UK Mid-market PE review

Perspectives on Private Equity activity in 2021

February 2022

kpmg.com/uk/midmarketPE

The landscape

Contents

All data provided by Pitchbook

** Environmental, Social and Governance (ESG)*

2021 activity versus 2020

All PE activity

1,545 deals, up 38%

£159.2bn deal value, up 60%

Mid-market* PE activity

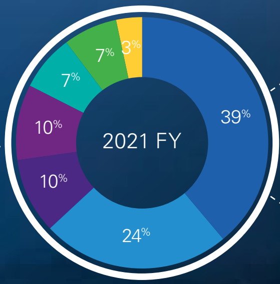
803 deals, up 40%

£46.8bn deal value, up 36%

PE exit activity

162 deals, down 9%

UK mid-market PE deal volume % by sector



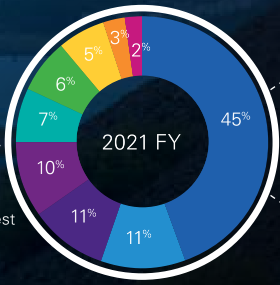
- Business services
- TMT
- CG&R
- Financial services
- Healthcare
- Industries
- Energy

Business services **312** deals, **39%** of all mid-market PE deals

TMT **194** deals, **24%** of all mid-market PE deals

CG&R **79** deals, **10%** of all mid-market PE deals

UK mid-market PE deal volume % by UK region



- London Region
- Midlands
- N. West
- S. East
- Yorkshire & Humber
- S. West
- Scotland
- N. East
- N.I/IOM/C. Isles

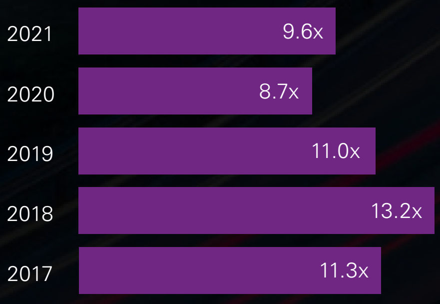
London **359** deals, **45%** of all mid-market PE deals

Midlands **86** deals, **11%** of all mid-market PE deals

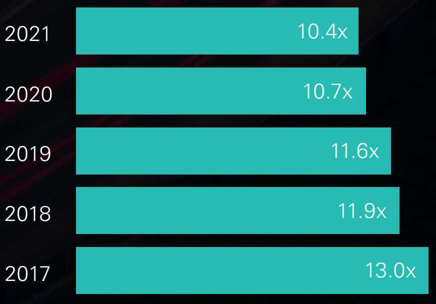
N. West **84** deals, **11%** of all mid-market PE deals

The landscape

UK PE buyout average EV/EBITDA* multiples



UK mid-market PE average EV/EBITDA* multiples



Period covered 1 January to 31 December 2021

Source: *Pitchbook*

** deals with an EV of £10-£300m*

Welcome

Jonathan Boyers
Partner, UK Head of Corporate Finance

The UK PE market saw a dramatic return to form in 2021. Our analysis shows that both deal volumes and values hit the highest levels ever recorded, as confidence returned and pent-up demand was released.

Those sectors that have consistently demonstrated their resilience through the pandemic, such as TMT, and the tech-based segments of Business Services, and Consumer Goods and Retail, led the charge, but performance was generally strong across the board.

The first half of the year was especially busy, continuing the high level of momentum evident in the latter half of 2020. Activity slowed over the rest of the year, particularly in Q4, amid concerns around long-term inflation, fiscal-monetary policy and supply-chain stability, plus increased uncertainties around the COVID-19 Omicron variant. Nevertheless, it was a decline from a very high peak, and overall H2 deal flow was in line with recent historic levels.

PE deal values, in particular, increased by 60% on the 2020 figure, boosted by mega-deals such as supermarket group Morrisons' sale to CD&R, and the acquisition of motoring group AA by TowerBrook and Warburg Pincus.

In line with the increase in PE activity, deal multiples across the UK PE market as a whole rose in 2021, from 8.7x earnings in 2020 to 9.6x in 2021. Multiples in the mid-market remained fairly steady at 10.4x, a slight drop from 10.7x in 2020.

It was notable, too, that the IPO market returned, not only in the UK but across the globe. Again, key sectors such as TMT, tech-driven Business Services, and Consumer Goods in particular, outperformed, reflecting the strong performance of these sectors over the past two years.

We are also seeing ESG considerations having a growing influence on deals, a topic discussed in more detail later in this report. This is driven by higher expectations from PE investors, stakeholders and consumers for companies to be making a conscious and meaningful contribution. Businesses that can demonstrate a robust, meaningful ESG strategy will attract more buyers and secure higher valuations – and this is only going to increase.

Despite some headwinds coming into focus towards the end of the year, longer-term market sentiment is positive and we expect to see a healthy level of PE deal activity continuing into 2022.

In this report, we look further at some of the key trends shaping UK mid-market PE investment. These include:

- The bounce-back from the pandemic
- The strength of the TMT and Business Services sectors
- The growth bolt-ons and minority investments
- The return of IPOs as an exit option
- The rise of ESG in PE deal-making

Our perspective

Alex Hartley
Partner, Head of Private Equity and London Regions, Corporate Finance

It was encouraging to see that mid-market PE deal volumes reached a record high in 2021, up by 40% on 2020 and up 20% on 2019, which was itself a strong year.

We see three main drivers for this stellar performance in the mid-market. One of the main factors was the widely expected overhaul of the Capital Gains Tax (CGT) regime, including changes to CGT rates for business disposals. The CGT increase did not in the end materialise, but it remains very much on the cards, and is likely to remain a factor in entrepreneurs' thinking in the early part of 2022.

At the same time entrepreneurs, having withstood the shock of the pandemic, were keen to release some of their wealth. This brought more businesses to the market, as business owners looked to rebalance their investments and reduce the risks in their personal asset portfolios.

This fed into a window of opportunity at the end of 2020 and into 2021 as the worst of the Covid-19 pandemic seemed to have passed and lockdown began to ease. PE capital, which had been pent up all year, needed to be deployed, and PE investors took advantage of the relaxing of restrictions to make up for lost time.

A noticeable feature of the market in 2021 was that, even after the huge spike in activity in Q1, activity levels remained strong, relatively speaking, right through the year. It was only in Q4 that we saw a little more hesitancy around future prospects.

The number of exits saw a slight decline from 2020, but still surpassed 2019 levels. Exit values, on the other hand, increased by 12.7%. This tailing off in exit volumes is part of an ongoing trend we have seen over the past few years, whereby investment levels have been consistently higher than exit levels – a disparity that will need correcting at some point, although probably not while the market remains volatile.

Interestingly, there was a notable upsurge in mid-market IPOs, as there was in the wider PE market, with vendors of high-performing businesses seeking the higher multiples and higher valuations this exit route tends to deliver. In fact, the UK saw the highest number of IPOs since 2007, with over 120 companies listed, raising over £16.8 bn. The IPO market is driven by confidence, so the fact there were so many mid-market IPOs in 2021 bodes well for 2022.

Total UK PE activity

£159.2bn
deal value, up
60%

1,545
deals, up
38%

The first half of 2021 picked up where 2020 left off, with a high level of confidence and a large amount of capital in the market.

The resurgence of PE activity that brought 2020 to a close continued in 2021, with the highest deal volumes and values ever recorded.

The volume of deals reached a record 1,545, up from 1,117 in 2020, an increase of 38%. Putting 2020 to one side as an atypically low year, this still represented a 24% increase on 2019.

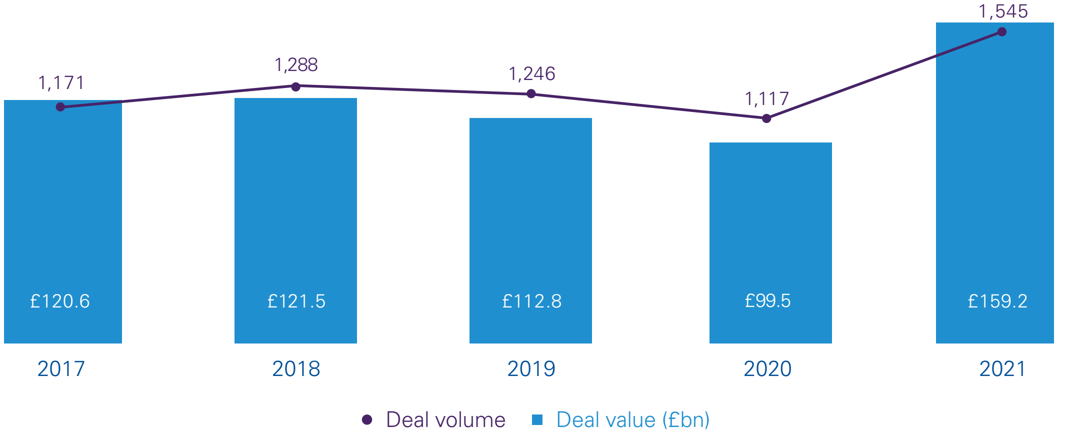
The value of deals was equally strong at £159.2 bn, up 60% on the £99.5 bn of deals completed in 2020, and an increase of 41% on the £112.8 bn achieved in 2019.

The fact that deal values increased by significantly more than volumes (60% vs. 38%) suggests it was larger PE deals driving activity.

The first half of the year was particularly busy. There were 912 deals in H1 at a value of £94.3 bn, compared to 633 deals in H2, at a value of £64.9 bn. At a quarterly level, Q1 2021 was the stand-out performer, with 550 deals at a value of £54.3 bn. Although still strong in relation to previous years, performance in the remaining three quarters of the year did not reach the same highs. The number of deals in Q4 was 19% down on Q4 2020 and 17% down on Q4 2019, but still on a par with historic quarterly levels.

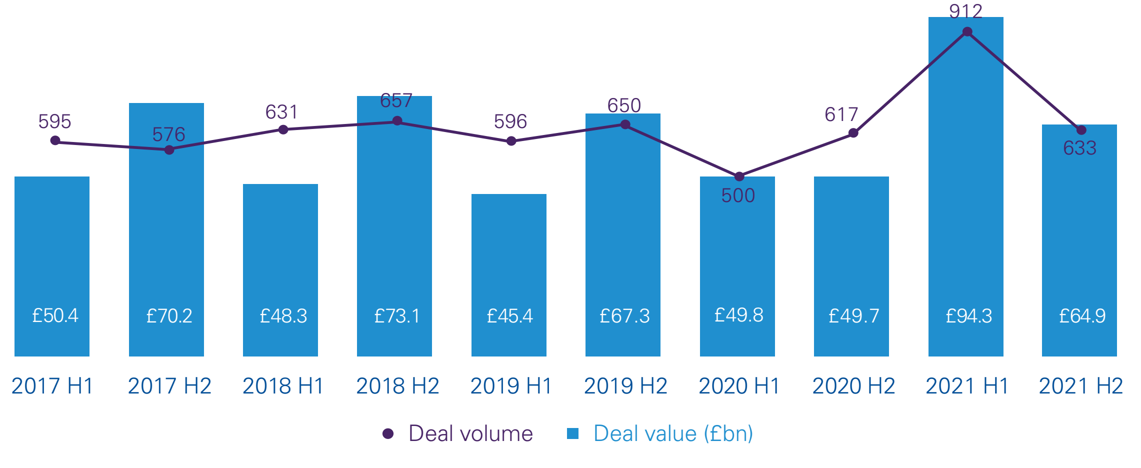
Much of the strong performance in 2021 can be attributed to returning optimism, supply of dealflow and impact of concerns over CGT rates, combined with a large amount of available capital needing to be deployed after the muted activity levels of recent years.

Annual UK PE deal volumes and values (£bn)



	% Change YoY	
	2020 v 2021	2019 v 2021
% Value Change	60.0%	41.2%
% Volume Change	38.3%	24.0%

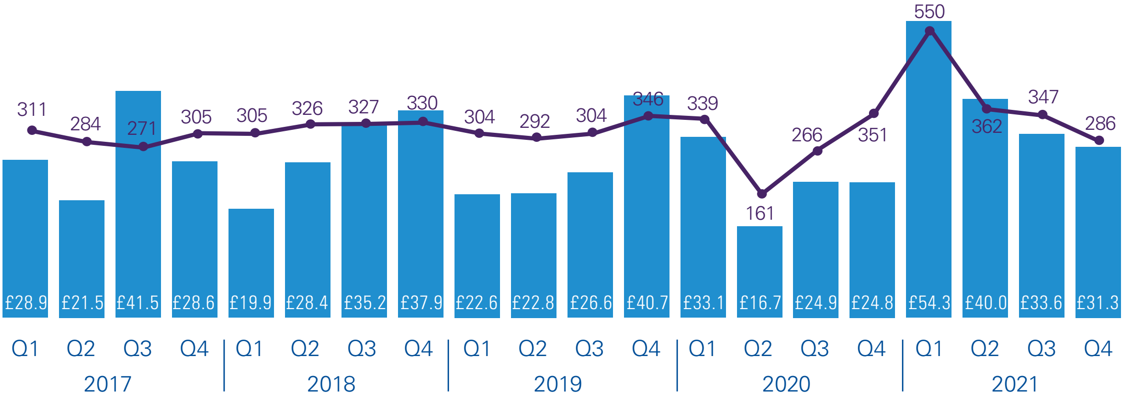
Half year UK PE deal volumes



	% Change YoY 2020 v 2021		% Change YoY 2019 v 2021	
	H1 v H1	H2 v H2	H1 v H1	H2 v H2
% Value Change	89.2%	30.7%	107.5%	-3.6%
% Volume Change	82.4%	2.6%	53.0%	-2.6%

Source: *Pitchbook, data period 1 Jan 2021 - 31 Dec 2021*

Total UK PE Quarterly Deal volume and value (£bn)



	% Change YoY 2020 v 2021				% Change YoY 2019 v 2021			
	Q1 v Q1	Q2 v Q2	Q3 v Q3	Q4 v Q4	Q1 v Q1	Q2 v Q2	Q3 v Q3	Q4 v Q4
% Value Change	64.2%	138.8%	35.0%	26.3%	139.8%	75.4%	25.9%	-23.0%
% Volume Change	62.2%	124.8%	30.5%	-18.5%	80.9%	24.0%	14.1%	-17.3%

Source: *Pitchbook, data period 1 Jan 2021 - 31 Dec 2021*

UK mid-market PE activity

£46.8bn
deal value, up
36%

803
deals, up
40%

Mid-market PE
52%
of all PE deals

PE deal activity in the mid-market reached the highest levels ever recorded.

Mirroring the strong performance in the overall PE market, PE deal activity in the mid-market also reached the highest levels ever seen.

Deal volumes increased to 803, up 40% on the 572 mid-market deals completed in 2020, and up 20% on 2019. Deal values also increased, although not quite as strongly. The total mid-market deal value in 2021 was £46.8bn, an increase of 36% on 2020 and 15% on 2019.

Activity was notably higher in H1, with 470 deals at a value of £29.5bn. In comparison, H2 achieved figures of 333 deals at a value of £17.3bn.

