Private equity in Europe and the UK

November 2024

Introduction

Over the past year, marked by unprecedented developments, we witnessed notable macroeconomic shifts, including record-high inflation rates and aggressive monetary policy tightening across advanced economies.

These headwinds precipitated a global downturn, injecting significant uncertainty into markets. Private markets, in turn, faced substantial pressure, with some notable exceptions across strategies and regions.

As we progress through the second half of 2024 and into 2025, a more optimistic outlook is taking shape. Major economies are experiencing disinflationary trends and have begun entering a period of easing interest rates. Central banks, including the Federal Reserve (the Fed), the Bank of England (BoE), the European Central Bank (ECB), have already implemented at least one rate cut, marking the start of this easing cycle.

However, in contrast, the Bank of Japan raised its interest rate for the first time since 2007, with two hikes in March and July 2024. Although this move diverges from the global trend, its impact on overall asset prices should not be overstated, as markets often overreact initially to such decisions and are now showing signs of correction.

Optimism surrounding a more accommodative borrowing environment sets the stage for a potential resurgence in private market activity. However, broader uncertainty is expected to linger due to geopolitical tensions, the prospect of significant shifts in the global political order amid numerous elections in 2024, and persistent macroeconomic challenges.

Against this intricate backdrop, we've been examining how these conditions will influence the outlook for private markets in the latter half of 2024 and into 2025. Our comprehensive series of reports has scrutinised the prospects for three specific asset classes – private debt, real estate and, now, private equity – across diverse geographical regions. We provide insights into how investors can navigate current market dynamics and leverage opportunities strategically to their advantage.

Macroeconomic overview

Headline inflation in Europe and the UK showed a disinflationary trend in the first half of 2024, though such a development has also been accompanied by lingering domestic price pressure, as seen via relatively sticky, elevated services inflation.

Despite this, both the ECB and the BoE opted to cut interest rates in recent months. In the UK, inflation hit the BoE's target of 2.0% in May for the first time in three years, and this alongside a partial unwinding of the labour market, likely prompted the BoE to embark on a cut in August.

Unlike the US, Europe and the UK have not experienced resilient growth under tighter monetary conditions. Both regions ended 2023 with poor growth, with the UK entering a technical recession in the second half of 2023. However, there have been signs of improvement, with both economies recording quarterly growth in Q1 and Q2 2024. Cebr forecasts the UK economy to grow by 1.2% in 2024, while the Eurozone is expected to grow by 0.8%. Despite these improvements, growth remains relatively subdued.

Even with recent rate cuts, interest rates are likely to remain above pre-pandemic levels through 2024 and 2025. Central bankers are expected to maintain restrictive rates to manage inflationary pressures, which could expose financial vulnerabilities for issuers facing limited access to financing and higher service costs.

Additionally, 2024 has seen significant political changes, including a new government in the UK and major political shifts in key European Union (EU) member states such as France. These changes add uncertainty to policy and regulatory frameworks. Ongoing geopolitical tensions, notably the Russia-Ukraine conflict and conflicts in the Middle East, also present challenges that could impact the overall economic outlook.

