KPMG

UK Mid-market PE review

Our perspective on Private Equity activity during 2022

February 2023

kpmg.com/uk/midmarketPE

PitchBook

Contents

The landscape

FY 2022 activity versus FY 2021

All PE activity

1,544 deals, down **17%**

£171bn deal value, down **6%**

Mid-market PE activity

680 deals, down **19%**

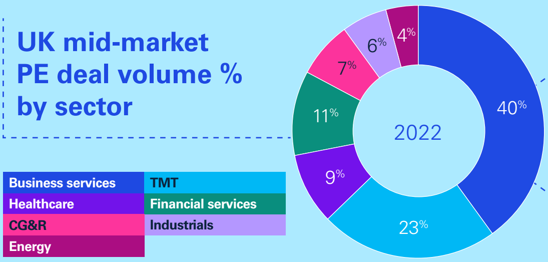
£46bn deal value, down **6%**

PE exit activity

146 deals, down **23%**

All data provided by Pitchbook

UK mid-market PE deal volume % by sector

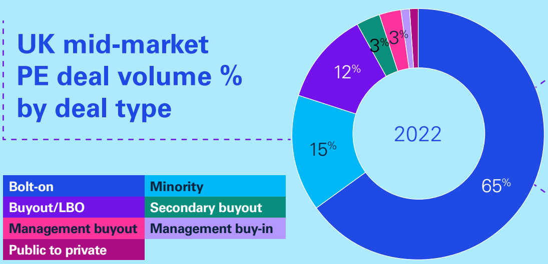


Business services **271** deals, **40%** of all mid-market PE deals

TMT **153** deals, **23%** of all mid-market PE deals

Financial Services **75** deals, **11%** of all mid-market PE deals

UK mid-market PE deal volume % by deal type

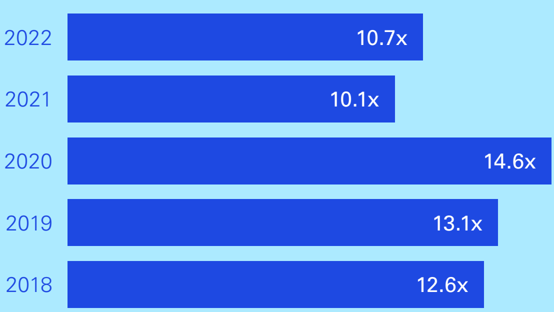


Bolt-on's **443** deals, **65%** of all mid-market PE deals

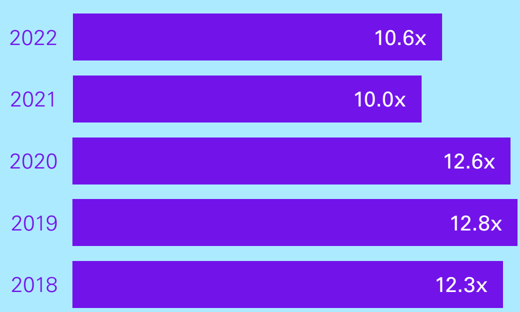
Minority **102** deals, **15%** of all mid-market PE deals

Buyout/LBO **84** deals, **12%** of all mid-market PE deals

UK PE buyout average EV/EBITDA* multiples



UK mid-market PE average EV/EBITDA* multiples



Period covered 1 January to 31 December 2022

Source: *Pitchbook*
** deals with an EV of £10-£300m*

Welcome

Robert Baxter
Partner, UK Head of Corporate Finance, Global Head of Consumer Goods M&A

After a remarkably strong year for the overall PE market in 2021, it was perhaps inevitable that activity levels in 2022 dropped off.

However, considering the 'poly-crisis' that was experienced during the year, particularly in H2, the decline was far less than may have been expected, and overall PE deal levels remained at or above the sort of levels we saw pre-COVID.

The fluctuating fortunes of the market are particularly evident in the quarterly breakdown. Q1 and Q2 2022 carried on at the levels seen in 2021. But activity dropped dramatically in Q3 and into Q4 as existing uncertainties, such as geo-political tensions, energy crises and supply chain issues, were exacerbated by more immediate factors closer to home: rising inflation leading to higher interest rates, tighter debt markets and political and economic instability.

It wasn't only the PE market that was affected, of course. The post-Covid bounce started to dissipate, not just in the deals market but also in trading performance and profitability.

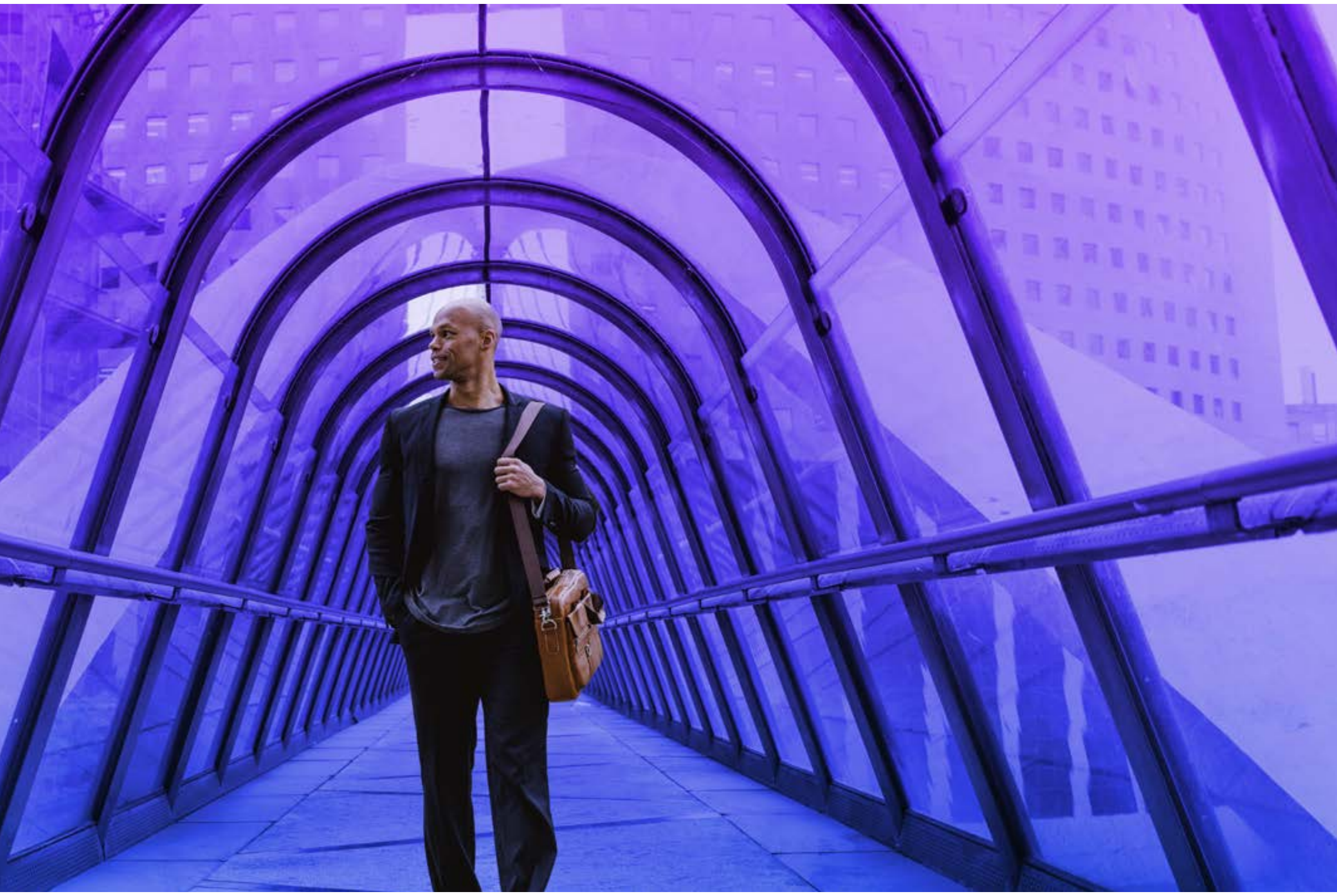
The invasion of Ukraine in February 2022 led to geo-political uncertainty and concerns over energy supply. This resulted in significant price rises, which were felt more acutely in the UK. More widely, and compounded by ongoing Covid lockdowns in China, significant supply chain challenges emerged, slowing the flow of goods and putting further pressure on prices.

As inflation began to climb, consumers faced a cost of living crisis, and interest rates were increased to help bring inflation under control. This drove up the price of debt, which affected deal activity and valuations.

Towards the latter part of the year, domestic political changes and the fall-out from the mini-budget further exacerbated uncertainty for business leaders, contributing to a slowdown in overall M&A activity.

However, despite these multiple barriers, the deals market remained remarkably resilient when compared to historical norms, with deal volumes exceeding 2019 levels.

The larger end of the PE deal market seemed to be most affected by these issues. Leveraged loans and underwriting appetite were severely curtailed and the high yield bond market was essentially shut. However, we saw private credit funds stepping in to fill some of this gap, but liquidity was largely reserved for key sponsor relationships, the most resilient businesses and bolt-on deals. As such, there were a number of high profile buy-outs that halted as a direct result of leveraged debt markets tightening.



As ever, although most of these challenges affected the whole market, some industry sectors were more resilient than others. TMT, Business Services, Financial Services, Healthcare, and Energy which have consistently demonstrated their resilience over the past few years, continued to attract considerable PE interest. Other sectors, such as Consumer Goods and Retail and Real Estate have seen a less activity.

In terms of deal types, bolt-ons remained the most popular type of deal. The growth in bolt-ons has been increasing for many years, reflecting the on-going focus towards investing behind existing platforms to establish new capabilities or enter new markets and where significant synergy potential can be released. In contrast, exit levels remained subdued, continuing the downward trend of the past five years.

Others key topics explored in this report include:

- Resilience in mid-market PE activity, despite poly-crisis
- Differing performance between sectors
- Pre-eminence of bolt-on investments
- Continuing decline in exits
- Expectations for 2023

Our perspective

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

2021 was a stellar year in the mid-market private equity space. As we entered 2022, it seemed like the momentum would continue, with a strong performance in both deal volumes and aggregate values in Q1.

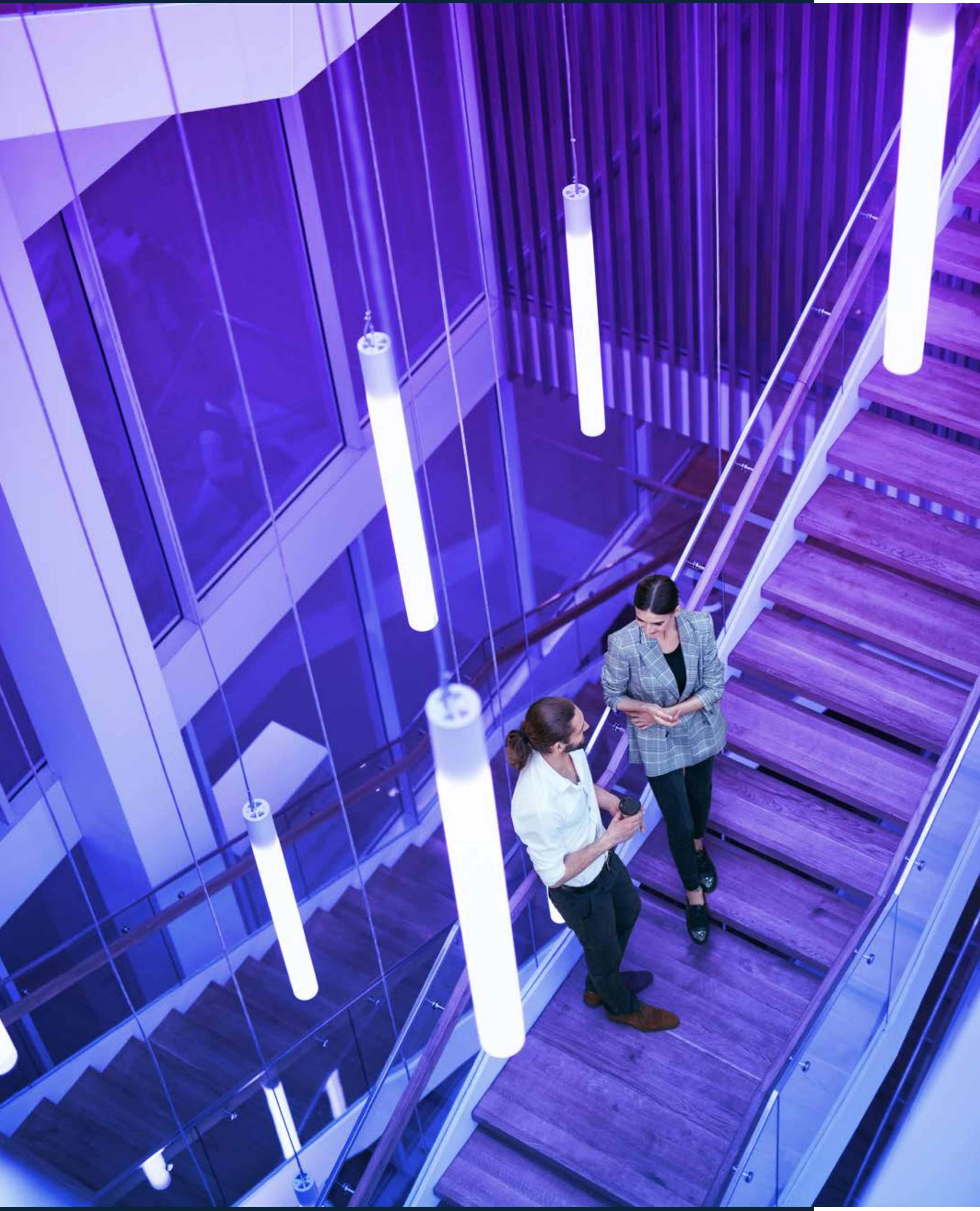
Although there were already some headwinds that were beginning to affect confidence, the deals market still had plenty of activity and PE houses were keen to deploy their capital while the market was strong. Coming into the year, the continuing uncertainty about potential changes to the capital gains tax regime also added to the impetus of some business owners to get deals done while prospects were generally positive.

