DC advisory

European Private Equity Mid-Market Monitor: Q2 2023 & Outlook

Pressure builds to deploy capital

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Contents

European overview

DC Advisory present our latest mid-market European activity report and discuss what this means for deal flow over the remainder of 2023.

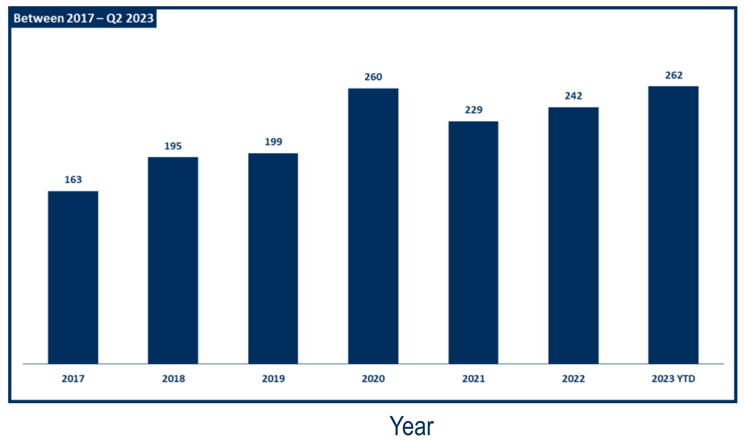
In this edition we explore:

- UK & European top trends
- Outlook for 2023 and beyond
- Market adoption of GP-led secondary solutions
- Country by country review

Resilient sectors and technology provide opportunities as pressure builds to deploy capital

- In Q2 2023, the European private equity market continued to remain depressed given tough macroeconomic conditions and persisting high financing costs. However, amidst this backdrop, handfuls of assets in resilient sectors (particularly Infrastructure Services, Industrials and IT Services), continued to transact. Typically, these businesses share similar characteristics, such as long-term contracts, low churn and diverse customer bases, that allow them to better withstand external macroeconomic and geopolitical pressures
- Fundraising for mid-market private equity across the continent remains challenging and increasingly we are seeing sponsors close funds ahead of reaching their initial targets or withdraw from fundraising processes entirely. However, the continued resilience in fundraising for megafunds is further evidence for the growing preference of LPs to deploy larger cheques into larger fund vehicles which may have stronger track records, where modest returns can be perceived to be more likely
- Given the decreased availability of debt financing and higher premiums, we have experienced an increased focus on the mid-market by large-cap investors seeking to complete transactions with leverage requirements that may be more scalable. Similarly, given the need to lower leverage amounts on smaller deals, we are seeing sponsors pursue bolt-on acquisitions for existing portfolio companies with greater frequency[i]
- With fewer deals circulating the market, fund managers are taking more time to focus on valuation maximization, seeking ways to enhance the performance of portfolio companies through operational improvements, strategic initiatives and M&A. Technologies such as Artificial Intelligence are becoming more prevalent and wieldable in a business capacity[ii], and we are increasingly seeing private equity-backed companies form external partnerships with technology providers to better access new capabilities and drive efficiency
- Ultimately, we anticipate that the European private equity market will remain subdued for the remainder of 2023 as inflation and interest rates in Europe continue to remain sticky.

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



Source: Mergermarket: Q2 2023 European mid-market deal data

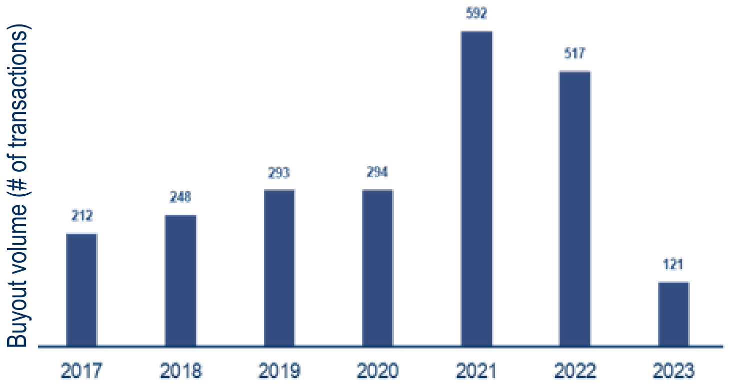
However, with significant dry powder still available in the market, sponsors will likely come under increasing pressure to deploy capital and to keep on track with investment curves. This sentiment suggests that we could experience a busier H1 2024, as sponsors look to deploy capital into processes they have spent significant time prepping for throughout the remainder of 2023

All data included in this publication was sourced from Mergermarket unless otherwise indicated.

European overview

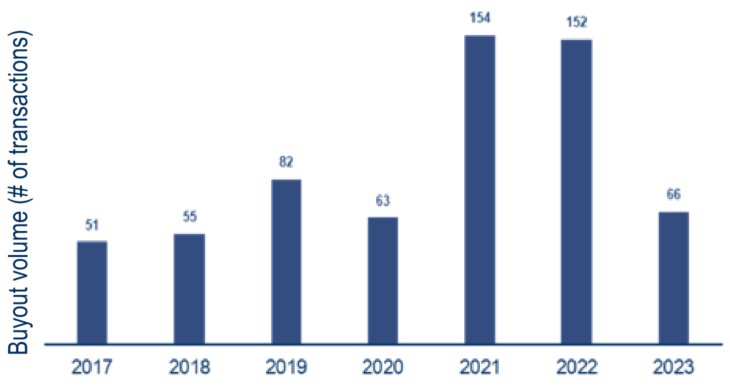
Buyout activity in the European mid-market

