


The UK mid-market private equity outlook

A low-angle, upward-looking photograph of several modern skyscrapers with glass facades. The buildings are framed by a clear blue sky. The perspective creates a sense of height and architectural scale. The glass reflects the sky and each other, creating a complex pattern of lines and reflections.

Private equity is screening UK opportunities

During September 2023, Deutsche Numis polled 200 senior private equity professionals who focus on the mid-market for unique insights into mid-market sentiment.

2023 has seen subdued M&A activity driven by ongoing economic uncertainty, differing views on valuation between buyers and sellers, and constrained debt markets. The average transaction size in public markets is significantly lower than in prior years, which has been to the benefit of mid-market participants.

UK more attractive than other geographies

The UK continues to be seen as a highly attractive investment destination, with strong competition for assets. 85% of private equity investors surveyed believe the UK is more attractive, or significantly more attractive, than other markets available to them (2022: 91%).

33% (2022: 29%)

cite recent regulatory tailwinds in the UK as the key factor attracting them to UK PLCs.

29% (2022: 12%)

believe that current depressed valuations are the main attraction of UK assets.

Significant switch of focus towards UK private market assets

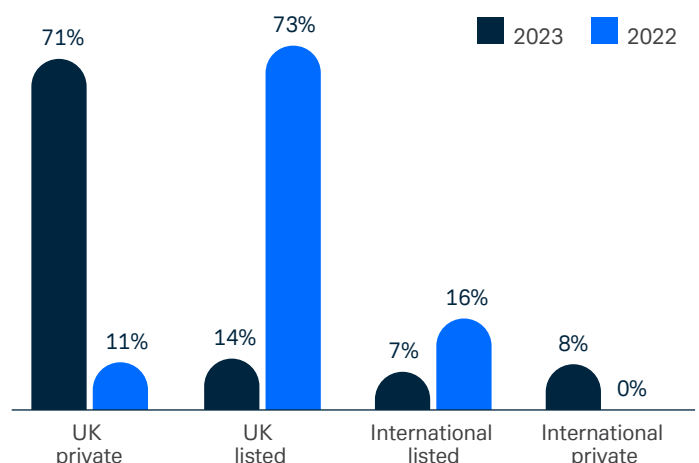
Our survey shows that sponsors have shifted focus to UK private companies in 2023, with 71% of respondents citing private assets as their main focus (2022: 11%).

It is clear from our research and conversations with market participants that the decline in appetite for UK public assets is significant (2023: 14%, 2022: 73%) and reflects a perception that public investors may be less willing to sell currently, making it harder to execute deals, and that there is a wider opportunity set in UK private markets.

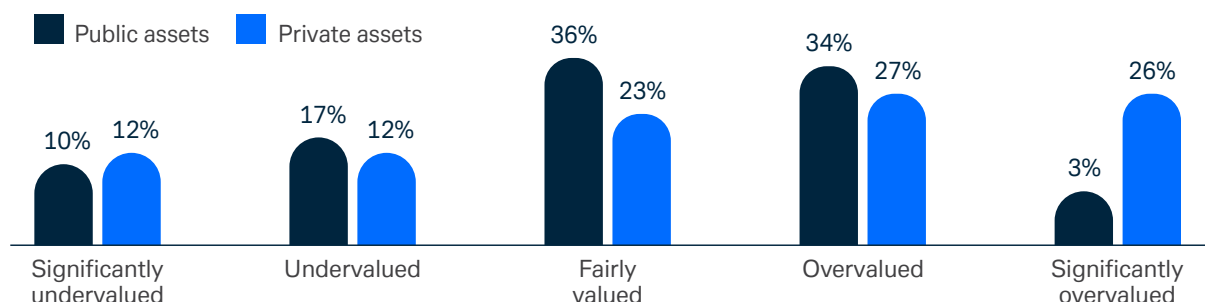
This is despite respondents viewing private assets to be more overvalued than public assets (53% vs. 37%) which is a change from 2022 when only 10% considered all assets overvalued.

On balance, private equity buyers still believe that institutional owners of listed companies will be receptive to public-to-private deals, however, the proportion responding 'highly receptive' fell significantly from 42% last year to 11% this year.

Where is the main focus of your pipeline currently?



In your opinion, is your general universe of investable assets fairly valued?