By Q2, however, that sentiment was changing. The crisis in Ukraine and resulting geo-political and financial shocks, on top of the existing uncertainties around supply chains, interest rates and labour force shortages, rapidly depressed transaction levels. In the second half of the year this was further compounded by unfavourable market reaction to the 'mini-budget' in September.

It's interesting to note, however, that mid-market PE activity levels proved more resilient during this period than the PE market as a whole. By Q3, deal volumes and values in the mid-market were edging up again and only dipped slightly in Q4, whereas overall PE deal volumes continued to fall throughout H2. This may reflect the fact that mid-market deals are not as dependent on traditional multi-bank solutions with high leverage multiples. The mid-market has access to more debt options via credit funds, which has meant that this part of the market may have been less affected by the travails in the lending market.

As a result, taking the year as a whole, mid-market PE transactions were over 12% higher than 2019 – the last relatively 'normal' year - in both volumes and values, which given the wider economic and geo-political situation, is a very robust performance.

As a result, taking the year as a whole, mid-market PE transactions were over 12% higher than 2019.



Total UK PE activity

£171bn deal value, down **6.0%**

1,544 deals, down **16.5%**

Unsurprisingly after the burst of activity in 2021 – an exceptional, record-breaking year – the volume and aggregate value of UK PE deals fell back 16.5% in 2022.

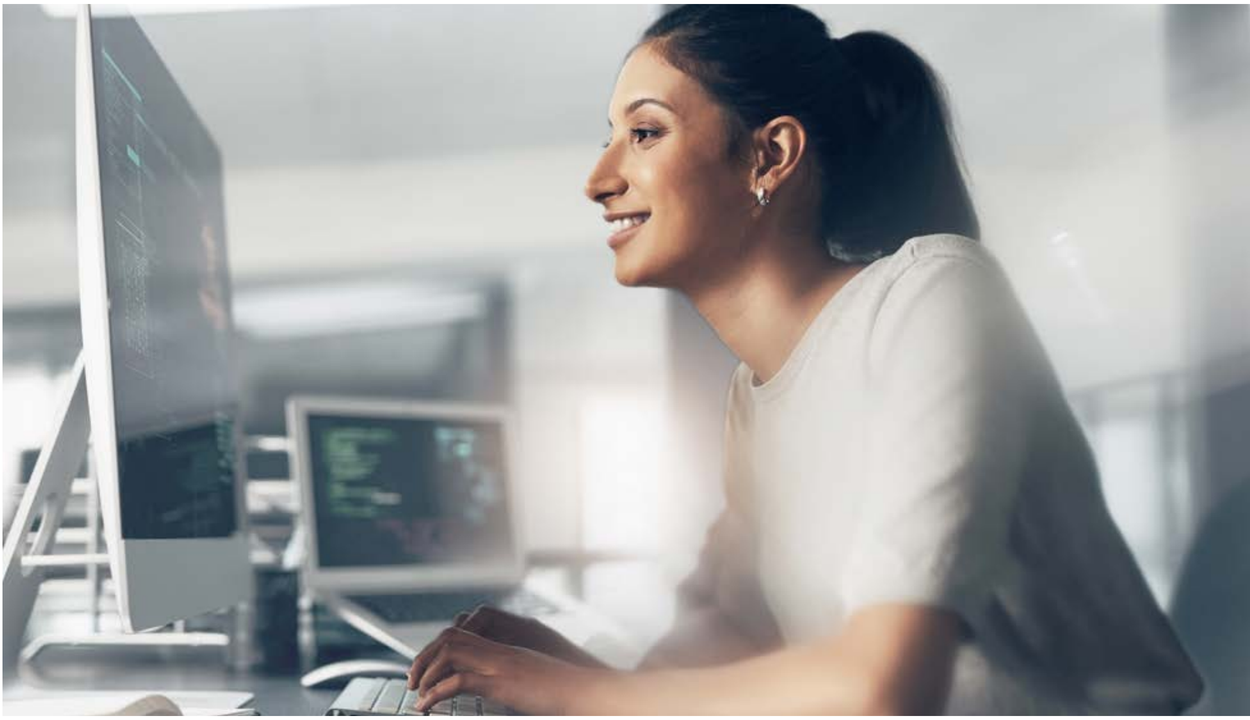
Taking a longer-term view, however, both deal volumes, with 1,544 deals, and values, at £170.58bn, were up on 2019. Deal volumes were up 18.3% and values up 55.3%, well above historic levels.

In effect, it was a year of two halves in the overall PE market. A fast start picked up where 2021 left off, before slowing down in the final six months. Nevertheless, annual deal volumes and values remained strong compared to the pre-Covid period.

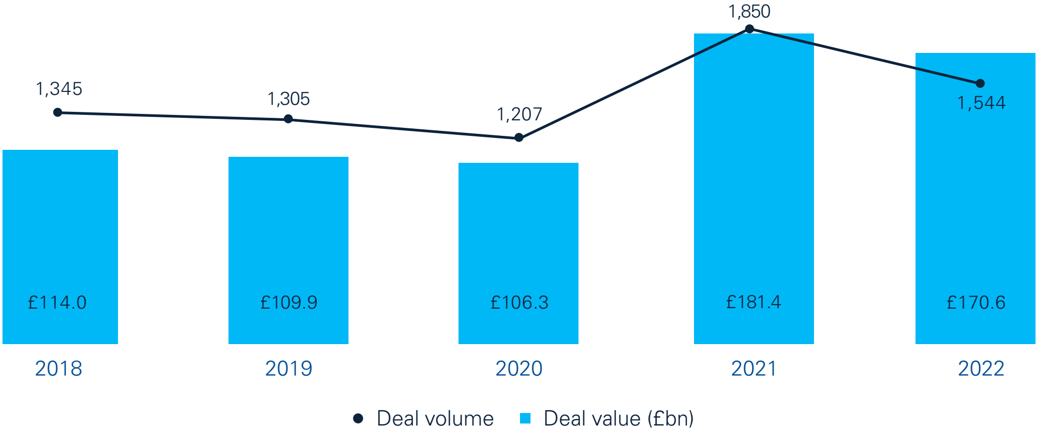
> **Annual deal volumes and values remained strong compared to the pre-Covid period.**

Over half (54%) of deals transacted in the first half of 2022, when the value of deals completed was actually higher than the same period in 2021, and over 100% up on H1 2019. The number of deals completed in H1 was also 35.2% up on H1 2019.

The majority of activity occurred in Q1, with 422 deals completed, higher than all other quarters in 2022. Activity then slowed, with only 312 deals in Q4 as confidence waned in the face of multiple headwinds, not least rising inflation, interest rates and a tighter lending market.



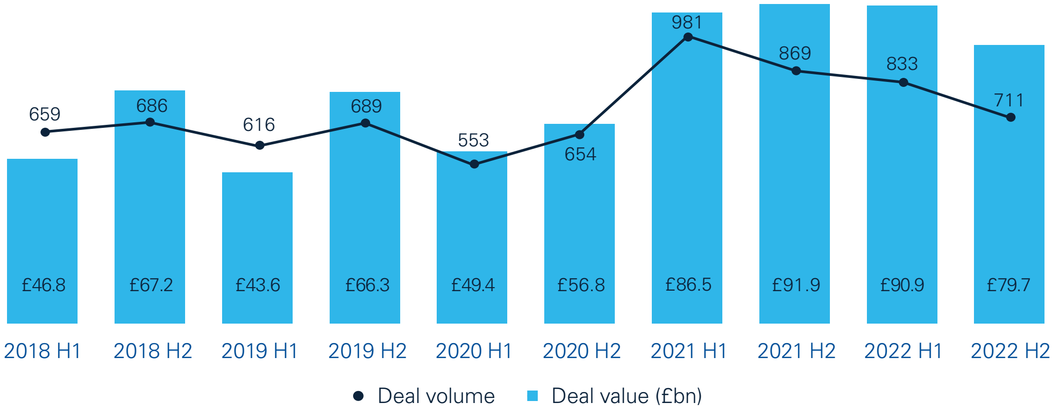
UK PE deal volumes and values (£bn)



	% Change 2022 v 2021	% Change 2022 v 2019
Value Change	-6.0%	55.3%
Volume Change	-16.5%	18.3%

Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*

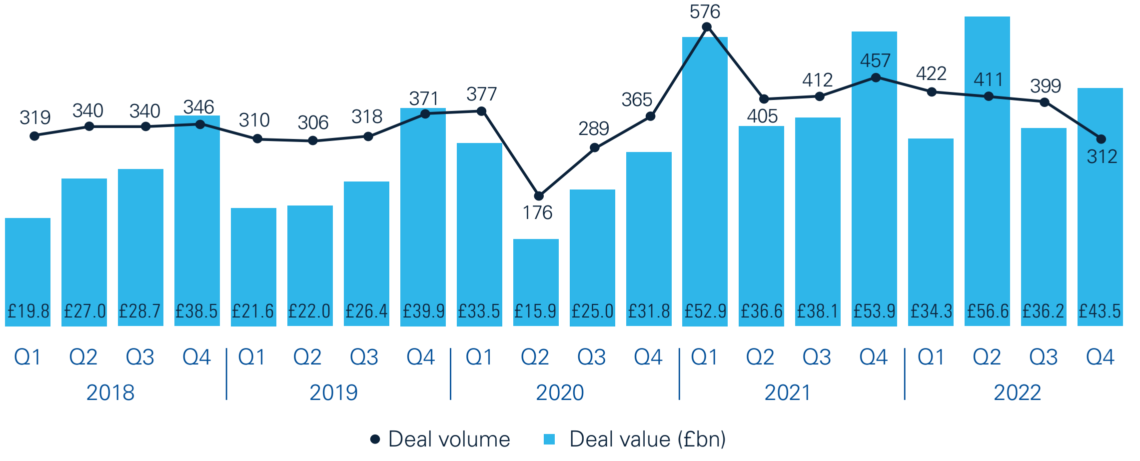
Half year UK PE deal volumes and values (£bn)



	% Change 2022 v 2021		% Change 2022 v 2019	
	H1 v H1	H2 v H2	H1 v H1	H2 v H2
Value Change	1.6%	-13.3%	108.6%	20.2%
Volume Change	-15.1%	-18.2%	35.2%	3.2%

Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*

Quarterly UK PE deal volumes and values (£bn)



	% Change 2022 v 2021				% Change 2022 v 2019			
	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	-35.2%	54.8%	-5.0%	-19.1%	58.7%	157.7%	37.1%	9.0%
Volume Change	-26.7%	1.5%	-3.2%	-31.7%	36.1%	34.3%	25.5%	-15.9%

Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*

UK mid-market PE activity

£46bn
deal value, down
6.4%

680
deals, down
19.3%

Mid-market PE
680
of all PE deals

"

It was a very resilient year for mid-market PE activity. Despite the multiple challenges facing the market in 2022.

Both mid-market deal volumes and values declined in 2022 after the post-lockdown surge in 2021, by 19.3% and 6.4% respectively.

But as with overall PE activity, a longer-term lens shows that in relative terms, 2022 was still a strong year for mid-market PE transactions. There were 680 deals completed, 12.4% higher than 2019, at a value of £46bn, which is 13.1% up on 2019.

Performance across the year was also more consistent in the mid-market than the overall PE market, with only 12 fewer deals in H2 than H1, and aggregate values actually increasing in H2. This compares to the overall PE market, where there were 122 fewer deals in H2 and a £10bn decline in values.

The quarterly picture is more mixed. Uncertainty around capital gains tax, coupled with the feel-good factor of 2021, combined to ensure Q1 was a bumper quarter for mid-market PE activity, with 202 deals at a combined value of £15bn. With the exception of 2021, these were the highest Q1 figures for at least five years.

Q2 saw a dramatic change, however, as geo-political tensions and economic instability slowed down deal activity. Deal volumes saw a steep decline to 144 while aggregate deal values dropped to £7bn.

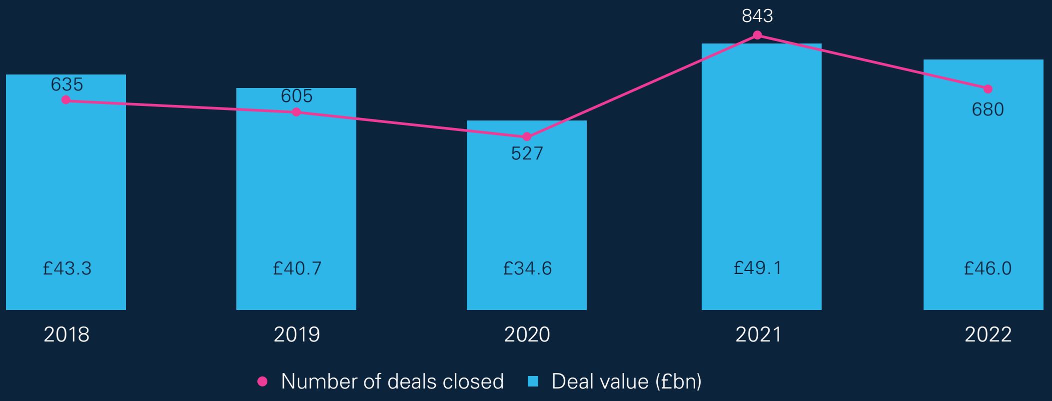
The fall-off was only temporary, though. Deal volumes and values were up again in Q3 – up on the same period in 2019 by 2.4% and 4.8% respectively, before a slowdown in Q4, which saw a 5.1% increase in values over 2019, but a 17.1% decline in deal volumes.

This reflects anecdotal evidence from the market where adverse market reaction to the political and economic uncertainty around the UK government's 'mini-budget', on top of the existing challenges previously mentioned, dampened confidence and led to less capital being deployed.

