Private Equity Trend Report 2021

Can Private Equity save the world?

pwc

Preface by Steve Roberts

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Preface

Dear friends,

Firstly, and most importantly, I trust that you are all well and healthy. After an unprecedented twelve months impacting all levels of both business and personal life, I am sure we are all eagerly awaiting the new normality, whatever that may bring. On that note, I want to use this preface to look forwards and not backwards. This report naturally gauges sentiment over the historical period; however, the challenges ahead are what will define the future of the PE industry as it moves through the current decade. It is for this reason that we have provocatively titled this year's report "Can Private Equity Save The World?", which I have unashamedly stolen from a recent blog post from our UK firm. The turbulence of the last year, and the inevitable recovery that will significantly impact the next few years ahead, offer an exceptional opportunity for an agile asset class like PE with the vast amount of expertise and capital at its disposal. As such, the PE industry finds itself in a potentially unprecedented position of being not only able to be part of the solution, but to define and shape it.

Where can PE play?

The economic pressures and consequences of the pandemic are still being assessed and measured. It is, however, clear that there will be an immediate need for liquidity in many businesses as the world begins to turn again and the significant state aid packages and programmes run out. This will require many companies to assess all options available, which will lead to a high deal flow in the short term as large, listed corporations consider and accelerate portfolio divestitures, and private companies (maybe for the first time) consider opening their doors to fresh capital, new equity and/or the sale of minority stakes. Public-to-private deals that have long been mooted as a target area for PE may well be more realistic, in particular if stock market valuations begin to cool down once the economic reality hits.

PE may well find itself in a unique position in its history to capitalise on these many opportunities and be the solution that is sought. Of course, this goes way beyond just being a provider of capital due to the aforementioned short-term market needs and opportunities, and it is here that the decades of brand building and trust that has been earned will reap the benefits. The value creation experience that the industry has developed, in particular in the period since the financial crisis of 2008/2009, evidenced through the many successful partnerships with companies and successful acquisitions and exits, have positioned it well to credibly and genuinely be front of mind for driving the future chapters for many of these businesses. The lessons learned through the tough years following the last crisis played a major role in building that trust and changing its image from a financially driven to a value creation driven investor. This has been further evidenced by the significant fundraising that happened during 2020, with many houses raising record fund levels, showing the faith that the LPs have in the industry's ability to generate returns despite all the current uncertainty and turmoil in the wider economy.

Where could PE make a difference beyond the deal?

This current opportunity allows PE to go above and beyond the obvious economic benefits of company ownership. The whole topic of ESG has come even more into focus recently, and we have noticed a rapid shift in perception within the industry from a mainly compliance-focused strategy, to one of looking at the topic through a value creation lens. This is gaining significant momentum with the realisation that there are major value levers available across a spectrum ranging from avoiding value erosion ("do nothing") through to actively driving an ESG strategy around topics such as decarbonisation, diversity and sustainability. We have seen recent trends of financing structures linked to performance against ESG metrics, the raising of climate and social-impact-focused funds, bold statements regarding carbon neutral timelines: the list goes on and only serves to reinforce that this is an area that will only increase in importance. While value creation is a major driver, the consequential societal benefits that come out of this are significant and benefit us all. PE can, and almost certainly will use its position, capital and influence to be a catalyst for this transformation and further enhance its standing within the wider society.

What are we seeing right now?

For the last two quarters there has been a frankly enormous level of deal activity. While a part of this has clearly been driven by the backlog of transactions that were deferred during the second and third quarters of

2020, this has now been cleared and current activity as well as the upcoming pipeline relates to a multitude of new assets coming to market. This is over and above the normal levels of growth we would have anticipated and is driven by many of the factors discussed earlier. With the vast amount of dry powder available, pricing continues to rise, multiples in many sectors seemingly not having been impacted by the events of the last year and even increasing further. Healthcare and Tech remain at the forefront of this and the trend shows no signs of abating. As we highlighted last year, PE has historically profited from multiple expansion and reaped returns of on average over 2x EBITDA from multiple arbitrage alone. The current situation continues to support this, however, the pinch will have to come at some point (we had expected it to be 2021) and reinforces the need to be able to compensate for it through deeper value creation and longer holding periods to achieve it. ESG can play a major role in this, and inevitably will have to.

So, can PE save the world?

Well, we didn't see the last twelve months coming as they did, but we firmly believe that the current situation offers significant opportunity on many levels. It will obviously not be an easy ride and there are many obstacles and challenges to come, however, the industry may well never have been so well positioned to benefit from these and continue to make a major contribution both economically and socially to the solutions required.

As always, our thanks go to all those who participated in this year's survey and shared their opinions. We look forward to working with you again in 2021 and beyond!

Steve Roberts
Private Equity Leader

Introduction

The European PE industry has demonstrated remarkable resilience in the face of truly exceptional circumstances. After a strong start to proceedings, deal markets all but shut down in the second quarter as stay-at-home measures were put in place across the continent. But this pause was short lived. Pent-up demand for new deals and divestments, postponed during the critical months of March to May, carried over into the second half of 2020 and resulted in a burst of activity. All told, volume grew by the close of the year but by a mere 4%. And value exceeded 2019 as some massive assets were brought to market.

With such an impressive showing amid the most widespread pandemic in living memory, you may be forgiven for thinking the European industry barely flinched during 2020. That has not been the case. Most funds have seen earnings fall in their portfolio companies and this has caused complications in servicing leveraged loans. GPs will be hoping that the anticipated economic recovery in 2021 comes to bear, lifting earnings and reducing debt-to-EBITDA ratios.

Improved company performance should also result in improved deal flow. One of the major challenges of 2020 was determining the fair value of assets amid all of the the earnings noise as company performance bifurcated. For the best-performing assets, many investors baulked at paying a multiple on earnings inflated by short-term and potentially only temporary demand.

One characteristic of companies that were able to successfully ride the storm of 2020 is digitisation. Companies with digital business models and that were able to continue to deliver goods and services amid remote conditions flourished as others were left behind. Now more than ever, PE funds recognise that investment into their portfolio companies' digital foundations is what will set these businesses apart from the competition and will be fundamental in delivering the outsized returns that private equity has so consistently offered.

The efficiency of vaccine rollouts will prove pivotal in the pace of the economic recovery this year. At the time of writing, there is potential for a double-dip recession in Europe. However, with the experience of 2020 under its belt and armed with persistently high levels of dry powder, there is good reason to believe that the European PE market will, once again, exceed expectations.

1.

Market overview

Private equity in Europe

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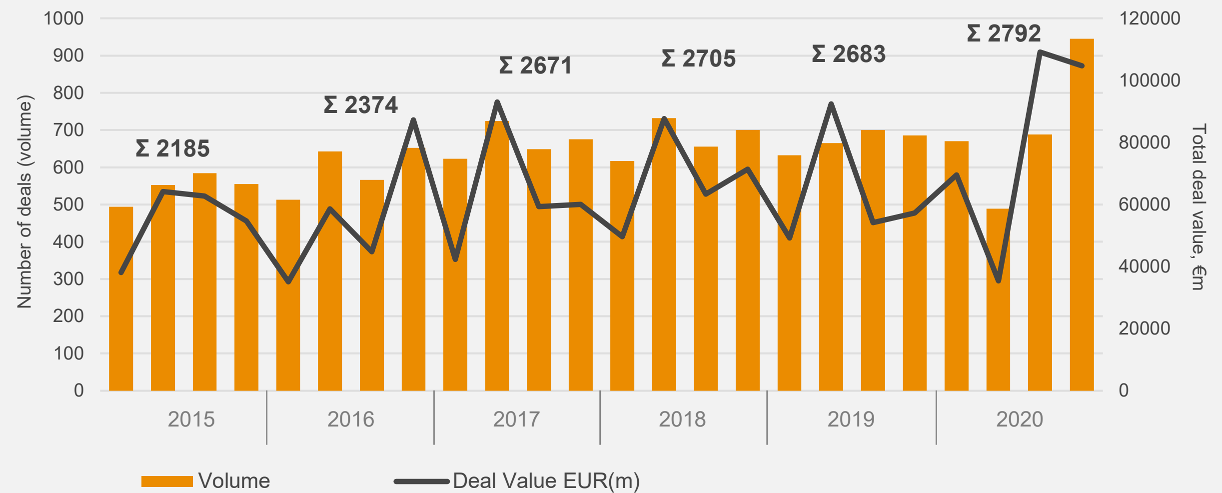
Private equity's adamantine will to invest could not be broken even by a global pandemic, in what has been an exceptional showing by the industry in Europe. In 2020, total PE activity, including both portfolio company acquisitions and disposals, increased by 4% to 2,792 transactions and value surged by a full 26% to €318.8bn. For context, the five-year trailing average between 2015 and 2019 comes to 2,524 transactions worth a combined €245bn.