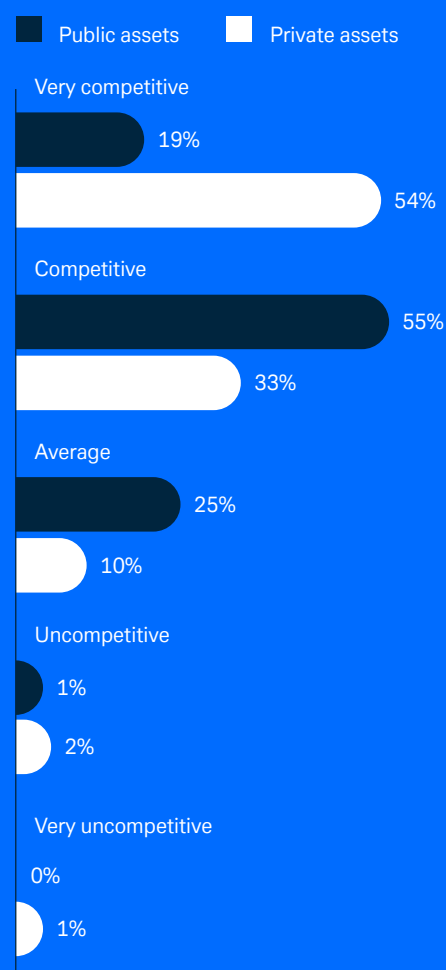


Competition has increased and is expected to increase further

Last year's prediction that competition for UK assets would increase has been proven, with 87% and 74% of respondents viewing private and public assets as 'competitive' or 'very competitive', respectively. Given the heightened focus, private markets are also expected to be relatively more competitive than public, with 54% of respondents viewing private markets as 'very competitive' (public markets: 19%).

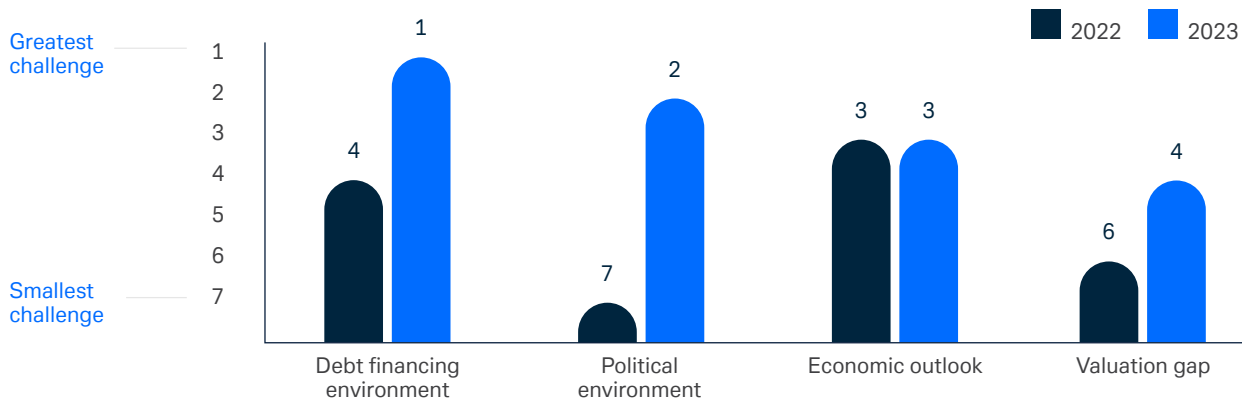
Looking forward, private equity professionals were clear that competition for both UK public and private assets would continue to intensify. Last year, private equity was expected to be the main source of competition, which is still expected to be the case for private assets. However, respondents expect to see UK corporates as the main source of competition for UK public assets. This possibly reflects a more stable operating environment allowing corporates to focus more on strategic acquisitions rather than operations, and the ability of listed companies to use their own shares to fund acquisitions in a more challenging financing environment.

How are you seeing competition for assets currently?



Headwinds continue to weigh on transaction execution

What are the key challenges to execute a transaction in the next 12 months?



Greatest to smallest challenges ranked from 1-6 and 1-7 in 2023 and 2022, respectively.

As concerns over COVID-19 and buyer distractions have dissipated, the financing environment has become the primary concern, exacerbated by political uncertainty owing to upcoming elections which have become a significant concern on top of ongoing macroeconomic challenges.

73% (2022: 82%)

of respondents view the UK debt market as challenging or significantly challenging; however...

77% (2022: 87%)

believe that current financing markets will improve over the next twelve months.

Private equity continues to actively assess private and public opportunities, but financing conditions have remained challenging, despite a slight perceived improvement possibly reflecting mindset adjustment to the higher rate and lower leverage environment.