Over the last six months PE houses have started to place a greater focus on factors such as proven resilience, revenue stability and robust margins. Businesses that could meet these criteria that were able to pass on price increases to customers and maintain good visibility of earnings continued to attract PE investment, even in a challenging market.

Those businesses whose metrics were not quite as strong, or where the price expectations of vendors and sellers were too far apart, were more likely to see processes stall as confidence weakened towards the end of the year.

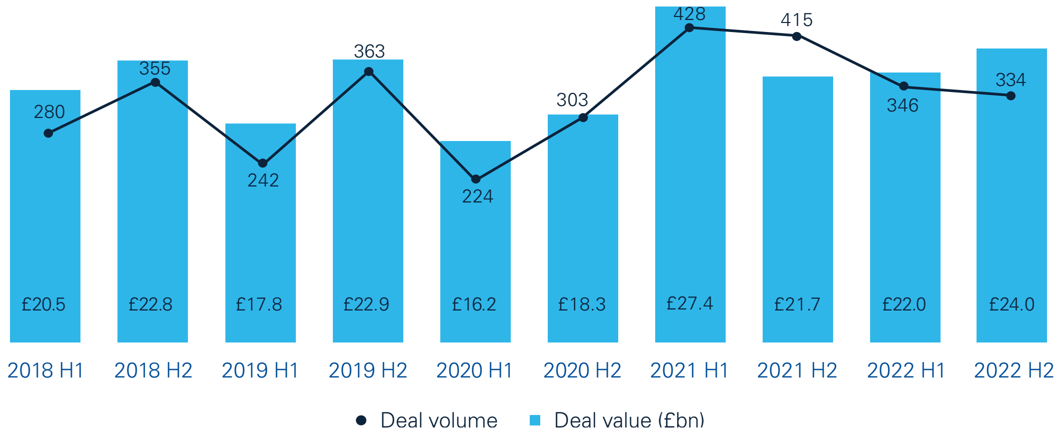
UK mid-market PE deal volumes and values (£bn)



	% Change 2022 v 2021	% Change 2022 v 2019
Value Change	-6.4%	13.1%
Volume Change	-19.3%	12.4%

Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*

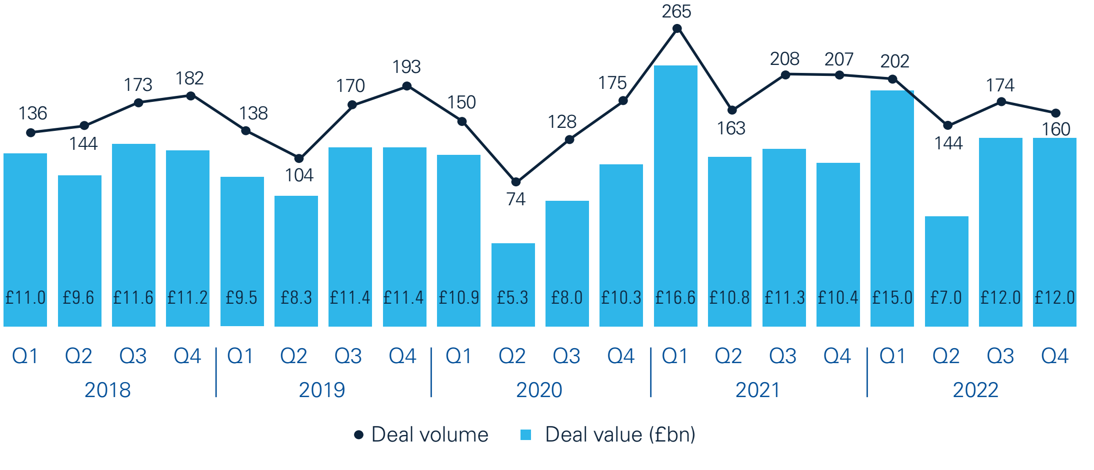
Half year UK mid-market PE deal volumes and value (£bn)



	% Change 2022 v 2021		% Change 2022 v 2019	
	H1 v H1	H2 v H2	H1 v H1	H2 v H2
Value Change	-19.7%	10.5%	23.5%	5.0%
Volume Change	-19.2%	-19.5%	43.0%	-8.0%

Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*

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



	% Change 2022 v 2021				% Change 2022 v 2019			
	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	-9.8%	-35.0%	6.4%	14.9%	57.4%	-15.4%	4.8%	5.1%
Volume Change	-23.8%	-11.7%	-16.3%	-22.7%	46.4%	38.5%	2.4%	-17.1%

Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*

VC activity in the UK

Patrick Molyneux
Partner, KPMG Acceleris

£23.1bn raised, across **2,693** deals in FY 22

£15.5bn raised, across **1,568** deals in H1 22

£7.6bn raised, across **1,125** deals in H2 22

Value of investment into UK businesses falls by a third in 2022 as global economic challenges force Venture Capital (VC) funds to proceed with caution, however, it is pleasing to note that VC investment in UK companies is still above pre-pandemic levels.

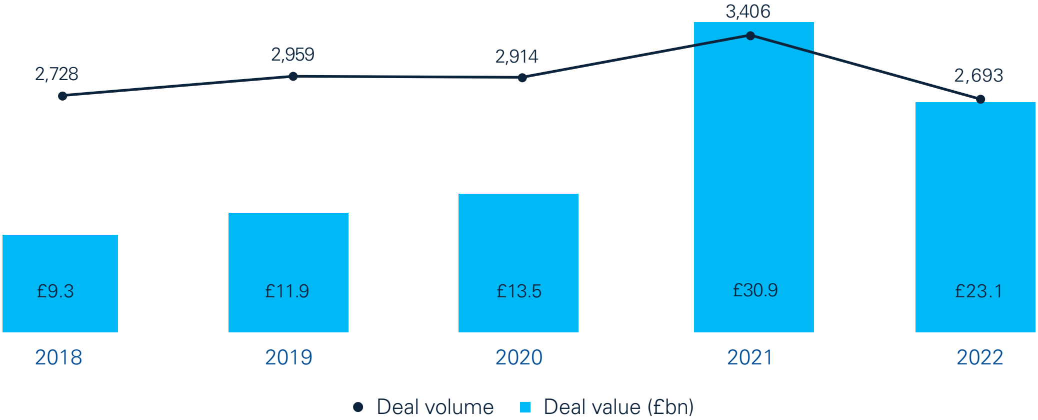
- UK raised £23.1bn ($27.7bn) in 2022
- VC investment into UK falls by a third in final quarter of the year
- Q4 2022 sees lowest level of VC investment since Q2 2020

VC investment levels into UK businesses fell by almost a third (30%) in 2022 as global economic turmoil forced investors to take a more cautious approach, according to KPMG's latest Venture Pulse report.

Following an incredible year of fundraising in 2021, which saw over £39.9bn ($37.3bn) raised by UK businesses, the first half of 2022 continued to see high levels of investment with £15.5bn ($18.6bn) raised. However, levels started to tail off in the latter half of the year as the ongoing conflict in Ukraine, rapidly rising interest rates, high levels of inflation, and concerns about a global recession all combined to drive VC investment down. The year ended with £23.1bn ($27.7bn) being raised by UK businesses.

However, it is important to note that this is the second highest level since the Venture Pulse report began. Over £3bn ($3.7bn) was raised in the final quarter of the year, down on the £8.2bn ($9.8bn) raised in the closing quarter of 2021, representing the lowest level of quarterly VC investment seen since Q2 2020. Deal volume also fell, with the number of deals completed in 2022 (2,693) down by 21% on the 3,406 deals completed in 2021.

Yearly UK VC deal volumes and values (£bn)



	2018	2019	2020	2021	2022
Deal value (£bn)	£9.3	£11.9	£13.5	£30.9	£23.1
Deal count	2,728	2,959	2,914	3,406	2,693

Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*

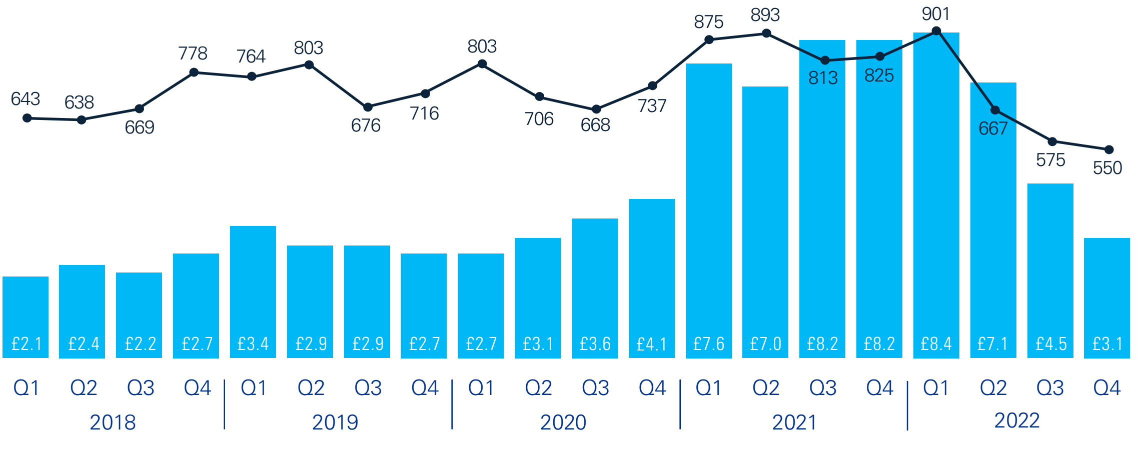
Although many sectors saw VC investment fall, the UK saw several pockets of strong activity, including sustainability, gaming, and health and biotech. A number of tech subsectors also continued to attract VC investors and corporates — including regtech, cybersecurity, and B2B solutions.

On the back of an extraordinary year of post-Covid fundraising in 2021, UK businesses got off to a strong start to 2022, however investor sentiment was subdued in the final half of the year, driven both by global macroeconomic factors and by the uncertain domestic political situation experienced from the summer onwards.

Despite the challenges, it was still a very good performance by our UK innovators as the past three years have seen healthy tallies for capital commitments to venture coffers. With over £22bn committed, fund managers gathered plenty of capital commitments to fuel dealmaking in the years to come.

VC investment into UK businesses remains well above pre-pandemic levels, and as we look ahead to 2023 it is likely that we're about to enter a period of "new normal" in terms of valuations and M&A. Dry powder is still being deployed — what's changing is the way it's being invested.

Quarterly UK VC deal volumes and values (£bn)



	% Change 2022 v 2021				% Change 2022 v 2019			
	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	11.2%	2.3%	-45.5%	-62.3%	147.5%	142.7%	55.1%	15.9%
Volume Change	3.0%	-25.3%	-29.3%	-33.3%	17.9%	-16.9%	-14.9%	-23.2%

Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*

Soaring energy costs sparked a significant uptick in VC investment in new energy alternatives, electric vehicles, and cleantech. Heading into 2023, the acceleration of investment in energy alternatives is particularly exciting as such investment is critical for meeting the world's climate change targets.

There is some sense that IPO activity could make a broad return in the second half of the year, with some pockets of activity even before that. ESG businesses could be particularly compelling; while we might not see IPOs in the space right away, we could start to see companies beginning the work required to become IPO ready.

A difficult year but some signs of normality returning

Peter Bate
Head of Leveraged Finance, KPMG Debt Advisory, Corporate Finance

Christopher Lloyd
Director, KPMG Debt Advisory, Corporate Finance

Overall 2022 was a difficult year for the debt markets. Bullish early sentiment following a strong 2021 and optimism around a "return to normality" following the Covid Pandemic tempering inflationary pressure were then dealt a significant blow by the war in Ukraine.

High energy prices and the knock-on effect of high inflation and high interest rates have pushed borrowing costs to levels not seen since before the Global Financial Crisis. Even into 2023, there is no certainty that either interest rates or inflation have peaked, globally or in the UK, and recession remains a very real possibility. At the very least, there are concerns over a period of anaemic growth, which may feel like a recession in all but name. As a result, the debt market has been very much 'risk off'.

Whilst the first quarter of 2022 did see strong deal flow as a continuation of the activity that closed 2021, the consequences of conflict in Ukraine coupled with worrying macro-economic factors, brought a rapid end to any remaining new year optimism. Consequently, we saw a significant drop-off in both lender appetite and deal flow into the second quarter.

To some degree, by the half year sentiment had adjusted to the new situation and deal flow strengthened once more, albeit with lenders and investors viewing this through a more thoughtful prism. Question marks over the sustainability of earnings, including the impact of elevated borrowing costs and worries around the economy going forward impacted lenders willingness to lend to certain sectors. Again, a "flight to quality" for many lenders increased demand for financial services, tech and healthcare, sectors in which earnings are viewed as resilient and/or recurring. The perennial least favoured sectors, consumer, retail and lower value industrials found it increasingly challenging to gain support.

The second half also saw some credit funds move to play in the syndicated TLB market where they could make significantly higher returns than in the mid market space, with the perceived benefit of liquidity.

There was also a trend away from the very large credit fund holds and a willingness to share with competitors in the good credits that were in the market. Post the summer therefore, with additional political turmoil occurring, the debt market looked very different from its previous benign conditions.

Against that backdrop of changing risk appetites and an evolving market, 2022 saw a clear reduction in leverage appetite as lenders went 'risk off', alongside increased pricing. However, the typical 50-100 bps margin increase paled in the face of soaring SONIA costs, leaving borrowers facing a dramatic increase in the overall cost of funding.

In addition, some of the pre-2022 looser documentation terms, such as one covenant and aggressive add-backs were negotiated out of term sheets. Lenders used those tighter terms, and reduced headroom when setting financial covenants, to gain more control in documentation.

The worsening economic outlook in the second half of 2022 may explain the rationale for bolt-on deals having remained so attractive.

Investors and lenders chose to deploy funds behind existing portfolio businesses and known management teams. Platform deals continued to be the most attractive and best supported for many.

