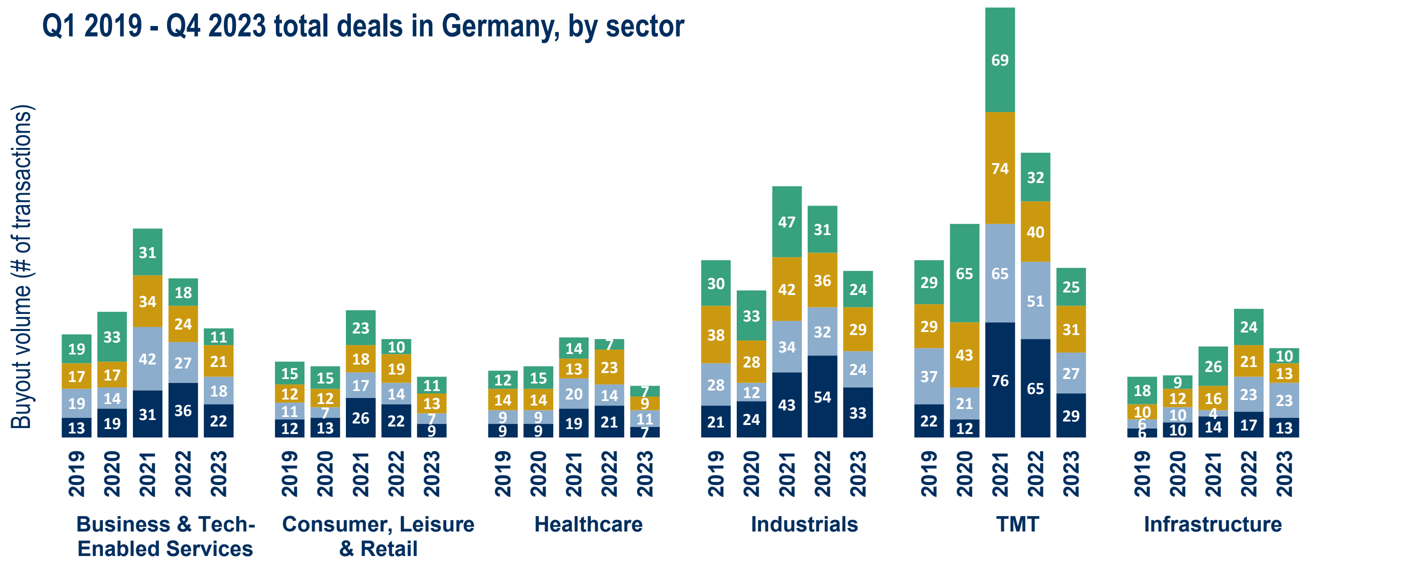
Edward de Stigter
Executive Director

Sven Lange
Vice President

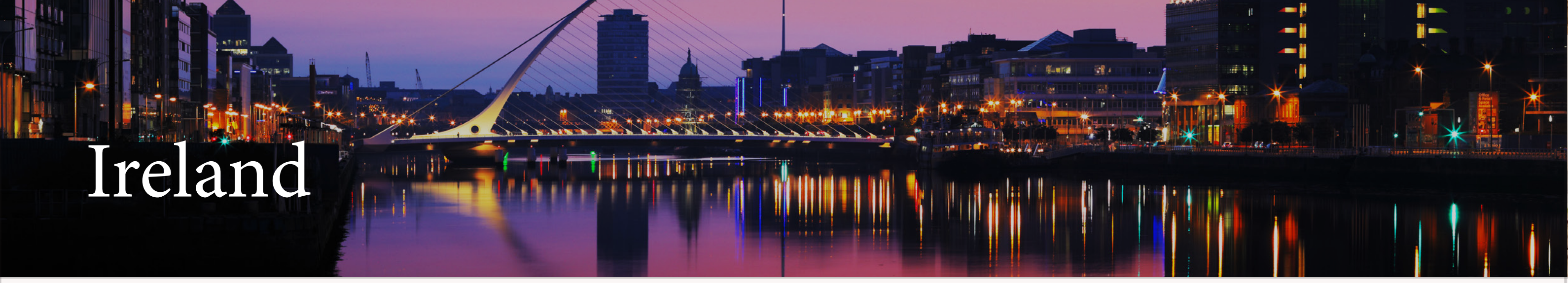
> *"Dry powder reserves, coupled with infrastructure demand and corporate carve-outs, set the stage for increased dealmaking"*