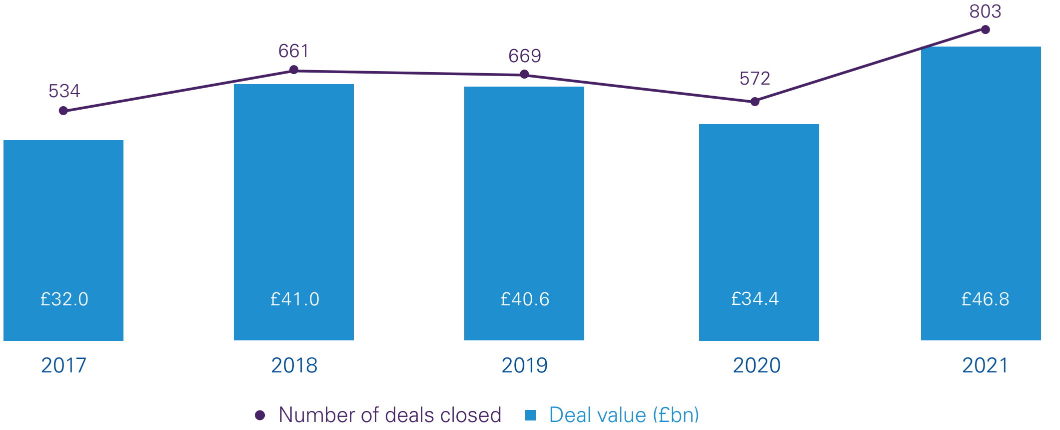
As well as the returning confidence and availability of capital that characterised the second half of 2020, a key factor in the strong mid-market activity in 2021 was concern over changes to Capital Gains Tax (CGT), which were widely expected in the Spring Budget.

Many entrepreneurs were keen to realise their positions before the expected CGT changes. This led to a spike of activity in Q1, some of which continued into Q2. The fact that CGT rules did not ultimately change means it is likely to remain a factor in the mid-market until the issue is resolved.

This is reflected in the quarterly breakdown of mid-market deal activity. Q1 saw by far the highest level of activity, with 283 deals – the highest quarterly figure for at least five years. Q2 and Q3 also performed strongly, although at a significantly lower level than Q1.

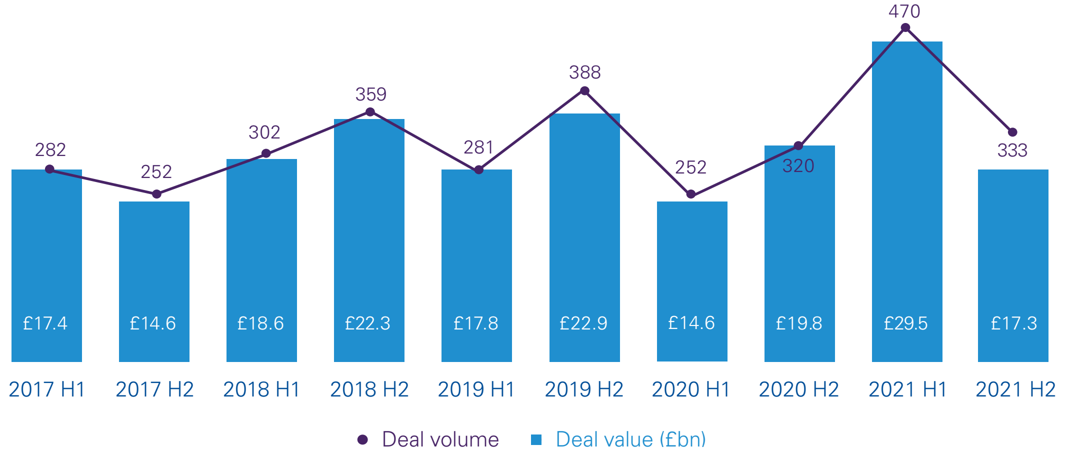
After a stellar H1, uncertainties over what a post-COVID market might mean for key sectors such as consumer goods, retail and hospitality, plus concerns over macro issues such as supply chains, labour markets and energy prices, all contributed to a lower level of activity in Q4.

Annual UK mid-market PE deal volumes and values (£bn)



	% Change YoY	
	2020 v 2021	2019 v 2021
% Value Change	36.0%	15.0%
% Volume Change	40.4%	20.0%

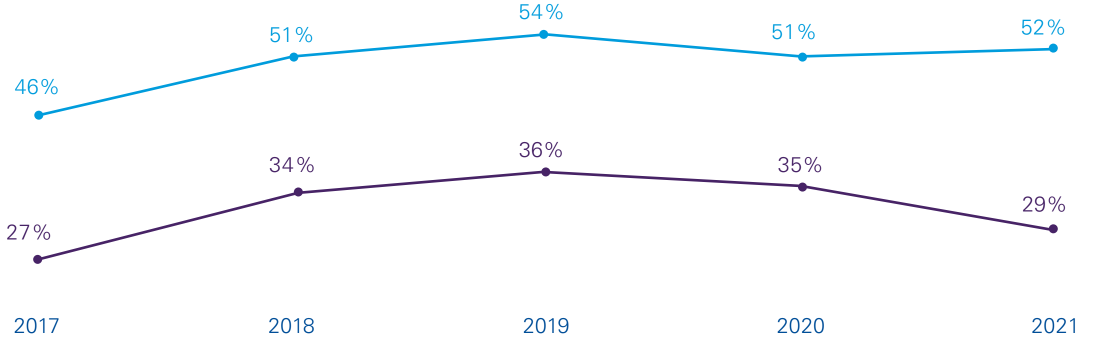
Half year UK mid-market PE deal volumes and value (£bn)



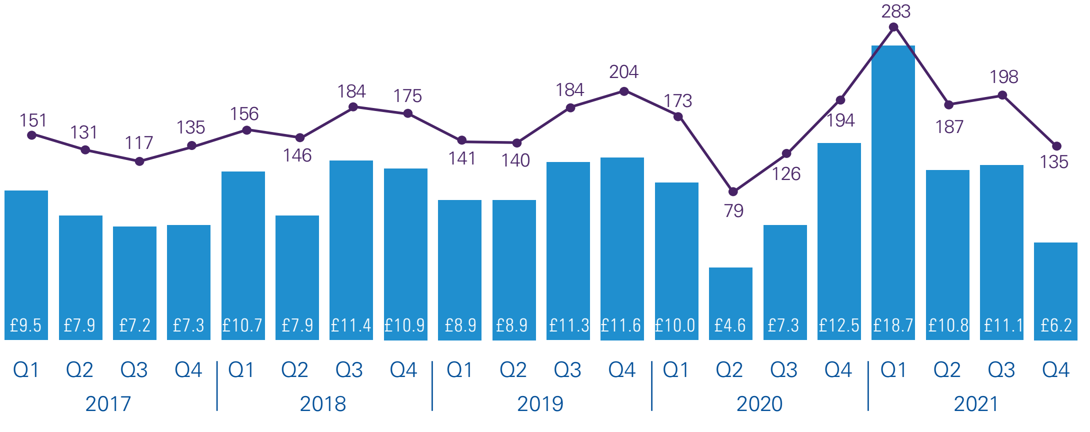
	% Change YoY 2020 v 2021		% Change YoY 2019 v 2021	
	H1 v H1	H2 v H2	H1 v H1	H2 v H2
% Value Change	102.0%	-12.7%	66.0%	-24.5%
% Volume Change	86.5%	4.1%	67.3%	-14.2%

Source: *Pitchbook, data period 1 Jan 2021 - 31 Dec 2021*

UK mid-market PE deals as a % of all UK PE deals



Quarterly UK mid-market PE deal volumes and value (£bn)



	% Change YoY 2020 v 2021				% Change YoY 2019 v 2021			
	Q1 v Q1	Q2 v Q2	Q3 v Q3	Q4 v Q4	Q1 v Q1	Q2 v Q2	Q3 v Q3	Q4 v Q4
% Value Change	86.4%	136.1%	51.7%	-50.4%	110.8%	21.4%	-1.7%	-46.7%
% Volume Change	63.6%	136.7%	57.1%	-30.4%	100.7%	33.6%	7.6%	-33.8%

Source: *Pitchbook, data period 1 Jan 2021 - 31 Dec 2021*

Debt capital perspective

Peter Bate
Director, Debt Advisory

"One of the biggest surprises since the global pandemic hit in March 2020 has been the sheer resilience of the global leveraged finance markets as companies have been able to secure financing via leveraged loans, private debt and high-yield bonds."

The European leveraged finance market has seen unprecedented levels of activity through 2021. This was fuelled by private equity-sponsored dealflow and an insatiable demand for yield as private debt continued to raise more capital and needed 'safe homes' to invest, whilst banks looked to put more capital to work in an increasingly fund-dominated market.

One of the biggest surprises since the global pandemic hit in March 2020 has been the sheer resilience of the global leveraged finance markets as companies have been able to secure financing via leveraged loans, private debt and high-yield bonds. The momentum is likely to carry into 2022 as private equity sponsors seek new M&A activity and look to drive growth through portfolio bolt-ons while opportunistically taking dividends out of their portfolio companies and refinancing debt.

However, as is always the case, there are challenges ahead for lenders and borrowers as we navigate the move away from the pandemic/fear of another variant, high inflation and supply chain issues, rising interest rates and the need to really focus on ESG.

So what are the trends that we saw in 2021, and which will continue in 2022 and beyond?

Trend 1: ESG is critical

It was only in October 2020 that the first ESG-style loan – with suitable KPIs – was written. Over the subsequent period we have seen more loans provided by both funds and banks having varying degrees of KPIs and also capital being specifically granted to further ESG projects.

The market is now seeing two distinct trends aside from the KPI-specific scenarios:

1. The rise of specific Impact Debt Funds to support both ESG focussed companies and companies that require specific capital to fulfil an ESG agenda – for example a change from petrol to electric vehicles
2. ESG being a specific gating item, where certain lenders will rule out lending to companies and so previous sector exclusions widen

This is covered in more detail on page 22.

Trend 2: Uncertainty has lenders searching for certainty

A key trend through the financial crisis and the pandemic was a flight to perceived quality – both through sectors and companies. This was paramount in the second half of 2020 and in 2021. Sectors such as financial services, TMT and Healthcare gained substantial support. And lenders pushed leverage on deals like Kids Planet and CFC Underwriting to extreme levels with no higher premium on yield, as these were viewed as premium assets.

At the same time, lower performing, economically impacted sectors and companies, such as bricks and mortar retail, did not attract the same heady multiples or support at all.

With uncertainty across the economic environment likely to remain through 2022, it is likely we will continue to see this bifurcation in lending appetite.

Trend 3: It remains a fund market

In 2020 and 2021, Private Debt Funds appeared undeterred by the pandemic and with an incredible amount of liquidity to deploy, direct lenders continued to expand their presence across the UK and Europe. Funds were seen in all parts of the market, including the largest deals, and the majority of mid-market transactions were funded by Private Debt. We see this trend continuing, with Funds taking advantage of banks' preoccupation with state loans, sizeable portfolios and their different tolerance to risk.

Trend 4: Is that a covenant or not?

The constant debate on covenant lite / covenant loose is impacting structures for private loans on both sides of the Atlantic, with pressure to remove covenants intensifying.

It is true that some lenders are caving to market demands to forgo the protections even on smaller loans to midsize borrowers. In the U.S., lenders had traditionally drawn a line at $50 million in EBITDA, but are now financing without covenants at a level as low as $30 million EBITDA.

We do not believe this trend will gain real traction in Europe on anything but the largest, most sought after deals – too many fund LPs insist on covenants, and without the ability to sell out (i.e. a true liquid market), then the lack of covenants may be a step too far.

However, we do see a trend continuing of large headroom buffers on covenants based on flatline base cases, with allowances for sizeable adjustments. This means that headroom continues to be borrower-friendly across favourable sectors.

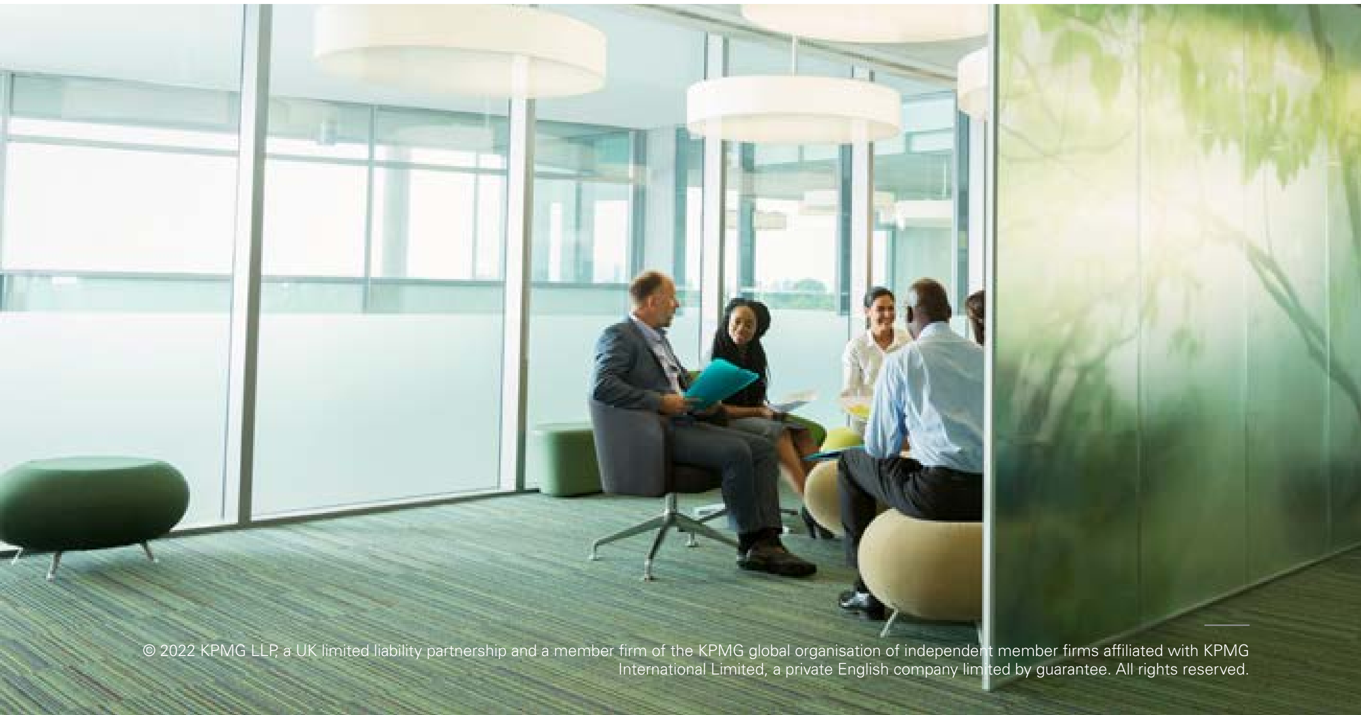
Trend 5: Innovation and consolidation

Apart from the rise of Private Credit in the 2000s (in the US), and later in Europe and emergence of ESG in 2021, the leveraged market has often lacked real innovation.

Perhaps 2022 will be the year that funds start focussing on raising discrete vehicles for ESG, as mentioned before, for a real stretch senior product where there is still a scarcity of truly focussed funds and/or senior to price equal to banks, a larger focus on venture debt and a greater focus on non-sponsor, corporate credit.