Fig 1 | European Private Equity Trends | 2015-2020



Buyout trends

Deal numbers and capital invested surged in the latter half of the year after a difficult second quarter. All told, deal volume came to 1,473, a 5% annual fall yet still above the six-year (2015-2020) trailing average of 1,459. Value meanwhile increased by 14% year on year to €179.7bn.

Unsurprisingly, activity suffered in Q2 as restrictions on movement came into effect and the reality of the pandemic set in. The second quarter was the weakest for deal volume and value since 2015. As economies reopened in the second half, buyout activity returned with gusto: Q1 was the strongest quarter for buyout value since 2015 and Q4 had the highest number of deals of any quarter over the past five years. The reason for this upsurge is simple: funds still have copious dry powder to invest. Pent-up demand for deals caused by the timeout in the second quarter created a rush in the second half of 2020 before further lockdowns were introduced.

The top deal of the year saw Cinven and Advent International acquire the elevator division of German industrial conglomerate ThyssenKrupp for €17.2bn, which helped Germany to overtake France as Europe's second highest-value buyout market in 2020. **In second place, KKR and Fastweb took a 37.5% stake in Fibercop alongside Telecom Italia in a deal valued at €7.7bn.** In a close third place was TDR Capital and the Issa brothers' **€7.5bn** takeover of UK supermarket chain ASDA from Walmart.

These deals share a common thread – all are strategic spin-offs. This is a theme that is likely to remain in 2021 as corporates have been forced to review their strategies and operations over the past 12 months to determine whether the two are genuinely aligned. Businesses are concentrating on what is core to their business model and how they can use the M&A market to divest and acquire assets to ensure their future in a post-COVID environment. Equipped with record dry powder, PE stands to benefit from this mass restructuring phase.

Fig 2 | European Buyout trends | 2015-2020

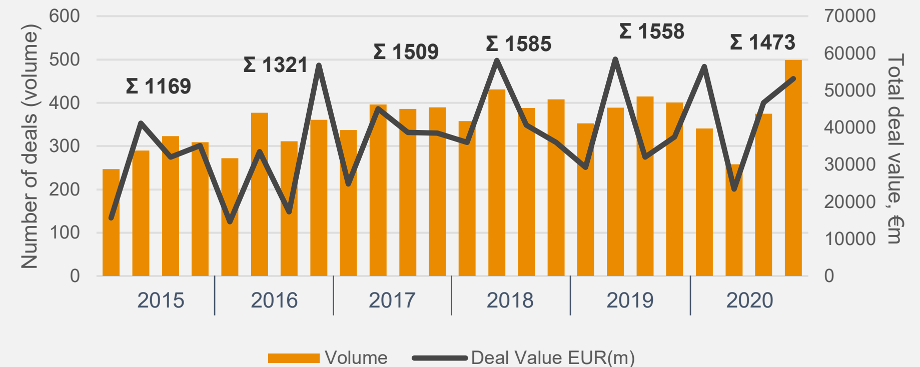
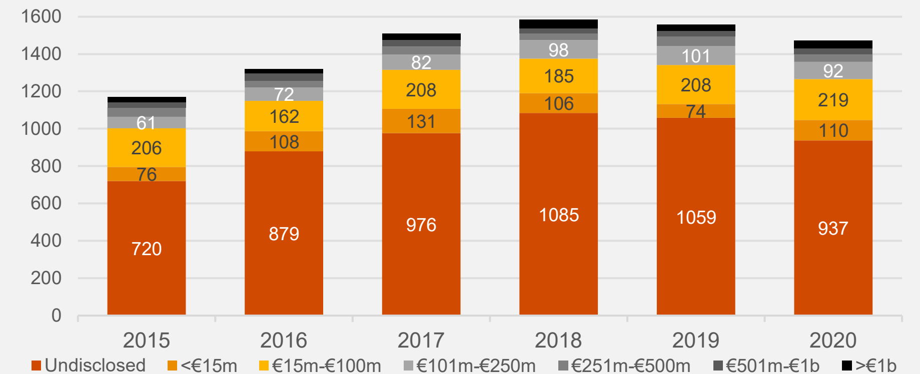


Fig 3 | European Buyouts, Split by Deal Size **|** 2015-2020



Exit trends

PE exits had begun to ease off in recent years, the attention and efforts of firms shifting from selling portfolio companies to deploying newly raised funds into fresh acquisitions. In 2020, the total number of European exits fell once again, by 17% to 807, the lowest volume for more than five years. However, exit value confounded expectations by clocking in at €172bn, a 33% yearly gain.

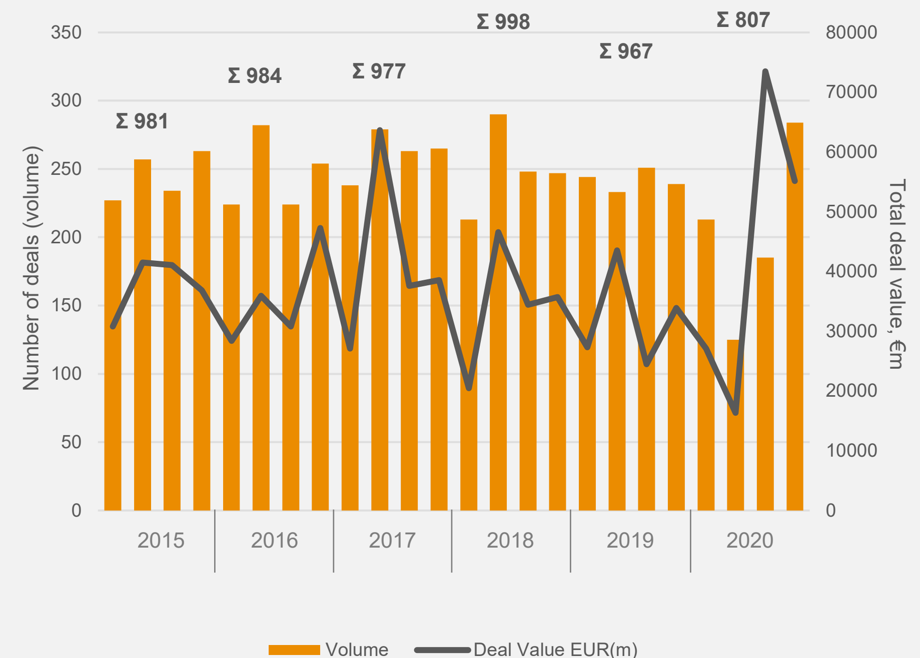
This winning performance was helped in no small part by the sale by Softbank's Vision Fund of the chipmaker **ARM Holdings to NVIDIA Corporation for €32.5bn**. Discounting this transaction brings exit value just under 2019's total – still impressive given the momentous challenges that 2020 posed.

The second-biggest PE sale of the year was considerably smaller, Italian bank Nexi acquiring Danish paytech player Nets for €8.1bn, representing an exit for Bain Capital and Advent International. In third place, Caisse de dépôt et placement du Québec's sale and reinvestment into Germany's Bombardier Transportation alongside incoming investor Alstom was valued at €7.1bn.

Notably, only one of the top ten largest exits did not take place in the second half of the year. Following a period of intense uncertainty during the months of March through May, there was a rush among funds to divest once deal parties were willing to return to the negotiating table, albeit this time remotely by virtual means.