- Private equity in Germany has witnessed a notable deceleration in deal activity during H2 2023. Economic conditions marked by higher inflation, tighter financing conditions, weaker foreign demand and cautious investor sentiment have impacted investment appetite and led to a 0.3% drop[xxii] in deal activity in 2023 compared to 2022. Despite these challenges, we believe the industry is poised for a resurgence in 2024, driven by various factors, including dry powder reserves, infrastructure demand, corporate carve-outs, and a persistent pursuit of stability
- Technology & Software and Healthcare are poised to maintain strong valuations as they remain attractive sectors to investors. Infrastructure deals may face tougher financing conditions, but strong pipelines persist due to the pressing need for development in Germany[xxiii]. We expect data centers and infrastructure "core-plus" assets to see increased activity, whilst corporate portfolio optimization with the sale of non-core units can present opportunities for strategic investors
- The fundraising environment, particularly for mid-market GPs, in our view, has proven difficult. German institutional investors remain hesitant to commit to high-volume, later stage venture capital funds, limiting access to funding for growth-oriented private equity strategies. Foreign conglomerates focusing their portfolios by offloading quality assets in Germany, can create attractive opportunities for discerning investors. There is potential for increased public-to-private deals, especially if stock market volatility persists
- In late 2023, inflation in Germany was high[xxiv], and in our view, influenced interest rate trajectories, valuations and deal structures. Navigating macroeconomic and geopolitical headwinds will require strategic thinking and adaptability, with a keen eye on mitigating risks
- Private equity in the region is poised for a resurgence in 2024. Dry powder reserves, coupled with infrastructure demand and corporate carve-outs, set the stage for increased dealmaking. Despite ongoing challenges, we believe that forced exits and dealmaking will likely gain momentum in 2024, albeit at potentially lower valuations

Q1 2019 - Q4 2023 total deals in Germany, by sector



Source: Mergermarket, European mid-market deal data[xxv]