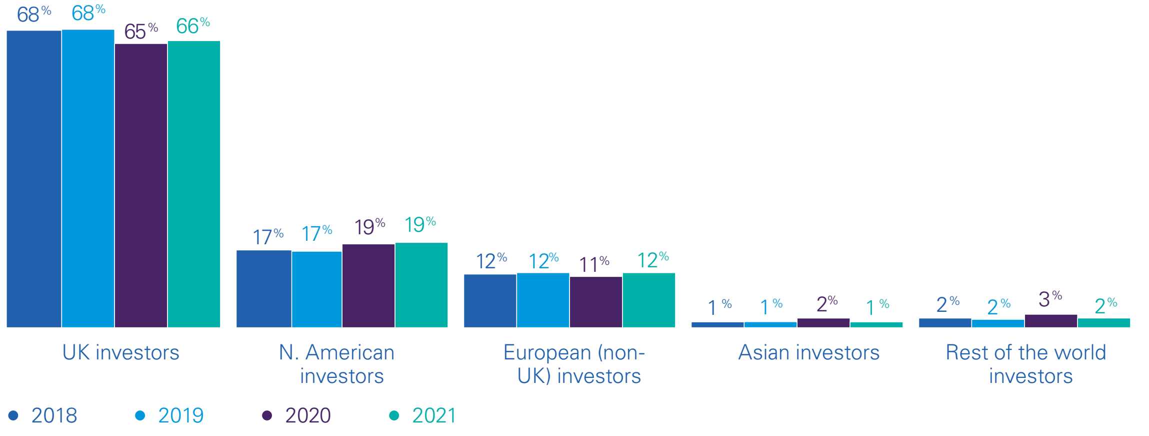
We may also see the start of consolidation in funds as the desire for scale and access to LPs pushes people for a need for size.

However, innovation takes time and requires the buy-in of LPs, so we will wait and see whether this ends up being a hope rather than a prediction as we go through the year.

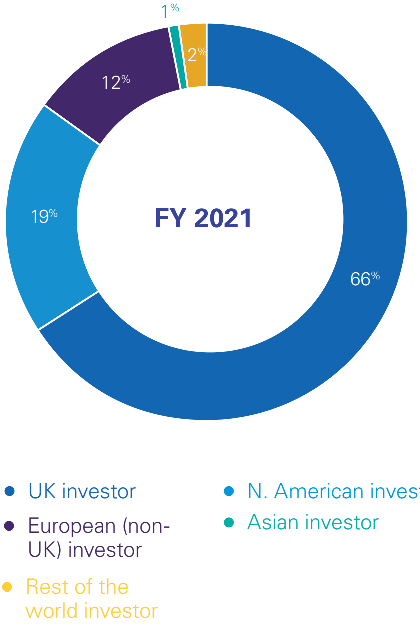


PE Investors into UK by location

% split of UK M&A deal volume by investor geography



North American firms notched their highest proportion of UK M&A in 2021, up from 18.9% in 2020 to 19.3% in 2021.



Source: *Pitchbook, data period 1 Jan 2021 - 31 Dec 2021*

Over the last five years, the share of M&A activity accounted for by domestic investors has slightly declined from 68% in 2018 to 66% in 2021. However, last year's figure was a slight increase on 2020, when UK investors accounted for 65% of deals.

For US firms, the long-term trend is the opposite. The proportion of UK transactions undertaken by US investors has risen from 15% in 2017 to 19.3% in 2021. Not a dramatic change, but a clear direction of travel. US investors are being noticeably more proactive in identifying and reaching out to UK companies directly. They also seem to be taking a more open-minded view of the level of revenue derived from the US currently. UK-centric businesses are now certainly within their remit, with international roll-out no longer a hard-line requisite. In particular, US investors are proving to be highly competitive in TMT processes, being comfortable with ARR-based multiples which reflect the recurring, subscription nature of revenue models.

Without the restrictions around Covid-19, it is likely the level of investment from the US could have been higher, particularly in sectors where US firms are traditionally strong, such as technology and tech-enabled business services. Although the move to digital transacting did level the playing field to a certain extent, it is undoubtedly harder for a US investor to buy into the domestic market if the UK is in some degree of lockdown, or if US flight restrictions limit international travel.

European firms have accounted for a relatively steady proportion of M&A activity over the past five years, and this continued in 2021, with 12% of deals, up from 11% in 2020. Historically, the European PE market has been less mature than the UK's. But this is changing and we may see a higher level of European investment in future. European investors may also be well placed to capitalise on the post-Brexit EU-UK relationship, which could lead to future investment opportunities.

Activity from Asian and RoW investors fell marginally, but remains at its historic levels.

ESG in Private Equity Deals

Private equity deals with an ESG component*

Whilst ESG reporting and ratings has largely been the focus of large and public companies, there is a growing interest from Private Equity firms in companies that have some ESG characteristics. This is often driven by a requirement from individual investors who invest in impact or ESG-specific funds. But there is there is an emerging rationale that ESG investing is more than box-ticking; it's a route to creating longer-term genuine value.

With the exception of investments made by pure impact/ESG funds, there is no clear way of defining a PE deal as having a specific ESG rationale. However, it is possible to take a view on the investments made, by looking at the type of business (and its component parts) and assessing the likelihood that it had some ESG characteristics.

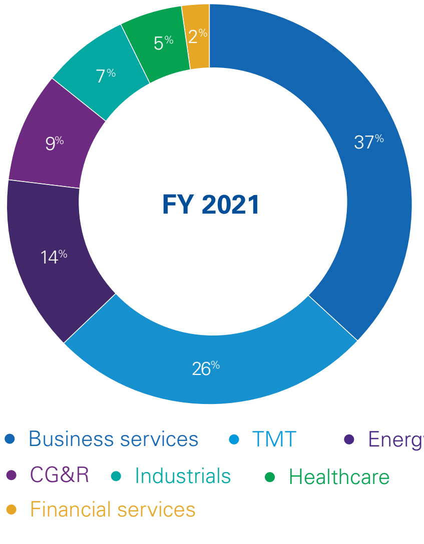
Having undertaken such a review on the PE investments made in FY 2021, it appears that:

– ESG deals (203) accounted for 13% share of all UK PE deals in 2021.

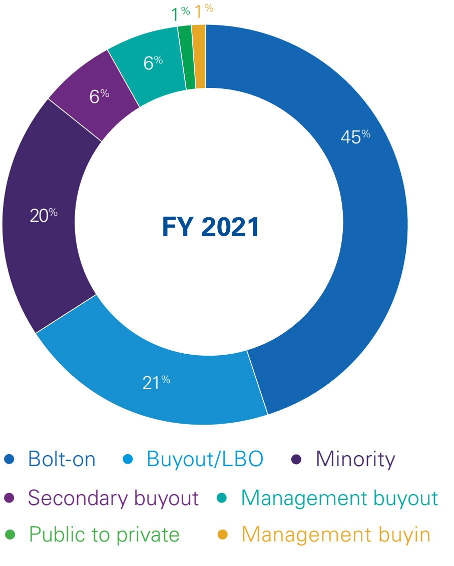
– ESG deals by sector indicates that Business services accounted for 76 ESG deals, followed by TMT and Energy with 52 and 28 respectively.

– Deal types represent more bolt-ons into companies with ESG credentials at 92 deals, indicating that PE firms are gearing up to scale platform investments and drive further value from ESG investing. Traditional buyouts with an ESG angle (accounting for 43 deals) are going almost head-to-head with minority deals representing 40 deals in 2021.

ESG deals by sector



ESG deals by type



Source: *Pitchbook, data period 1 Jan 2021 - 31 Dec 2021*

* See methodology on page 57 for identifying deals with an ESG component.

A perspective on ESG - Leveraging ESG financing in PE deals

Marc Finer
Director and ESG Lead,
Debt Advisory

"In recent months, we have started to see some lenders refuse to participate in financing deals where they consider a borrower's thinking and planning on ESG should be more developed than it is."

In our half-year update, we described the rapid acceleration in sustainability-linked financing activity in the corporate and leveraged financing markets, noting that ESG is becoming ever more deeply embedded into credit processes. This trend has continued in the second half of the year at pace, evidencing that our cautionary message, "No ESG, No Capital", is no longer purely directional: it is already happening. In recent months, we have started to see some lenders refuse to participate in financing deals where they consider a borrower's thinking and planning on ESG should be more developed than it is. We have also seen lenders making the development of a formal sustainability strategy, with associated targets, a Condition Subsequent to lending.

It is important to be clear that lenders are not saying every business needs to have, at this stage, a fully developed sustainability strategy, with targets and reporting frameworks in place. But to use an illustration, a business continuing to invest in a fleet of diesel vehicles, for example, where key competitors are heavily investing in cleaner/alternative fuels as a strategic priority, is now likely to face significantly reduced appetite from lenders. Lenders may not expect the business to have a fully "green" fleet now, nor even that the business should be able to give a formal commitment at this stage as to the scale of or timeframes for its transition to greener fuels. However, lenders would need to be convinced that such transition is a high priority for the business, and that the business has at least an outline plan to deliver that transition.

So how can sponsors and borrowers convince lenders (and be honest with themselves) not only that they are on the ESG journey, but also where on that journey they are and where they are aiming to get to (and by when)? The European Leverage Finance Association ("ELFA") and the Loan Market Association ("LMA") have continued to develop guidance for borrowers and lenders in efforts to create some form of standardisation of approach to defining sustainability strategies and performance targets, as well as avoiding the greenwashing challenge by requiring those targets to stretch beyond BAU, be relevant to the business and be measurable and externally assured. The ELFA has recently created an ESG questionnaire (summarised on the adjacent page) for consideration by participants in leveraged deals, which illustrates the level of detail required before any sustainability performance target can be considered for incorporating into a financing agreement.

Developing a coherent ESG strategy and setting sustainability performance targets (SPTs) – what a lender may expect you to tell them:

- **What** are the SPTs? **When** are the SPTs assessed?
- What is the **base year**?
- How much has the company **achieved already** since the base year vs. the SPT?
- What were the **historical levels**? What are the **target levels** by year? What were the **previous targets** (if any)?
- What is the **methodology** for establishing the SPT, and **how does it go beyond business as usual**?
- What are the **key strategic initiatives and investments** required to achieve the SPT?
- How does the SPT compare to **regulation-set** target(s) in the industry?
- Has (and will) the SPT been **verified** by a second party?
- What are the **longer-term goals** related to the SPT?
- What is the **frequency of reporting** planned for the SPT, and will this be made **publicly available**?
- Will **ongoing reporting be externally verified/ assured**?

Source: *Extracted from "ESG Provisions in Leverage Loans" (ELFA)*

The ESG bar therefore remains high and continues to rise. But the growing maturity of the ESG agenda, and improvements in the availability of guidance for market participants, should help reassure sponsors and borrowers – especially in the mid-market where resources available to tackle this complex and often technical issue may be more limited – that ESG and sustainable financing provide an opportunity to drive attractive deal outcomes and wider business value, including:

1. Ensuring best access to capital in a difficult credit market

With lenders now applying an ESG lens to every lending decision, borrowers with a clear ESG story, who can make firm commitments on ESG to lenders can see a materially greater appetite for their credit.

2. Achieving the best terms, including potential cost of capital benefits

As credit markets see a tightening of terms and increased pricing, the access to capital benefits of ESG financing can enhance competition and terms, including pricing incentives directly linked to meeting ESG performance targets.

3. Evidencing ESG commitments to other stakeholders

Accountability on ESG to lenders can bring greater focus on ESG delivery within the business, as well as evidencing to customers and suppliers that the business takes ESG seriously.

A perspective on ESG - PE and the road to Net Zero

Gavin Quantock
Partner, M&A Energy

"One of the biggest challenges for PE investors is access to climate performance metrics."

Net Zero is a phrase we are going to be hearing a lot more of over the next few years. Not only as a core aspect of the 'E' in ESG, but also as a priority issue in its own right, as the world responds to the urgency of climate challenge.

With the UK government committing to achieving Net Zero carbon emissions by 2050, all businesses are likely to feel pressure to change and adopt decarbonisation strategies. And that pressure will increase as we move closer to 2050.

This transition will bring with it significant changes, but also significant opportunities for PE firms to play a key role in the journey to Net Zero. In particular, PE investors can help to drive long-term change by focusing their funds and fund investments on climate positive businesses, while guiding their existing portfolio companies to become climate neutral or positive. They can also use their insights and expertise to create reportable, climate-focused KPIs to show the progress of their funds, current investments and future investments in relation to Net Zero.

How do we accelerate on the road to Net Zero in private equity?

To ensure PE firms have the information and tools they need to lead the transition to Net Zero, there are a number of key obstacles that need to be addressed:

– **Access to data**

One of the biggest challenges is around access to climate performance metrics, and if possible, in a way that can be standardised across portfolios and funds. There is a clear need to access reliable climate-related data in order to assess investment opportunities, portfolio company growth opportunities, and their impact.

– **Lack of universally adopted standards and frameworks**

As well as a lack of metrics, there has been a lack of universal standards and frameworks to guide companies and PE investors in their strategies. There are signs of positive progress, however. For example, from 6 April 2022, the UK will become the first G20 country to make it mandatory for large companies and financial institutions to report on climate-related risks and opportunities, in line with the recommendations of the international Taskforce on Climate-related Financial Disclosures (TCFD). This will include over 1,300 of the UK's largest traded companies, banks and insurers, as well as private companies with over 500 employees and £500 million in turnover. An increasing number of investors are already using TCFD to report on climate risk and climate strategy, but much more needs to be done.

- **Practice what you preach**

PE investors face these same growing pressures to show their commitment to the Net Zero cause. On the one hand, they can do this by investing in businesses that are operating responsibly, or at least, can demonstrate a strategy that will enable them to do so. But PE funds are also businesses themselves and need to be able to demonstrate their commitment to Net Zero within their own operations. That's not to say they need to have developed a comprehensive Net Zero strategy that addresses all relevant touchpoints, and has been fully implemented across the business. Rather, they need to be able to show they are committed to meeting their climate change responsibilities, with clear values and transparent targets, even if their ultimate destination is still some way off. Some of it might be as simple as retaining a commitment to virtual deal processes post-pandemic to minimise travel and reduce the carbon footprint. Other changes will need to go much further and deeper.

- **Collaboration and cooperation**

PE firms cannot do this by themselves. They need to work collaboratively with industry and government to create the required benchmarks, frameworks and standards. More PE houses need to communicate their commitment to the cause, so it becomes the norm rather than the exception. There are already some international mechanisms that enable them to do this. The Principles for Responsible Investment (PRI), for example, is a UN-supported international network of investors working together to implement six aspirational ESG investment principles. It has around 3,500 signatories across the globe, although according to Ceres, of the estimated 8,800 PE firms globally, only 700+ are currently signatories.

Navigating the Net Zero journey

There is no standardised approach to Net Zero in private equity. A powerful combination of market sentiment, stakeholder expectations and regulatory pressure will continue to drive the climate change agenda in investments. Are PE houses up to the challenge? Only time will tell. Every firm will take a different approach. But those differences are to be expected – and should be embraced – as we all embark on our own Net Zero journeys.

Sectors

Business services PE activity FY 2021

Business services deal values
£15.5bn

Business services volumes up
45%
and account for
39%
of all mid-market PE volume

Business services deal volumes
312

TMT mid-market PE activity FY 2021

TMT deal values
£11.0bn

TMT volumes up
55%
and account for
24%
of all mid-market PE volume

TMT deal volumes
194

Together, TMT and Business Services accounted for 63% of PE deals in the mid-market in 2021.

Deal volumes increased across every sector measured in 2021. Business Services in particular saw a significant spike in activity, from 215 deals in 2020 to 312 deals in 2021.