In Q2, there were just 125 exits which is around half the historical average and only €16.3bn of value was realised. However, the floodgates opened in the third quarter with €73.5bn being the highest quarterly realised value in the past five years, followed by the sale of 284 assets across Europe in the fourth quarter – 6 deals short of the quarterly record set in Q2 2018 (290). For the right asset and the right price, there has been no shortage of appetite to transact.

Fig 4 | European Exit trends | 2015-2020



Geography of European deals

Just as Europe's buyout industry has taken the pandemic in its stride, to date Brexit has had limited impact on the UK & Ireland's buyout market. In fact, while the territory's share of volume in 2019-2020 held firm at 21% of European deals, a loss of one percentage point, its share of value increased by five percentage points, from 25% to 30%. Sterling remains weak by historical standards, which makes UK deals attractive for foreign GPs managing euro and dollar funds. This has helped to keep deal value at elevated levels. However, it is worth noting that the UK's departure from the EU was made official on 1 January 2021. Therefore, the true impact of Brexit on dealmaking will only be visible once the year has concluded – and the lasting effects may only be apparent in years to come.

Like the UK & Ireland, both France and Germany have seen their deal volume maintain previous levels at 17% and 13% of all European buyouts respectively. In value terms, however, there has been some change in the rankings. Germany has leapfrogged both the Nordics and France to become the second-highest-value deal market in Europe, claiming 18% of all invested euro in 2019-20, a seven percentage point gain. Without a doubt this achievement is owed to Cinven and Advent's purchase of ThyssenKrupp's elevator business for €17.2bn

France's proportion of value was static over this period, putting it in third place behind Germany for the first time but we expect the country to regain its number two spot in 2021, a position it has held for decades. The Nordics meanwhile lost five percentage points and slipped behind Germany, France and Iberia to sit neck and neck with Italy.

Brexit may drag on UK & Ireland's PE performance over the longer term and this could see France become Europe's most active buyout market by deal count in due course. It is doubtful that the UK & Ireland will lose its top place as the highest-value PE market in Europe any time soon, however, given that competing markets in Europe are consistently a distant second with around half the aggregate deal value.