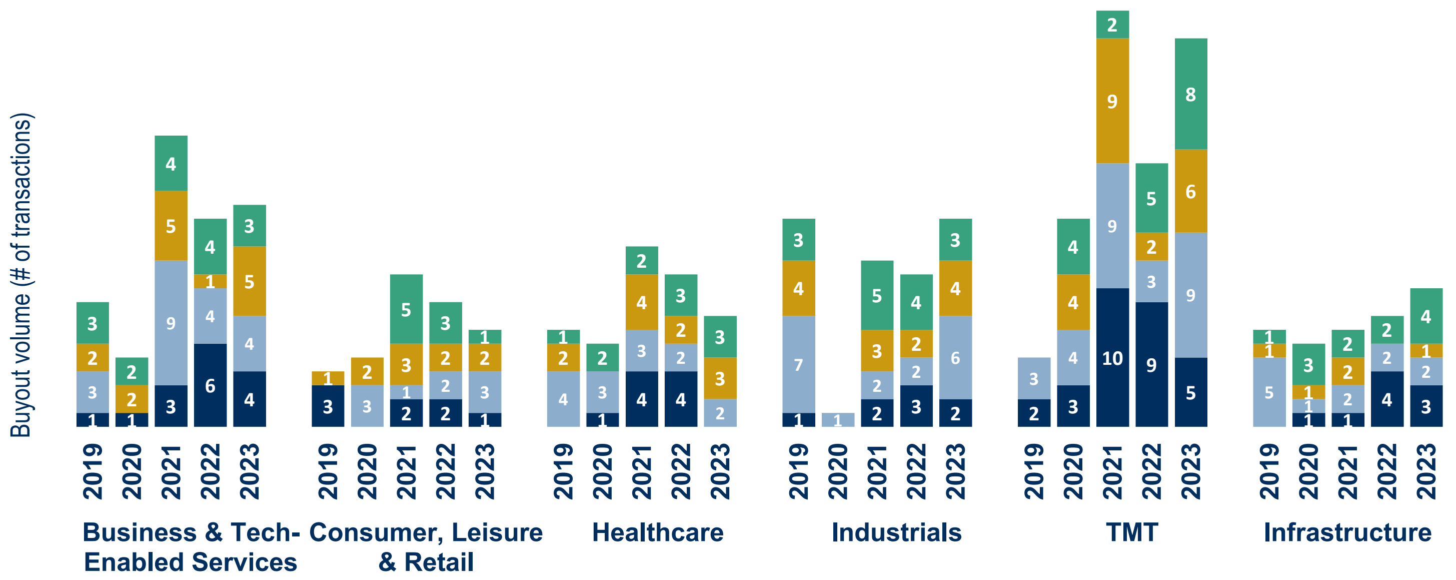
Ireland

Tom Godfrey
Chairman & CEO

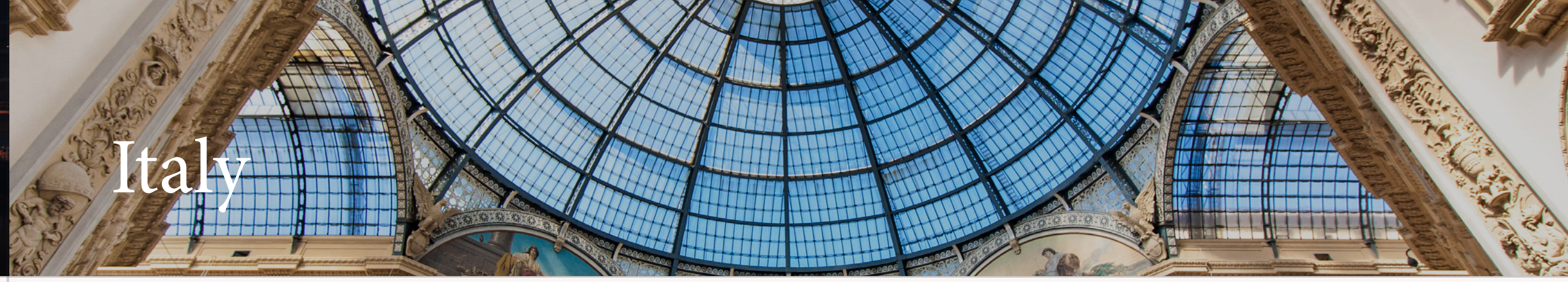
> *"The Irish economy continues to perform strongly, with expectations it will record growth throughout 2024 and into 2025, providing attractive conditions for deal flow in the country and a strong outlook for M&A"*

- Sectors including Business & Tech Enabled Services, Industrials, Infrastructure and TMT have experienced growth in Q4 compared to the previous quarter, which had a positive impact on M&A activity in Ireland
- We believe trade consolidation and sponsor-backed trade platform consolidation were the key drivers of transaction volume growth in Q4 2023
- Large Irish corporates continued to be acquisitive in Q4 2023, with notable transactions including the Irish-based building materials group, CRH's announced transactions of Martin Marietta, a leading supplier of construction aggregates and heavy building materials, for a total consideration of $2.1bn[xxvi], and Adbri, a supplier of construction materials and industrial minerals, at an equity valuation of $1.4bn[xxvii]
- The Irish economy continues to perform strongly, with expectations it will record growth throughout 2024 and into 2025[xxviii], providing attractive conditions for deal flow in the country and a strong outlook for M&A

Q1 2019 - Q4 2023 total deals in Ireland, by sector



Source: Mergermarket, European mid-market deal data[xxix]



Italy

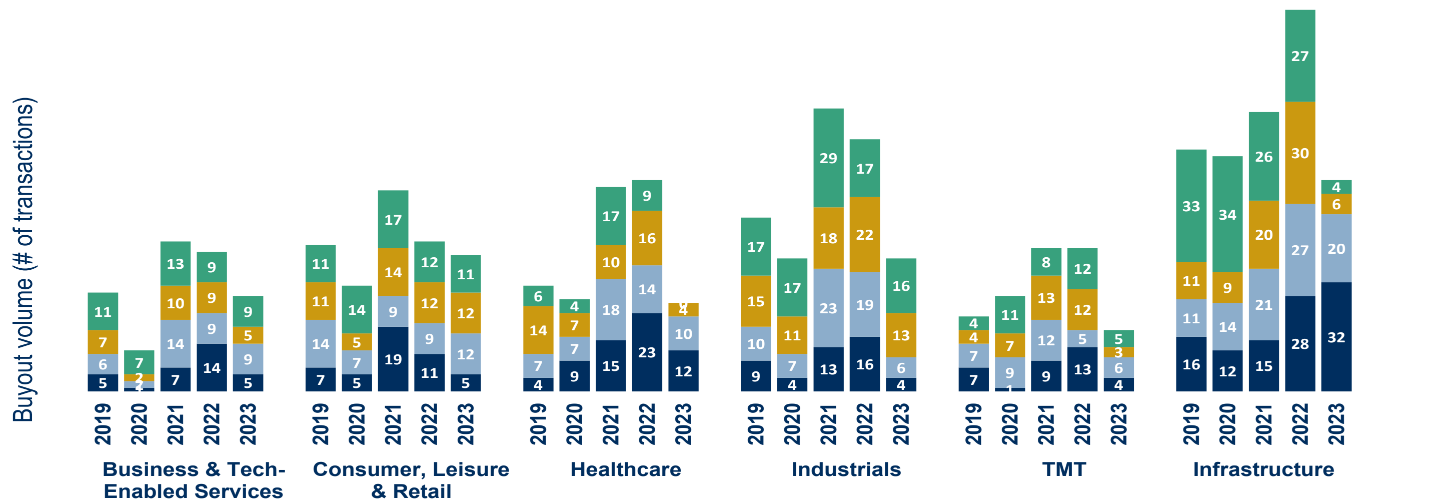

Giuliano Guarino
Co-Head

Alberto Tack
Director

> *"In the network and software subsectors, we have seen vibrant levels of M&A activity as a result of the ongoing digital transformation, accelerated by AI adoption and the incremental requirements for the transition to 5G"*