Annual buyout volume 2017-2023



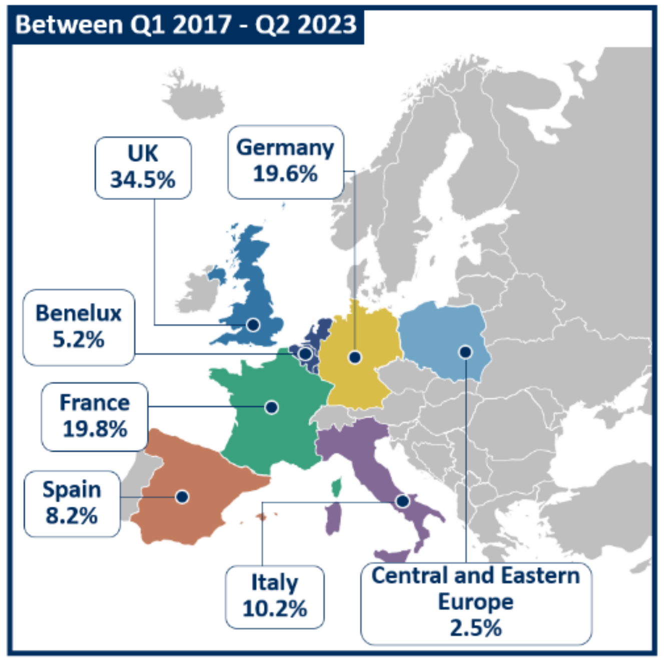
Source: Mergermarket: Q2 2023 European mid-market deal data[ii]

Q2 buyout volume 2017-2023

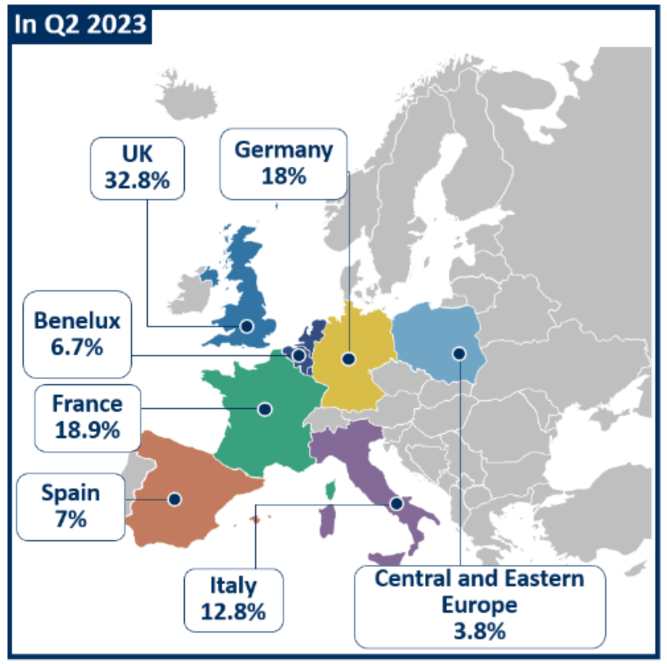


Source: Mergermarket: Q2 2023 European mid-market deal data

Buyout volumes split by region (%)

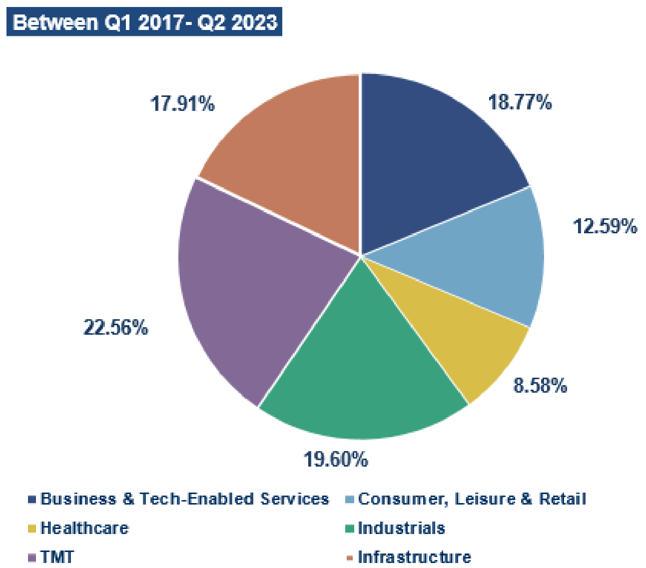


Source: Q2 2023 European mid-market deal data, Mergermarket July 1, 2023

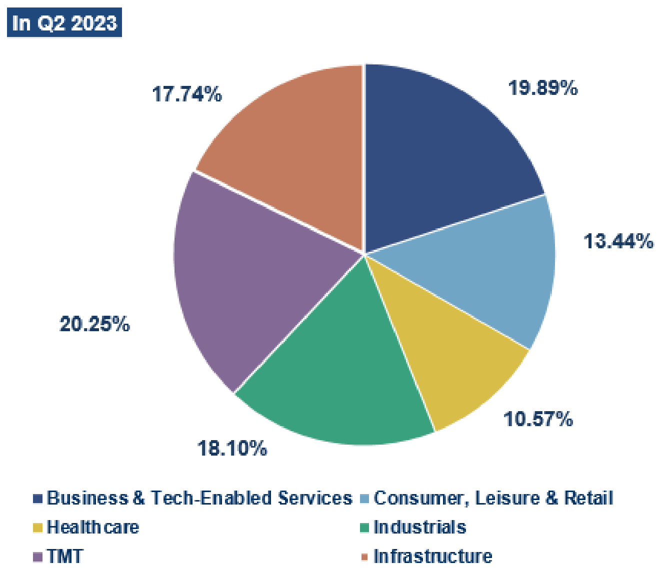


Source: Q2 2023 European mid-market deal data, Mergermarket July 1, 2023

European buyout volumes split by sector (%)