Fig 5 | European Buyout Volume, Split by region | 2015-2018

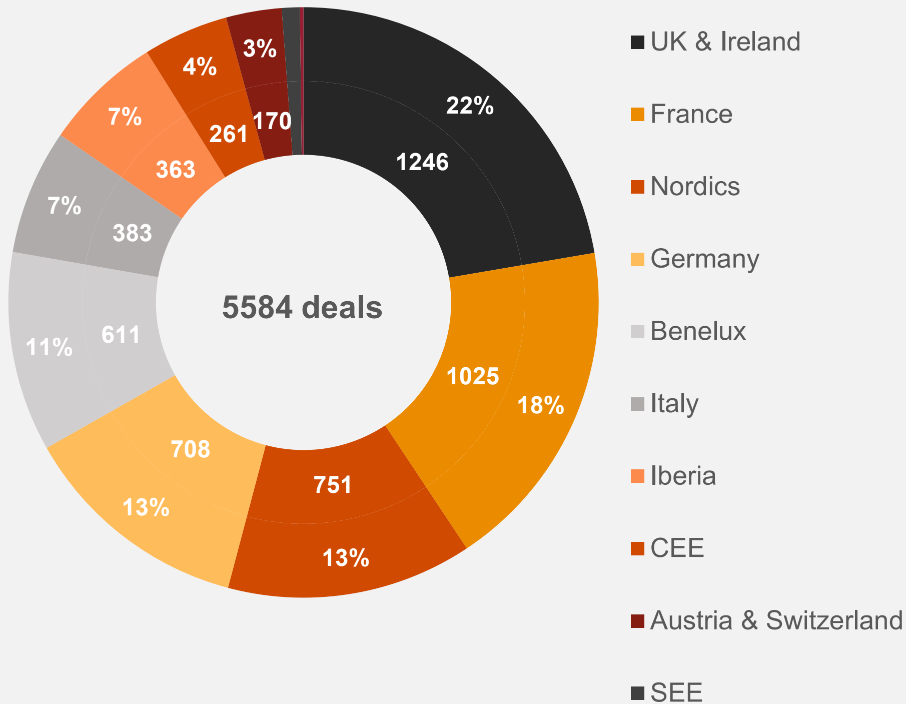


Fig 6 | European Buyout Volume, Split by region | 2019-2020

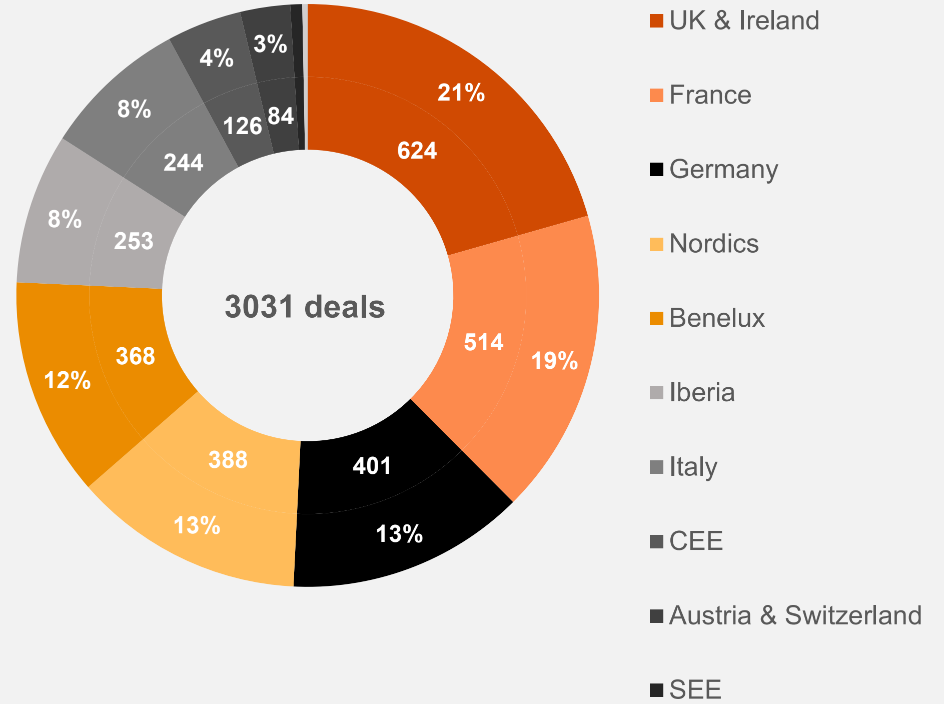


Fig 7 | European Buyout Value, Split by region | 2015-2018

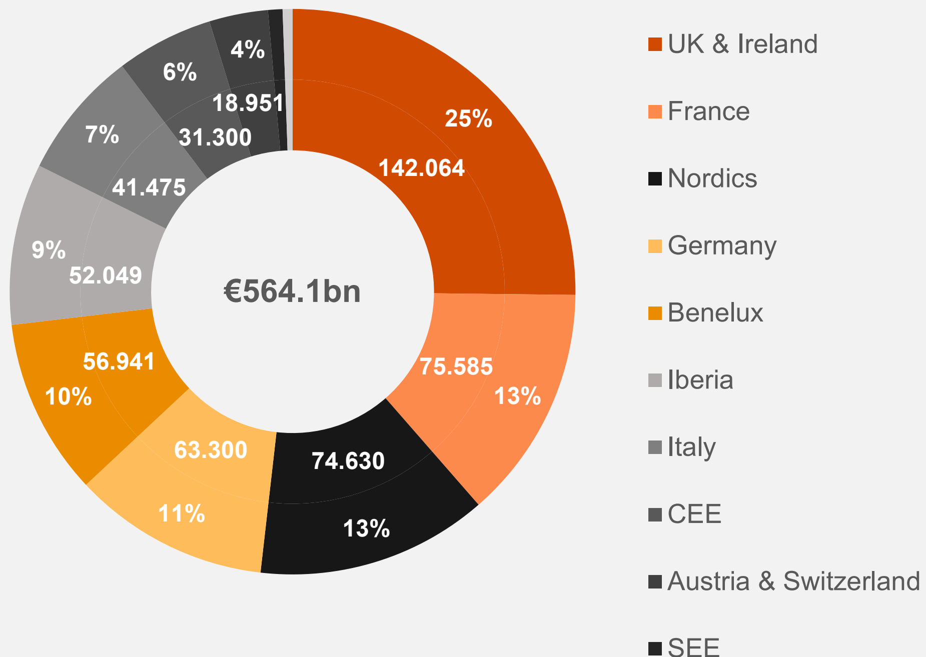
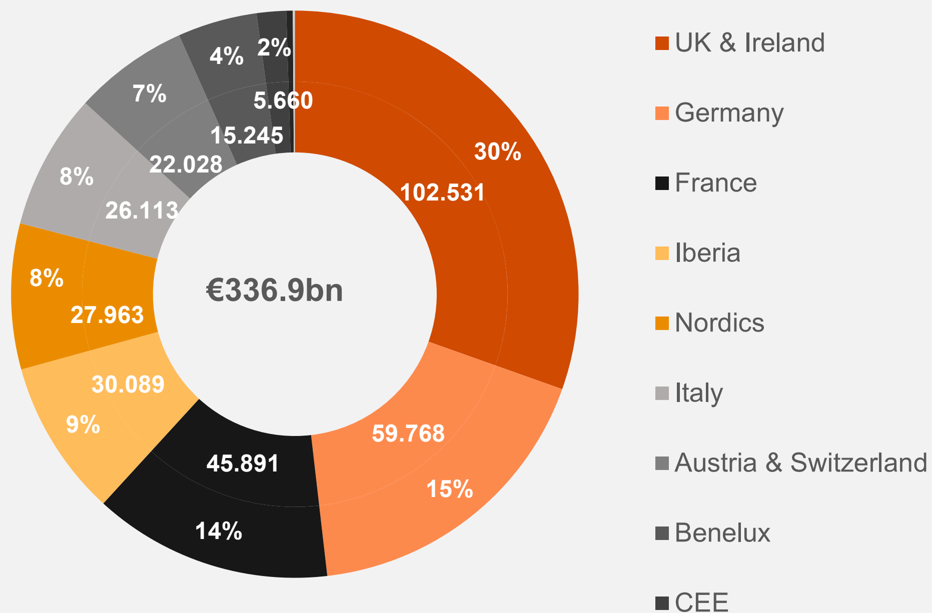


Fig 8 | European Buyout Value, Split by region | 2019-2020



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Industry focus

Technology has been a defining theme of the past year as businesses that were ahead of the digital curve at the beginning of 2020 adapted, in some cases almost seamlessly, to the challenges of the COVID environment. This is reflected in Europe's PE activity. The technology, media and telecommunications (TMT) sector took the most deals and the most invested capital in 2019-2020, displacing industrials and chemicals. There were €84bn worth of TMT deals and this was invested across 751 deals, accounting for 25% of both value and volume.

In previous years, investment value was relatively evenly divided along sectoral lines. The pandemic appears to have catalysed a concentration of capital into industries that have been outperforming, and away from highly cyclical sectors. TMT has not been the only beneficiary of this effect.

The PE value share of pharma, medical and biotech (PMB) deals in Europe has climbed three percentage points from 9% to 12%, while the energy, mining and utilities (EMU) sector's share of deal value more than halved from 11% to just 5%.

Investors have long been attracted to the PMB sector during times of economic stress. The healthcare and pharma segments in particular possess inherently defensive qualities, their goods and services being well insulated from wider falls in demand during recessionary periods. Now, the need for global vaccine development and distribution and care services for the many people affected by the health crisis has put related assets in high demand in the eyes of PE investors.

The same cannot be said for the EMU sector. Already struggling in the face of commodity volatility prior to the pandemic, the second major price collapse in two years occurred in early 2020, oil futures falling below zero for the first time in history. This turbulence has had a clear impact on appetite for PE investment into the sector as funds stepped away from EMU businesses with falling revenues. That said, the outlook for energy M&A is compelling given the continued rise of crude prices since April 2020 and the anticipated recovery in the global economy over the next two years as vaccines are rolled out and the health crisis abates.