Fresh issuance was harder and rarer, partly because investors preferred to back their existing portfolios, but also because those businesses that historically would be prime names could not command best terms given the tighter debt market and the wider economic and political situation. Many borrowers and processes decided to wait, citing market conditions and this meant that to some extent there was a circular equation. Deals and enterprise values were being impacted by the actual availability of debt, but often also by the expectation that debt would be less available.

This perception of lack of availability of debt on suitable terms is continuing through the first weeks of 2023 for less favoured borrowers and elements of the 2022 'risk off' mentality are continuing to affect live transactions except in the most resilient sectors. There are other hangovers from the 2022 risk appetite adjustments which continue to affect terms: leverage remains generally muted, pricing has not yet normalised, and increased protections and controls are the starting point for lenders. Expect debt processes to take longer as lenders have higher hurdles to clear through their credit processes and then documentation, so full negotiation of terms will take more time on both sides.

Whilst conditions remain challenging, for now at least, the situation does appear to have stabilised. There is capital available, and people do want to lend, though the bar remains high. Leverage, pricing and other terms will continue to evolve over the next few months, but we feel that there are reasons to be cautiously optimistic and many of the potential risks look to be priced in.

The debt market may look and feel rather different to the mill pond of the last few years, but for borrowers with sound fundamentals and a well-positioned credit story the market is becoming more predictable. I therefore start the year cautiously hopeful that in six months' time we will be able to look back on the first half of 2023 with a positive lens.

Sectors

Business services PE activity 2022

Business services volumes down
16%
and account for
40%
of all mid-market PE volume

Business services deal values
£15bn

Business services deal volumes
271

TMT mid-market PE activity 2022

TMT volumes down
23%
and account for
23%
of all mid-market PE volume

TMT deal values
£10bn

TMT deal volumes
153

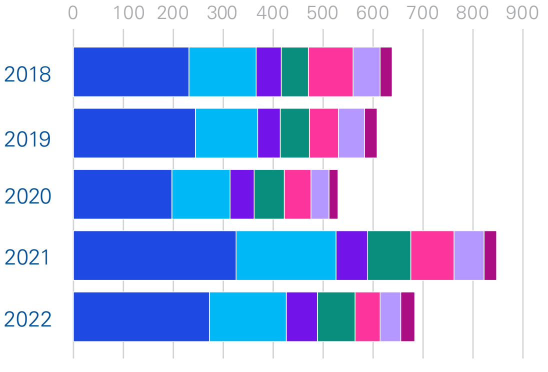
The sharper focus of PE investors on factors such as resilience, recurring revenues and visibility of earnings has meant businesses in certain industry sectors have been demonstrably more attractive than others.

As they have done consistently for the past few years, Business Services and TMT dominated mid-market deal volumes, accounting for 62% of all PE mid-market deals. Business Services accounted for around 40% of deals and TMT for 22.5%. The Business Services segment includes Energy Services, which is itself seeing heightened activity levels, as discussed elsewhere in this report. These sectors also tend to be quite fragmented, which lends itself to PE houses looking for lower risk bolt-on acquisitions to add to existing platforms.

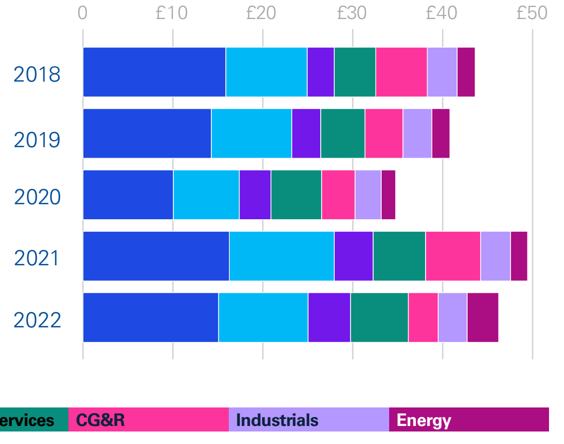
Financial Services and Healthcare deals held steady, increasing their proportion slightly, with Financial Services accounting for 11% and Healthcare just over 9% of the total PE mid-market deals. The volume of Healthcare deals in 2022 was up almost 38% on 2019, while values were 47% up on 2019. This spike in Healthcare activity reflects the growing demand for private-pay healthcare services and the related ecosystem. This is being driven by an ageing UK demographic on top of labour shortages and an NHS funding crisis.

It was a different story for Consumer Goods and Retail (CG&R), and Industrials, which both saw a decline in volumes and values on 2021, as well as a reduced share overall of mid-market deal activity, down to 7.4% for CG&R and 6% for Industrials. These sectors are more likely to be affected by some of the challenges that were gathering strength in 2022, such as higher inflation, weak consumer spending, rising interest rates and supply chain uncertainty.

UK mid-market PE deal volumes by sector



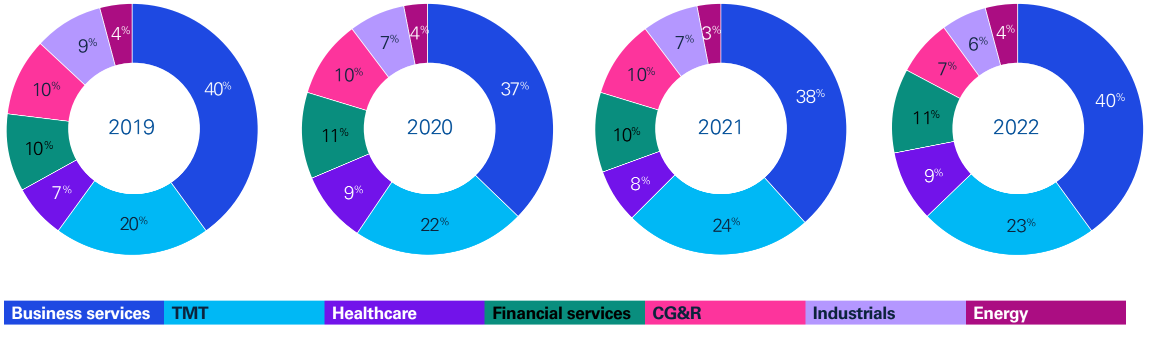
UK mid-market PE deal values by sector (£bn)



% change deal volume and value by sector

Sector	% Volume Change 2022 v 2021	% Volume Change 2022 v 2019	% Value Change 2022 v 2021	% Value Change 2022 v 2019
Business services	-16.4%	11.5%	-7.5%	5.3%
TMT	-23.1%	23.4%	-14.3%	11.5%
Healthcare	-1.6%	37.8%	11.3%	47.0%
Financial services	-12.8%	29.3%	11.8%	31.2%
CG&R	-41.9%	-13.8%	-46.2%	-22.5%
Industrials	-31.7%	-21.2%	-4.5%	-0.8%
Energy	12.0%	12.0%	80.8%	75.0%

UK mid-market PE deal volume % by sector

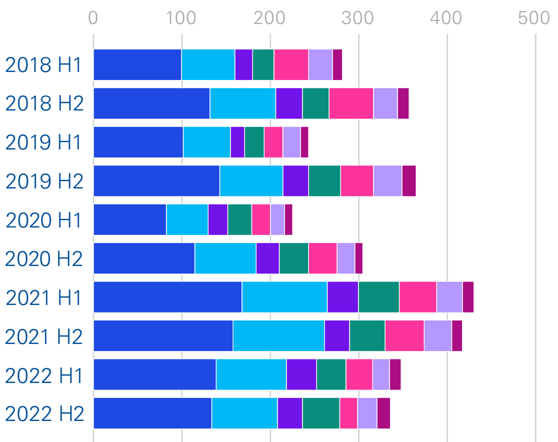


Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*

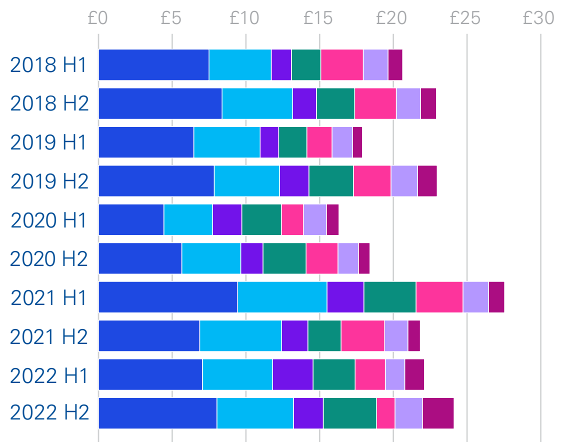
Energy was the only sector that saw an increase in deal activity in real terms, with 28 deals completed in 2022, compared to 25 in 2021, representing a 12% uptick. Energy deal values also increased year on year, from £1.9bn in 2021 to £3.5bn in 2022 – a 75% increase on 2019 and an 80.8% increase on 2021. This is in line with a greater focus on Energy in general, given the challenges facing the global energy market. However, the nature of the energy sector means that much of the PE activity will be large cap deals and fall outside the scope of this report.

The double digit increases in volume and values across the board in 2022 when compared to 2019, with the exception of CG&R and Industrials, shows the resilience of the mid-market PE deals market last year. Despite the challenges of the poly-crisis, businesses with the right fundamentals in resilient sectors continued to attract PE capital at levels on a par, if not above, historic trends.

UK half year mid-market PE deal volumes by sector



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



Business services | TMT | Healthcare | Financial services | CG&R | Industrials | Energy

Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*

% change deal volume and value by sector

Sector	% Volume Change			
	H1'22 v H1'21	H2'22 v H2'21	H1'22 v H1'19	H2'22 v H2'19
Business services	-17%	-15%	37%	-6%
TMT	-18%	-28%	49%	4%
Healthcare	-3%	0%	113%	-3%
Financial services	-28%	5%	50%	17%
CG&R	-29%	-55%	43%	-46%
Industrials	-34%	-29%	-5%	-31%
Energy	0%	25%	44%	-6%

Sector	% Value Change			
	H1'22 v H1'21	H2'22 v H2'21	H1'22 v H1'19	H2'22 v H2'19
Business services	-25.3%	17.0%	9.0%	2.3%
TMT	-21.4%	-6.5%	5.8%	17.2%
Healthcare	9.8%	13.5%	119.2%	1.6%
Financial services	-19.3%	60.7%	49.7%	19.5%
CG&R	-35.5%	-57.8%	19.9%	-51.1%
Industrials	-24.5%	17.5%	-5.7%	3.0%
Energy	22.9%	155.6%	100.7%	62.2%

Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*

Sector perspective: Powering growth in energy services

Richard Stark
Director, Head of PE in the North, Corporate Finance

James Gaffney
Associate Director, Energy Services, Corporate Finance

Given the enhanced focus on energy costs, the journey to net zero and sustainability more generally, exacerbated by the events of the last 18 months, it's no surprise that businesses operating in the energy services ecosystem have been receiving a lot of interest from PE funds.

Energy services itself covers a broad range of activities relating to the provision of outsourced support to corporates around their energy journey, from procurement and the transition to net zero, to energy efficiency through to the development of energy infrastructure.

The inherent complexity of the UK energy market creates opportunities for energy services businesses to step-in to provide clarity, often delivered via high quality, recurring revenue models.

M&A interest in the sector has been strong from both corporates and PE, unsurprisingly given the clear alignment to ESG and sustainable priorities. The impact-focused PE funds have been joined first by the more traditional mid-market funds and now by the ESG offshoots of some of the large-cap funds in mapping the market for opportunities to deploy capital.

Energy now a boardroom topic

While the focus on energy is nothing new, the volatile market conditions seen during 2022 have firmly elevated it to Board level. C-suite decision-makers now acknowledge that they need to fundamentally change the way that they engage in decisions around energy.

Boards are now heavily focussed on understanding and reporting on their sustainability targets, in order to ensure they not only meet their own Net-Zero commitments but also to appeal to multiple stakeholders, be that customers, suppliers, shareholders or employees.

In the context of soaring energy costs, the ROI on innovative technologies that will support businesses to reduce their energy consumption (e.g Solar Panels and Ground Source Heat Pumps) now also look significantly more attractive.

This is driving the roll-out of Net-Zero technologies, with adoption levels of these solutions at an all-time high.

Allied to this, the significant investment into the UK's energy infrastructure through the roll-out of technologies designed to support the energy transition (e.g. EV charging points and Smart Meters) is gaining pace. This is creating long-term recurring revenue streams in supporting both the deployment of technologies but also the ongoing support and maintenance required to ensure they deliver their desired sustainability impact.

Adding more fuel to appetite is the fragmented, fast moving nature of the sector, with new disruptive entrants able to enter and scale quickly through new and exciting propositions. There's a plethora of small-to-medium-sized players making a significant impact and showing strong growth, primed to become potential bolt-ons, or platforms themselves.

Looking ahead, the expectation is that volatility in the market will probably soften, but there will still be that inherent complexity that continues to drive strong demand for energy services.

There is also the B2C angle to consider.

Consumers, too, are becoming more engaged in their own energy use, with concepts like the 'connected home' now becomes reality. This will create further opportunities for innovative energy services providers to tap into.

Sector perspective: Eyes on industrial tech

Surinderpal Matharu
Director, Corporate Finance

There is often the potential to scale up industrial technologies relatively quickly.

Industrial technology remains an active space for both venture capital and mid-market private equity investors.

This is primarily due to the fast pace at which the sector is evolving and the rate at which these kinds of technologies are being adopted, making it an attractive market for private equity firms to be involved in.

This has long been the case, with the focus on Industry 4.0, but it has accelerated since the pandemic, when a lot of industrial companies began to take a closer look at how they could make better use of technology to improve business resilience.

A lot of industrial technologies can be very specialised and serve complex requirements, so the barriers to entry are quite high, which often means better margins. Industrial technology businesses will typically partner with a handful of key customers at an early stage, to help develop, test and commercialise their product or solution.