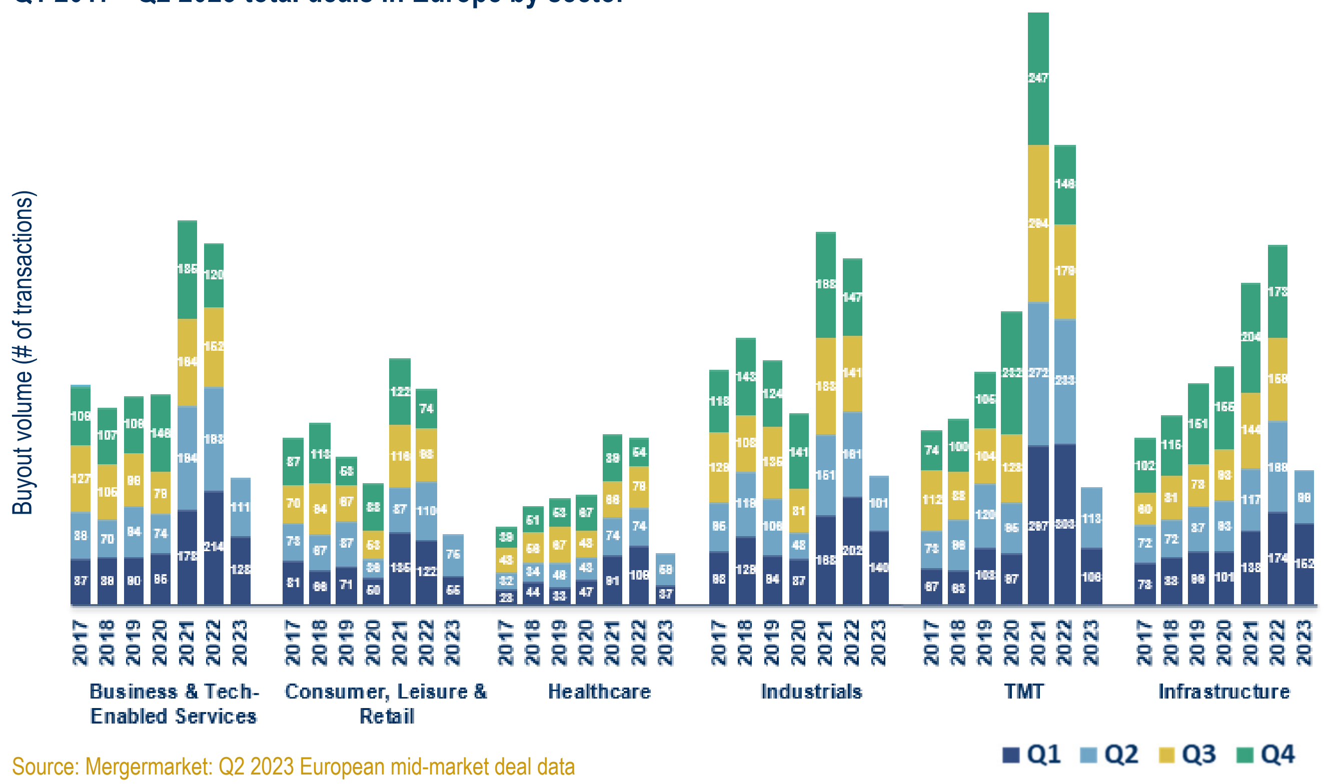


Source: Mergermarket: Q2 2023 European mid-market deal data



Source: Mergermarket: Q2 2023 European mid-market deal data

Q1 2017 - Q2 2023 total deals in Europe by sector



Source: Mergermarket: Q2 2023 European mid-market deal data

Benelux



Paul de Hek
Co-CEO

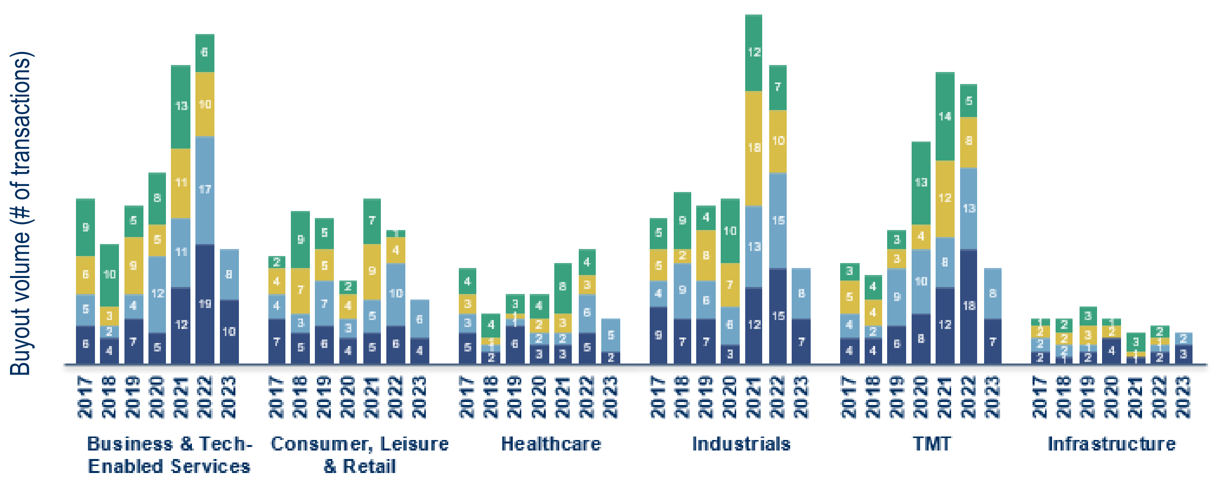
Robert Ruiter
Co-CEO

Verner Uiterwijk
Vice President

> ***"We see fundamental growth niches prevailing in Technology, ESG and Infrastructure, whilst stable, late cyclical sectors such as Industrials are being prepared for sale again"***

- Regulatory policy supporting sustainable investments has led Benelux investors to focus on ESG[iv]. This has resulted in an increase in deal flow in niche areas within the Infrastructure and Industrials sectors, which we expect to drive growth in H2 2023
- We see fundamental growth niches prevailing in Technology, ESG and Infrastructure, whilst stable, late cyclical sectors such as Industrials are being prepared for sale again
- Private equity investors need to churn their portfolios and the deals backlog is material. Funds raised between 2018 and 2020 may still need to be partially deployed, whilst at the other end of the spectrum, there are private equity firms keen to exit portfolio investments to show liquidity to LPs
- It can be challenging to raise traditional debt financing, due to limited appetite in the local club deal lending landscape[v]. The recent deployment by debt funds (combined with perceived high margins) as well as banks shifting their focus away from leveraged loans has made the debt process an increasingly core track of the deal. Potential acquirors are placing extra scrutiny on target companies performing behind their business plans, and in these situations, we continue to see a significant valuation gap between buyer and seller. We anticipate increased activity[vi] for the remainder of 2023 due to a stabilizing macro and geopolitical environment