Fig 9 | Buyout Volume, Split by region | 2015-2018

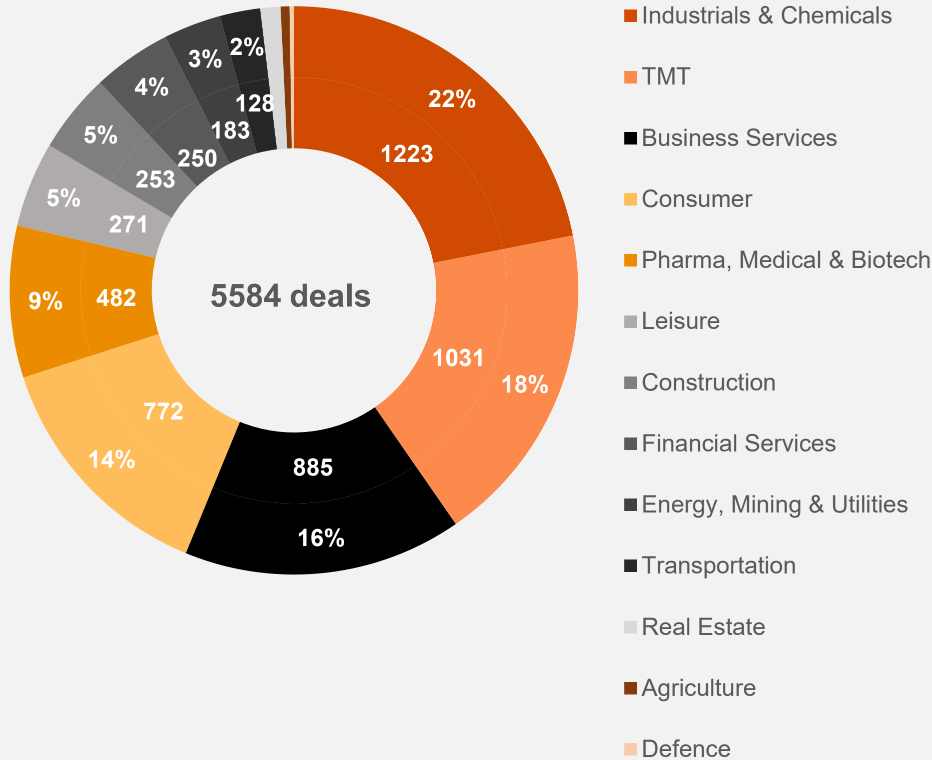


Fig 10 | Buyout Volume, Split by region | 2019-2020

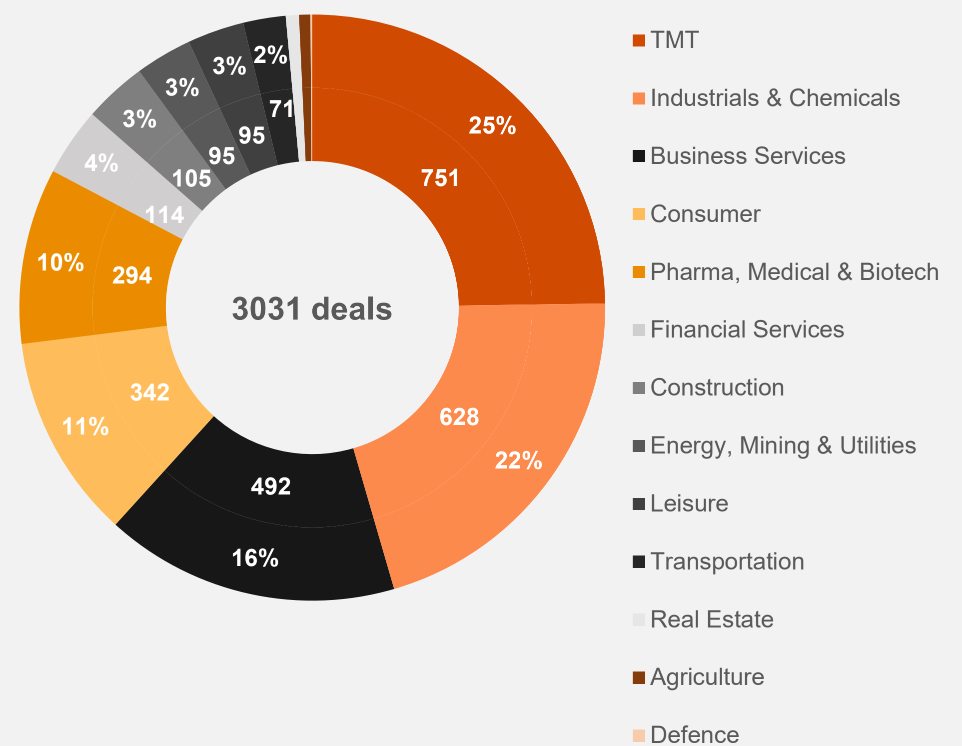


Fig 11 | Buyout Value, Split by region | 2015-2018

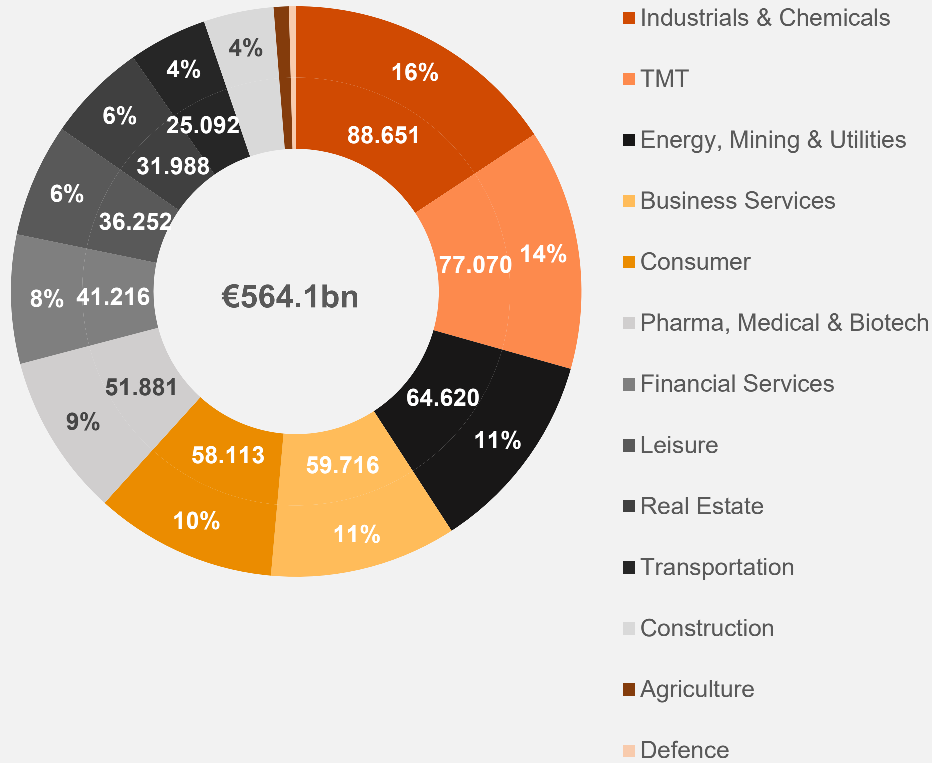
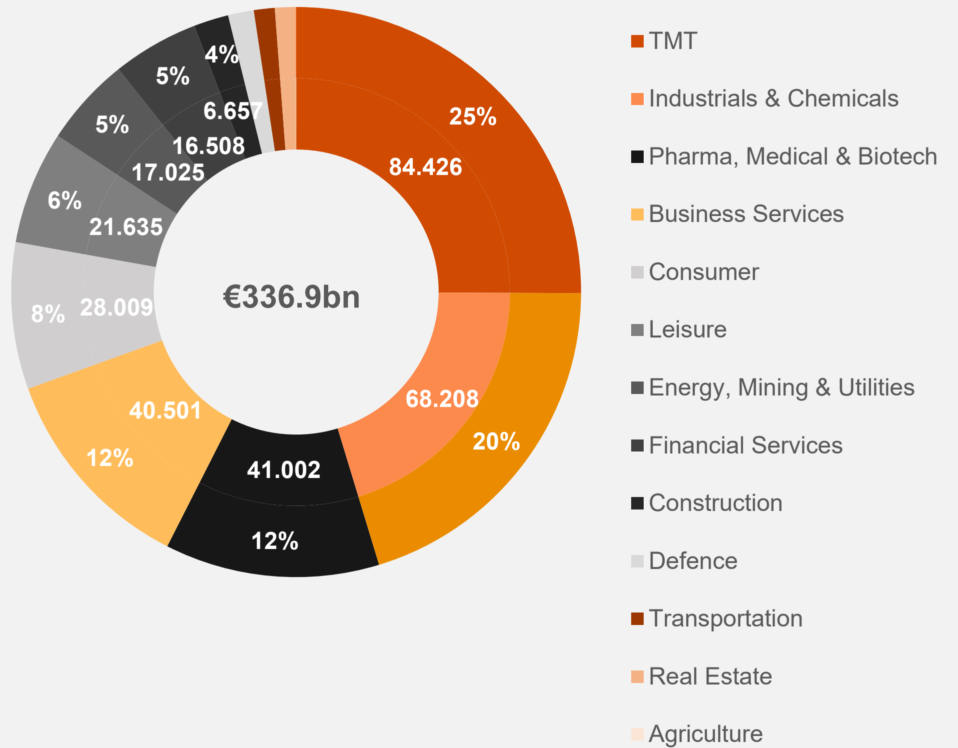


Fig 12 | Buyout Value, Split by region | 2019-2020



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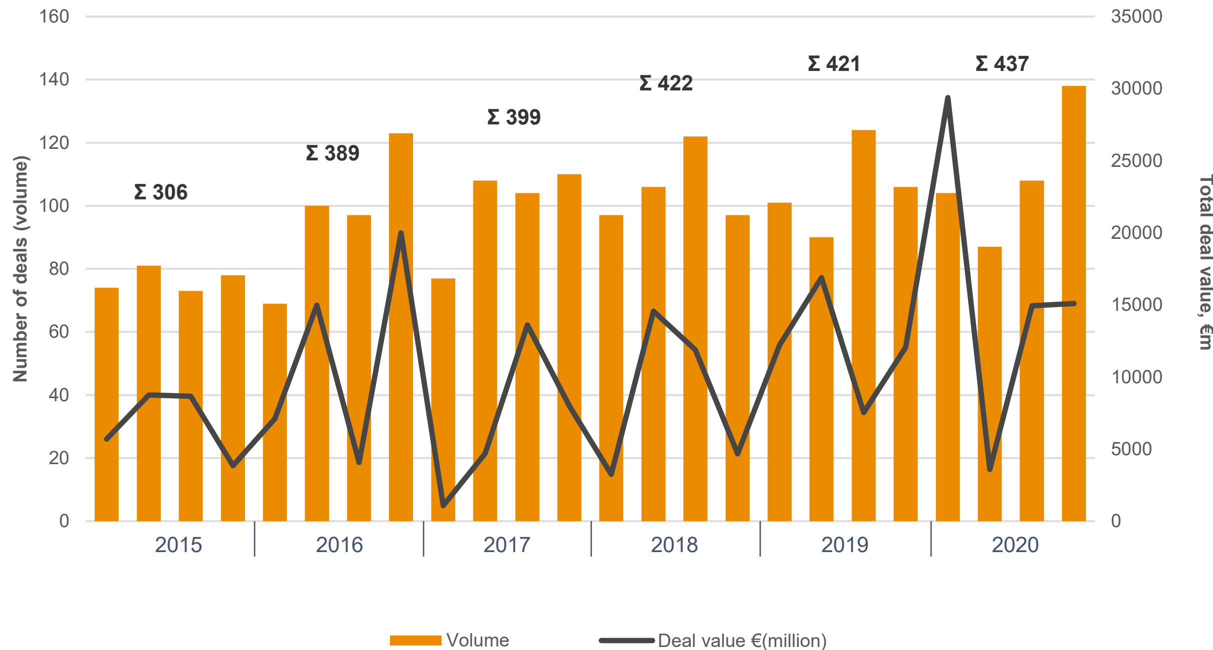
Deep dive: DACH spotlight

The DACH region's PE market was a tale of value over volume in 2020. Deals (including exits) declined by 4% compared with 2019, totalling 437. But value was up by 29% to €63bn, the highest mark since 2015. Activity was not inflated by a buying frenzy as funds sought to capitalise on disruption and price dislocation but, amazingly, a rampant exit market."