- Italian M&A activity for 2023 remained stable in terms of the total number of deals executed compared to the previous year (1,210 in 2023 vs. 1,301 in 2022)[xxx], while the total value of deals was substantially lower (€58.6bn in 2023 vs €93.7bn in 2022)[xxxi]
- In Q4 2023, M&A activity was impacted by: widespread uncertainty around the market trendline, both internationally and domestically; economic downturns in significant European countries, such as Germany, an important trading partner of Italy; and a limited availability of debt, particularly through regular bank loans
- We have seen an increase in cross-border transactions in 2023, with 195 deals totaling €14bn[xxxii]. We believe the rise is due to the increasing internationalization of Italian companies, with a focus on nearshoring and friendshoring; the consolidation of Made-in-Italy supply chains; and private equity market consolidation. A substantial 40% of 2023 transactions involved private equity [xxxiii]
- In the network and software subsectors, we have seen vibrant levels of M&A activity[xxxiv], as a result of the ongoing digital transformation, accelerated by AI adoption and the incremental requirements for the transition to 5G, including KKR's US$23.3bn[xxxv] acquisition of Telecom Italia's FiberCop fixed network business (one of the largest EMEA acquisitions in 2023)
- We believe current macroeconomic conditions, which are causing a slowdown in exports to major trading partners, particularly Germany[xxxvi], are providing a challenging M&A climate for Italian private equity players
- Limited credit availability and lower demand for credit pose challenges, as high interest rates[xxxvii] and a new government windfall tax on banks[xxxviii] might further reduce yields, making it more difficult for borrowers to access capital[xxxix] as banks introduce stricter lending requirements
- We expect Italian M&A to maintain a steady trajectory in 2024, in line with late 2023. Despite this optimistic outlook, tighter credit market conditions will potentially threaten deal-making activity in Italy throughout 2024. Buoyed by necessary structural changes, such as 5G adoption, renewable installations, and the consolidation of Made-in-Italy markets, we anticipate M&A activity to grow compared to 2023

Q1 2019 - Q4 2023 total deals in Italy, by sector



Source: Mergermarket, European mid-market deal data[xl]

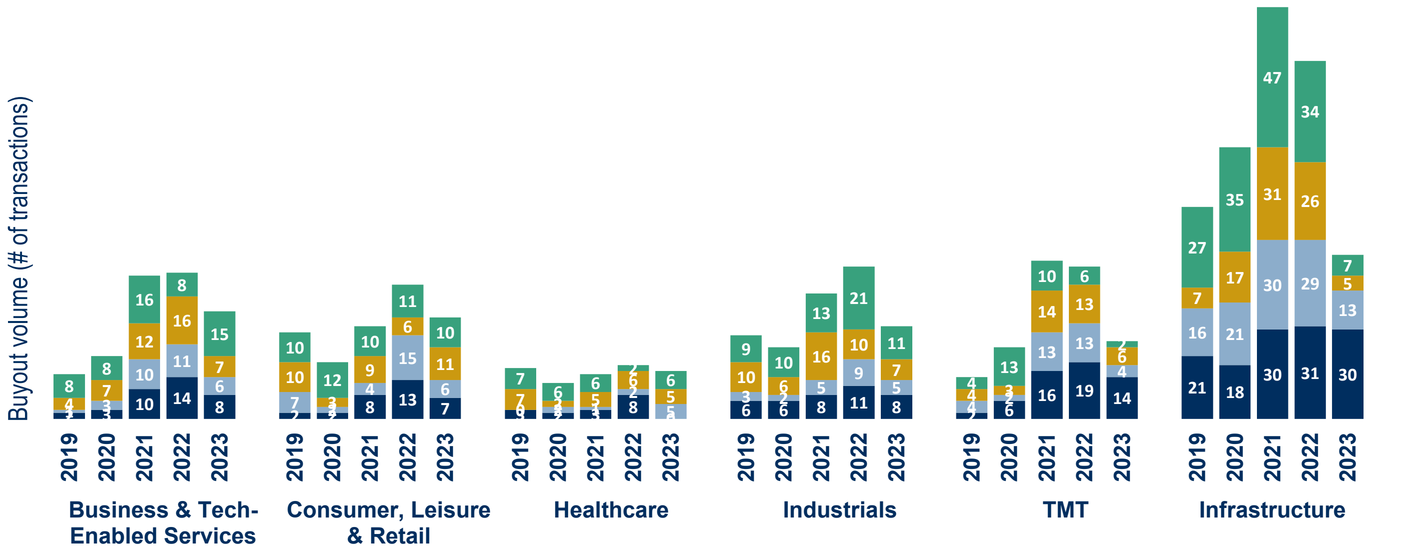
Spain

César Garcia
Managing Director

> *"The M&A outlook for 2024 is cautious optimism that the market can stabilize and reactivate"*