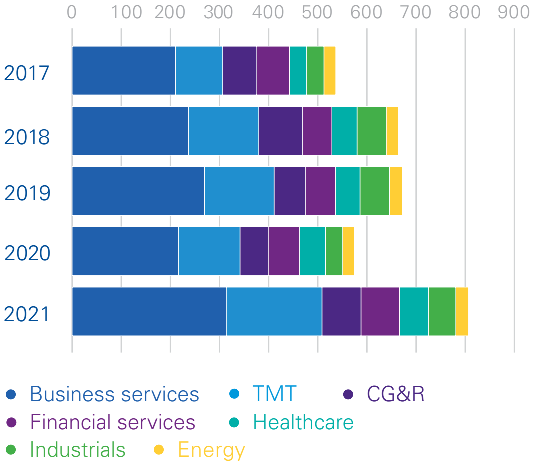
The shift to remote working and the effect of lockdowns on digital adoption buoyed investment in TMT businesses, with TMT deals increasing from 125 in 2020 to 194 in 2021. Tech firms continued to receive significant interest from PE firms, given their resilience to current trends and the accelerated demand for digital and SaaS solutions. Tech businesses tend to be relatively fast moving, young businesses. Very often owners seem more open minded to taking external investment to either scale, de-risk, or a combination of the two. Many of the UK's largest tech hubs like London, Manchester and Glasgow have been focusing on driving entrepreneurial activity in the tech arena over the the past few years, and we're now seeing this translate to mid-marke PE activity. The most successful of these start-ups are now moving out of the incubator phase and into the accelerator phase, attracting interest from PE firms as they quickly scale up.

Deal values were similarly strong. Business Services saw the highest value of deals and accounted for a third of all deals by value. The sector's aggregate deal value increased by over 50% to £15.5 bn in 2021, up from £10 bn in 2020 and £14.4 bn in pre-COVID 2019.

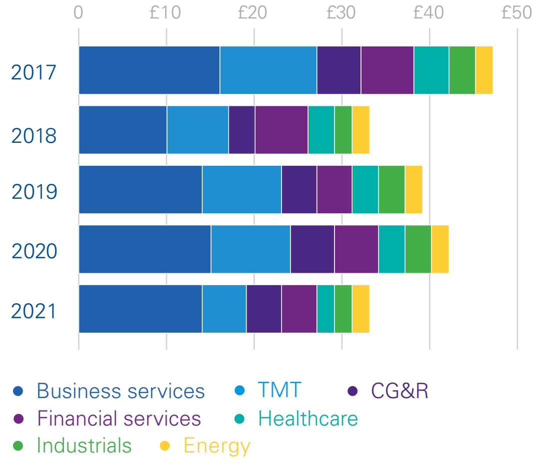
TMT made up the next highest tranche in terms of deal value, with an aggregate value of £11 bn, or just under 25%. This was an increase on the £7.1 bn achieved in 2020 and £9.2 bn in 2019.

The level of activity across all other sectors measured also increased, albeit not at the same rate as Business Services and TMT. Consumer Goods and Retail was the next highest proportion, at 9.8% of all mid-market deals. This is a similar proportion to 2020, and is likely driven by heightened activity in the online and direct-to-consumer growth. Financial services accounted for 9.7%, marginally down from 11% in 2020, but remains a significant sector of interest to private equity investors driven in particular by consolidation in sub-sectors such as insurance broking and wealth management.

UK full year mid-market PE deal volumes by sector



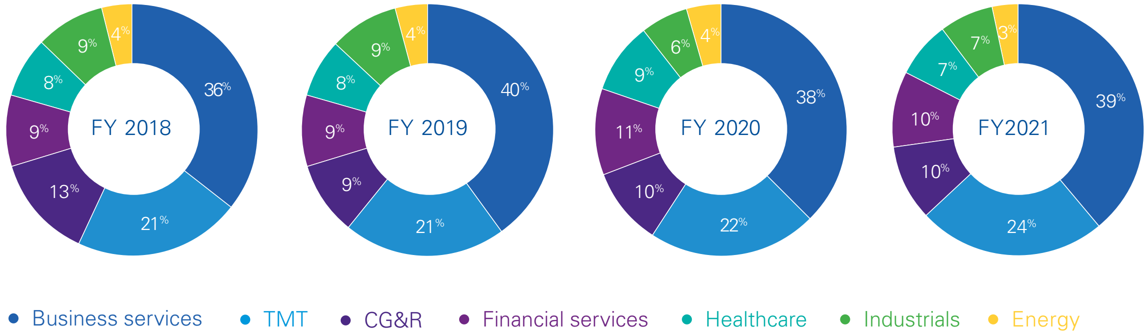
UK full year mid-market PE deal values by sector (£bn)



Annual % change deal volume and value by sector

	% YoY Volume Change		% YoY Value Change	
Sector	2020 v 2021	2019 v 2021	2020 v 2021	2019 v 2021
Business services	45.1%	16.4%	54.9%	7.8%
CG&R	38.6%	25.4%	48.0%	25.8%
Energy	8.3%	0.0%	-9.3%	9.6%
Financial services	23.8%	27.9%	4.7%	37.1%
Healthcare	11.3%	18.0%	19.0%	13.8%
Industrials	57.1%	-8.3%	26.4%	-9.4%
TMT	55.2%	37.6%	55.3%	21.3%

UK mid-market PE deal volume % by sector

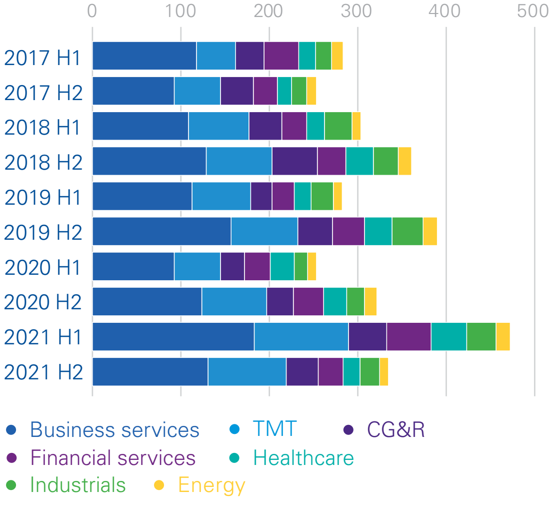


Source: *Pitchbook, data period 1 Jan 2020 - 31 Dec 2020*

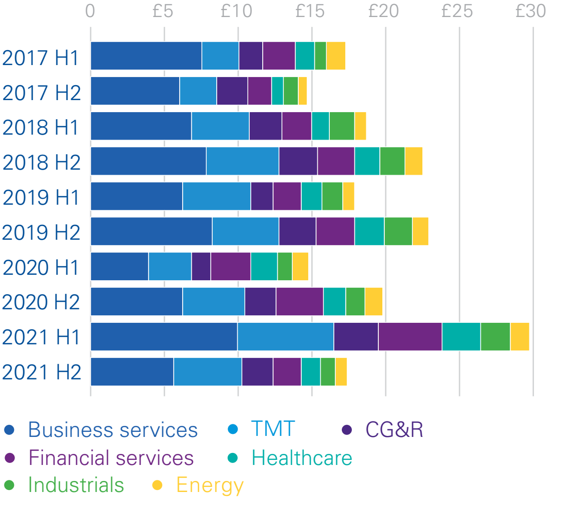
Healthcare recorded 59 deals, or 7% of the total, the highest number of deals in this sector for at least five years. This likely reflects the continuing focus on healthcare, not only due to the pandemic, but also the broader demographic and social changes that feed into this sector.

The number of deals in the energy sector remained relatively flat, up two to 26. This is in line with its historical levels and reflects the heightened level of uncertainty that currently surrounds the energy sector. It is worth noting that categorisation means that B2B propositions related to energy efficiency and compliance may be captured in business services, underplaying the volume of energy-related deals.

UK half year mid-market deal volumes by sector



UK half year mid-market deal values by sector (£bn)

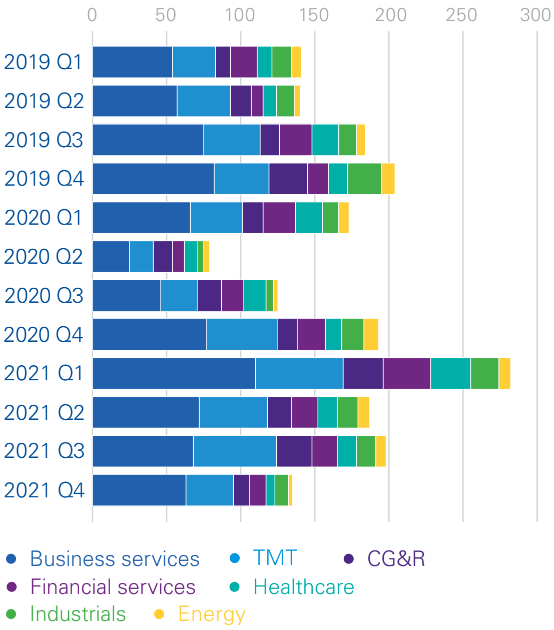


% change deal volume and value by sector

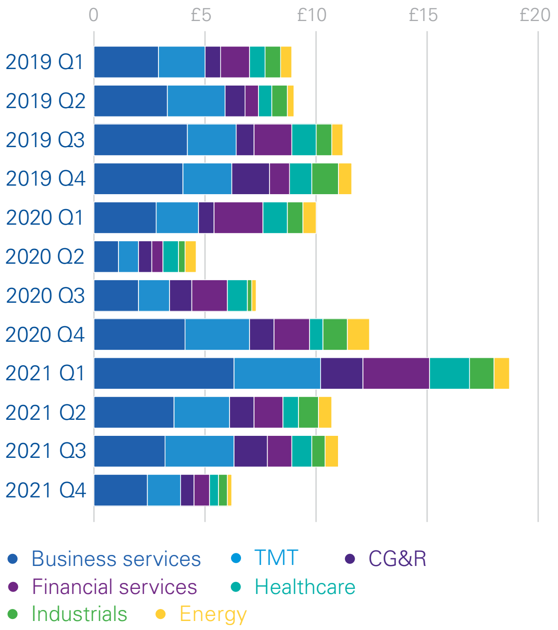
	% Volume Change 2020 v 2021		% Volume Change 2019 v 2021		% Value Change 2020 v 2021		% Value Change 2019 v 2021	
Sector	H1 V H1	H2 v H2	H1 V H1	H2 v H2	H1 V H1	H2 v H2	H1 V H1	H2 v H2
Business services	97.8%	5.7%	62.5%	-16.7%	156.6%	-9.0%	60.6%	-31.8%
CG&R	59.3%	20.0%	79.2%	-7.7%	124.9%	-0.9%	95.8%	-17.0%
Energy	60.0%	-28.6%	60.0%	-37.5%	16.9%	-32.6%	60.0%	-26.1%
Financial services	72.4%	-17.6%	100.0%	-22.2%	60.2%	-41.8%	130.2%	-29.0%
Healthcare	48.1%	-26.9%	110.5%	-38.7%	46.1%	-12.8%	88.4%	-35.9%
Industrials	120.0%	10.0%	32.0%	-37.1%	93.3%	-24.3%	42.5%	-46.9%
TMT	103.8%	20.5%	60.6%	17.3%	126.4%	7.6%	39.2%	2.6%

Source: *Pitchbook, data period 1 Jan 2021 - 31 Dec 2021*

UK quarterly mid-market deal volumes by sector



UK quarterly mid-market deal values by sector (£bn)



Source: *Pitchbook, data period 1 Jan 2021 - 31 Dec 2021*

Sector perspective: Technology - a focus on Enterprise Software

Graham Pearce
Partner, Head of TMT, Corporate Finance

"Mid-market private equity has demonstrated a willingness to compete heavily for enterprise software assets, and should be able to generate strong returns as the sector continues to grow".

As new ways of living and working have become more normalised and ingrained, the technology and software sector has continued its strong performance throughout 2021. Many digital technologies that came to the forefront during the pandemic, in particular those centred around remote working and collaboration, are now firmly entrenched within work environments. However, technology requirements have extended beyond these initial use cases to encompass other areas such as: better cloud integration and enterprise software tools to support the requirements of a hybrid workforce; seamless mobile technology and edge computing; customer engagement as well as better visibility and control of complex supply chains.

From a mergers and acquisitions perspective (trade, PE, IPO, and early stage investment), technology accounted for approximately a quarter of all deals in the UK in 2021, the largest single sector. KPMG's Technology Corporate Finance team advised on 21 transactions in total over the year – a record year.

Private equity was a highly active participant in transactions involving software and technology companies that came to market. Increasingly in the UK, US PE acquirers are becoming more active and bidding aggressively for high quality assets, even those that historically would have been considered too small to attract interest from across the pond. We saw this in many of our processes, advising on four deals in the sector which attracted significant minority or majority investment from the US.

Enterprise software has been particularly active in terms of deals, with certain sub-verticals seeing record levels of activity. These include accounting and financial software (e.g. the acquisition of asset finance software provider White Clarke Group by Thoma Bravo-backed IDS and the acquisition of process automation player Xceptor by Astorg and Corsair Capital) and architecture, engineering, construction (AEC) software (e.g. the acquisition of NBS by Byggfakta Group and the acquisition of Causeway Technologies by Five Arrows). KPMG Corporate Finance is currently advising a number of software businesses within these segments.

The demand in the sector is driving up valuation multiples, with the average price paid representing c.6x revenue[(1)], with profitability, or lack thereof, not necessarily impacting buyer sentiment. Large trade consolidators have been comfortable paying high prices for strategic assets, for example Sage's recent acquisition of retail software provider Brightpearl for c.14x revenue. Other major UK software consolidators such as Advanced, Access, Allocate and IRIS were similarly active throughout 2021.

Nevertheless, mid-market private equity has demonstrated a willingness to compete heavily for enterprise software assets and should be able to generate strong returns as the sector continues to grow.

(1) KPMG analysis

Sector perspective: Healthcare - MedTech bounces back

Al-Munther Sultan
Director, Health & Life Sciences
M&A, Corporate Finance

"Innovative products that can improve health data, support remote care and facilitate digitised workflows are seen as a strong opportunity for private equity".

M&A activity within the medical technology (MedTech) vertical has risen over the past two years and interest remains high across both strategic acquirers and private equity investors.

The MedTech market is highly fragmented, characterised by a large number of innovative start-ups, as well as small to mid-sized, fast-growing businesses, making it highly attractive to PE investors. Such a market creates significant opportunities for consolidation and value creation for private equity.

This was seen first hand at KPMG when we advised on the sale of Robinson Healthcare, which owns the UK's market-leading, single-use surgical instrument brand – Instrapac, to Vernacare, which is backed by PE firm H.I.G. Capital, in September 2021.

Activity levels continue to increase

Like other sub-sectors within healthcare, the medical devices segment within the MedTech market saw some disruption during the early days of the pandemic as patient levels fell dramatically, especially for elective procedures, which temporarily softened M&A activity in this vertical. But that has bounced back quicker than expected, and 2021 represented notable evidence of that.

There are several factors driving increased M&A activity in MedTech. The pandemic has undoubtedly created pent-up demand for planned medical treatments, which will drive increasing requirements for technologically advanced medical devices to support patient demand. In addition, it has been widely recognised that innovative technologies more generally have an important role to play within healthcare, and can contribute significantly to improving patient care and increasing efficiencies across healthcare systems. This presents opportunities for MedTech and digital health firms, particularly in certain sub-sectors, like diagnostics and patient monitoring. Innovative products that can improve health data, support remote care and facilitate digitised workflows are seen as a strong opportunity for private equity.