Fig 13 | DACH Private Equity Trends | 2015-2020



New buyout volume decreased by 8% year on year to 232 deals and value inched up by a single percentage point to €41.9bn, made possible by the €17.2bn ThyssenKrupp carve-out.

Fig 14 | DACH Buyout, Split by Deal Size | 2015-2020

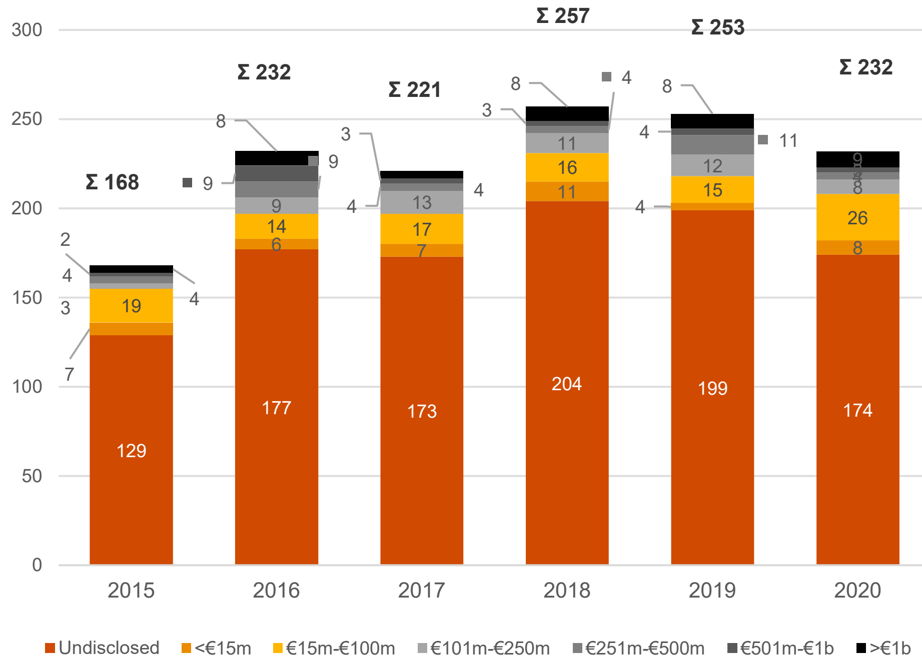
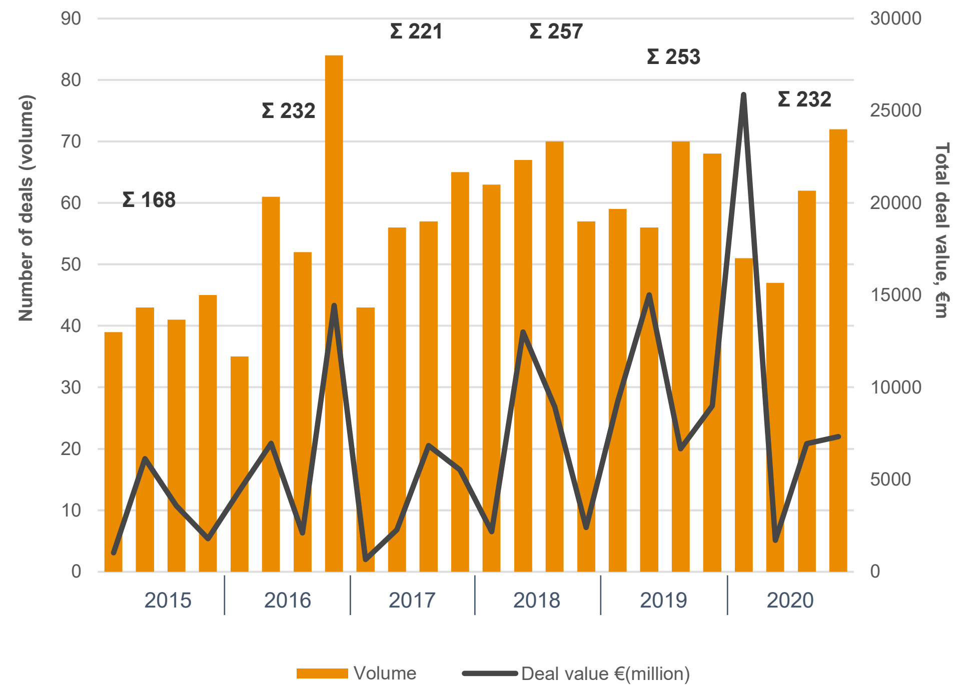


Fig 15 | DACH Buyout Trends | 2015-2020

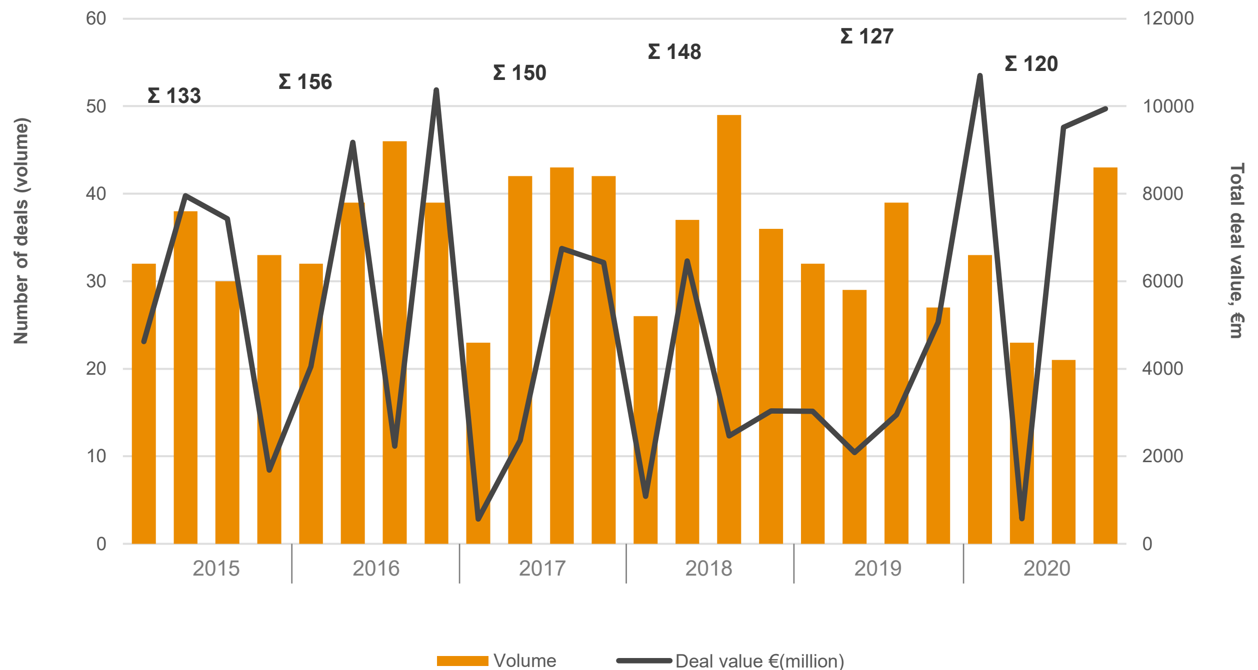


However, it was exits that stole the show in the DACH region in 2020. While exit volume slipped by 6% to 120 portfolio company disposals, value more than doubled. At €30.7bn in realised capital, a 134% annual gain, this was the highest annual value total for the DACH region since 2015.

A number of DACH exits made it into Europe's top 10, **including the €7.1bn sale and reinvestment into Bombardier Transportation by Caisse de dépôt et placement du Québec.**

Some way behind this was KKR and Reggeborgh's €2.8bn sale of Deutsche Glasfaser, a provider of fibre-to-the-home gigabit internet connections, to EQT Infrastructure and OMERS. In Switzerland, the payments company Global Blue was sold by Silver Lake Partners and Partners Group for €2.2bn. That deal was notable for its structure, having been sold to Far Point Acquisition, a blank-cheque special acquisition company, vehicles better known as a SPACs that saw record volumes of issuance in the US in 2020.