Overview of global private equity market

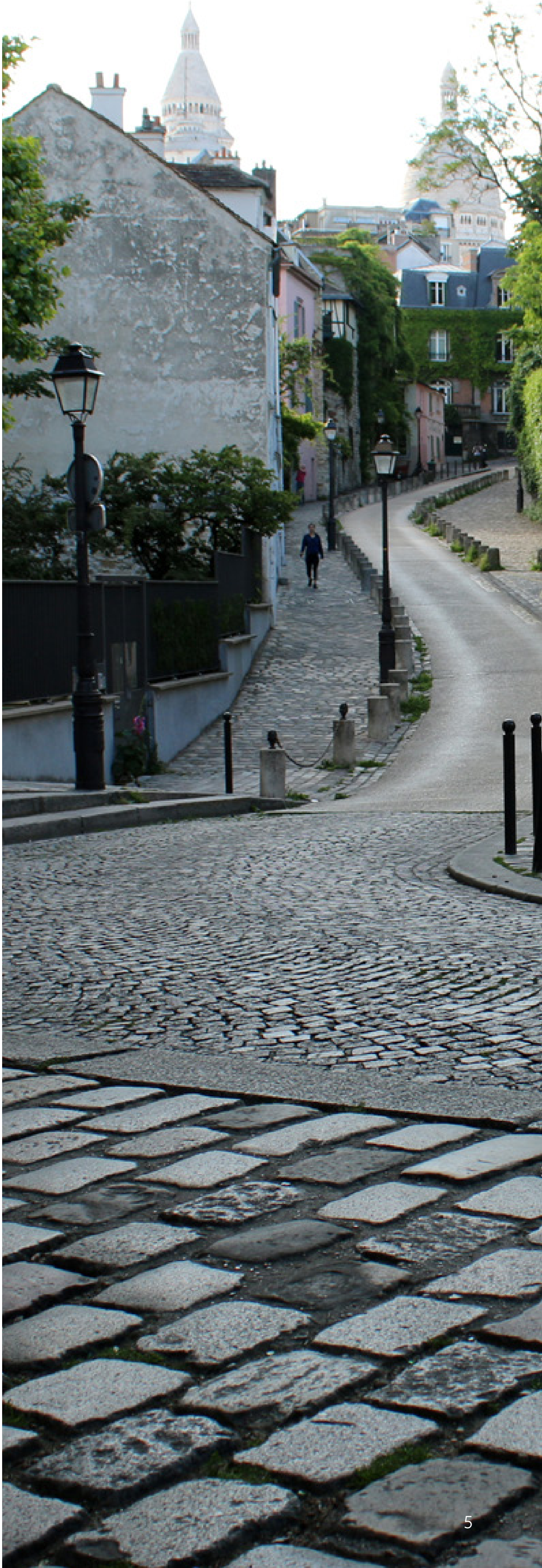
Elevated inflation in the first half of 2023 continued to put downward pressure on company operating margins. In addition, monetary policy tightening kept borrowing costs elevated for leveraged buyouts and decreased investment valuations.

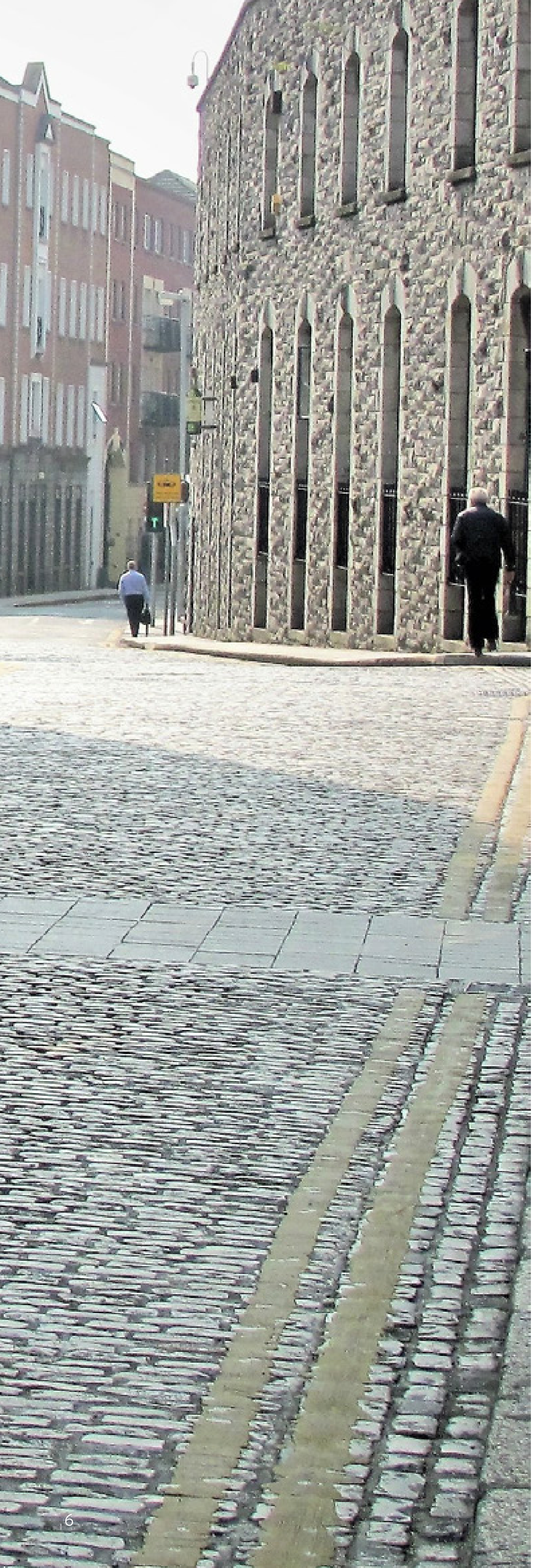
Consequently, the slowdown in private equity witnessed in the second half of 2022 continued throughout 2023. Deal-making activity experienced a notable decline, with deal value and count plummeting by 60% and 35%, respectively, from their 2021 peaks.[1] Buyout investments, excluding add-ons, saw their value drop to $438 billion in 2023, a 37% decrease from the year prior and representing the lowest total since 2016.[2]