- The Spanish private equity market, mirroring global trends, focused on smaller, mid-market deals in 2023. Macroeconomic uncertainties and financing challenges steered investors away from large-cap transactions
- Political instability and uncertainty due to elections in July 2023, led to a decline in the government deficit to 3.2%[xli] of GDP in 2024 (from 4.1% in 2023), driven by a moderation of tax revenue growth combined with increasing costs [xlii]
- Despite a challenging year marked by a decrease in deal activity, representing a -12% fluctuation[xliii], we believe Spain remains an attractive destination for private equity investment
- The Infrastructure, Healthcare and Technology & Software sectors[xliv] were resilient, and in our view, emerged as key areas for private equity interest. Spain has evolved from a local market to a global one, attracting international attention from private equity firms
- Buy-and-build strategies establishing platforms across sectors enable private equity firms to build diverse portfolios, fostering resilience and adaptability
- Spain's GDP growth forecast remains at 2.4% for 2023[xlv], but economic activity is expected to slow down to 1.7% in 2024, influenced by weakening economic conditions in Europe and geopolitical uncertainty, while an acceleration to 2.5% is likely in 2025[xlvi]
- Our M&A outlook for Spain in 2024 is one of cautious optimism that the market will stabilize and reactivate. While visibility remains low, we believe there are signs of increased preparation for new transactions and the refinancing of assets potentially slated for future exits

Q1 2019 - Q4 2023 total deals in Spain, by sector



Source: Mergermarket, European mid-market deal data[xlvii]

UK

Andrew Strudwick
Managing Director

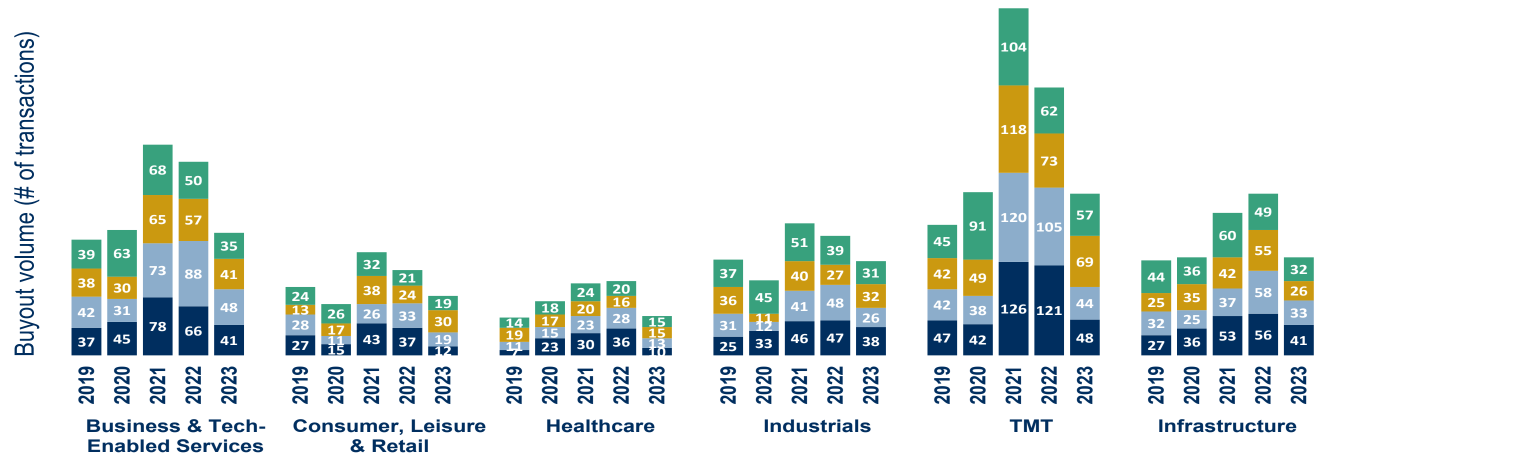
Tara Stowe
Director

Gemma Drabble
Director

> *"The appetite for alternative exit routes in the mid-market has continued to fuel the demand for secondaries amongst sponsors"*