Fig 16 | DACH Exit Trends | 2015-2020



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Deep dive: Benelux spotlight

The Benelux PE market significantly underperformed the DACH region in 2020, with activity falling across the board. This was a function of both a subdued dealmaking market and, to an even greater extent, weak exit activity. The volume of PE deals (including exits) grew by 12% to 347 in 2020, while value dropped by 48% to just €11.4bn.

Buyout volume slipped by 6% to 178 transactions and value was down by 29% to €6.3bn in aggregate enterprise value. With regard to realisations, exit volume and value were short by -16% and -40% respectively year on year, with 86 company sales worth a combined €7.8bn recorded in the year.

To illustrate the dormancy of the market, not a single Benelux deal featured among Europe's top 20 buyouts or exits. The largest new deal was valued at a modest €1bn and saw KKR acquire Dutch holiday parks operator Roompot Vakanties from French private equity firm PAI Partners. **Behind this, UK PE firm Pamplona Capital Management bought Dutch chilled convenience food business Signature Foods for €750m from IK Investment Partners.** All told, nine of the region's ten largest deals were companies based in the Netherlands, with a single Belgium deal, Vision Healthcare, worth **€305m** and purchased by Avista Capital Partners.

Exits had a similarly Dutch bias, with eight divestments originating from the country and the two remaining taking place in Belgium. The largest saw Oaktree Capital clinch €1.5bn in its sale of cold storage company AGRO Merchants Group. The second- and third-largest exits were the aforementioned secondary buyouts of Roompot and Signature Foods.

This dearth of activity is likely to be only temporary, and once company earnings and valuations stabilise this should provide the foundations for improved transaction volume and value in 2021.

From an investor perspective, Benelux PE has long topped the table on returns by European standards. Indeed, with an average TVPI of 1.81x and an IRR in excess of 13%, technology solution provider eFront reports that Benelux buyout funds continue to outperform ever other country and region, not only on the continent but worldwide. For this reason, we expect Benelux managers to continue to raise fresh funds and that pan-European and global GPs will seek out deals in this dynamic market, boosting activity from these mid-pandemic lows.

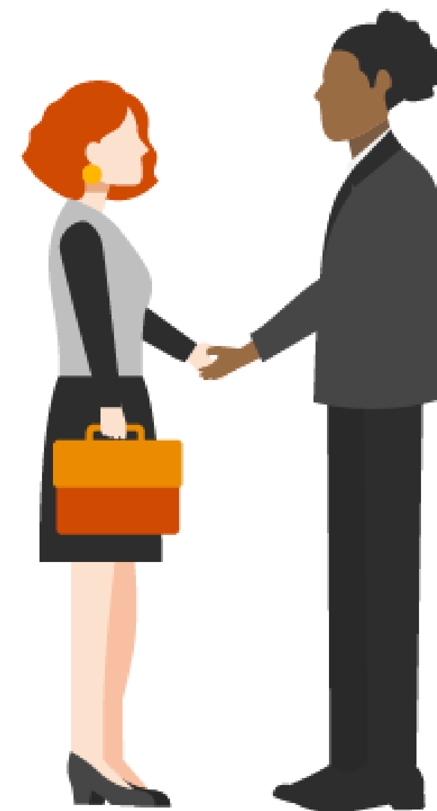


Fig 17 | Benelux Private Equity Trends | 2015-2020

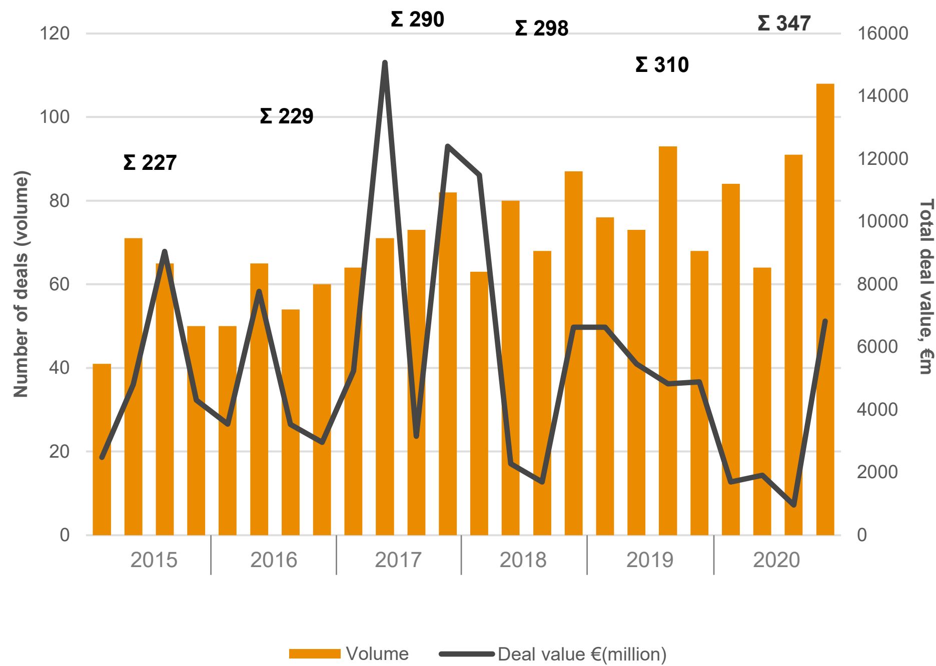


Fig 18 | Benelux Exit Trends | 2015-2020

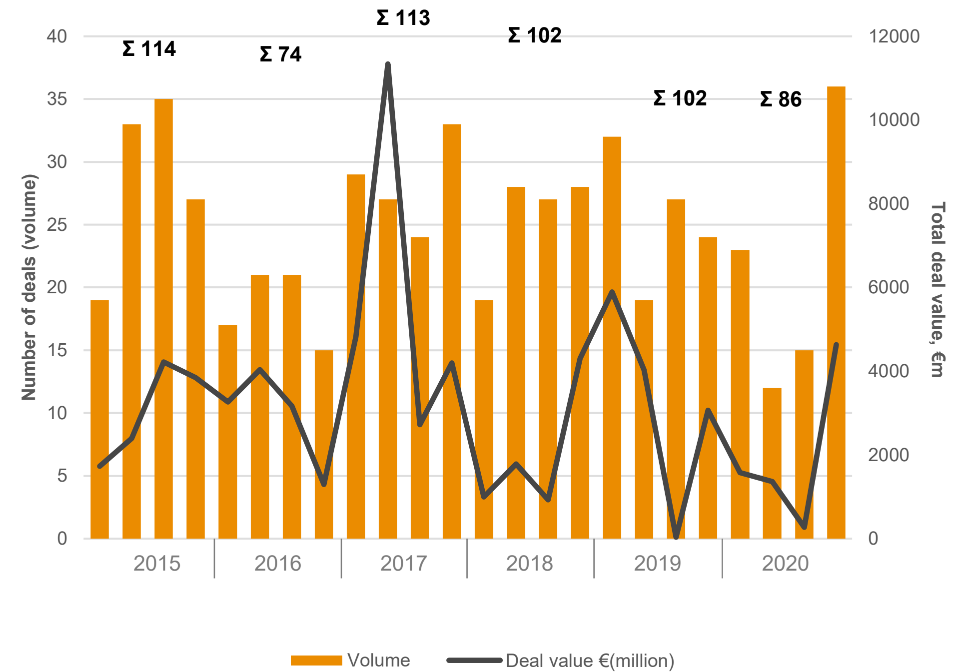
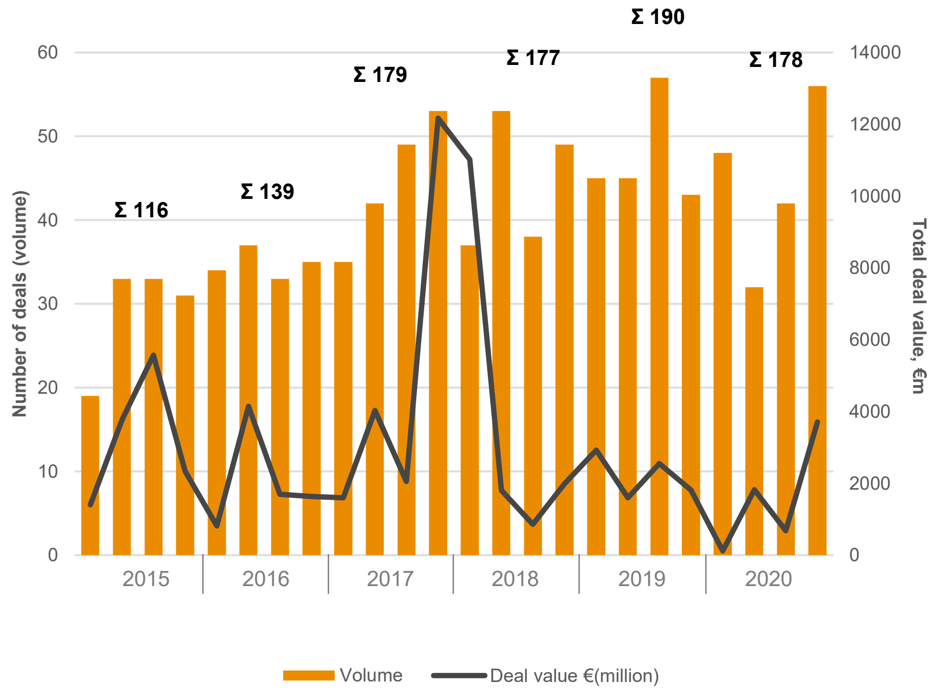