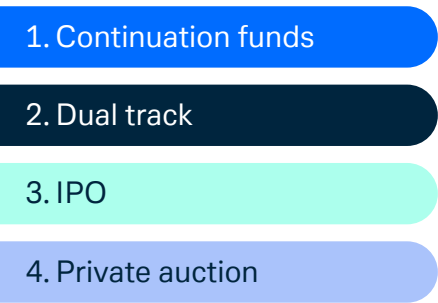
Our survey also showed that 48% of respondents consider their need to maintain interest cover in the face of higher rates as the main limiting factor on taking on debt and that the majority view private credit funds as their “go-to” source of debt.

Whilst there is still an appetite for adding bolt-on acquisitions to portfolio companies, far fewer respondents (12%) said they were ‘highly likely’ to execute these, demonstrating the impact of these headwinds even on smaller transactions.

Difficult exit environment

Our research shows that private equity firms expect to be active on the buy-side in private markets, but it is clear that on the sell-side they are less confident in the exit environment than they were last year.

How do you rank your preference for exiting assets in the current environment?

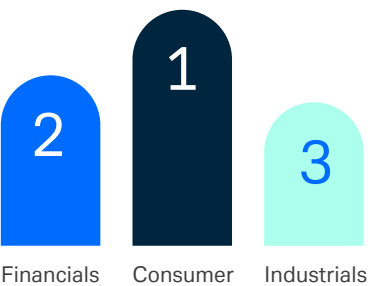


Respondents cited continuation funds as the preferred exit option and demoted private auctions from the most to least favoured position, reflecting the aforementioned headwinds. The IPO route is now more preferred than a private auction, although the vast majority do not anticipate a fully functioning IPO market before Q4 of 2024. As a result, it seems that dual track processes are being prioritised to retain optionality.

Financials and Industrials are most active

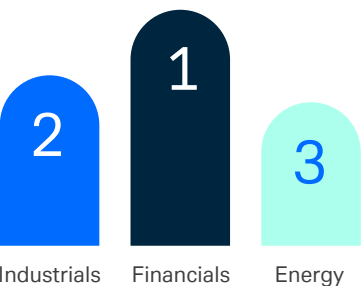
Which sectors do you view as the most active or competitive at present?

Private acquisitions



Across both public and private markets, Financial and Industrial-related assets are in the top-3 most active and competitive sectors for M&A. In private markets, Consumer is seen to be the most active, arguably reflecting a degree of distressed M&A in that space.

Public-to-private



Conversely, TMT and Healthcare markets are considered to be subdued, despite recent sponsor bids for Blancco Technology, Dechra Pharmaceuticals, Ergomed, Instem and Network International.

Challenging fundraising environment

Whilst a number of sponsors have successfully raised funds during 2023, the survey shows that the fundraising environment is challenging and is expected to become even more so.

How do you view the current fundraising environment compared to the last 12 months?



How do you view the outlook for fund raising to be over the next 12 months?

66% (2022: 51%)
of respondents view the outlook for fundraising as somewhat challenging, and...

17% (2022: 30%)
expect it to be very challenging over the next 12 months.





Stuart Ord, Co-Head of M&A at Deutsche Numis comments:

"The conclusions of this year's survey are multi-layered and highlight an environment with both opportunities and complexities.

The UK continues to be viewed by private equity as a highly attractive investment destination. The survey identifies it as the most attractive geography, albeit on a relative basis, given both public and private markets are seen as overvalued and are acknowledged as heavily competed.

The challenging environment that private equity is operating in is manifested by the survey. There are still significant funds to deploy but there are material transaction execution headwinds to be overcome with limited prospect of near-term improvement identified.

In recent months, private equity has been relatively active compared to corporate bidders, particularly in UK public markets where they have made takeover bids in the mid-market across a range of sectors.

Public market transactions will continue in the mid-market so some PLC boards need to recognise potential vulnerability and prepare for a bid, but private markets are seen to offer a wider opportunity set of potential targets and are now the focus of buy-side activity by private equity. However, while willing to hunt for value as buyers from the private markets, there is notable caution about exiting via private auction or IPO, with continuation funds being flagged as the preferred exit route.

This continued activity shows the resilience and adaptability of the industry but it is undoubtedly harder to find and execute deals and a difficult fundraising environment is reflective of this. We expect to see corporate bidders becoming relatively more active but remain confident that private equity will remain an important and significant component of UK M&A."



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