Once the concept is proven, that customer intimacy becomes incredibly important during the lifecycle of the technology. The strength and 'stickiness' of these customer relationships is crucial and leads to recurring revenues based on long-term partnerships, together with help to support an investor's investment thesis. In addition, there is often the potential to scale up industrial technologies relatively quickly.

Key attractions for PE investors

These are precisely the kinds of factors that private equity houses are increasingly prioritising, so it's no surprise they take such an interest in this sector. Plus, there's often a strong strategic angle. For PE houses that already have industrial investments in their portfolio, industrial tech is an ideal sector for potential bolt-on deals, where bringing in a tech-led acquisition can add value to an existing business. It's not only UK PE houses that are active. We've seen some bolt-on activity from US and Scandinavian investors over the past 12-18 months, for example, taking advantage of the currency situation to pick up industrial tech acquisitions.

Going into 2023, we've got a number of headwinds, be it the energy crisis, inflationary pressures, supply chain constraints. These haven't gone away. So the first half of the year is likely to be more muted, but we expect a pick up in the second half.

In terms of particular areas that are attracting investment, there are three main ones: the first is technologies for making factories and industrial processes smarter and more efficient, like automation and robotic technologies in warehouses and packaging industries, and sensors for things like flow, pressure, vibration and measurement.

The second area is around the energy transition and decarbonisation agenda, such as electric vehicles, battery technologies, hydrogen production, recycling and renewable energies like wind and solar, including the supply chains that feed into these industries.

And the third is about embracing software to supplement traditional hardware and services. Examples include ERP systems that are fully integrated into the business, rather than serving just one purpose, applying data and analytics to inform decision-making, and using AI and augmented reality to help support and sell products and services in the market.

Out of hospital services: Healthy prospects

Anthony Ball
Partner, Head of Healthcare and Life Sciences, Corporate Finance

It's the non-cyclical demand that gives investors confidence to invest. In that regard, it's robust, it's investable, and it's fundamentally growing.

Given the well-publicised challenges facing the NHS, plus the ongoing effects of the Covid-19 pandemic, few people will be surprised there has been a significant increase in the provision of private healthcare to people wanting to access elective procedures more quickly, and there has been a similar uptick in the propensity of people to self-pay.

Add in the demographic trends we see across much of the world, in terms of ageing populations, and it's clear to see why out-of-hospital services is such an attractive market for mid-market PE investors.

The broad investment case around these investments is that they are platforms providing services where demand is likely to increase, and there's often the ability to expand provision of these services more nationally, or even internationally. PE houses can invest behind their platform and take something that is proven on a regional scale to a more national level.

The attractiveness of out-of-hospital services, particularly relevant in the current economic environment, is the non-discretionary spend. It doesn't suffer the same vulnerabilities as a consumer proposition like retail or hospitality. It's a non-cyclical demand that gives investors confidence to invest. In that regard, it's robust, it's investable, and it's fundamentally growing.

The structure of the market also suits mid-market PE investors. Large parts of the market are fragmented and ripe for consolidation, in areas of primary care for example, like private GPs and dentistry. Other parts are nascent and fast-growing, where the NHS is increasingly having to lean on private provision to clear its backlog and keep up with growing demand. From a PE point of view, it's an opportunity to gain first-mover advantage and build scale quickly.

Strong transaction levels

Looking back at mid-market PE transaction levels in 2022, there was only one less healthcare deal than there was in 2021, which was an exceptional year, and an increase of almost 38% on deal volumes in 2019. It was the same with aggregate deal values, which were up almost 50% on 2019. The proportion of healthcare deals, at 9.1% of all mid-market PE transactions, was also the joint highest for five years. Although, like most sectors, there was a slight drop-off in the second half of the year, it was more driven by the desire of people to try and get a read of how the market was playing out from a pricing perspective, in terms of cost of debt, leverage multiples, and ultimately the impact on value. I don't think there was any reduction in appetite to invest in healthcare.

Labour market challenges

One of the market dynamics that has the most impact on the healthcare sector in general, and out-of-hospital services are no different, is labour force challenges. The provision of healthcare in the UK is still predominantly person-driven, whether that's radiographers, consultants, nurse-led practitioners or care workers. So although demand is strong and growing, many providers have been unable to take full advantage of the growth opportunities because the tightness of the labour market holds back their ability to scale quickly.

Operators and providers of out-of-hospital services are having to think more creatively around how they provide services, making sure they recruit enough appropriately qualified people to maintain service and quality levels, as well as looking overseas and taking advantage of sponsoring programmes to bring qualified healthcare professionals into the UK.

I'm expecting healthcare to be a strong sector as we go through 2023 in terms of volume of PE transactional activity. In a more challenged economic environment, healthcare is likely to attract more rather than less capital. The competition for good quality assets will be intense, because it will be seen as an investable sector during the turbulent times we're still working through.

The second area is around the energy transition and decarbonisation agenda, such as electric vehicles, battery technologies, hydrogen production, recycling and renewable energies like wind and solar, including the supply chains that feed into these industries.

And the third is about embracing software to supplement traditional hardware and services. Examples include ERP systems that are fully integrated into the business, rather than serving just one purpose, applying data and analytics to inform decision-making, and using AI and augmented reality to help support and sell products and services in the market.

Deal types

Bolt-ons
443 deals
65%
of all mid-market PE volume

Bolt-ons
£27bn
58% of total deal value in the mid-market

Minority
£5.4bn
12% of all deal value in the mid-market

Minority
102 deals
15%
of all mid-market PE volume

Bolt-ons and minority deals dominated deal types in 2022, together representing 80% of all mid-market PE deals.

Bolt-ons accounted for 443 deals, representing just over 65% of deals. Minority deals accounted for 15% of all mid-market PE activity, with 102 deals in 2022. The volume of bolt-on deals was 24.4% higher than 2019, while values were up 15.8% on the same period. The volume of minority deals was 14.6% higher than 2019, and values were 49.5% higher.

Traditional buy-out deals accounted for 12.4% of all mid-market PE activity, at 84 deals. This was 4.5% lower than 2019 in terms of volumes, and 17.9% higher in terms of aggregate value.

> **Bolt-ons have remained the largest component of PE mid-market activity for quite some time as they are particularly critical to mid-market deal flow.**

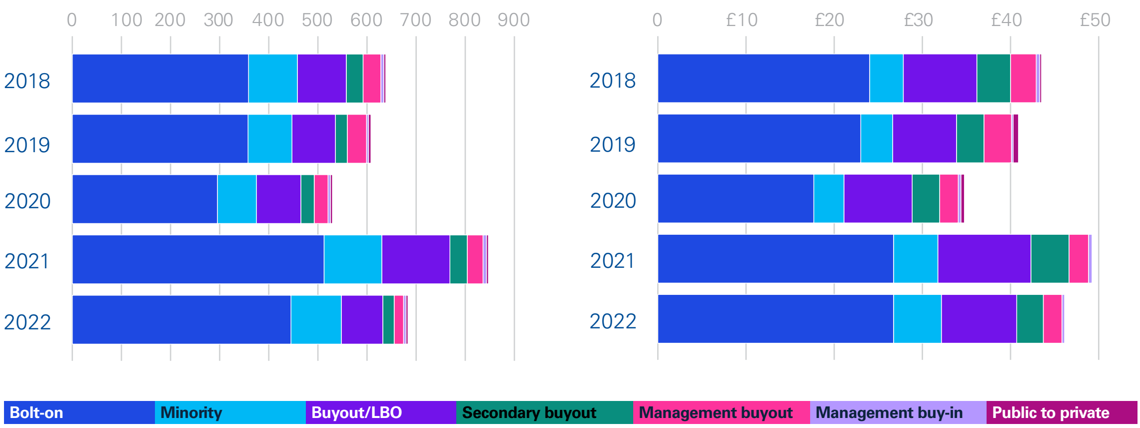
Bolt-ons have remained the largest component of PE mid-market activity for quite some time as they are particularly critical to mid-market deal flow, given their efficacy as a lower-risk consolidation strategy for PE firms targeting specific, fragmented sectors, such as Business Services and TMT.

In the highly competitive PE mid-market, investors recognise the need to drive value where valuations are high. Deploying capital behind existing platforms via bolt-ons to drive growth and create value in a highly competitive environment is an increasingly attractive strategy, perhaps more so than a higher-risk primary acquisition.

Minority deals have also gained prominence in 2022, likely due to PE firms' willingness to gain minority exposure to fast-growing businesses in order to diversify their overall portfolio holdings. Minority deals also tend to be less reliant on debt, so in an environment where the cost of debt is rising and the lending market is tightening, minority deals become even more attractive.

UK mid-market deal volumes by type

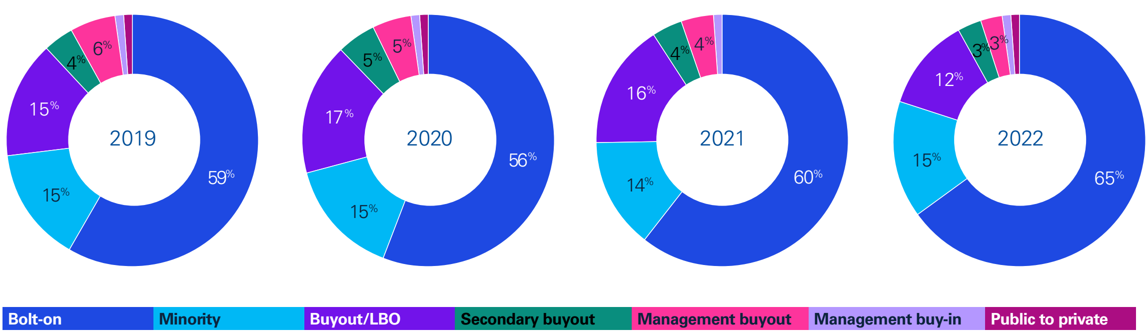
UK mid-market deal value by type (£bn)



% Change deal volume and value by deal type

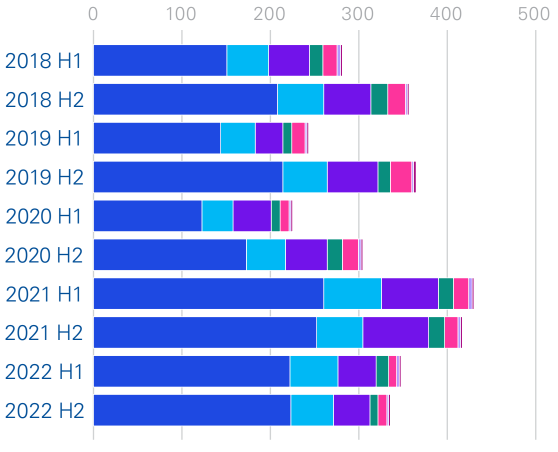
Deal type	% Volume Change 2022 v 2021	% Volume Change 2022 v 2019	% Value Change 2022 v 2021	% Value Change 2022 v 2019
Bolt-on	-13.1%	24.4%	0.0%	15.8%
Minority	-12.8%	14.6%	7.5%	49.5%
Buyout/LBO	-39.1%	-4.5%	-19.4%	17.9%
Secondary buyout	-34.3%	-4.2%	-30.1%	-2.0%
Management buyout	-40.6%	-51.3%	-4.7%	-30.8%
Management buy-in	-28.6%	25.0%	-15.8%	86.2%
Public to private	0.0%	-20.0%	-0.9%	-92.4%

UK mid-market PE deal volume % by deal type

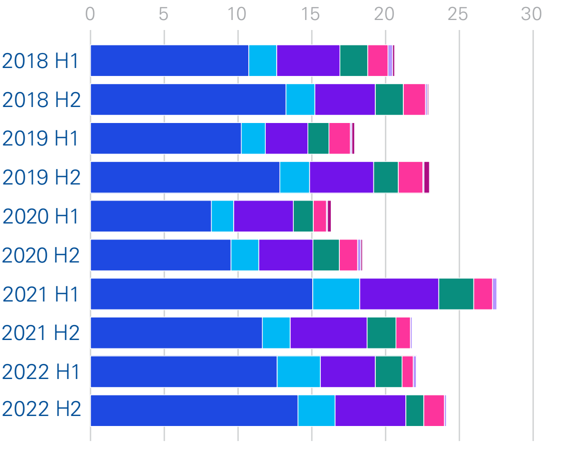


Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*

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



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



Bolt-on | Minority | Buyout/LBO | Secondary buyout | Management buyout | Management buy-in | Public to private

% change deal volume and value by deal type

Deal type	% Volume Change			
	H1'22 v H1'21	H2'22 v H2'21	H1'22 v H1'19	H2'22 v H2'19
Bolt-on	-14.7%	-11.6%	54.5%	4.2%
Minority	-16.9%	-7.7%	38.5%	-4.0%
Buyout/LBO	-32.8%	-44.6%	38.7%	-28.1%
Secondary buyout	-17.6%	-50.0%	40.0%	-35.7%
Management buyout	-47.1%	-33.3%	-40.0%	-58.3%
Management buy-in	-25.0%	-33.3%	50.0%	0.0%
Public to private	0.0%	0.0%	0.0%	-33.3%

Deal type	% Value Change			
	H1'22 v H1'21	H2'22 v H2'21	H1'22 v H1'19	H2'22 v H2'19
Bolt-on	-16.0%	20.8%	23.6%	9.5%
Minority	-7.9%	33.6%	80.2%	24.7%
Buyout/LBO	-30.5%	-8.0%	29.2%	10.5%
Secondary buyout	-23.6%	-38.1%	27.6%	-27.2%
Management buyout	-41.0%	42.7%	-47.7%	-16.1%
Management buy-in	-29.7%	17.5%	99.6%	69.9%
Public to private	382.6%	-100.0%	-77.9%	-100.0%

Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*

Maximising value from bolt-on acquisitions

Lizzie Meadowcroft
Partner, Integration, TSG

Francesca Scott
Partner, Head of Synergies, TSG

In many bolt-on acquisitions, completing the deal is the easy part, it's the post-deal integration phase where the strategic plans and the value case created pre-deal are actually implemented, and where true long-term value is realised - or lost.