Q1 2017 - Q2 2023 total deals in Benelux, by sector



Source: Mergermarket: Q2 2023 European mid-market deal data

■ Q1 ■ Q2 ■ Q3 ■ Q4

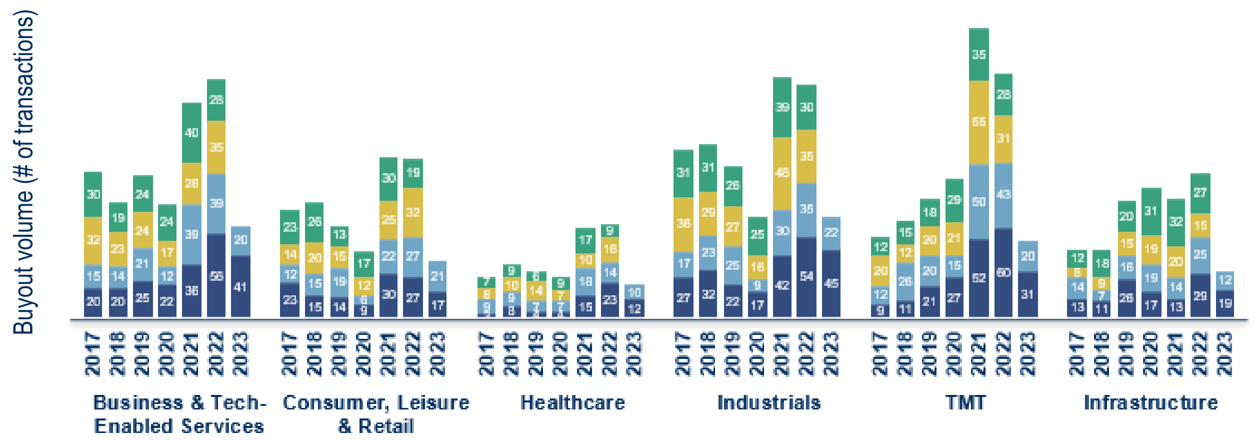
France

François Prioux
Managing Director

> ***"We expect the remainder of 2023 to be more active, especially in non-cyclical sectors including Business & Tech-Enabled Services, and the hydrogen industry"***

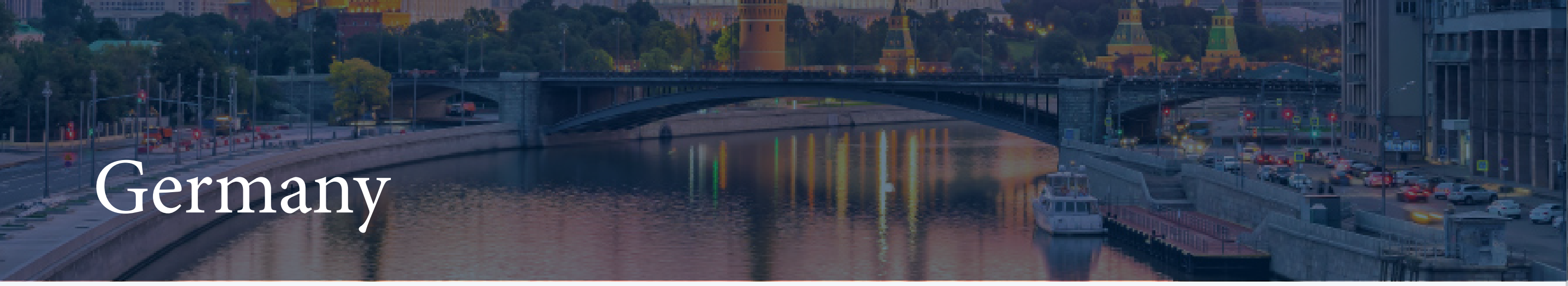
- An economic slowdown has caused a drop in French deal activity in Q2 2023.[vii] Growing strategic uncertainty and a lack of financing led to higher risk aversion, accordingly the upper mid-market has become increasingly selective with large-cap transactions. Consequently, private equity funds shifted their investment strategies to focus more on mid or small-cap transactions, with perceived lower financial risk[viii]
- We have observed some French companies opt for a 'wait and see' strategy before selling their assets, even when they can show strong performance. Financing difficulties and increased complexity in transactions have negatively impacted valuation multiples
- We expect the remainder of 2023 to be more active, especially in non-cyclical sectors including Business & Tech-Enabled Services, and the hydrogen industry Technology & Software is lagging as historical valuations were high, so adjustments are necessary to adapt to the 'new normal'. Healthcare shows resilience[ix] and we see it providing a relatively stable and promising landscape for investors
- Overall, the market outlook for France remains uncertain, influenced by the current macroeconomic and political climate, but there is hope for increased activity in the coming months[x]