At the same time, there are a variety of wider structural factors that feed into creating a positive MedTech environment. These include an ageing population, increasing levels of chronic illnesses, and rising expenditure across healthcare ecosystems and firms. This in turn drives a need for greater efficiencies and new technologies and devices within the industry, which presents long-term value creation opportunities for private equity investors.

In particular, there is an emerging trend towards the use of machine learning and AI technologies, such as designing and upgrading surgical tools that allow greater precision and speed during operations. These contribute to shorter patient recovery times, and therefore less strain on healthcare workers, specifically in hospitals.

Consumers, too, have shown themselves increasingly willing to increase their level of discretionary spending on healthcare products in the non-surgical home use devices market which is forecast to grow considerably, especially as we move towards a longer-term hybrid working proposition. It is a behavioural change that has again been accelerated by the pandemic. MedTech firms with a direct-to-consumer proposition are able to capitalise on these channel shifts, which in turn places them is a strong position to maximise future growth opportunities in 2022 and beyond.

Sector perspective: Video Gaming

Ekrem Shahin
Associate Director, M&A TMT, Corporate Finance

"Video Gaming is now considered one of the highest potential untapped TMT segments for private equity firms."

Video Gaming is now considered one of the highest potential untapped TMT segments for private equity firms.

2020 demonstrated unprecedented growth for the video games market. Whilst everyone was confined to their homes, the role of video games became much more meaningful and, some may argue, accelerated an inevitable shift towards becoming one of the fastest growing areas of digital entertainment. With this backdrop, the market witnessed a continuation of this momentum in 2021 and the future looks as exciting as ever.

Now, sceptics may ask if this is simply a reflection of a 'Covid bubble' of increased gamers? Or challenge the notion of video gaming really being a sustainable high-growth market. To address these questions, we must look deeper at the video gaming market's journey to date to appreciate how far it's come.

Whilst the industry is extremely creative, artistic and engaging, it has long suffered from the underlying stigma of being a distraction or providing a false sense of fulfilment. Gaming was somewhat of a taboo.

However, this outdated mindset has started to dissolve. For many gamers, the long-awaited time has arrived when video gaming is at the forefront of digital media and being recognised for its many social benefits, including having a positive impact on mental health and wellbeing (as seen during multiple lockdowns), enabling collaboration and creativity. This recognition has allowed the video gaming industry to mature and become an extension of the 'real world'. Indeed, it is at the core of the development of the metaverse, and is set to be one of the most powerful enablers of this new virtual economy.

It has widely been reported that the video gaming market is worth over $175bn. With over 3 billion players across the globe identifying as 'gamers', it is clear gaming is not only here to stay, but is only in the early phase of its journey. Over 45% of video games revenues are generated from mobile. The accessibility of such mobile devices has pushed the industry towards an era of user acquisition never seen before.

Like challenges faced in the TV and film industries, content is critical for the evolution of the gaming industry, as is development talent. Both IP and development power are a finite resource and provide opportunities for private equity backers to play a role in supporting some of the most exciting, up-and-coming video games companies.

On average, almost one deal a week closed involving a UK video games target in 2021. Although a number of these were to international corporates, this alone should have private equity investors taking a closer look at the market.

We speak with investors regularly and wanted to address the top 5 common queries we are asked about the video gaming market in a quick Q&A:

1. Are video games hit-driven businesses?

Whilst there are examples of hit driven successes, there are plenty of complementary businesses within the ecosystem that are more diversified in nature or indeed serve the gaming community.

2. What area of video games should we focus on when looking for a diversified model?

UK mid-market private equity would do well to focus on one of these two key areas:

i. Services based businesses that have grown beyond the work-for-hire model and need an injection of capital to take some further upside bets in order to generate royalty income

ii. Services businesses that have a specialist angle within the video games sphere, such as artistic talent, localisation, audio etc.

3. Are there any particular areas that have a good amount of upside but are less obvious?

Mobile games can be very interesting and at times fairly algorithmic when growing users. Given PE investors' financial backgrounds, they will appreciate the art of user acquisition modelling. There are European mobile companies that have started to build an umbrella of mobile development studios and have begun to perfect the art of tweaking user acquisitions as well as centralising several functions. This is an area to watch!

4. Can video gaming be a platform-based investment?

Definitely. You only have to look at the sheer scale of some of the companies listed in the European market and the complexity of their offerings to understand this is a sub-sector where inorganic expansion is critical.

5. How should we look to engage with video games companies?

Founders and management teams of video game companies are inundated with emails from financial institutions! However, what really stands out are those investors that are genuinely interested in helping to participate in moving the gaming industry forward rather than just being return focussed. Surrounding yourself in the community and embracing the ecosystem will naturally yield great relationships for you. In video games - where there is passion and a meeting of minds, the returns tend to naturally follow.

Demand for video games companies is higher than ever. UK mid-market private equity firms who have previously held video games assets will look to build upon their success. It is vital for new market entrants, from the world of mid-market private equity firms, to appreciate the business models in this space and look to embed themselves in the gaming community for the long term rather than a one-off investment. This level of engagement with the creative founders of video games and their teams will pay dividends.

Regions

London deal volumes up 40%, to 359.

45%

of all mid-market PE deals

Midlands deal volumes up 54%, to 86.

11%

of all mid-market PE deals

N. West deal volumes, up 45%, to 84.

11%

of all mid-market PE deals

Post-COVID 'urban flight' and the success or otherwise of the government's levelling up agenda could affect the regional picture over the next few years.

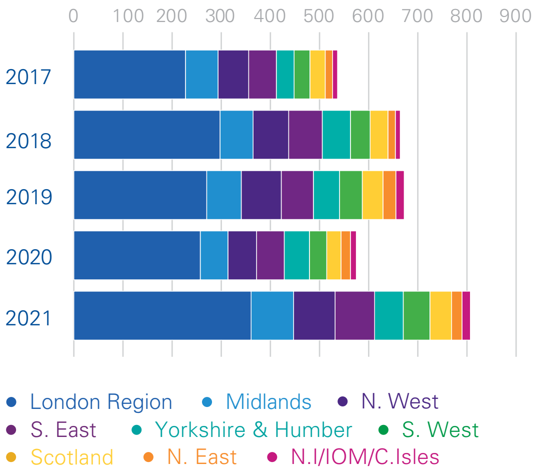
After the uncertainties of 2020, nearly all regions saw a resurgence in PE dealmaking in 2021, although some saw greater proportional growth than others.

Following the trend of recent years, London increased its number of deals by 40%, from 256 in 2020 to 359 in 2021. The Midlands saw a healthy increase of 54% in deal volumes (56 to 86), as did the South West (35 to 54). In Scotland, deals rose 52% (29 to 44). Other notable increases were in the North West, where deals were up 45% (58 to 84) and the South East, where deals rose 43%, from 56 to 80.

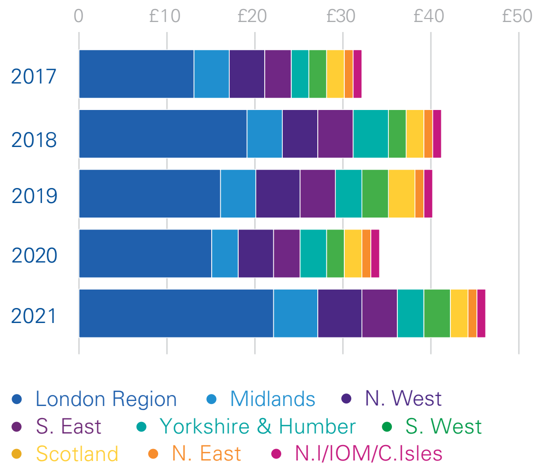
Deal values also rose in every region. London accounted for the lion's share with deals worth £21.9 bn, up 45% on 2020. The Midlands leapfrogged the North West to become the second largest region by deal value at £5.2 bn, up from £3.5 bn in 2020. The North West completed £4.6 bn of deals, compared to £3.6 bn the previous year.

In terms of the proportion of deals in each region, the picture remained largely unchanged, with London by far the largest region, with 44.7% of all deals. The most notable change across the other regions was the increase in the proportion of deals completed in the Midlands (from 9.8% to 10.7%), seemingly at the expense of the North East and Yorkshire and Humber, which both saw a decline in their proportion of deals.

UK full year mid-market PE deal volumes by region



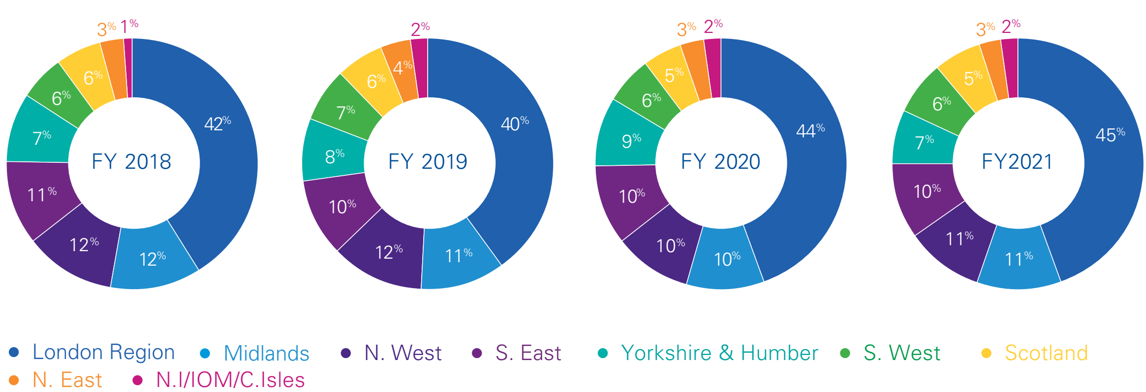
UK full year mid-market PE deal value by region (£bn)



% Change deal volume and value by region

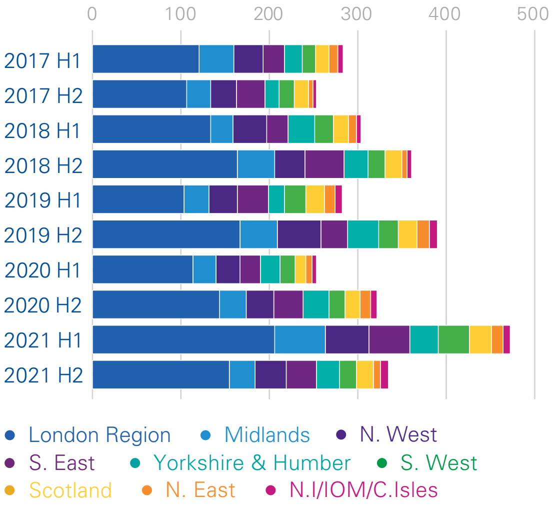
	% YoY Volume Change		% YoY Value Change	
Region	2020 v 2021	2019 v 2021	2020 v 2021	2019 v 2021
London Region	40.2%	33.5%	45.5%	34.5%
Midlands	53.6%	22.9%	50.2%	20.6%
N. West	44.8%	3.7%	27.7%	-1.6%
N. East	10.5%	-19.2%	8.6%	-25.2%
N.I/IOM/C. Isles	41.7%	0.0%	15.2%	-11.0%
Scotland	51.7%	4.8%	19.3%	-18.7%
Yorkshire & Humber	13.7%	9.4%	2.8%	5.8%
S. East	42.9%	23.1%	34.7%	12.2%
S. West	54.3%	17.4%	48.6%	-0.4%

UK mid-market PE deal volume % by UK region

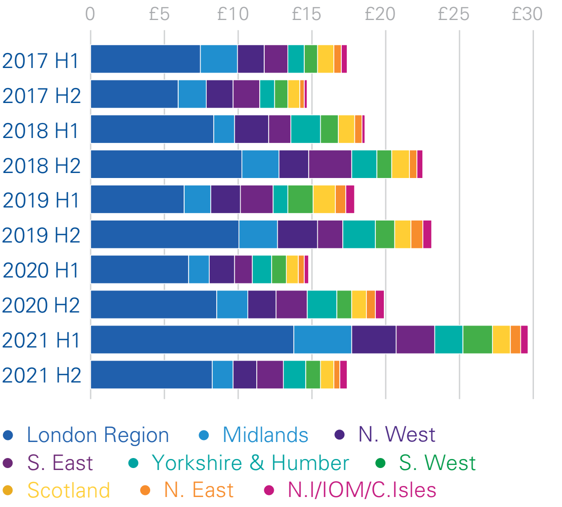


Source: *Pitchbook, data period 1 Jan 2020 - 31 Dec 2020*

UK half year mid-market deal volumes by region



UK half year mid-market deal values by region (£bn)

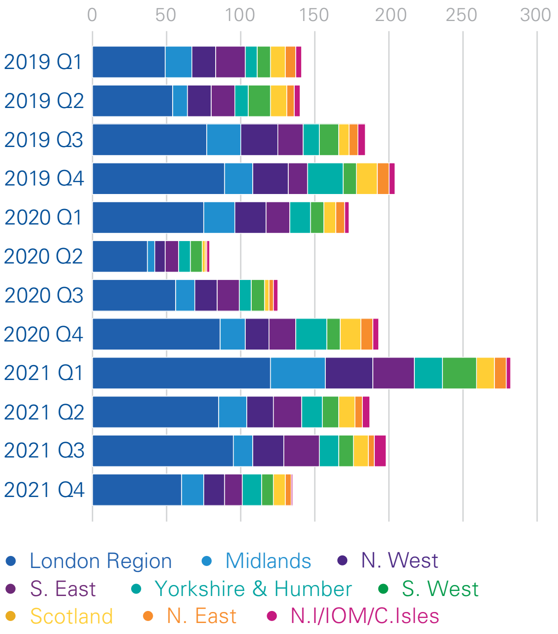


% change deal volume and value by region

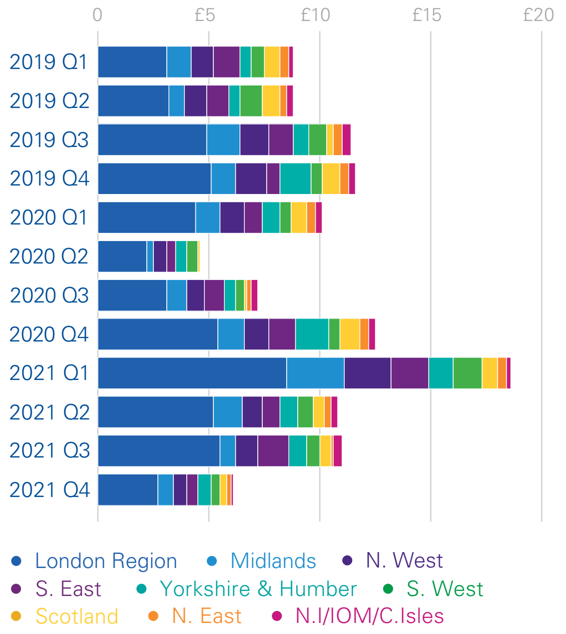
	% Volume Change 2020 v 2021		% Volume Change 2019 v 2021		% Value Change 2020 v 2021		% Value Change 2019 v 2021	
Sector	H1 V H1	H2 v H2	H1 V H1	H2 v H2	H1 V H1	H2 v H2	H1 V H1	H2 v H2
London Region	81.4%	7.7%	99.0%	-7.2%	108.9%	-3.5%	116.4%	-17.7%
Midlands	119.2%	-3.3%	103.6%	-31.0%	183.0%	-35.6%	118.4%	-46.9%
N. West	81.5%	12.9%	53.1%	-28.6%	78.2%	-16.2%	51.7%	-40.4%
N.East	85.7%	-33.3%	8.3%	-42.9%	78.6%	-37.4%	1.8%	-50.1%
N.I/IOM/C.Isles	60.0%	28.6%	0.0%	0.0%	57.4%	-7.8%	-11.1%	-10.9%
Scotland	108.3%	11.8%	19.0%	-9.5%	63.9%	-14.2%	-14.9%	-23.5%
Yorkshire & Humber	45.5%	-10.3%	77.8%	-25.7%	45.6%	-25.6%	86.9%	-32.3%
S. East	100.0%	3.0%	31.4%	13.3%	116.9%	-12.1%	15.7%	7.6%
S.West	105.9%	5.6%	45.8%	-13.6%	93.2%	2.7%	15.8%	-21.6%

Source: *Pitchbook, data period 1 Jan 2021 - 31 Dec 2021*

UK quarterly mid-market deal volumes by region



UK quarterly mid-market deal values by region (£bn)



Source: *Pitchbook, data period 1 Jan 2021 - 31 Dec 2021*

Deal types

Bolt-ons
488 deals,
61%
of all mid-market PE volume

Bolt-ons
£25.8bn
55% of total deal value in the mid-market

Minority
121 deals,
15%
of all mid-market PE volume

Minority
£5.7bn
12% of all deal value in the mid-market

Buyout/LBO
126 deals,
16%
of all mid-market PE volume

Buyout/LBO
£9.6bn
21% of total deal value in the mid-market

Bolt-ons continue to be seen as a lower risk strategy to support the growth of PE firms' existing platform businesses.