Mistakes here can not only delay or reduce value realisation, they can destroy existing value, delay any follow-on acquisitions and expend precious time and effort in resolving them. The risks are especially high for PE firms, where value creation is at the very heart of the business model and key to a successful exit.

Many mid-market companies or Private Equity houses acquire businesses and state they have a bolt-on strategy in place, but once the deal is done the business is left to standalone - less 'bolt-on' and more 'lightly nailed on'. Which leaves value on the table for future buyers when the business is sold years later.

Why does this happen? Because successfully implementing a bolt-on strategy post-deal is hard and it involves more than just numbers and data. It involves messy factors like people, emotions, cultures and technology. Often people simply do the deal and move on.

Our research shows that bolt-ons were the most common type of mid-market PE transaction in 2022, accounting for 65% of deal volumes - a trend that has been growing steadily over the past five years. One of the factors driving the popularity of bolt-on deals is that they are perceived as less risky and as having the potential to offer higher value, because the acquirer is looking at a business with similar operations, so the learning curve is less steep and there are opportunities for synergies. But this only holds true if the acquirer is able to realise the synergies post-deal by integrating the new business effectively into the existing platform.

"Doing the deal may be the easy part, but that doesn't mean post-deal integration has to be difficult. It's likely to be the best way to realise the value that underpinned your interest in the first place.

The power of integration

Whilst integration execution happens post-deal, thinking about and planning for integration should start pre-deal, long before a deal is signed or closed. Pre-sign, the integration principles should be at the heart of the synergy case to ensure that the value expectations are rooted in the reality of what is planned for the bolted-on business. Pre-close, an integration team should be mobilised to ensure a successful Day One (including communication and employee engagement plans) and start to undertake detailed integration planning to deliver the synergy case.

At any stage of the deal, the approach to integration is not an all or nothing activity. At one end, there's the 'integrate everything option' so the acquired business becomes unrecognisable in the new integrated company. At the other end, there's the 'buy it and leave it well alone' option. The business still looks almost exactly the same as it did before, so what value has it truly brought? And what risks does this raise?

There's a sliding scale of integration between these two extremes, which is where the optimum approach can typically be found. Buyers should focus on why they wanted to acquire the business in the first place. What were their original intentions and what is required to realise the value that was promised pre-deal? It might be a route to market, a product or innovative technology that makes a deal attractive. This is what needs to be protected or enhanced through the integration process – and conversely which areas could be integrated to deliver synergies.

Never too late to start

There is never a bad time to start to focus on integrating and realising value from a bolt-on, even months or years after the acquisition. Or even having a second look to see where you might find more value now that you know the business better.

Doing the deal may very well be the easy part, but that doesn't mean post-deal integration has to be difficult. And it's likely to be the best way to realise the value that underpinned your interest in the acquisition in the first place.

4 tips to a successful bolt-on integration

Through our experience advising mid-market PE houses and large corporates during the deals process, we have identified four key steps for a successful bolt-on integration:

1. Define what you want the integration to achieve – your integration principles. Think about it function by function – what will be integrated (and to what extent), what stays as is.

2. Develop the synergy case (considering all potential types) for the integrated business, based on the integration principles. Think about how the synergies will be achieved, the phasing of them and any interdependencies. And don't forget to quantify any one-off costs required to execute this.

3. Work out who will own the integration programme and delivery of the synergies case in the business - driving a successful integration is not an "on top of the day job" activity.

4. Make sure you can prove how successful the integration the actually was – including tracking and reporting synergy realisation.

Driving value through data

Emily Watkins
Partner, DA Analytics

PE houses that come to a transaction with a clear understanding of how data can be used to interrogate the business proposition and identify potential value creation opportunities can put themselves ahead of the competition.

Data and analytics have always played a key role in dealmaking, but they have become even more important over the past 12 months as, given the economic environment, vendors and potential investors have had to work harder to identify and validate value creation opportunities.

The volume, velocity and quality of data has improved significantly in recent years, providing a much richer source of information for analysis. The US market saw this shift seven or eight years ago, and the UK and European markets are rapidly catching up.

A key development is that whereas using and analysing data used to be largely confined to the sell-side of a transaction, it is now increasingly expected on the buy-side, too, particularly in fast-moving sectors like Business Services and TMT.

Dealmakers have access to unprecedented levels of structured, granular data across almost every area of a business, and countless ways to analyse it and dig down into more specific details. It is one thing for a business's growth plan to confidently predict 15% sales growth in the next 12 months, for example. It becomes a much more compelling prediction if you can interrogate the data to back-up those predictions.

It is not always necessary to wait for a transaction data room to open before starting the data analysis process. There is a large amount of publicly available information that can provide useful insights and validate core elements of the value proposition.

These could include scraping online reviews and ratings to highlight common topics and key words customers use to describe satisfaction with their purchase. Or using social media tracking tools to analyse the social sentiment towards a target business and its peers, as well as the volume of social conversations and the resulting impact on overall brand reputation.

Making the most of data

The different types of data available, and the different questions you need answers to, will determine the best type of analysis for your needs. For PE investors, one of the challenges is to ensure that knowledge and insights gained through data analysis during the buying process are fed back into the target business after the transaction.

Another is to ensure the data is cleansed and structured in the best way to meet their needs. This might include building a data warehouse to track information correctly, or if a data warehouse already exists, refining the KPIs that need prioritising in the hold period, which may be different to those used to run the business day to day. Getting the right data infrastructure set up in the first 100 days post-acquisition enables you to start developing the growth story from the day one and self-correct as you go. Rather than getting three years into the hold period and realising you need to retro-fit the growth story around some unexpected surprises.

PE houses that come to a transaction with a clear understanding of how data can be used to interrogate the business proposition and identify potential value creation opportunities can put themselves ahead of the competition. In terms of the mid-market, the opportunities could be even greater. Often, businesses in this sector will never have been acquired before, so their data will tend to be messy and unstructured. This makes it harder to work with, but also means the potential insights to be gained are even more valuable.

Preserving and restoring value in special portfolio situations

Lloyd Williams
Director, Special Situations Group, Corporate Finance

It's important for management teams to be objective in assessing the situation and to embrace change – both good and bad.

The past couple of years have been incredibly challenging for many businesses, and current micro-economic uncertainties mean that for many, they continue to be so.

During uncertain times, timing is everything. And early intervention significantly increases the likelihood of a positive outcome.

The Special Situations Group at KPMG UK works with clients to preserve and restore value. This could range from the extremes of a liquidity crisis, accelerated fund raising and balance sheet restructuring, through to short term cashflow forecasting support, operational improvement, or working capital and cost optimisation projects.

PE investors have increased their focus on portfolio management in recent years and this is likely to continue. Firms are taking the opportunity to drive value creation from their 'winners' and increase their focus on value preservation for challenged or under-performing assets.

For management teams, managing uncertainty has become the new normal; and this needs to be driven at board level with rigour and discipline.

Those business that took advantage of government support during the pandemic may now find their balance sheet is out of shape or is no longer suitable for a business that may have adapted or changed its business model to survive. There may be a need to optimise working capital to release cash; or deal with liability or debt overhangs that were once deemed short term and may now have become core longer term.

Visibility is vital

Another key part of managing this uncertainty will be making sure robust forecasting systems are in place. Rolling weekly cashflow forecasts are essential to provide good visibility over the short-term liquidity needs of a business, while medium to longer-term integrated trading forecasts (P&L, cashflow and balance sheet) can provide visibility on the availability of banking and financing facilities.

It is important these forecasting systems provide flexibility to test assumptions and perform sensitivity and scenario analysis, based on changing market conditions. Management teams needs to challenge both risks and opportunities to understand how they affect liquidity, financing facilities and covenant headroom. These forecasting tools are a company's early warning system, allowing a business sufficient time to react to potential challenges or opportunities.

When a business is updating its forecasts, it's also a great opportunity for the management team and Board to reflect and challenge what shape the business is in. Have exit aspirations changed either in value or timing? Is the value creation plan still appropriate? Are revenue growth and margins at the desired level? Is more tech investment required? Could the cost-base be optimised?

It's important for management teams to be objective in assessing the situation and to embrace change – both good and bad.

If there's a problem, acknowledge it exists and challenge your own thinking and your existing plans. Engage with your Board early and face into the problem. Likewise, opportunities need to be assessed and grasped quickly. Make sure you prioritise the actions that can have the quickest and biggest impact. And don't procrastinate; time is rarely on your side.

What next for value creation?

There is now a recognition from PE houses that they have to work far more strategically with the management team on more innovative, more integrated value creation thinking than they have in the past.

Nick Davies
Director, Value Creation,
Corporate Finance

Understanding how you can create value in a business is an important part of any deal, but it's particularly relevant for PE houses, where value creation is the cornerstone of the business model.

In recent years, the strategies that are used for creating value have changed – and are still changing. Traditional approaches like financial reengineering, renegotiating debt, bringing in a new management team, revamping the marketing strategy, for example, are increasingly taken for granted. There is now a recognition from PE houses that they have to work far more strategically with the management team on more innovative, more integrated value creation thinking than they have in the past.

A key factor driving this change in approach is technology. This includes looking at the digital strategy, or investing in scalable tech platforms, for example. This is particularly the case in the PE mid-market, where many businesses are coming under the scrutiny of potential PE investors for the first time and need to be professionalised.

From a PE acquirer's perspective, digital transformation needs to be planned and implemented early, so the benefits can be fully demonstrated during the hold period, in terms of improved business performance.

An integral part of this tech-driven approach is the cyber strategy. More and more businesses are effectively digital led. They may not be a 'tech' business, but they are likely to have significant digital assets that need protecting, such as product specs, bespoke software or branding.

Creating value through ESG

The third big change in how value creation is perceived relates to ESG, where the opportunity to take a business from brown to green, or at least greener, is something investors will pay for. Having a comprehensive ESG strategy is therefore becoming a fundamental part of value creation.

This is reflected in the rise of ESG due diligence, which more and more PE houses are paying for on potential targets to identify ways in which the ESG performance could be improved. Adding to this is the fact that debt funding is increasingly tied into ESG, too. A strong ESG strategy, with the appropriate certification and validation metrics, opens up more preferable lending terms and makes a company more investable.

The shift in how value creation is perceived and delivered is also being driven by the fact that PE firms are increasing their investment in their own internal operational teams. The larger PE houses have always had a strong value creation capability in-house, but it's percolating down into the mid-market far more. They are building up their capacity and capabilities on the value creation side, largely in recognition of the fact that if they don't, those assets they bought at high multiples in 2021 or 2022 will probably struggle to deliver the returns they anticipated.

Allied to this, PE owners are increasingly looking at pan-portfolio opportunities to reduce costs and increase efficiencies across multiple business, such as energy procurement, legal services or cyber security, where the requirements of several businesses can be rolled up into one service agreement.

This professionalisation of value creation before, in and after the deal will become something a lot more PE houses invest in because it's a better way of ensuring their investments deliver the returns they need to achieve.

Mid-market PE exits

Richard Stark
Director, Head of PE in the North, Corporate Finance

Mid-market PE exit volume down
23%
to 146

Mid-market PE exit values down
55%
to £8.6bn

Secondary buyouts of 61,
42%
of all mid-market PE exits

Trade exits of 79,
55%
of all mid-market PE exits

Full year 2022 exit volumes fell by 22.8% on 2021 and by 10.4% on 2019, with a total of 146 exits reported. Exit values saw an even more dramatic decline. The aggregate value of £8.6bn was 32.9% down on 2019 and 55.1% lower than 2021.

Exit activity picked up more in H2 (82 exits) compared with H1 (64 exits). H1 was the lowest half-yearly exit total for the last five years. Q3 saw the highest quarterly levels of exit activity, with 47.

In terms of Exit types, trade acquirers accounted for 54.1% of exits at 79 deals, followed by secondary buy-outs, with 41.8% of all exits (61 deals). There were no IPO exits in 2022 due to ongoing volatility in capital markets.

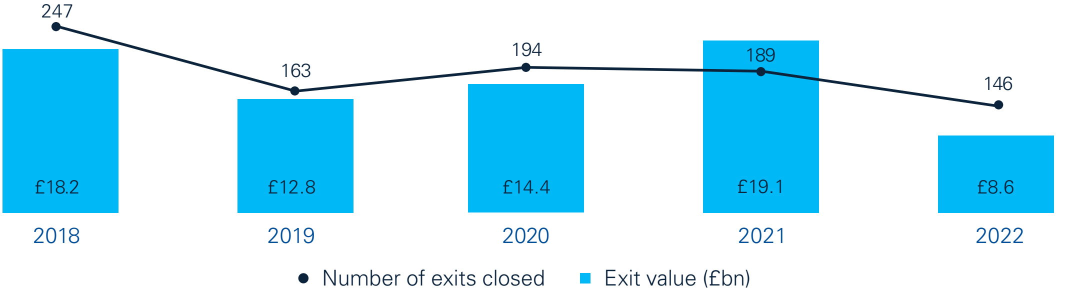
The top three exit sectors were Business Services at 37% (54 exits), TMT at 21.9% (32 exits) and CG&R at 11.6% (17 exits). There was also a slight uplift in exits in the Energy sector, from 6 to 9 exits – the only sector to report an increase in exits.

CG&R, although accounting for the third highest proportion of exits, actually saw the biggest decline, from 37 exits in 2021 (and 35 in 2019) to just 17 deals. CG&R exit values saw a similar collapse, from £3.8bn in 2021 (£2.4bn in 2019) to £0.9bn in 2022.

The imbalance of exits versus new platform investments has been a recurring feature of the mid-market PE sector in recent years and 2022 was no different.