Q1 2017 - Q2 2023 total deals in France, by sector



Source: Mergermarket: Q2 2023 European mid-market deal data

■ Q1 ■ Q2 ■ Q3 ■ Q4



Germany

Stefan Jaecker
CEO

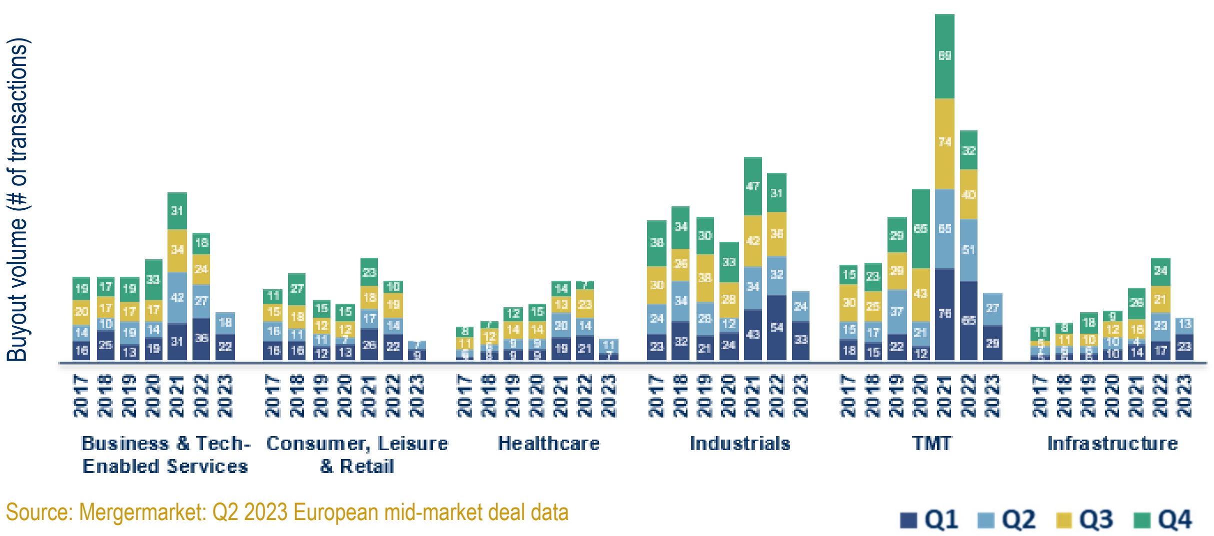
Edward de Stigter
Executive Director

Sven Lange
Vice President

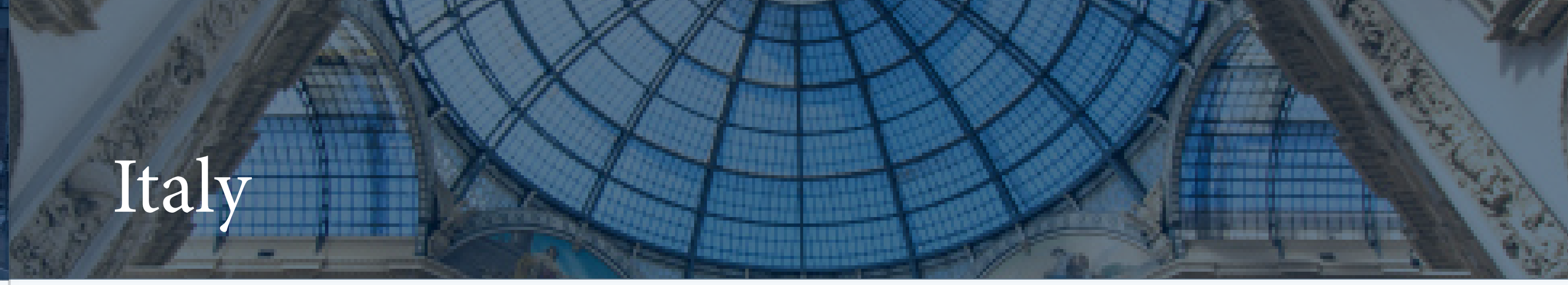
> ***"In Germany, talks of increasing deal activity are ongoing while pressure in the pipeline is building up"***

- We observed increased momentum in Germany private equity activity over Q2[xi], and expect that activity to increase over the remainder of Q3. This is a result of the financing market opening up, with debt financing becoming available through debt funds and senior bankers returning for certain assets
- Leading sectors include Business & Tech-Enabled Services, Healthcare, and Technology & Software[xii], which are bouncing back after recovering from valuation reductions. The Industrial sector faces challenges as government subsidies fade out, putting pressure on financing and triggering carve-outs
- Private equity buyers and sellers are facing unique challenges, but liquidity and trust in the market are increasing. Market players are gradually adapting to the "new normal" - sellers understand that they may not always achieve high EBITDA multiples, while buyers are more willing to strike deals
- In Germany, talks of increasing deal activity are ongoing while pressure in the pipeline is building up. Investors who are willing to take on some risk and who are focused on the right sectors and trends are likely to execute successful transactions