Exit activity struggled more than deal-making, with buyout-backed exits declining by 44% in 2023 compared to 2022, to $345 billion.[3] Increased borrowing costs led to a scenario where potential purchasers of a portfolio company would need to spend more for reduced borrowing capacity relative to EBITDA multiples, compared to the seller's initial purchase conditions. This discrepancy created a significant gap between the buying and selling price expectations for the same asset, specifically within the sponsor-to-sponsor channel.

This has resulted in buyout funds sitting on roughly 28,000 unsold companies worth $3.2 trillion.[4] Moreover, sellers are not only mindful of the bid-ask spread but are also selectively offering only premium assets to the market, ensuring these investments yield satisfactory returns.

Despite ongoing loosening, interest rates are projected to remain high relative to pre-pandemic levels, potentially leading to a persistence of wide bid-ask spreads and selective offerings. This situation is likely to continue obstructing exit pathways for private equity, casting uncertainty over investment returns and dampening future fundraising efforts.





Despite facing obstacles, a cautiously optimistic outlook prevails for general partners (GPs).

For one, undeployed capital worth $3.9 trillion acts as a significant motivator. Furthermore, the slowdown in deal-making presents an upside by increasing the average age of buy-out capital. This increase implies funds are approaching the latter stages of their investment periods, encouraging companies to explore investment opportunities more promptly. This scenario harbours optimism for the asset class, signalling a likelihood of heightened investment activities in the near term.

Moreover, global private equity raised more capital in 2023 compared to the year prior, amounting to $629 billion, signalling a positive outlook amidst lingering uncertainty and tighter monetary conditions more broadly.[5]

However, while these build-ups and anticipated rate cuts may provide some relief in unclogging exit channels, GPs will need to adopt more innovative approaches and prioritise returning capital to limited partners (LPs) to revitalise fundraising levels, particularly amidst broader macroeconomic uncertainties.

Navigating fundraising and exit strategies in Europe and the UK amidst prevailing macroeconomic conditions

Dealmaking activity across Europe saw a notable decline in 2023, dropping to historically low figures. It marked the first occasion in six years that the aggregate value of transactions fell beneath the €100 billion mark.[6] Relative to 2022, there was a 45% decrease in the number of deals and a 65% reduction in overall deal value.[7]

Despite these downturns, the UK maintained its leading role in the European private equity sector, securing the top spot with 160 transactions valued at €16.1 billion. Meanwhile, Germany, the bloc's biggest economy, recorded 90 transactions amounting to €12.2 billion.[8]

Within the industry, the impact of this downturn varied across deal sizes. Mega deals were particularly affected, encountering greater challenges compared to mid-market value deals. This, in part, was due to the reliance of such deals on debt financing which was restricted over the past year due tighter monetary conditions.

This is exemplified by the surge in yields on large, syndicated loans, reaching 9% in Europe, the highest level in a decade.[9] Resultantly, transactions significantly dependent on bank financing were discontinued, exacerbating the challenges encountered by large-scale deals. On the other hand, transactions within the mid-market sector exhibited robustness, accounting for 25% of the transaction volume and 32% of the transaction value in 2023, an increase from 23% and 18% respectively in the previous year. Remarkably, activity in the lower mid-market segment in 2023 reached levels comparable to the peak observed in 2021.[10] Resilience in the mid-market segment suggests a potentially more diversified and stable investment landscape moving forward, amidst expectations of interest rates not reaching their pre-pandemic levels anytime soon.

Another noteworthy development within the private equity space in is the increase in public-to-private transactions, where private equity markets are leveraging relatively lower valuations of companies on European stock exchanges. Notably, the UK accounted for half of these deals in 2023, underscoring a strategic pivot towards such investments.