Bolt-ons remained by far the most popular type of deal in 2021, as they have been for the past five years and more.

There were 488 bolt-ons, accounting for 60.8% of all deals and with an aggregate value of £25.8 bn. This is up from 316 deals in 2020 (with a value of £17.2 bn) and 393 in 2019 (£22.8 bn).

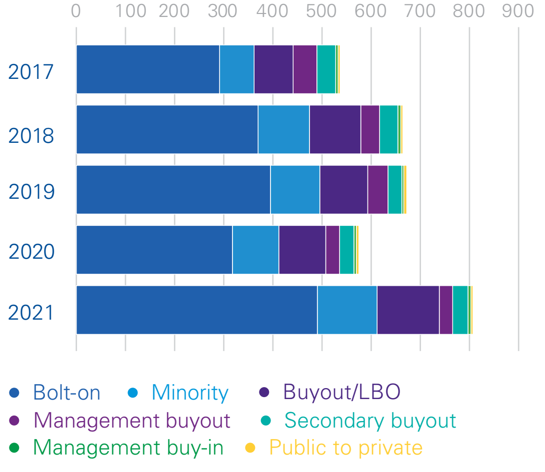
As PE firms focus on creating value within their existing portfolios, bolt-ons are seen as a relatively low risk strategy to support the growth of their existing platform businesses. In doing so, they are putting their investments into sectors they already know and leveraging potential cost synergies to drive value. It also opens up the opportunity to reduce the average multiple paid for an investment if PE houses can bolt on businesses at a lower multiple than the primary investment was made at.

Notably, minority investments increased from 94 in 2020 (and 100 in 2019) to a new high of 121 in 2021. This was matched by an increase in the aggregate value of minority investments, from £3.7 bn in 2020 to £5.7 bn in 2021.

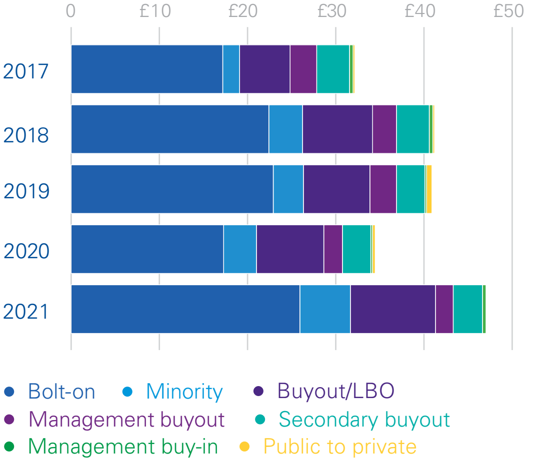
The growth in minority investments is arguably reflective of a new willingness from entrepreneurs, buffeted by the ups and downs of the pandemic, to de-risk their personal portfolio and realise a return on some of their capital, without losing ownership or control of the business. This could have been given further impetus by concerns over the possible rise in Capital Gains Tax (CGT).

Buyouts/LBOs was the other type of deal that saw a large increase in volumes and value. The number of buyouts increased from 95 in 2020 to 126 in 2021, while the aggregate value increased from £7.6 bn to £9.6 bn. This should continue to drive bolt-ons going forward, as the number of platforms increase.

UK full year mid-market PE deal volumes by deal type



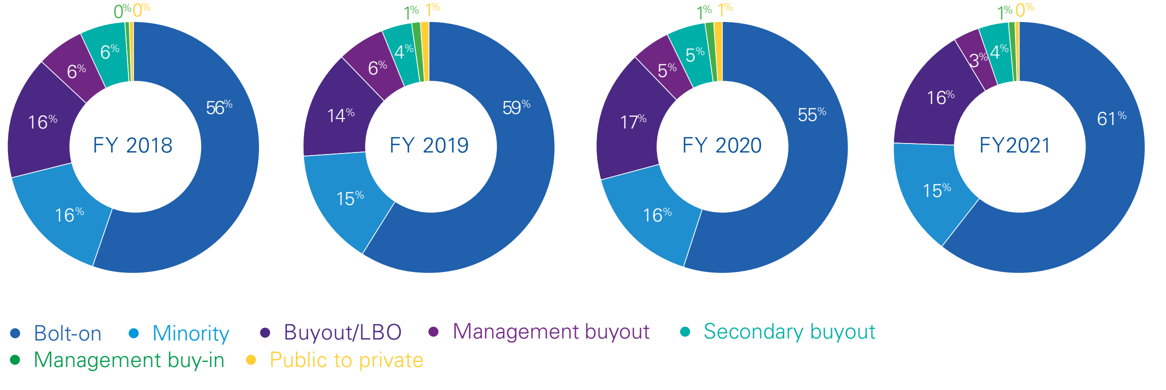
UK full year mid-market PE deal value by deal type (£bn)



% Change deal volume and value by deal type

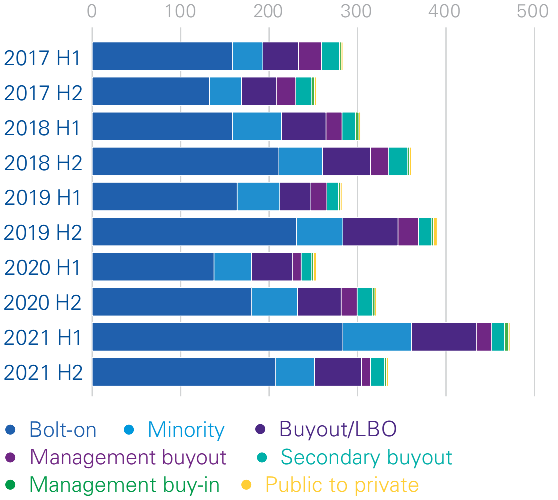
	% YoY Volume Change		% YoY Value Change	
Deal type	2020 v 2021	2019 v 2021	2020 v 2021	2019 v 2021
Bolt-on	54.4%	24.2%	49.6%	13.0%
Buyout/LBO	32.6%	29.9%	26.7%	28.5%
Management buy-in	20.0%	50.0%	43.0%	86.2%
Management buyout	-3.6%	-34.1%	-4.4%	-32.7%
Minority	28.7%	21.0%	54.5%	66.4%
Public to private	-20.0%	-33.3%	-88.6%	-94.0%
Secondary buyout	6.9%	10.7%	2.1%	3.7%

UK mid-market PE deal volume % by deal type

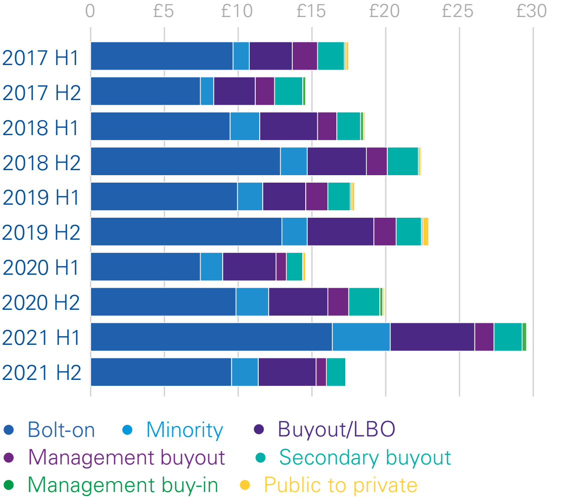


Source: *Pitchbook, data period 1 Jan 2021 - 31 Dec 2021*

UK half year mid-market deal volumes by deal types by volume



UK half year mid-market deal values by deal types by value (£bn)

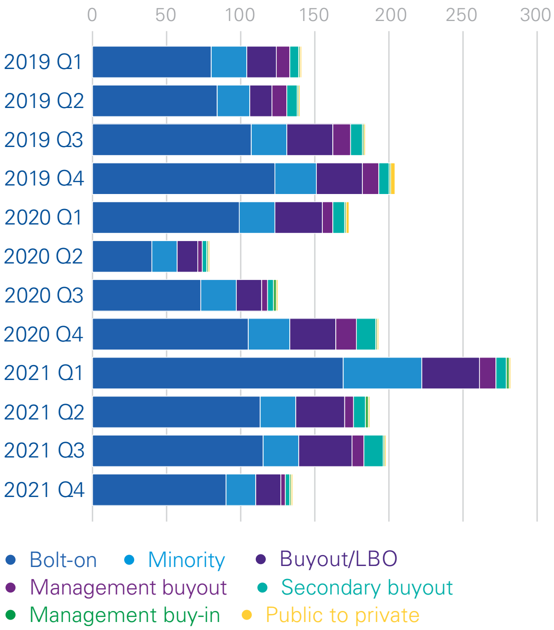


% change deal volume and value by deal types

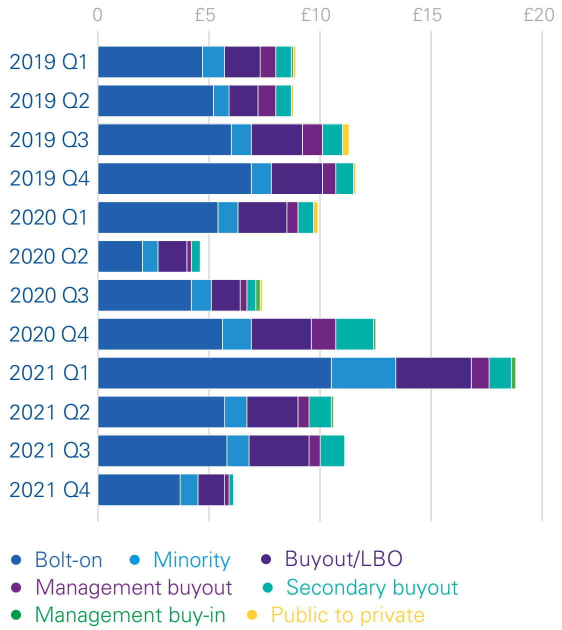
	% Volume Change 2020 v 2021		% Volume Change 2019 v 2021		% Value Change 2020 v 2021		% Value Change 2019 v 2021	
Deal type	H1 V H1	H2 v H2	H1 V H1	H2 v H2	H1 V H1	H2 v H2	H1 V H1	H2 v H2
Bolt-on	105.8%	15.1%	73.0%	-10.4%	119.1%	-3.0%	64.5%	-26.4%
Buyout/LBO	58.7%	8.2%	108.6%	-14.5%	60.0%	-2.9%	93.9%	-14.0%
Management buy-in	100.0%	-33.3%	100.0%	0.0%	1118.5%	-87.5%	232.7%	-70.0%
Management buyout	70.0%	-44.4%	-5.6%	-56.5%	82.2%	-51.0%	-10.5%	-55.0%
Minority	83.3%	-15.4%	60.4%	-15.4%	161.0%	-18.3%	131.3%	3.2%
Public to private	-33.3%	0.0%	0.0%	-50.0%	-100.0%	-63.7%	-100.0%	-91.2%
Secondary buyout	25.0%	-5.9%	15.4%	6.7%	71.1%	-35.8%	33.1%	-21.6%

Source: *Pitchbook, data period 1 Jan 2021 - 31 Dec 2021*

UK quarterly mid-market deal volumes by deal type

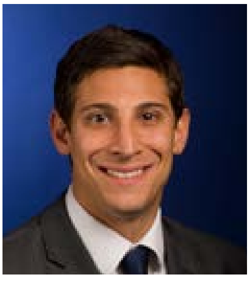


UK quarterly mid-market deal values by deal type (£bn)



Source: *Pitchbook, data period 1 Jan 2021 - 31 Dec 2021*

Mid-market PE exits



Richard Stark
Director, Head of PE in the North

Mid-market PE exit volume down 9% to 162

Mid-market PE exit values up 13% to £15.4bn

Secondary buyouts of 58, 36% of all mid-market PE exits

Trade exits of 73, 45% of all mid-market PE exits

IPO exits up from 8 to 25, 15% of all mid-market PE exits

The real story with exits is not so much the year-on-year comparison, but the huge spike we saw in Q4 2020 and Q1 2021.

There were 162 exits in 2021, down from 178 in 2020, a reduction of 9%, but remained up against 2019 activity. Deal values increased slightly from £13.6 bn to £15.4 bn, a 12.7% increase.

There were 69 exits in Q4 2020 followed by 48 in Q1 2021 – the biggest two-quarter total in three years. Exit values were even stronger, with £5.4 bn in Q4 2020, and £6.8 bn in Q1 2021 – the two biggest quarterly totals in at least five years. This flurry of exit activity was likely driven by a window of optimism at the end of 2020 that carried into 2021 and a rush, driven by non-institutional shareholders, to finalise deals before the anticipated changes to CGT in the Spring Budget, in turn also pulling deals into the first quarter rather than Q3.

Over the rest of the year, exit volumes unsurprisingly decreased. PE firms are professional sellers of businesses, as well as professional buyers, taking a measured, considered approach to exit timing to maximise value. Where trading had been impacted adversely, and exit timing was discretionary, 2021 was therefore not an optimal year to exit. For many businesses, the scenario was just that - the market in 2021 was still very delicate, with financial results were still reflecting the full force of the pandemic in 2020.

It has been noticeable over recent years that there is an ongoing imbalance between the volume of new investments and exits. There will need to be a correction at some point, although it is unlikely to happen in 2022 given the softening in market sentiment and macro-economic concerns.