- The UK mid-market faced one of its toughest years, with fundraising representing the lowest amount for a decade, £9bn in H1 2023[xlviii]. We believe high inflation and interest rates created uncertainty, leading LPs to reduce primary deployments and favor multi-strategy global large-cap funds. In response to prevailing low valuations, we anticipate investors are exploring alternative methods for value creation. Large-cap firms are active in the mid-market, focusing on acquiring smaller deals with the prospect of conducting multiple acquisitions to bolster their overall market presence, particularly in resilient sectors, such as TMT and Business & Tech-Enabled Services
- Sponsors took a more cautious approach, and in our view, are opting to hold onto assets for longer due to a range of factors, including market uncertainty, stunted trading and growth, and increased exposure to process risk, which has limited deal activity
- We have seen an increase in LPs choosing to deploy capital to secondaries funds, representing a 33% increase in 2023 from 28% the prior year[xlix], as appetite for alternative exit routes in the mid-market has continued to fuel demand
- Decreased consumer confidence[l] in the UK has led to slow trading, causing widespread underperformance among businesses, affecting portfolio performance, and reducing the pool of attractive assets. Many businesses are grappling with the burden of debt, resulting in a surge in insolvencies, particularly in sectors like Construction, Retail, and Hospitality. Despite a robust volume of 'amend-and-extend' (A&E) and refinancing in Q4 2023[li], a significant number of businesses failed to avoid insolvency. This trend is expected to continue into 2024, as businesses continue to suffer from the challenges of high borrowing costs and limited growth
- We anticipate the mid-market will face a more positive outlook for sponsor deal activity, driven by the need for General Partners (GPs) to deliver returns following a period of limited capital generation, as well as the high levels of dry powder available in the market, the uptick in the UK economy and improving investor confidence
- Despite UK GDP growth slowing to 0.4% in 2023, representing the second slowest in the G7 behind Germany at -0.3%[lii], we predict a rebound for 2024[liii]. Recovery in the UK and Europe may lag behind other global counterparts, with Japan already benefiting from elevated M&A levels. The uncertain timing of a recovery may lead to increased volumes in alternative exit routes including secondaries and debt restructuring in the interim period

Q1 2019 - Q4 2023 total deals in the UK, by sector



Source: Mergermarket, European mid-market deal data[liv]

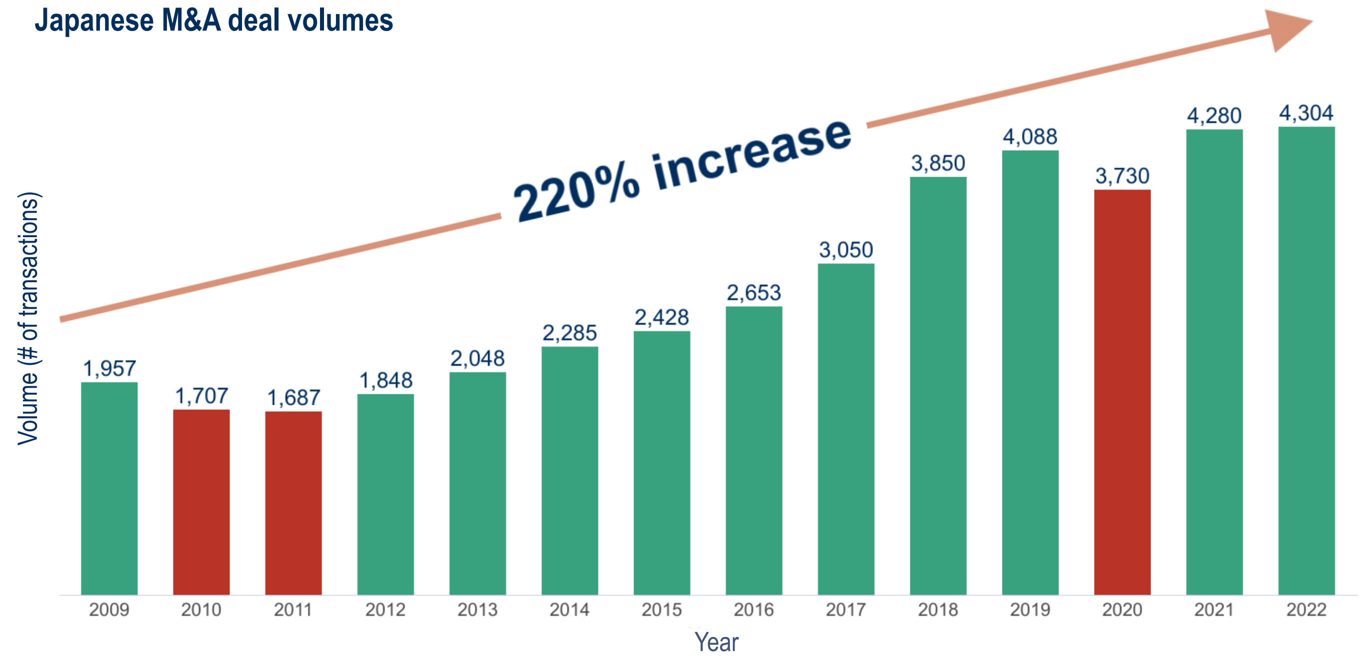
Cross-border opportunities in Asia
Japan