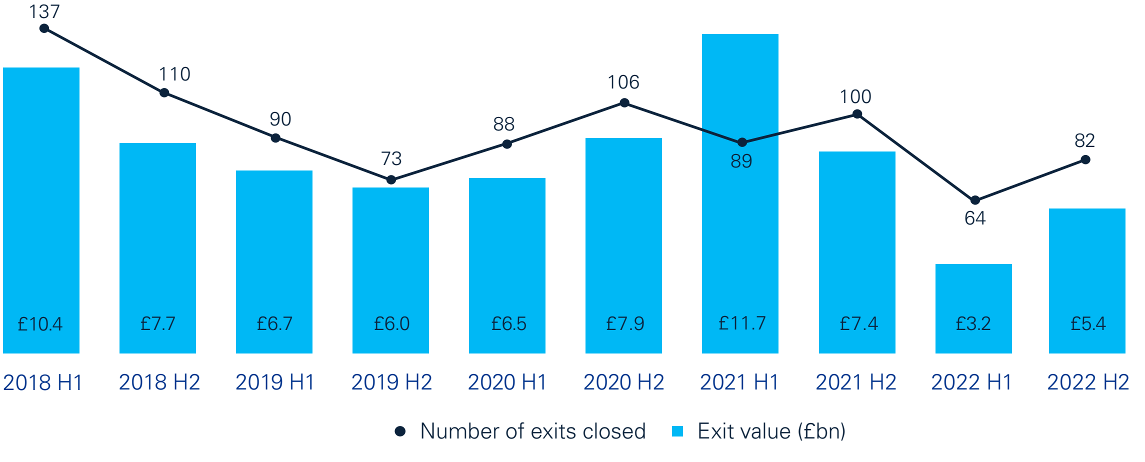
Given the challenging macro-economic situation combined with political and economic instabilities at home, alongside pressure on the cost and availability of debt to underpin exit pricing, many institutional vendors simply decided 2022 was not the optimal time to realise their investments.

UK mid-market PE Exits by deal volume and value (£bn)



	% Change 2022 v 2021	% Change 2022 v 2019
Value Change	-55.1%	-32.9%
Volume Change	-22.8%	-10.4%

UK half year mid-market PE Exits by deal volume and value (£bn)



Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*

The general exit trend between 2015 and 2022 is downward, but comparing all PE investments to exit activity there are 4.6x more investments than exits. However, as bolt-on deals now account for 65% of all PE investments in the mid-market, this is not really an accurate picture.

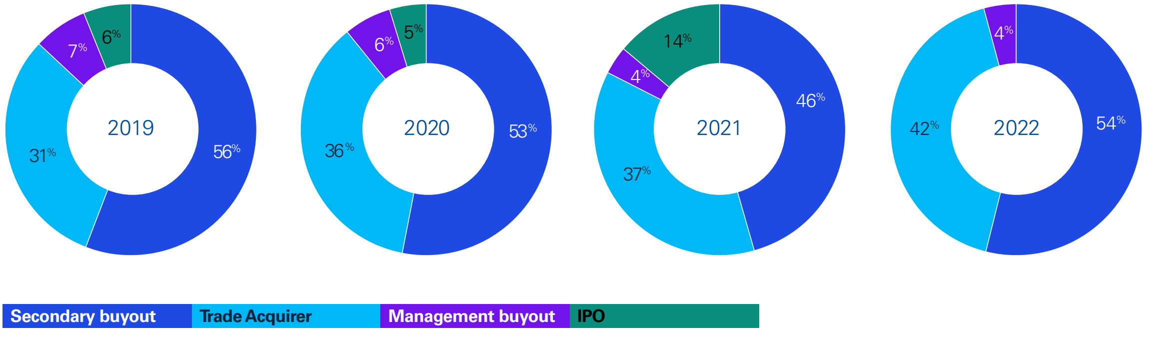
When bolt-on investments are removed the investment to exit ratio comes down from 1.63x suggesting there is less of a gap or future pent-up demand in exits.

The sustained level of bolt-on activity during this period of slightly longer hold times should mean that when exit conditions do improve that there will be sizeable platforms brought to market, which should in turn drive PE investment from another round of PE investment into some of these assets.

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

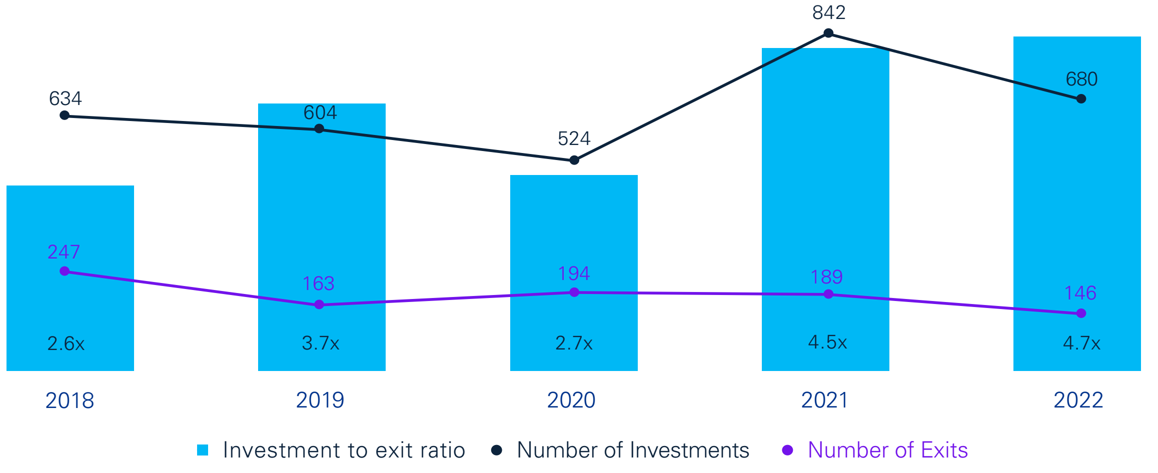
	% Change 2022 v 2021				% Change 2022 v 2019			
	Q1 V Q1	Q2 V Q2	Q3 V Q3	Q4 V Q4	Q1 V Q1	Q2 V Q2	Q3 V Q3	Q4 V Q4
Value Change	-77.2%	-64.1%	-36.9%	-11.2%	-23.3%	-66.6%	-27.7%	20.5%
Volume Change	-34.7%	-20.0%	-9.6%	-27.1%	-34.7%	-22.0%	9.3%	16.7%

UK mid-market PE deal volume % by Exit type

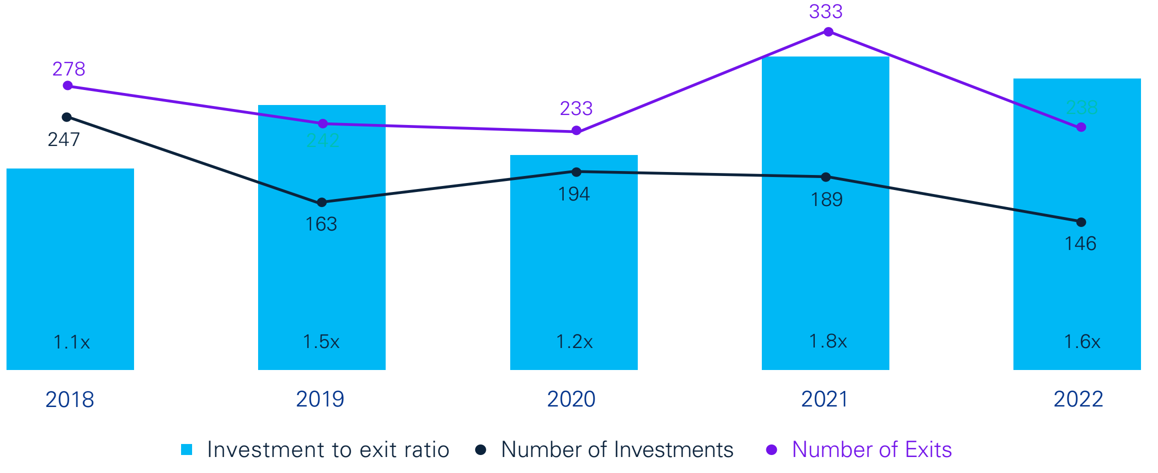


Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*

UK Mid-market PE investment to exit ratio's all investments

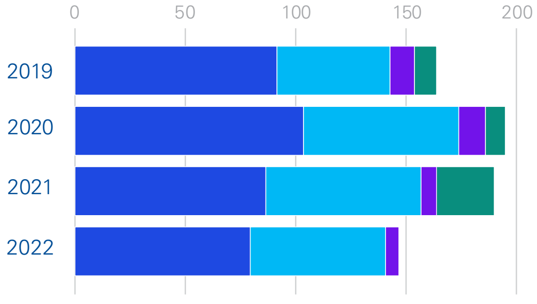


UK Mid-market PE investment to exit ratio's excluding bolt-on deals

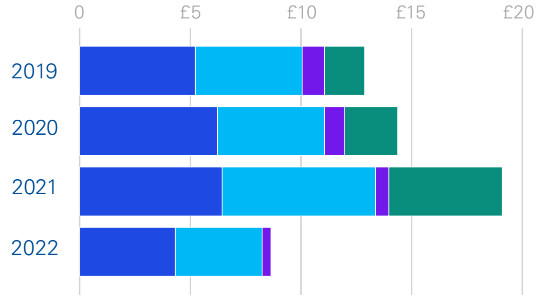


Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*

UK mid-market UK PE exit volume by exit type



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



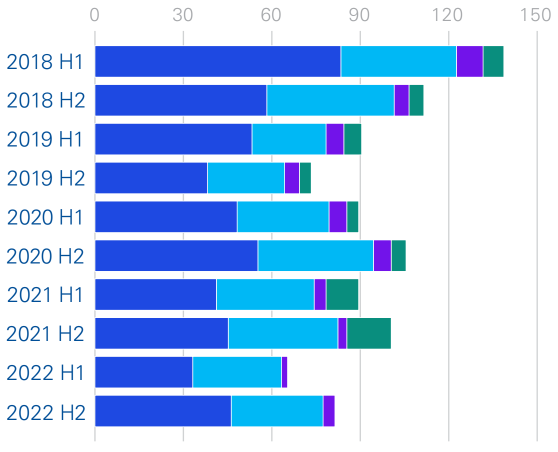
Trade Acquirer | Secondary buyout | Management buyout | IPO

% change deal volume and value by exit type

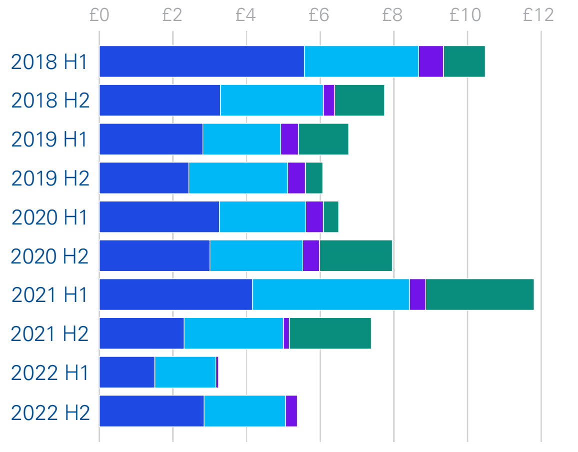
Exit type	% Volume Change		% Value Change	
	2022 v 2021	2022 v 2019	2022 v 2021	2022 v 2019
Trade Acquirer	-8.1%	-13.2%	-32.6%	-16.9%
Secondary buyout	-12.9%	19.6%	-44.4%	-19.3%
Management buyout	-14.3%	-45.5%	-35.1%	-59.7%
IPO	-100.0%	-100.0%	-100.0%	-100.0%

Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*

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



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



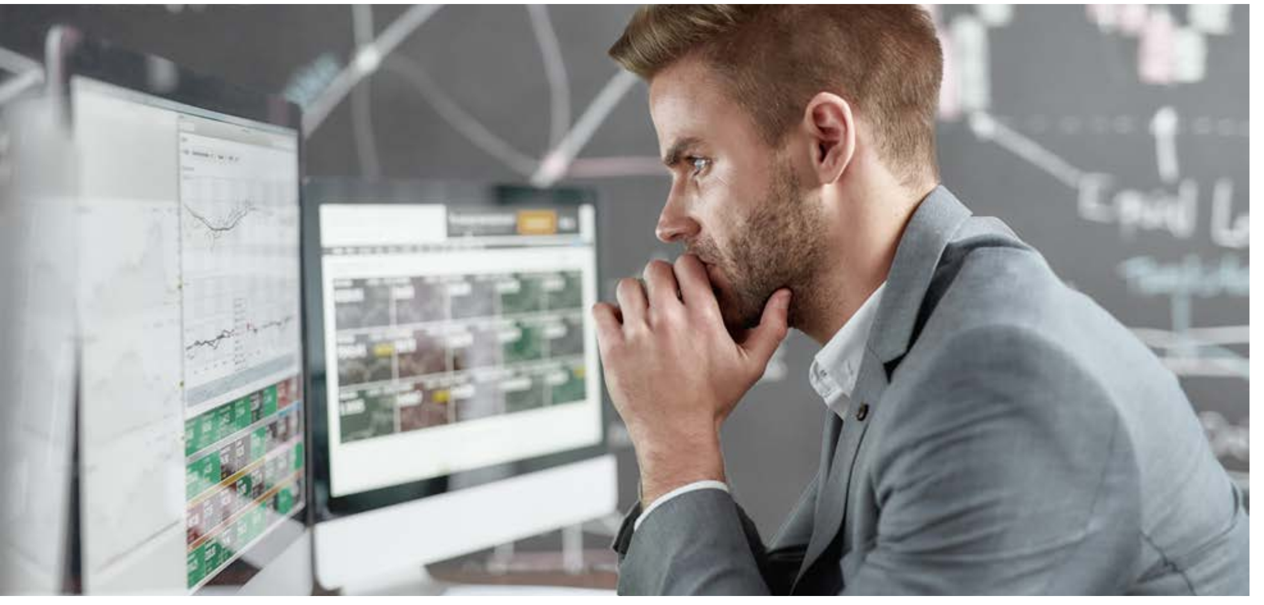
Trade Acquirer | Secondary buyout | Management buyout | IPO