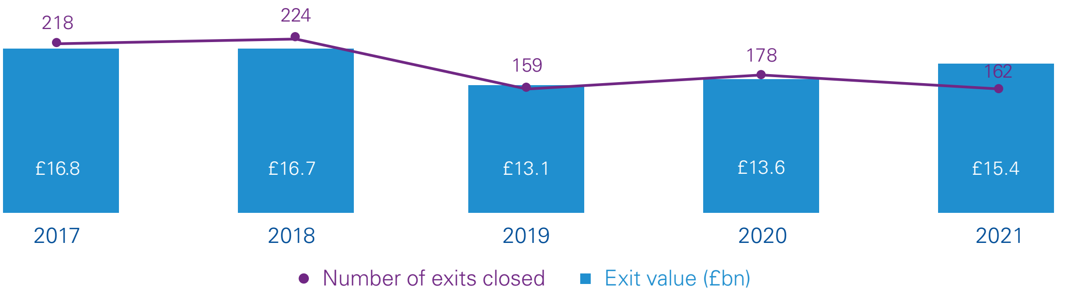
Looking at the types of exits that occurred, trade sales remained the most prevalent exit route, at 45.1% of all exits. This will remain a primary exit route, given that its existence as an exit option is pretty much a precursor for any PE firms going into a deal.

This includes a notable increase in the appetite of European-based, PE backed businesses, on the back of increased levels of private equity investment in continental Europe, combined with the onset of Brexit-related challenges when looking to effectively trade in the UK.

Arguably the most notable change, however, was the uptick in IPOs as the markets opened, bringing with them the potential of higher multiples and higher valuations that often come via this type of exit. IPOs made up 15.4% of all exits, up from 8 in 2020 to 25 in 2021 – the highest level for at least four years. This was an increase of 212.5% on 2020 and 150% on 2019.

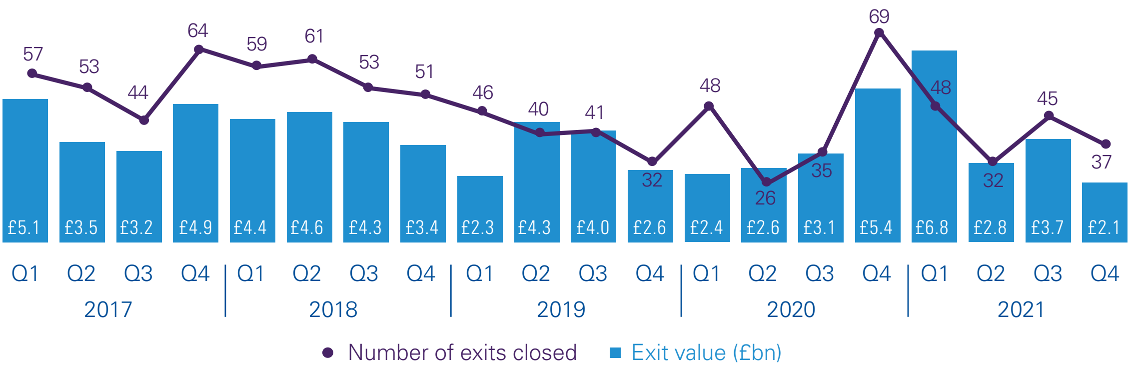
In terms of sectors, the biggest changes of note were the increased proportion of exits in the categories of Consumer Goods and Retail (17.8% to 20.4%), and Healthcare (5.6% to 8.6%). This is possibly a reflection of the positive impact of the pandemic on certain categories of business in these sectors, and in the case of retail the growth of ecommerce models.

Full year mid-Market PE Exits by deal volume and value (£bn)



	% Change YoY	
	2020 v 2021	2019 v 2021
% Value Change	12.7%	17.0%
% Volume Change	-9.0%	1.9%

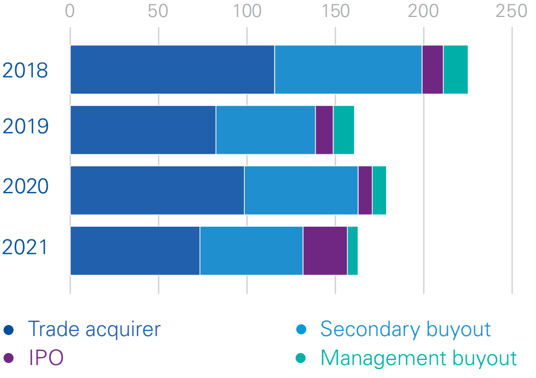
UK quarterly mid-market PE deal volumes and value (£bn)



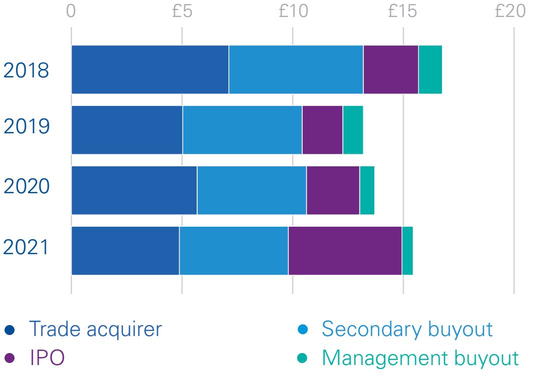
	% Change YoY 2020 v 2021				% Change YoY 2019 v 2021			
	Q1 v Q1	Q2 v Q2	Q3 v Q3	Q4 v Q4	Q1 v Q1	Q2 v Q2	Q3 v Q3	Q4 v Q4
% Value Change	182.1%	6.4%	16.1%	-61.2%	189.8%	-34.2%	-7.8%	-17.6%
% Volume Change	0.0%	23.1%	28.6%	-46.4%	4.3%	-20.0%	9.8%	15.6%

Source: *Pitchbook, data period 1 Jan 2021 - 31 Dec 2021*

Full year mid-market UK PE exit volume by exit type



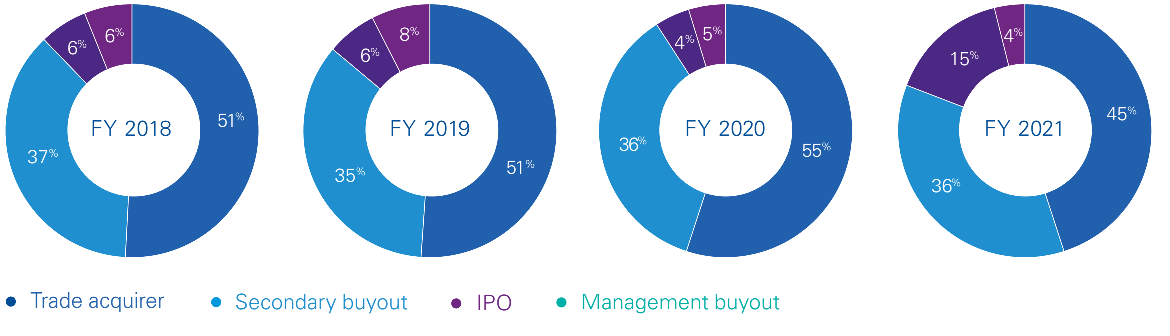
Full year mid-market PE exit by deal value (£bn)



% change deal volume and value by exit type

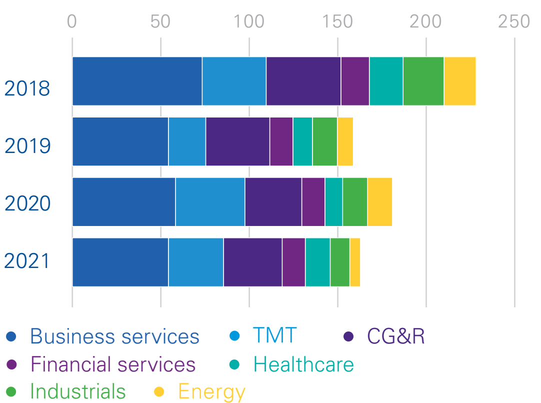
	% YoY Volume Change		% YoY Value Change	
Exit type	2020 v 2021	2019 v 2021	2020 v 2021	2019 v 2021
Management buyout	-25.0%	-50.0%	-25.7%	-45.6%
Trade acquirer	-25.5%	-11.0%	-14.1%	-3.0%
Secondary buyout	-9.4%	3.6%	-0.4%	-8.7%
IPO	212.5%	150.0%	113.8%	179.3%

UK mid-market PE deal volume % by exit type

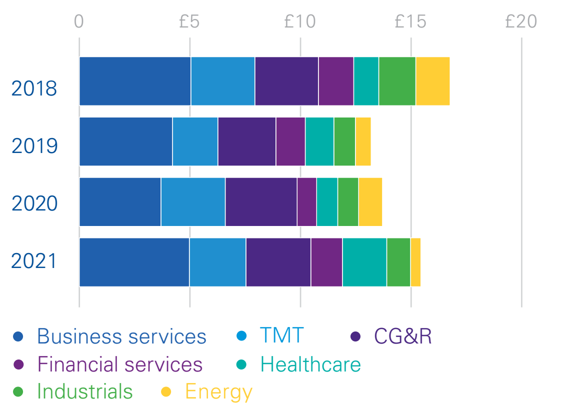


Source: *Pitchbook, data period 1 Jan 2021 - 31 Dec 2021*

UK mid-market exit volumes by sector



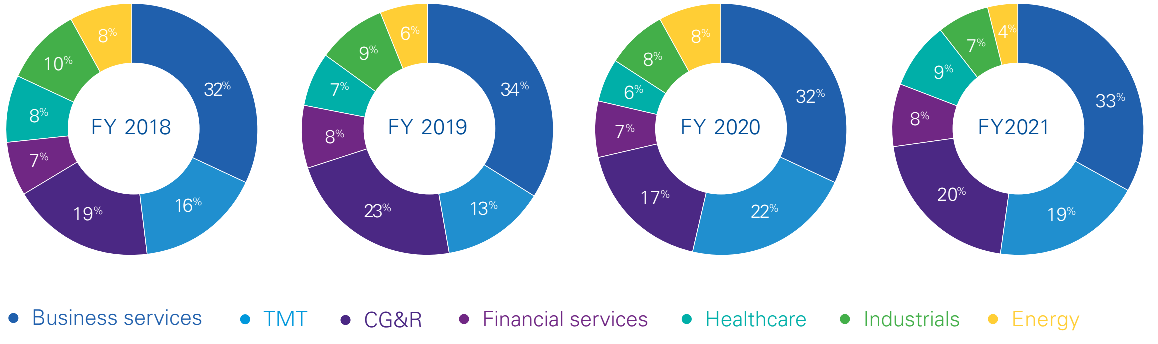
UK mid-market exit values by sector (£bn)



% change deal volume and value by exit sector

	% YoY Volume Change		% YoY Value Change	
Sector	2020 v 2021	2019 v 2021	2020 v 2021	2019 v 2021
Business services	-6.9%	0.0%	34.8%	18.1%
CG&R	3.1%	-8.3%	-9.7%	11.9%
Energy	-57.1%	-33.3%	-56.6%	-34.2%
Financial services	0.0%	0.0%	62.0%	7.5%
Healthcare	40.0%	27.3%	110.1%	54.9%
Industrials	-21.4%	-21.4%	14.0%	10.4%
TMT	-20.5%	47.6%	-12.1%	24.7%

UK mid-market PE deal volume % by exit sector



Source: *Pitchbook, data period 1 Jan 2021 - 31 Dec 2021*

A perspective on IPOs

Helen Roxburgh
Partner, M&A PLC Advisory

Aadam Brown
Managing Director, Independent IPO Advisory

"Private Equity is particularly adept at identifying future successful market trends, not to mention the rigour and expertise that goes into researching and filtering for investments, meaning PE-backed companies are typically high-quality IPO candidates."

2021 was a remarkable year for the IPO market in the UK and around the world. The year marked an all-time high for the number of IPOs completed in the US, and for some time in the Eurozone, while in the UK over 120 companies listed on the London Stock Exchange, raising over £16.8 bn, the most since 2007. This resurgence was equally evident in the mid-market private equity market, where we saw the number of IPOs more than triple in 12 months, to account for 15% of all mid-market PE exits.

The increase in IPOs was driven by strong equity markets benefiting from loose monetary policy, reopening trades and resilient corporate earnings. High valuations across some sectors made listings attractive, particularly Technology, and those sectors that have thrived through the pandemic, like tech-driven Consumer Goods and Retail. Added to this was plenty of pent-up investor demand from the previous few years due to Brexit and the first wave of the pandemic in 2020.

Much like the wider M&A market, an upturn in confidence towards the end of 2020 led to a number of successful IPOs, which kickstarted the momentum for 2021 and the wave of IPOs coming to the market.

Benefits of the IPO option

For PE-backed companies, one of the major benefits of an IPO is the possibility of achieving a higher valuation versus the private market. This is one of the reasons why there has been a boom in listings for businesses in some sectors like Tech and tech-driven Business Services and Consumer Products, where public market valuations have been relatively higher.

An added benefit to listing is that PE owners do not generally release all their equity as part of the IPO. They usually retain a stake, which means they can also ride the post-IPO valuation curve upwards through a carefully coordinated series of exit trades over the following 12-18 months. An IPO can also lead to easier access to further capital to finance consolidation strategies or accelerate organic growth via public quoted equity raisings.

For individual business owners, there is the additional benefit that an IPO enables them to release some of their equity while retaining control of the business. A public market listing also brings heightened prestige and publicity for the company and the CEO, which can carry associated benefits.

More PE-backed IPOs please

Investors like PE-backed companies. Despite an often-higher focus at IPO on value optimisation for the selling shareholder, they have still generally outperformed the wider IPO market. For an investor, any successful stock picking strategy relies on the ability to identify the differentiating factor that leads to their portfolio of companies achieving successful market returns. Private Equity is particularly adept in identifying future successful market trends, not to mention the rigour and expertise that goes in to researching and filtering for investments, meaning PE-backed companies are typically high-quality IPO candidates.

New trends set to continue

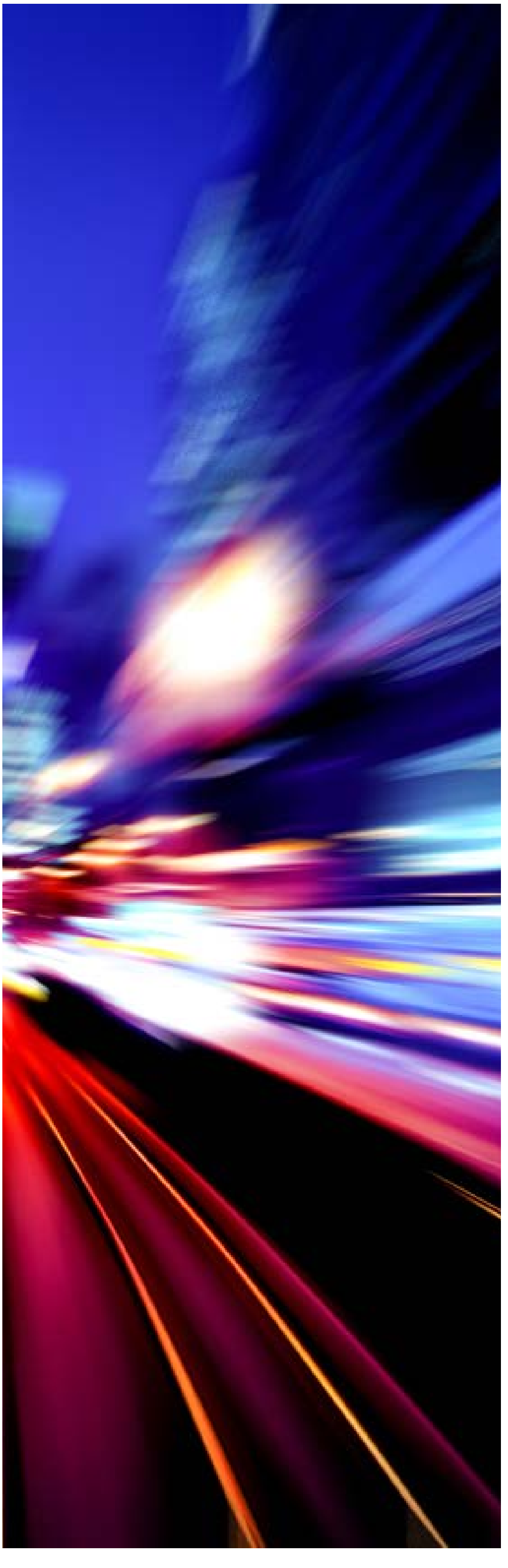
One of the major effects of the pandemic has been new ways of communicating through technology. In the IPO markets, this was evident in investor meetings mainly being held virtually, avoiding lost time travelling to meetings. The direct effect has been quicker roadshows and faster execution timetables, a trend that is expected to continue.