Amidst prevailing market conditions characterised by pricing disparities, financing constraints, and widespread uncertainty, private equity firms are increasingly recognising opportunities for value creation. As a result, take-private transactions and strategic acquisitions are expected to maintain their appeal and prominence in the investment landscape.

In addition, fundraising in Europe has proven to be more resilient compared to the global market, partly due to improved investor sentiment towards Europe.[11] In 2023, fundraising in Europe surged by 45% from 2022, reaching €117.8 billion, and just falling short of the record set in 2021 at €118.4 billion.[12] A significant portion of the fundraising efforts was allocated to larger, more established funds, while mid-sized funds also played a crucial role as major recipients.

A liquidity crunch, driven by diminished exit opportunities, prompted LPs to adopt a more cautious approach in their investment strategies, prioritising larger and more established funds. This shift is consistent with trends observed in both the US and Asian private equity sectors, indicating a worldwide movement towards heightened risk sensitivity among LPs in response to prevailing uncertainty.

Indeed, wider bid-ask spreads meant that European PE exit activity recorded declines in 2023. Deal count and deal value declined by 40% and 60% respectively compared to 2022.[13]

Nevertheless, there are signs that exit opportunities within European private equity firms are poised for improvement. Ongoing policy loosening, along with a slight uptick in economic conditions, are likely to stimulate activity in this area. Lower interest rates should reduce borrowing costs, thereby potentially easing leveraged buyouts and facilitating various exit mechanisms.

Moreover, recent data suggests a resurgence of interest in strategic sales and secondary buyouts as viable exit routes for private equity firms in Europe. Strategic buyers, including corporates seeking growth opportunities or synergistic acquisitions, present attractive options for exiting investments, particularly in industries experiencing consolidation or technological disruption. Furthermore, the European IPO market, despite experiencing fluctuations, remains a viable avenue for PE exits.

Looking forward, the European private equity sector is expected to experience an uptick in deal-making activity in 2025 and beyond. LPs are applying greater pressure on GPs to invest committed capital before diminishing exit opportunities and cashflow constraints arise. The buildup of unutilised capital, alongside the maturation of current investments, highlights the significant untapped investment opportunities available. On the other hand, it also underscores the imperative for GPs to generate sufficient returns for their investors.

To this end, GPs need to remain mindful of the need to navigate market uncertainties and manage risk effectively. Striking the right balance between deploying capital to seize opportunities and ensuring prudent investment decisions will be crucial in maximising returns for LPs while mitigating potential downside risks. GPs must adapt to this evolving landscape by deploying capital judiciously and pursuing opportunities that offer the potential for attractive returns while mitigating risk. To do so GPs should conduct thorough due diligence, leveraging all available tools at their disposal, while also coming up with creative solutions to maximise the opportunity available to them.

References

1 Bain & Company (2024), Global Private Equity Report 2024
2 Ibid
3 Ibid
4 Ibid
5 Preqin (2024), Future of Alternatives 2029
6 Centre for Private Equity and MBO Research (2024), European PE industry 'pauses for breath' after record period, as buyouts dip to lowest level in a decade
7 Ibid
8 Ibid
9 Bain & Company (2024), Global Private Equity Report 2024
10 Centre for Private Equity and MBO Research (2024), European PE industry 'pauses for breath' after record period, as buyouts dip to lowest level in a decade
11 Preqin (2024), Future of Alternatives 2029
12 Moonfare (2024), The state of European private equity
13 Baird (2024), Top Ten Trends in European PE in 2023 and Implications for 2024

Degree of opportunity for private equity markets posed by macroeconomic conditions