Tosh Kojima
Managing Director

> ***"The surge of assets entering the market, combined with pressure to optimize business performance provides a rich opportunity for private equity firms in Japan"***

- M&A has become a high growth activity and part of the cultural norm in Japan. M&A volumes have grown 220%[lv] over the 14-year period up to 2023, a staggering rate we expect to continue
- We observe a notable emphasis on portfolio cleanup that that has led to increased private equity deal activity, with a significant focus on restructuring. Large Japanese corporations are contributing high-quality assets to the European market, whilst also positioning themselves as active cross-border buyers. This dynamic market also sees Japanese entities strategically focusing on cherry-picking investments, leading to a corresponding increase in disposals of non-core assets abroad
- Japanese businesses, in our view, have a growing reputation as reliable sellers of expensive, high-quality assets, often involving off-market transactions
- Seller education is crucial in this environment, underscoring the need for a nuanced understanding of the preparation and deal styles required to maximize Japanese interest. Japanese sellers, still relatively new to the global M&A market, can encounter challenges in deal sourcing and buyer engagement in Europe
- The outlook for cross-border activity, particularly between Asia and Europe, remains optimistic. As Japanese corporations realign around profitability and shareholder returns, private capital will likely to continue to find ample deal-making opportunities for acquisitions and investments in Japan

Japanese M&A deal volumes



Source: RECOF M&A Database, Japan (All deal sizes, either buyer or seller or both from Japan, counterparty any region, all sectors, 2009-2022)

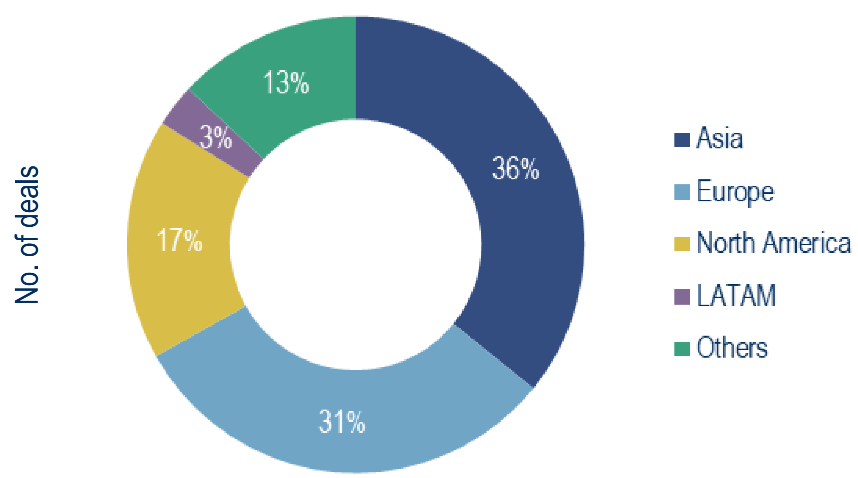
Cross-border opportunities in Asia
China

Endong Zhai
Managing Director

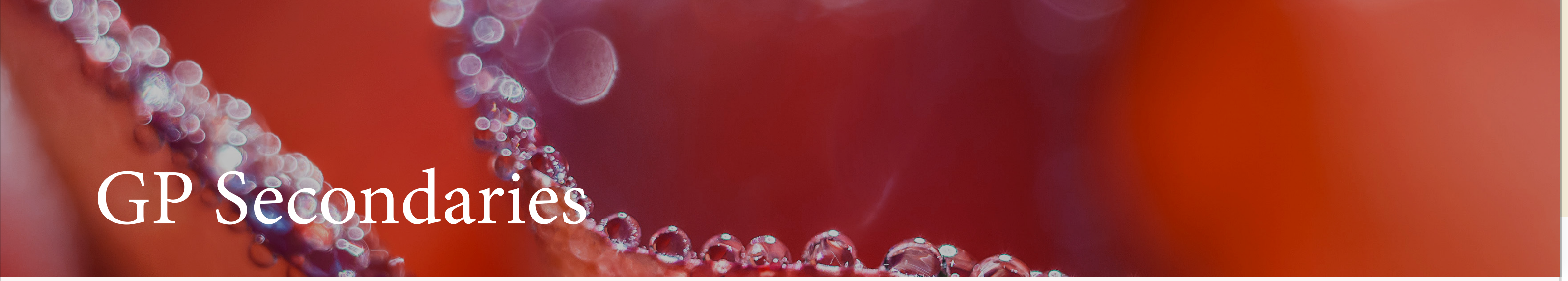
> ***"We expect a gradual recovery of Chinese investment in Europe as global economic and political tensions ease"***