Q1 2017 - Q2 2023 total deals in Germany, by sector



Source: Mergermarket: Q2 2023 European mid-market deal data



Italy

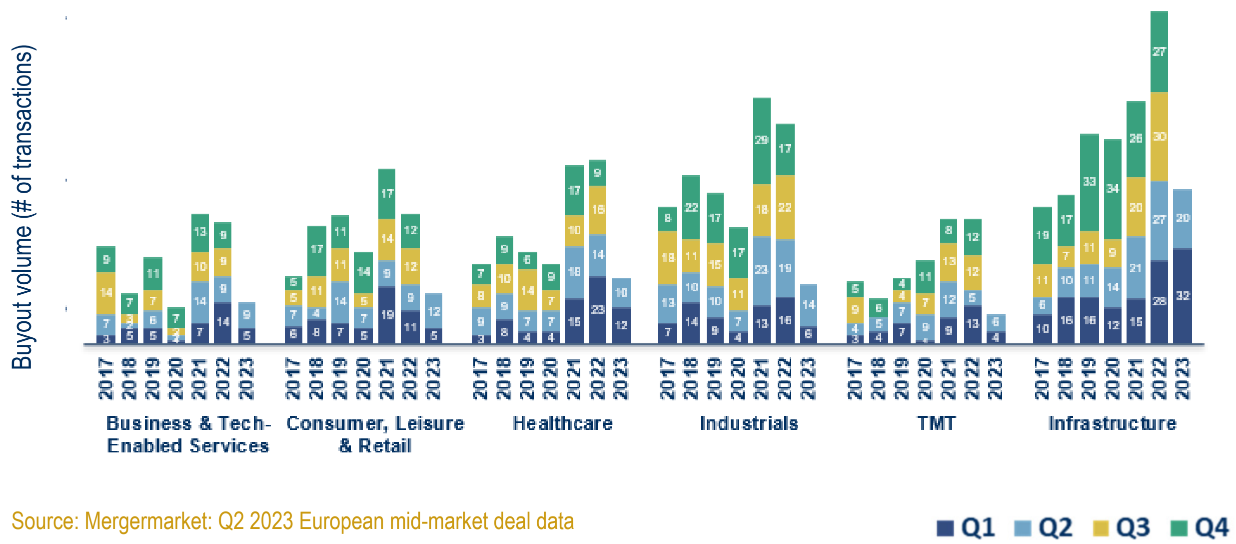
Giuliano Guarino
Co-Head

Alberto Tack
Director

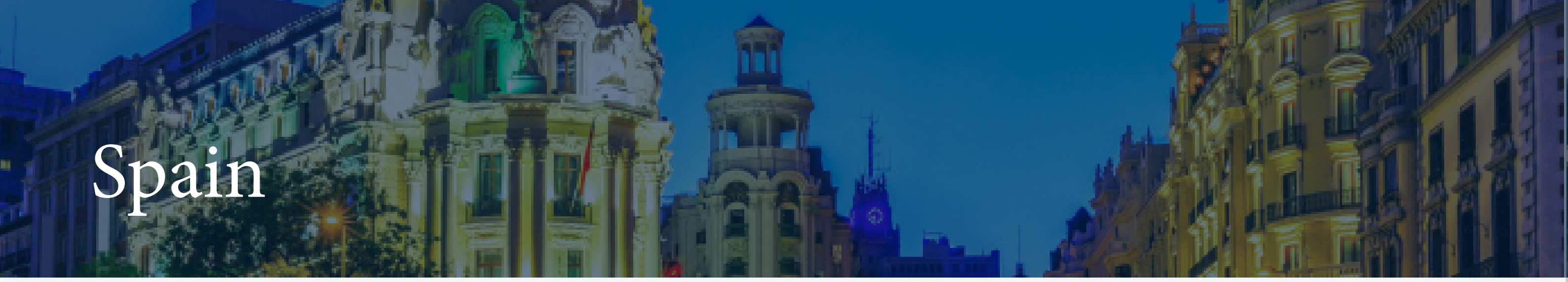
> ***"We have seen increased deal values of Italian investments abroad, due to Italian companies prioritizing expansion into foreign markets"***

- As demonstrated in the chart below, Italian M&A activity in Q1 2023 has largely been driven by the Consumer, Leisure & Retail and Healthcare sectors. The Business & Tech-Enabled Services and TMT sectors have experienced a slowdown due to the increased cost of capital
- Private equity continues to be active in the Italian market, albeit with a cautious attitude that has resulted in a reduction of deal volume and size. Slowing growth in European countries, including Germany, have negatively impacted exports from Italy. The sectors where investment activity has been most concentrated over Q2 2023 are the traditional 'Made in Italy' sectors, namely industrial products and consumer goods. We believe the high quality and growing export capacity of Italian companies are key drivers of this deal flow[xiii]
- We have seen increased deal values of Italian investments abroad[xiv], due to Italian companies prioritizing expansion into foreign markets
- Market participants' sentiment also appears changeable and highly dependent on foreign policy news. Liquidity in the system remains high, but the restrictive economic policies of central banks, raising interest rates to mitigate inflation, risk putting a brake on sourcing liquidity for deals. Revising supply chains, target markets, operational efficiency and defining new ways of interacting with customers, will continue to drive the M&A dynamic in Italy and other countries with limited capital availability, especially for SMEs. We expect these factors will mean the outlook for Italy will be increased deal volume, albeit at lower deal values

Q1 2017 - Q2 2023 total deals in Italy, by sector



Source: Mergermarket: Q2 2023 European mid-market deal data



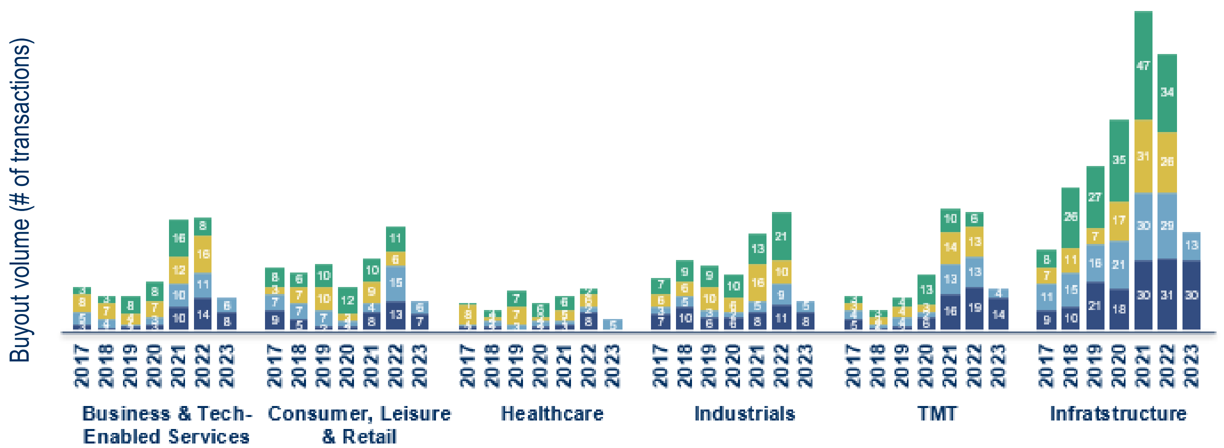
Spain

César Garcia
Managing Director

> ***Private equity firms focused on buy-and-build strategies, consolidation, and strategic opportunities, with trade buyers being more active in transactions***

- Private equity deal activity was negatively impacted in Spain when local elections pushed forward the anticipated year-end general elections to July 23, 2023[xv]. These unforeseen changes added complexities and uncertainties[xvi] to the investment landscape, coupled with valuation gaps and increasing execution risks[xvii]. Private equity firms focused on buy-and-build strategies, consolidation, and strategic opportunities, with trade buyers being more active in transactions
- Despite the challenges in financing, certain sectors showed promise in Spain, with increased activity observed in Infrastructure, Renewable Energy, and in Healthcare. However, after a period of accelerating growth for the economy in H1 2023, we have seen concerns arise regarding potential slower growth for the remainder of the year
- To address liquidity challenges, new financing options are emerging, such as net asset value financing as a result of difficulties to complete exits. We anticipate the Secondaries sector will have more activity as private equity firms seek solutions to divest during this period of difficult market conditions
- The outlook for the Spanish private equity market remains positive, as visibility on 2023 results increase and people are becoming more excited about opportunities[xviii]