% change deal volume and value by exit type

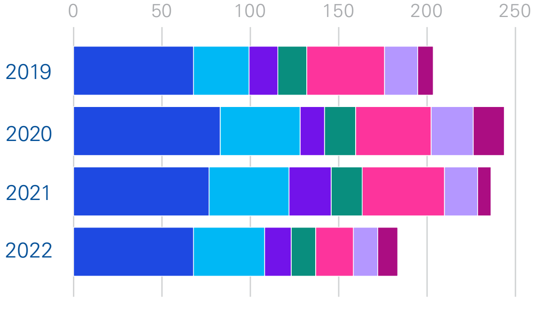
Exit type	% Volume Change			
	H1'22 v H1'21	H2'22 v H2'21	H1'22 v H1'19	H2'22 v H2'19
Trade Acquirer	-19.5%	2.2%	-37.7%	21.1%
Secondary buyout	-9.1%	-16.2%	20.0%	19.2%
Management buyout	-50.0%	33.3%	-66.7%	-20.0%
IPO	-100.0%	-100.0%	-100.0%	-100.0%

Exit type	% Value Change			
	H1'22 v H1'21	H2'22 v H2'21	H1'22 v H1'19	H2'22 v H2'19
Trade Acquirer	-63.8%	23.6%	-46.3%	17.2%
Secondary buyout	-61.0%	-18.1%	-21.4%	-17.7%
Management buyout	-84.8%	96.0%	-86.2%	-33.1%
IPO	-100.0%	-100.0%	-100.0%	-100.0%

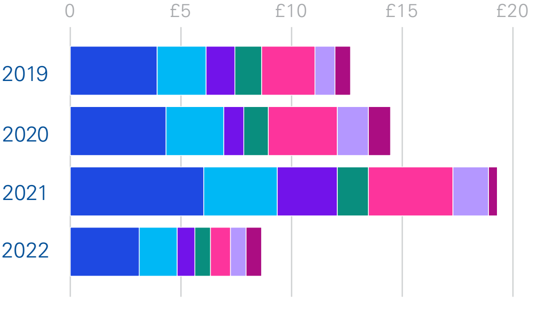
Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*



UK mid-market UK PE exit volume by sector



UK mid-market PE exit deal value by sector (£bn)



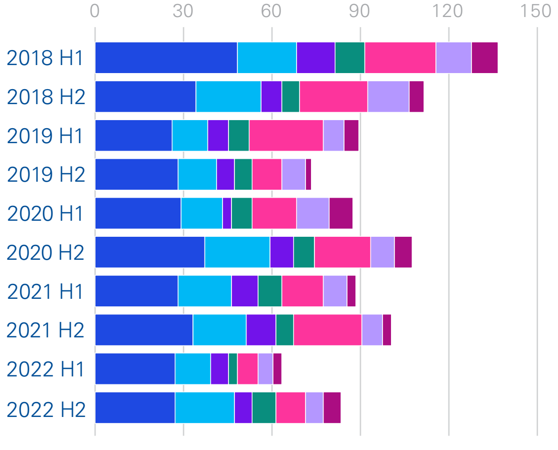
Business services | TMT | Healthcare | Financial services | CG&R | Industrials | Energy

% change deal volume and value by sector

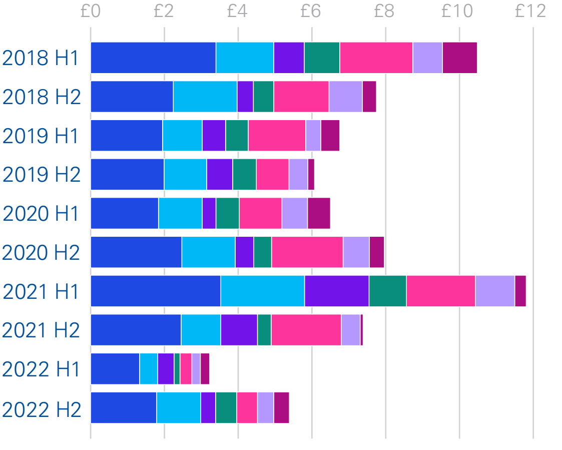
Sector	% Volume Change		% Value Change	
	2022 v 2021	2022 v 2019	2022 v 2021	2022 v 2019
Business services	-11.5%	0.0%	-47.8%	-20.8%
TMT	-11.1%	28.0%	-49.6%	-24.6%
Healthcare	-36.8%	-7.7%	-69.1%	-36.5%
Financial services	-21.4%	-15.4%	-47.1%	-41.6%
CG&R	-54.1%	-51.4%	-76.5%	-63.7%
Industrials	-26.7%	-26.7%	-57.6%	-28.4%
Energy	50.0%	28.6%	68.2%	-4.0%

Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*

Half year mid-market UK PE exit volume by sector



Half year mid-market PE exit by sector (£bn)



Business services | TMT | Healthcare | Financial services | CG&R | Industrials | Energy

% change deal volume and value by sector

Sector	% Volume Change			
	H1'22 v H1'21	H2'22 v H2'21	H1'22 v H1'19	H2'22 v H2'19
Business services	-3.6%	-18.2%	3.8%	-3.6%
TMT	-33.3%	11.1%	0.0%	53.8%
Healthcare	-33.3%	-40.0%	-14.3%	0.0%
Financial services	-62.5%	33.3%	-57.1%	33.3%
CG&R	-50.0%	-56.5%	-72.0%	0.0%
Industrials	-37.5%	-14.3%	-28.6%	-25.0%
Energy	0.0%	100.0%	-40.0%	200.0%

Sector	% Value Change			
	H1'22 v H1'21	H2'22 v H2'21	H1'22 v H1'19	H2'22 v H2'19
Business services	-62.2%	-27.0%	-31.8%	-9.9%
TMT	-78.2%	10.7%	-54.3%	3.2%
Healthcare	-74.4%	-59.9%	-29.1%	-43.2%
Financial services	-84.1%	55.0%	-73.6%	-11.0%
CG&R	-82.8%	-70.2%	-79.4%	-36.0%
Industrials	-78.3%	-14.7%	-44.7%	-15.2%
Energy	-20.4%	399.3%	-51.4%	129.8%

Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*

IPOs back on the agenda?

Aadam Brown
Managing Director, Head of Independent IPO Advisory

The environment and sentiment in 2023 is already looking more positive, as inflation and interest rates start to stabilise against a backdrop of strengthening stock markets.

Last year was clear confirmation, if any were needed, that investors do not like uncertainty. After a boom in IPOs in 2021, there was not a single mid-market PE IPO in 2022.

It's easy to understand the hesitation of PE houses to press the button on the IPO route last year. The combination of geopolitics, interest rates, inflation and market conditions all fed into an environment of uncertainty which did not bode well for IPO market activity.

There were additional factors that also added to this hesitance: many of the 2021 cohort of IPOs were trading significantly lower than their initial listing price, mostly being tech-related businesses suffering from the global tech backlash and broader market weakness. This was also compounded by continued fund outflows from UK equities. The result was that companies that had been preparing for IPOs either decided to postpone or pursue alternative options.

M&A was itself affected, particularly on the PE side, by the increased cost of debt, further restricting the options available. Both public market investors and potential new buyers are still understandably cautious about deploying funds and they will likely prefer to wait for companies to report their full-year earnings before they start making any significant investment decisions.

However, IPO markets are all about momentum. It can only take one or two successful listings to get the ball rolling again. A number of IPOs have already listed on the continent, and we will be watching the performance of these and any other further issuance closely.

Sectors in the spotlight

Early IPO success is likely to come from companies with more 'traditional' businesses, solid management teams, strong track records, healthy balance sheets, rather than the younger, higher growth companies we have seen over the past few years. In terms of sectors, there are some that are trading better than others, such as energy and healthcare, while consumer goods and retail continue to suffer headwinds. There will of course be exceptions to this rule.

Early IPO activity will initially be a buyer's market and these companies can expect to list at a discount. This is likely to discourage PE owners from early participation in the next IPO cycle. However, early successful listings will build confidence in the market which will encourage a broader market return.

The environment and sentiment in 2023 is already looking more positive, as inflation and interest rates start to stabilise against a backdrop of strengthening stock markets. There is a general consensus amongst IPO practitioners that we should see a broad return to activity by the second half of the year.

However, preparing for an IPO takes 6 to 9 months, so unless business owners considering the IPO route start preparing now, the early window is likely to consist of the existing pipeline of companies that are able to prepare themselves on a more accelerated timetable and take advantage of any positive turn in sentiment as we move through the year. The IPO market may still be relatively shut at the moment, but it is unlikely to remain so for too much longer.

Deal multiples

Perhaps counter-intuitively, given the uncertainty in the market, multiples in mid-market PE deals increased in 2022 versus 2021, although they were significantly down on 2019.

The average multiple for all M&A transactions was 10.8x, down from 11.9x in 2021. The PE market was more resilient, however. Across all PE deals the average multiple was 10.7x, up from 10.1x in 2021, while for mid-market PE deals, the average multiple was 10.6x, up from 10.0x in 2021, but down from a high of 12.8x in 2019.

This buoyancy in PE market multiples possibly reflects a polarisation the market. Almost two-thirds of mid-market PE activity in 2022 came from two sectors: Business Services and TMT. These are the sectors that have consistently demonstrated their resilience and growth potential in recent years, and as a result have been the most attractive to PE investors.

High-grade assets in these sectors are likely to generate a lot of interest from PE houses in a competitive deals market, leading to higher pricing and skewing the average multiple higher. Higher multiples generally equate to growth expectations, so sectors where strong growth is expected will inevitably produce stronger multiples.

This is in contrast to the overall UK PE market, where larger deals have been more affected by volatility, as well as by the drop-off in capital market fundraising, causing multiples to fall.

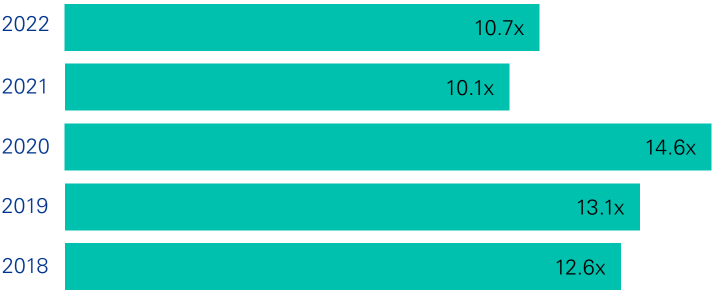
“Proven businesses in these sectors are likely to generate a lot of interest from PE houses in a competitive deals market, skewing the average multiple higher.

10.8x

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

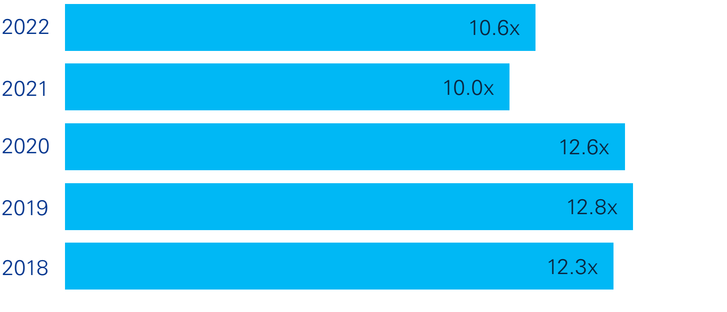
10.7x

UK PE Buyout
EV/EBITDA multiples



10.6x

All UK mid-market
average EV/EBITDA multiples



Source: *Pitchbook, data period 1 Jan 2022 - 31 Dec 2022*

PE trends to watch out for

Robert Baxter
Partner, UK Head of Corporate Finance, Global Head of Consumer Goods M&A

Although H2 2022 ended on a slightly downbeat note, it was following a period of unprecedented activity the previous year. There is a sense coming into 2023 that expectations have adjusted to the new environment and positivity is returning, albeit tentatively.

Even if inflation levels and interest rates remain relatively high, at least the situation is more stable than it was for much of 2022. The deals market does not like uncertainty and a higher cost of debt, high energy prices, consumer spending expectations and other factors can at least be priced into transactions, rather than volatility of these and other factors causing transactions to fall over.

The gap between vendor and buyer price expectations have also narrowed. Through much of 2022, vendors were still holding on to the high valuation levels of the previous year; prices that looked increasingly unrealistic as the year progressed and confidence waned. In many cases those expectations have now had time to realign to the new environment, which could contribute to a steadier deals pipeline in 2023.

> **There is a sense coming into to 2023 that price expectations are adjusting to the new environment and vendors have more confidence about coming to market than in Q4 2022.**

In addition, transaction levels could be boosted by the ongoing question of capital gains tax (CGT). It's long been mooted that the current CGT regime will be revised. Private business owners, wary of the financial implications of potential future CGT reform, might be tempted to get a deal done sooner rather than risk getting caught out by a change to CGT further down the line.

In terms of sectors, the laser focus of PE houses on issues like resilience, margins, visibility of earnings, recurring revenue streams, plus the digital transformation of large swathes of the economy in general, means that sectors like TMT, Business Services and Healthcare will continue to account for the lion's share of transactions for some time to come. Weak consumer spending, on the other hand, is likely to mean CG&R will continue to struggle.

There's a continuing question over dry powder. PE firms still have considerably more funds to invest than there are deals on (or coming to) the table. This will see the continued dominance of bolt-ons and minority deals in 2023 as PE houses look for lower-risk opportunities to deploy their funds. It is also likely to lead to a more aggressive approach to portfolio management as PE owners seek to create value in other ways.

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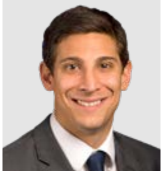

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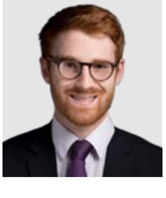

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Methodology

Report scope covers period
1 January 2022 – 31 December 2022

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 buyouts
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.

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