The requirement for companies to have ESG strategies embedded has continued. This has been reflected in the ongoing inflow of capital to ESG funds and attractiveness of strong ESG friendly businesses.

Special purpose acquisition companies (SPACs), the buzzword of the last few years, remain a focus for many. But after a frenzy of SPAC raising in Q1 2021 (mainly in the US), activity died down as the year progressed. While SPAC capital raising will be here to stay, it tends to be more popular in periods of market volatility. Instead, the focus for 2022 may be more on 'de-SPAC' transactions, which picked up in 2021 as the cash shells look for private companies to merge with.

Cautious optimism for 2022

IPO windows can open and shut relatively quickly and are quite sensitive to increased uncertainty and equity market volatility, as we have already seen in the early part of 2022. Although various macro headwinds remain, the IPO market in recent years has shown resilience and the pipeline is robust with several high-profile listings in preparation. The London Stock Exchange remains an exciting venue to list high quality businesses and while volumes are not expected to match 2021, we anticipate returning to the relatively healthy levels seen pre-pandemic.



Deal multiples

In the mid-market, it is a sellers' environment where multiples are strong.

In line with the increase in PE activity, deal multiples across the UK PE market as a whole rose in 2021, from 8.7x earnings in 2020 to 9.6x in 2021, while multiples in the Mid-market remained fairly steady at 10.4x, a slight drop from 10.7x in 2020.

After a period of very high deal multiples in the M&A market over the past few years, the marginal dip in mid-market multiples should not be seen as a cause for concern. That multiples have remained so high despite the considerable increase in deal volumes is a sign that demand remains strong.

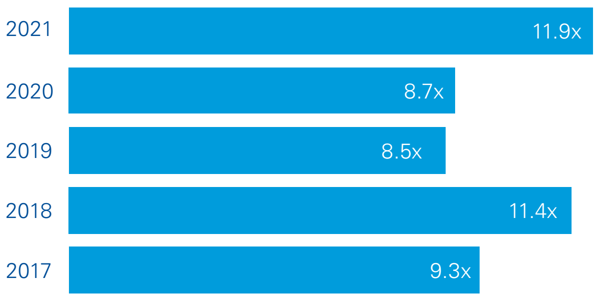
With the unprecedented flurry of activity at the end of 2020 and into early 2021, when PE houses were competing hard to secure the best opportunities, plus the fact that volumes were subdued in 2020 due to the initial Covid-19 uncertainty, it is logical there was a natural cooling off.

It also reflects recent market sentiment. Investors are being more cautious in the face of uncertainties around energy costs, labour supply and interest rates, as well as issues such as supply chains costs and global geo-political tensions. As a result, they are being more analytical in their approach to thoroughly understand the resilience of business models and opportunities. This is borne out by the fact we are seeing increasing use of data analysis on both the sell and buy side of deals.

Nevertheless, high double-digit multiples are still being achieved for good quality businesses, particularly in TMT deals (where EBITDA multiples are being triangulated with revenue multiples), tech-enabled Services and pockets of Healthcare. The imbalance of supply versus demand should sustain multiples for the best assets in the year to come.

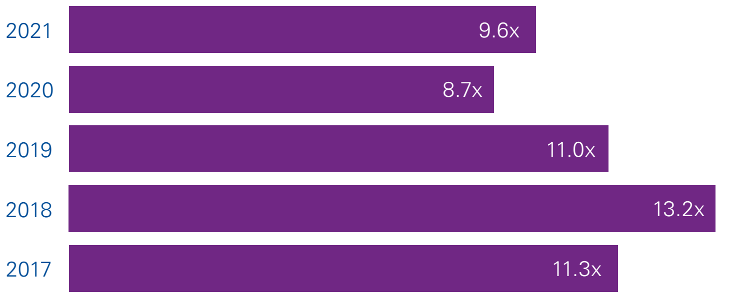
11.9x

UK M&A (including buyouts) EV/EBITDA multiples



9.6x

UK PE Buyout EV/EBITDA multiples



10.4x

All UK mid-market average EV/EBITDA multiples

Source: *Pitchbook, data period 1 Jan 2021 - 31 Dec 2021*

PE trends to watch out for

Jonathan Boyers
Partner, UK Head of Corporate Finance

2022 should be a cleaner year to value off. It will therefore provide more conviction for private equity houses when looking for the best investment opportunities.

Although 2021 ended on a more cautious note than it started, there are still reasons to be cautiously positive as we head into 2022.

The appetite for investment among PE firms is strong, with significant levels of capital ready for the right opportunity. The debt market is very much open for business, and there is still some residual nervousness around potential changes to the CGT regime in the Spring Budget, which could drive exit levels in the early part of the year.

ESG is going to be an increasingly important consideration for investors and a key element of due diligence. Both PE funds, and society as a whole, now have a much greater awareness and understanding of ESG issues. Although every business's ESG journey will be different, it is expected that ESG factors will be integrated into every area of operations, from supply chains to recruitment, marketing to distribution. In time, ESG will evolve from being a discrete issue that requires special attention to just an accepted part of how a business operates, and what investors expect.

Much of the 'noise' that has affected the PE market over the past few years – first Brexit and then COVID-19 – is lessening. 2022 looks set to be a clearer year of trading; of 'normal' business conditions to base a valuation on, which could encourage more deal flow.

The growth of the UK's TMT sector should continue to drive deal activity, with businesses that were set up four or five years ago now beginning to scale up and seek investment. This could also feed into a changing regional dynamic, as many of the UK's biggest cities are seeing their efforts to champion TMT innovation in recent years begin to bear fruit.

In addition, it will be interesting to see if the government's 'levelling up' agenda has an impact in 2022, as more investment and policy initiatives are aimed at supporting economic growth outside London and the South East.

The new National Security and Investment Act, the protocols of which came into force in January 2022, may also affect future transactions involving UK assets, potentially to the advantage of UK PE investors.

Navigating headwinds and special situations

Adam Broadbent
Managing Director, Special Situations, Corporate Finance

"Companies that can successfully revaluate their proposition to attract and retain key employees will be well placed to capitalise on further opportunities, whether it be organic growth or PE investment."

The economic outlook is undoubtedly brighter than it was 12 months ago, but the pandemic will continue to create uncertainty in the market for some time to come. As discussed earlier in this report there are a number of headwinds that have started to surface as the economy emerged from lockdown and some of these have intensified and are causing issues for businesses and their shareholders.

A resilient market

Surprisingly, against the backdrop of the challenges of the past 24 months, opportunities for special situations investments have been limited and the mainstream PE market remains buoyant, having just had its most active year on record. The wave of activity to support stressed and underperforming businesses anticipated at the start of 2021 did not materialise, as financial support measures such as furlough, government-backed loans and temporary legislation to protect businesses were extended. Now that these pandemic-related measures have largely been withdrawn, focus has shifted from survival to recovery, growth and how to deal with significant amounts of debt that have been accumulated by some.

Some corporates will seek to deleverage by raising cash from carveouts and non-core asset disposals, which could create opportunities for PE funds to acquire unloved assets with strong turnaround potential as either platform or bolt-on investments. Others will be able to draw upon (further) support from shareholders or new equity providers, while many will need to re-engage with their lenders for access to additional cash.

Managing lenders and investors effectively requires early engagement and delivery of credible, scenario-based forecasts that incorporate potential risks and mitigating actions, as well as possible upsides. Demonstrating a strong cash culture alongside a compelling recovery story will underpin access to ongoing funding and /or investment.

Amending and extending any existing borrowing arrangements and optimising cash and working capital management are important steps on the recovery journey. But many organisations will need to do much more both strategically and operationally. A return to what was normal pre-pandemic is no longer on the cards and rapidly changing customer and employee behaviours provide companies with an opportunity to radically reshape their business for the future, including demonstrating strong ESG credentials and adapting to a new post-COVID market.

At the more challenging end of the market, traditional lenders may need to exit relationships due to tighter credit requirements or regulatory constraints. This will create opportunities for PE funds that have a greater appetite for risk and can move quickly in time critical situations. The fundamentals all point to a more active turnaround market in the near future and debt providers and PE investors that thrive in complex and challenging situations are likely to play a prominent role.

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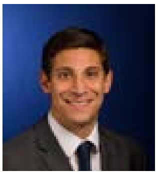

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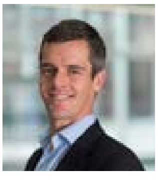

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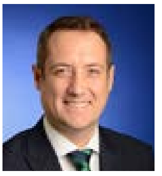

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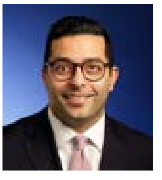

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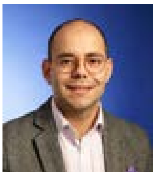

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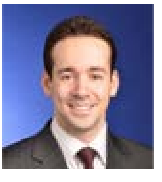

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Methodology

Report scope covers period 1 January 2021 - 30 December 2021

Mid-market transaction classification to be defined as deals with an EV/deal value/consideration value of between £10m-£300m.

Transaction type classification to be defined as:

1. All mid-market primary PE deals (all types), including:
    a. Primary investment/buyout
        i. Minority stake (PB term: growth/expansion)
        ii. Majority stake
    b. Management buyout
    c. Management buy-in
    d. Bolt-on (PB term: Add-on)
    e. Corporate divestiture
    f. Public-to-private buyout
2. PE Exits
    a. Secondary buyout
    b. PE to IPO
    c. Trade buyer (PE term: strategic)
3. General M&A
    a. Strategic Acquirer, non-financial acquirers (e.g. Amazon, J.P. Morgan)
        i. Reverse merger
    b. Financial acquirer (i.e. PE firms)
    c. Mid-market classification to be defined as deals with an EV/deal value/consideration value of between £10m-£300m.
    d. Note: General M&A to be included for purposes of comparison (defined by mid-market and regions)

PitchBook mid-market methodology

Capital invested is defined as the total amount of equity and debt used in the Private Equity investment. PitchBook's total capital invested figures include deal amounts that were not collected by PitchBook but have been extrapolated using a multidimensional estimation matrix. Regardless of the extrapolated deal value, deals are subsequently distributed into deal size buckets, below $1 billion, based on the corresponding proportion of known deal sizes. Some datasets will include these extrapolated numbers while others will be compiled using only data collected directly by PitchBook; this explains any potential discrepancies.

PitchBook only tracks completed exits, not rumored or announced transactions. Exit value, like deal value, includes exit amounts that were not collected by PitchBook but have been extrapolated using a multidimensional estimation matrix. Regardless of the extrapolated exit value, exits of unknown size are subsequently distributed into deal size buckets, below $1 billion, based on the corresponding proportion of known deal sizes. Unless otherwise noted, initial public offering (IPO) sizes are based on the pre-money valuation of the company at the time of IPO. We exclude exits in which the only PE backing was a PIPE.

The report only includes PE funds that have held their final close. Unless otherwise noted, PE fund data includes buyout, diversified PE, mezzanine, mezzanine captive, growth and restructuring/turnaround funds. Fund location is determined by specific location tagged to the fund entity, not the investor headquarters.

A Leveraged Buyout/LBO can refer to the overall category of transactions in which an acquiring entity utilizes leverage in order to gain a controlling portion of a target entity. It also refers to the specific case of a buyout wherein the entity is a PE firm and it acquires a majority share of the target company and may or may not dispense with the existing management or buy them out as well, without the management actively partaking in the transaction and also acquiring a significant stake.

A Management Buyout however refers to that latter case, wherein the managers often go out and find a buyer for the company and also put in their own capital to help finance the transaction so they can take over ownership of the company. A Management Buyout/MBO is a financial investment that occurs when a Private Equity investor partners with the company's existing management to acquire a majority (>50%) of the equity in a corporation (the Target Company). In these transactions, the PE Firm and the management receive a combined majority (>50%) stake in the company. Management or PE firm can hold majority or minority stake.

NOTE: founders retaining a stake is not considered an MBO. "Partnership" with management is not considered an MBO unless there is other evidence that the management truly invested or re-invested in this transaction.

Identifying deals with an ESG component:

These deals were identified using the following criteria:

Investments by pure ESG/Impact focused PE firms made during the period.

Analysis of keywords in company businesses descriptions using the following which are not exhaustive:

ESG, Low carbon, Smart cities, Biomass, electric vehicles, electric vehicle charging, Clean energy, renewables, Wind farms, Solar, Clean batteries, Hydrogen, Compressed air, Bioenergy, Biopharma, Elderly care, Supported living, Mental health, Children's specialist care/fostering, Omics (genomics/ transcriptomics/Proteonics), Synthetic biology, Medical equipment for elderly, Physiotherapy, Nutritional coaching, Corporate wellbeing, Addiction treatment, Data and digital in healthcare, IT asset management, Agri-tech, Health-tech, Supply-chain transparency tech, Data protection, Cyber security, Regulatory compliance tech, Governance, Risk and Compliance, Digital compliance tech, Ed-tech/e-learning, Learning management systems, HSEQ technology, Software around data analysis and increased productivity and energy management, Telematics/intelligence traffic software, environmental compliance, Sustainable and Educational travel, Sustainable fashion, Natural ingredients, Sustainable food products, Sustainable personal care products (reduced packaging/recycled(able) ingredients), Non-meat proteins/plant based food, Vertical farming, City agriculture, Surplus products/redistribution of food/ retail, Alcohol free spirits/drinks, Reversed logistics, Recycling technology, End-of life enhancement of equipment and goods, Extension of asset life, Water, Leak detection, quality monitoring, wastewater treatment, Waste Recycling (MSW, e-waste, paper & fly ash), EfW (pyrolysis, gasification, plasma & AD), Smart buildings/ Homes, Sustainable housing construction, Affordable homes, Smart hospitals, Care homes, IT Asset disposal, Supply chain management, Supply chain transparency, Consultancy – governance, regulatory compliance, energy, process engineering, Recruitment – upward social mobility, Waste services, Training and re-training, Lighting, LED power delivery, plasma lighting, Water, Leak detection, quality monitoring, wastewater treatment, Smart property Solutions & Services, Health and safety, Services to SMEs, Educational content providers, Industrial IoT, Home automation, Test & Measurement, Filtration, Marine transport, Agricultural sensors, Smart metres, Packaging (smart/recycled/re-purposed), Semiconductors, superconductors, minerals, Repair diagnostics, Fuel cells, PEM, phosphoric acid, direct methanol, alkaline, SOFC, Industrial filtration technologies, Employee benefits, Ethical consumer finance, Environmentally linked wealth and asset management.

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