Q1 2017 - Q2 2023 total deals in Spain, by sector



Source: Mergermarket: Q2 2023 European mid-market deal data

UK

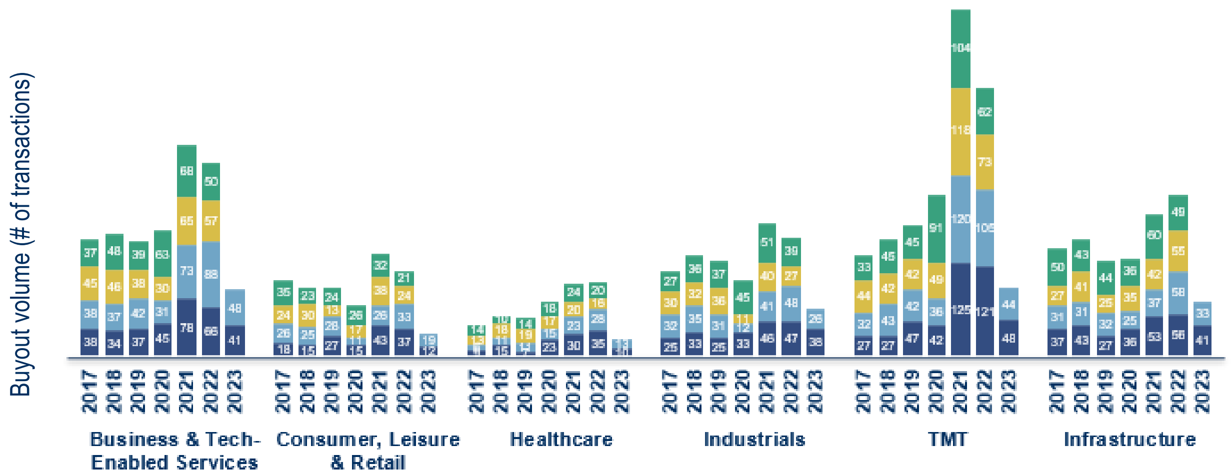
Andrew Strudwick
Managing Director

Tara Stowe
Director

> ***Trade buyers have taken advantage of a more cautious mid-market investor landscape and are taking the opportunity to acquire businesses***

- Given the prevailing market conditions, UK sponsors are now dedicating more time to diligently prepare portfolio investments for exit. As a result, we are seeing a growing trend of M&A advisors being appointed well ahead of anticipated process launch dates, often up to 12-18 months in advance. This proactive approach enables businesses to be thoroughly prepared and to respond promptly to any pre-emptive offers that may arise
- In the UK, we experienced most deal activity in Q2 2023 in the Infrastructure Services, Industrials[xix], IT Services and TICC (Testing, Inspection, Certification and Compliance)[xx] sectors. Quality businesses that are continuing to transact in these sectors are all underpinned by similar characteristics, including predictable and highly recurring revenue streams, diverse customer bases and low churn that make them resilient
- Despite the current market backdrop[xxi], interest from trade and private equity backed trade buyers has remained resilient in UK sale processes. Less constrained by the need to raise significant debt financing for add-on acquisitions, trade buyers have taken advantage of a more cautious mid-market investor landscape and are taking the opportunity to acquire businesses, particularly in the TMT & Tech-Enabled Services sectors, which allow them to bolster/reposition product offerings and move into new markets
- As sponsors have opted to hold onto portfolio assets for longer durations, we have experienced an uptick in sponsor enquiries regarding the viability of NAV (net asset value) facilities to extend portfolio lifespans. Additionally, there is a persistent interest from UK sponsors in exploring GP-led secondaries solutions as a method to optimize asset value for both LPs and General Partners GPs alike

Q1 2017 - Q2 2023 total deals in UK, by sector



Source: Mergermarket: Q2 2023 European mid-market deal data

Central and Eastern Europe (CEE)

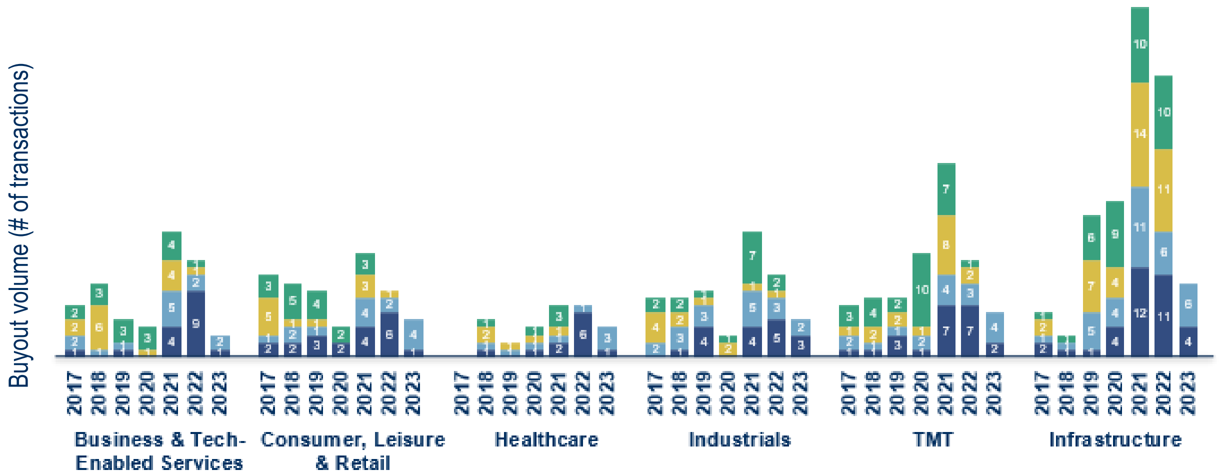

Tod Kersten
Managing Director

Mateusz Prudzynski
Vice President

> ***Although reduced pricing pressure creates a favorable environment for acquisitions, securing financing remains a challenge***

- Deal activity in Poland is currently influenced by two major factors: high interest rates, as well as the looming threat of the Ukrainian war and its impact on immigration flows[xxii]
- Although reduced pricing pressure creates a favorable environment for acquisitions, securing financing remains a challenge. Poland's exclusion from the Eurozone leaves its currency highly sensitive to inflation[xxiii], while the proximity to the Ukraine conflict results in a reduction of investment activity[xxiv]
- Leading trends in the market include downward price adjustments on seller's expectations and a significant 7-8% increase[xxv] in population growth due to the proximity of Ukraine. This demographic shift is particularly important in an aging population, such as Poland, influencing consumption patterns and the labor market
- The fundraising environment is significantly influenced by disputes over blocked EU funding and conflict-related uncertainties which manifest in inflation. Despite the hurdles, there are still deals being executed based on existing pipelines, where valuation expectations between buyer and seller meet