- China's post-pandemic economic rebound is deteriorating earlier than expected, leading to a decrease in Chinese companies acquiring European counterparts. Supply chain disruptions and tightened regulations, particularly from European and North American governments, are key contributors
- Despite the decline in outbound deals, Europe continues to be the top destination for Chinese investment, accounting for 33% of all transactions in Q3 2023.[lvi] Healthcare and Industrials were the most active sectors, each representing 20% of deals.[lvii] We expect a gradual recovery of Chinese investment in Europe as global economic and political tensions ease
- We expect Chinese strategic investors to make a strong return to deal-making, with sensitive areas like robot technology and software technology, originally resistant to Chinese bidders, providing potential opportunities to sell to a Chinese buyer, should there be a lack of satisfactory offers from European counterparts
- In the event of a gradual recovery as global tensions ease, we believe the pragmatic approach of Chinese investors, combined with a targeted focus on specific sectors, ensures China-Europe cross-border M&A has significant growth potential

China outbound M&A by target region (Q4 2023)



Source: Mergermarket, Q4 2023 China (including Taiwan, Hong Kong) mid-market deal data[lviii]



GP Secondaries

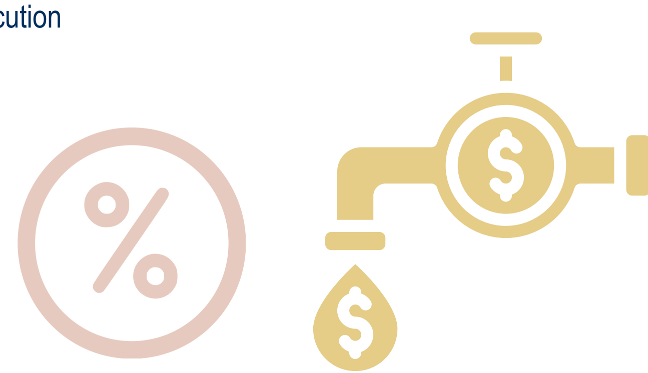
Michael Wieczorek
Managing Director

Sabina Sammartino
Managing Director

Ludovic Douge
Managing Director

> ***"We believe secondary solutions are demonstrating resilience in all market conditions as the adoption of GP-led solutions continues to expand with the gradual thawing of the M&A market. Sponsors are, in our view, increasingly turning to GP-led solutions to provide liquidity options to LPs and retain exposure to their most promising assets"***

- The resurgence of secondary market activity persisted through Q4 2023, driven by sponsors initiating transactions in the second half of 2023 to capitalize on returning secondary investor confidence. Bid-ask spreads narrowed as buyers and sellers came to an agreement on valuations[lix]
- Lower secondary volumes witnessed in H1 2023 provided an opportunity for investors to rebuild their capital base through ongoing fundraisings, which they deployed in Q4 2023
- Dry powder available for secondary deals continued to increase, propelled by the completion of multi-billion fundraises[lx] by secondary sponsors, as well as new participants entering the market
- We believe secondary solutions are demonstrating resilience in all market conditions as the adoption of GP-led solutions continues to expand with the gradual thawing of the M&A market. Sponsors are, in our view, increasingly turning to GP-led solutions to provide liquidity options to LPs and retain exposure to their most promising assets. Notably, the significant surge in the proportion of distributions from GP-led transactions in 2023, was nearly double the amount when compared to 2022[lxi]
- Sponsors are leveraging the GP-led market to raise additional growth capital for their best assets, enabling them to maximize value as they face higher financing costs and limited access to capital through traditional sources
- We believe the adoption rate for GP-led transactions amongst the mid-market is strong; this activity is being disguised in aggregated market volume data which is distorted by the decline in mega-cap transactions.
- We believe mid-market sponsors are also attracted by the significant quantum of large cap dry powder in the primary market, eyeing a longer hold to grow their star assets to eventually exit to well capitalized, larger cap buyers who are facing challenges of their own in deploying capital given the muted traditional M&A market activity
- Structured solutions involving non-dilutive capital against portfolio assets are gaining momentum to accelerate distributions and additional firepower for the existing portfolio or new platform investments
- We expect an active GP-led market in H1 2024, fueled by increased adoption among mid-market sponsors seeking to meet LPs' demands for liquidity and additional growth capital for their assets, while we anticipate traditional exit and financing routes will remain challenged. Secondary transactions in the Real Estate, Infrastructure, Real Assets, and Credit sectors are likely to continue their robust growth trajectory backed by recent successful secondary fundraises injecting dry powder to fund secondary transactions.
- As strong deal activity continues into 2024, generating investor interest and securing team diligence capacity ahead of transaction launch is vital. Well structured transactions with strong alignment between GPs and secondary investors and transparency with existing LPs will meaningfully increase the certainty of execution



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