Development	Degree of opportunity for asset class
Start of policy loosening cycle	
Both the ECB and BoE have entered the phase of lowering interest rates. Lower interest rates will reduce the cost of acquisition financing, allowing PE sponsors to return to leveraging their deals more effectively. This is also expected to loosen the more restrictive bank lending practices currently in play. However, it is worth noting that interest rates are unlikely to drop to their pre-pandemic lows, which will likely mean only a slight easing in spreads between buyers and sellers.	✓ HIGH / MEDIUM / LOW
Investment in green energy	
Government initiatives in both the UK and the EU are actively promoting decarbonisation efforts, aligning with the ambitious goal of achieving net zero emissions. These initiatives include tax incentives for green projects and mandates emphasising the use of renewable energy sources. Such favourable environments are creating significant opportunities for private equity investment in the green and renewable energy sector. With clear policy support and growing public awareness of environmental concerns, private equity firms are well-positioned to capitalise on this market.	HIGH / ✓ MEDIUM / LOW
Succession as a window of opportunity	
Approximately 60% of all European firms are family-owned, and within this demographic, there is a rising number of entrepreneurs seeking to cash out and retire. This presents two clear opportunities for PE sponsors: firstly, they can facilitate buy-out activities for those entrepreneurs looking to exit and retire. Secondly, for firms aiming to maintain their businesses within the family, PE funds can take minority stakes and provide crucial growth financing support. In essence, the ageing population of entrepreneurs in Europe creates a ripe environment for PE firms to engage in strategic investments and value creation.	HIGH / ✓ MEDIUM / LOW
AI as a value creation ally for both GPs and LPs	
AI is presenting LPs with compelling investment options and offering new ways for firms to enhance internal operations. For GPs, the trifecta of AI, big data and machine learning can be used to improve investor reporting, automate contract drafting and elevate the value proposition of their portfolio companies.	✓ HIGH / MEDIUM / LOW
Regulation	
The introduction of the European Long-Term Investment Fund (ELTIF) and the revised Alternative Investment Fund Managers Directive (AIFMD) 2.0 presents both challenges and opportunities for private equity in Europe. While the stricter compliance, reporting requirements, and investment mandates may increase operational complexities for PE firms, these regulations also facilitate greater access for retail investors, expanding the investor base, and potentially promoting greater capital inflow into private equity markets. This, combined with enhanced regulatory clarity and streamlined cross-border fund management, strengthens the appeal of private equity in Europe, fostering long-term growth and competitiveness, particularly against more established markets like the US, despite potential regulatory divergence post-Brexit.	HIGH / ✓ MEDIUM / LOW

IQEQ

Key contacts

Justin Partington
GROUP HEAD OF FUNDS AND ASSET MANAGERS

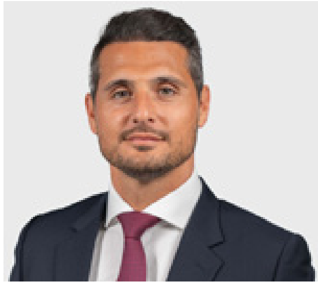
E justin.partington@iqeq.com

Emma Crabtree
GROUP CHIEF COMMERCIAL OFFICER

E emma.crabtree@iqeq.com

Bram Eijsbouts
CHIEF COMMERCIAL OFFICER, LUXEMBOURG & NETHERLANDS

E bram.eijsbouts@iqeq.com



Romain Mifsud
CHIEF COMMERCIAL OFFICER, FRANCE AND SWITZERLAND

E romain.mifsud@iqeq.com

Jacques Vermeulen
CHIEF COMMERCIAL OFFICER, UK

E jacques.vermeulen@iqeq.com

Paul Griffith
CHIEF COMMERCIAL OFFICER, IRELAND

E paul.griffith@iqeq.com

Mirek Gruna
REGIONAL CCO, UK, IRELAND AND CROWN DEPENDENCIES

E mirek.gruna@iqeq.com

This note is for informational purposes only and does not constitute financial advice, investment guidance, or an endorsement or recommendation for any particular security or trading strategy. The information contained herein is not intended to be a source of advice or credit analysis with respect to the material presented, and the information and/or documents contained in this note do not constitute investment advice.

This publication has been issued by IQ-EQ Group Holdings SA on behalf of certain companies that form part of IQ-EQ Group. The publication has been prepared for general circulation to clients and intermediaries and does not have regard to the circumstances or needs of any specific person who may read it. Nothing in this publication constitutes legal, accounting or tax advice or investment advice.

The information contained in this publication has been compiled by Cebr and/or its affiliates from sources believed to be reliable, but no representation or warranty, express or implied is made to its accuracy, completeness, or correctness. All opinions and estimates contained in this report are judgements as of the date of publication and are provided in good faith but without legal responsibility.

For information on the legal and regulatory status of our companies, please visit www.iqeq.com/legal-and-compliance

Follow us