Q1 2017 - Q2 2023 total deals in Central and Eastern Europe, by sector



Source: Mergermarket: Q2 2023 European mid-market deal data

GP Secondaries



Michael Wieczorek
Managing Director

Sabina Sammartino
Managing Director

Ludovic Douge
Managing Director

> ***Opportunities for portfolio companies to pursue accretive acquisitions have created the need for additional capital and time to capitalize on value creation initiatives***

- Overall secondary volumes have come in lower than we expected for H1 2023, LP-led volumes were strong, as secondary buyers sought to take advantage of higher optical discounts and rebalance their exposure with more diversified transactions. Buyers were highly selective in the GP-led transactions they pursued, where there was a higher bar for single-asset transactions
- Under deployment in H1 2023 contributed to an increase in the capital overhang in the secondaries market, which we expect to drive deal flow in H2 2023 as secondary investors come under pressure to deploy capital[xxvi] Opportunities for portfolio companies to pursue accretive acquisitions has created the need for additional capital and time to capitalize on value creation initiatives
- LP's need for liquidity is a key driver of GP-led transactions[xxvii]. In today's market, DPI (distributed to paid in capital) is the new IRR (internal rate of return). GPs are using secondary transactions to accelerate liquidity to LPs in the wake of slower portfolio distributions from traditional exits which can also free up capital to facilitate support for upcoming fundraisings. Elongated primary fundraises may require additional capital as a bridge to future fundraising, ahead of the establishment of the next vintage fund
- We are seeing sponsors required to present clearly articulated rationale and motivation in pursuing continuation vehicle transactions to secure support from existing LPs and backing from new secondary investors
- The secondary capital overhang has increased as several large incumbent investors have recently completed fundraising initiatives[xxviii], new entrants have continued to provide more depth to the market, and deployment pace has reduced in H1 2023, which we believe will lead to likely uptick in deployment in H2 2023
- As we expect deal activity to pick up markedly in H2 2023, 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 full access to information will meaningfully increase the certainty of execution
- We expect GP-led volumes to increase in H2 2023 as soft M&A markets, positive public market performance, and reduced macro uncertainty incentivizes sponsors to engage in secondary transactions on well-positioned assets which can benefit from additional capital and time to maximize value
- LP's drive for liquidity will likely continue to motivate sponsors to consider alternative solutions. Sponsors are increasingly considering portfolio financing options to provide non-dilutive capital, which can be used for a combination of distributions to LPs and deployment into add-ons in the current portfolio or new platform investments

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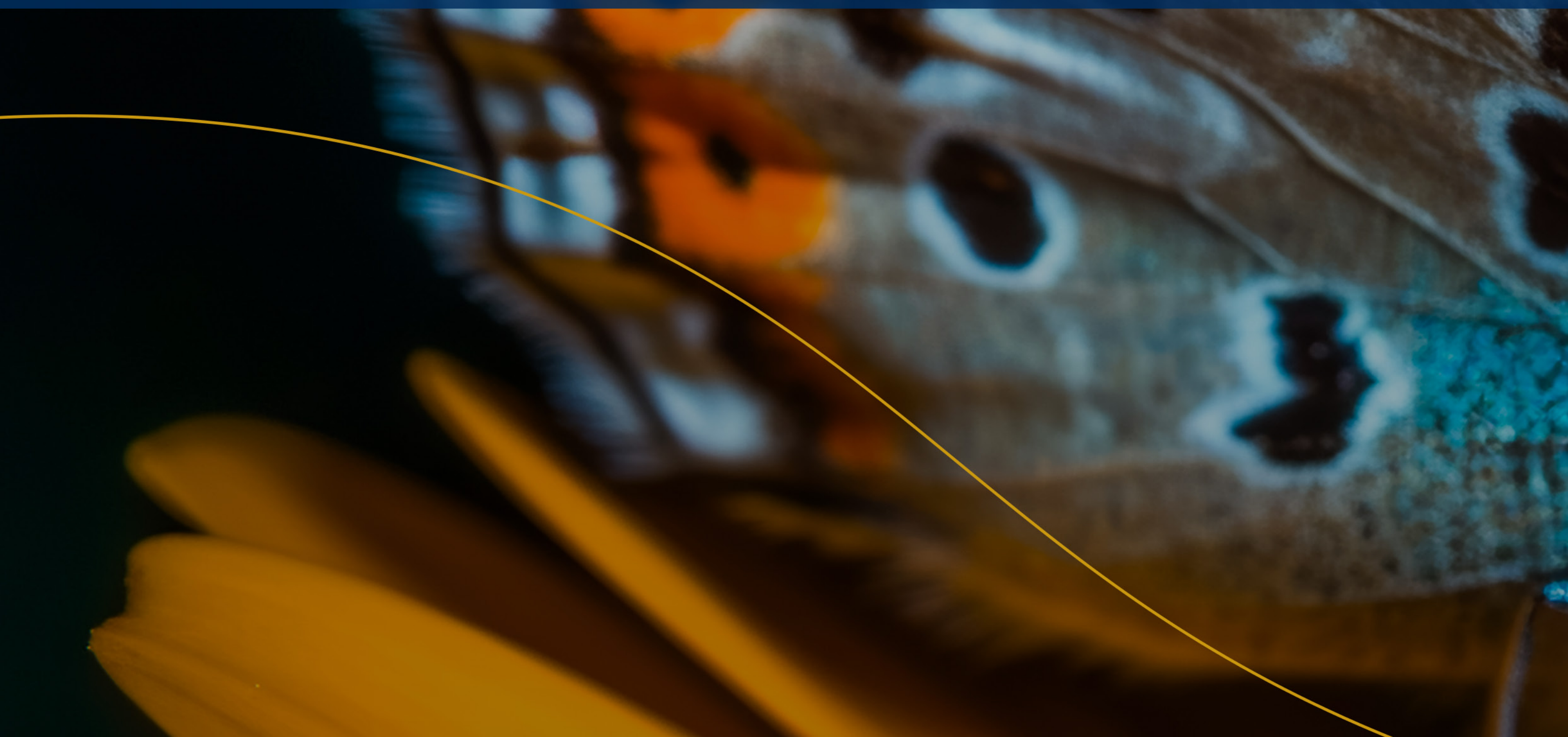

Predicting future activity is an art and not a science and this analysis is not scientific. It is informed judgement – much like the best M&A advice.

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