Fig 19 | Benelux Buyout Trends | 2015-2020

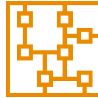


2.

Key findings

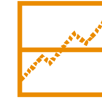
Deal volume sinks as deal value surges

In 2020, total PE activity in Europe increased in terms of volume, down by **4%** to 2,792 deals, but value increased by **26%**. This was the result of one of the largest buyouts in the industry's history (Cinven and Advent International's acquisition of ThyssenKrupp's elevator business for €17.2bn) and also one its largest exits (SoftBank Vision Fund's sale of ARM Holdings for €32.5bn).



Pandemic puts pressure on earnings

While some companies have benefitted from a spike in demand for their goods and services in the past year, many have been severely buffeted. For **58%** of respondents their portfolio companies had lower earnings or experienced financial distress in 2020 due to COVID-19.

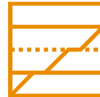


PE investors upbeat on the year ahead – especially in Germany

A **58%** majority of respondents expect the PE market in Europe to improve over the next 12 months, with as much as **80%** of funds based in Germany optimistic about the market outlook.

Germany rises up the ranks

Germany's proportion of European buyout deals by value jumped by seven percentage points to a **18%** market share, putting it in second place in the region behind the UK & Ireland.

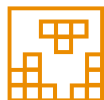


A higher proportion of PE companies broke bank covenants in the past year

Lower earnings of course mean a higher chance of default. **84%** of respondents say **10%** or more of their portfolio companies broke one or more bank covenants in 2020, compared with **71%** a year prior. Not a single respondent saw no covenant breaches somewhere in their portfolio last year.

Brexit chills

58% of respondents say Brexit makes the UK less attractive for PE investments in 2021, although **34%** say it has had no impact on the UK's attractiveness for deals.



Majority reduced the number of deals due to COVID-19

57% of respondents say the number of new investments their firm undertook decreased in 2020 due to the global pandemic, including **43%** who say the number decreased significantly.

Supply chain disruptions and business model upheaval

Supply chain challenges and disruption of established business models are the two biggest impacts of the pandemic on respondents' firms and portfolios, both cited by **40%** of the cohort.

Data analytics to unlock due diligence insights

97% of respondents say they will be investing in digitisation over the next year, with **86%** of these digiphiles planning to invest in data analytics. **94%** say they will use data analytics for due diligence purposes.

3.

Detailed findings

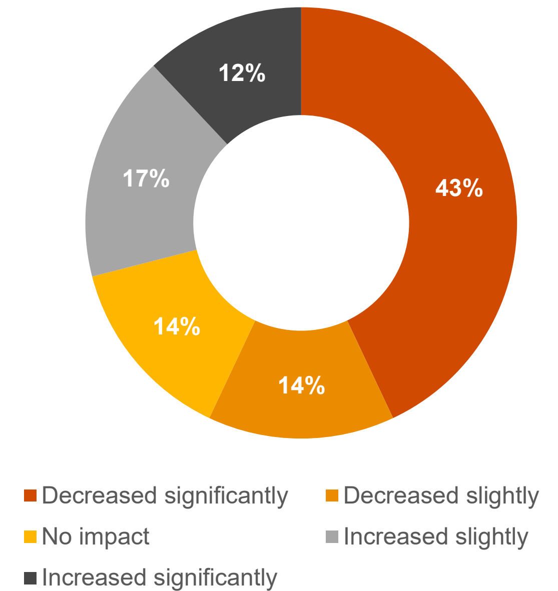
Majority reduced the number of deals due to COVID-19

The impact of the pandemic on industries varied dramatically but no sector was left unscathed, however, private equity made an exception. Volume and value defied the crisis, surging on the strength of a bumper buyout (ThyssenKrupp's elevator business) and a mammoth exit (ARM Holdings). New deal volume, however, grew by 4%, a relatively moderate fall given the circumstances.

Anxiety surrounding the trajectory of the pandemic combined with huge amounts of earnings noise, as revenues collapsed or soared depending on the sector, made valuing assets challenging. Due diligence processes have also been harder to conclude remotely. As the partner of a Swiss PE firm says, “Assessing the potential growth prospects and performance have been tough. Due diligence teams found that they could not uncover complete records remotely. The pandemic had many negative implications.”

All of this has made closing deals difficult even for the most bullish funds. Consistent with this, we find that 57% of respondents say the number of new investments their firm undertook decreased in 2020 due to the global pandemic, including 43% who say this number decreased significantly. This leaves 29% who increased their number of newly minted deals and 14% who saw no impact whatsoever.

Fig 20 | How has the global pandemic of COVID-19 in 2020 impacted the number of new investments of your organisation?

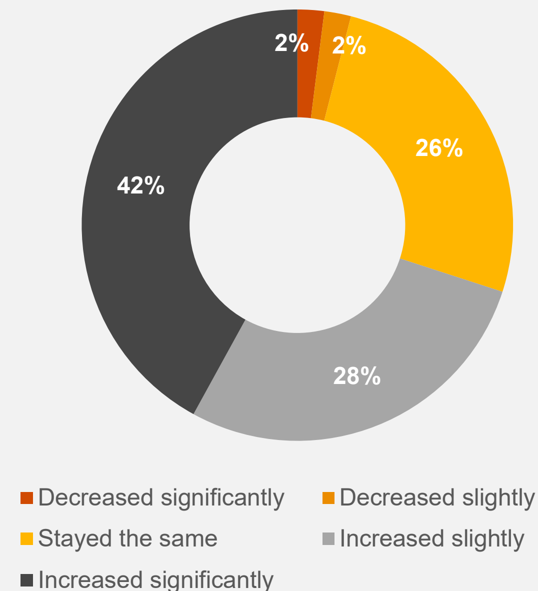


Chapter 1:
2020 in review

Increase in number of potential transactions that were reviewed

Of course, reviewing deals and closing on them are two very different things. GPs did not miss a beat in 2020, scouring for whatever opportunities they could find. Our research shows that 70% of respondents say the number of potential transactions they reviewed in 2020 increased compared with the year prior, including 42% who say the number increased significantly. With the volatility in earnings that businesses have been experiencing, the real challenge is determining a fair price of assets that is satisfactory for both buyer and seller. Vendors may choose to hang on to underperforming businesses that they believe will recover. At the same time, many companies in sectors such as technology, software, e-commerce and logistics have boomed through the pandemic. But how sustainable are those earnings in the long run and how willing will buyers be to pay multiples on those inflated earnings? That is today's primary PE market challenge.

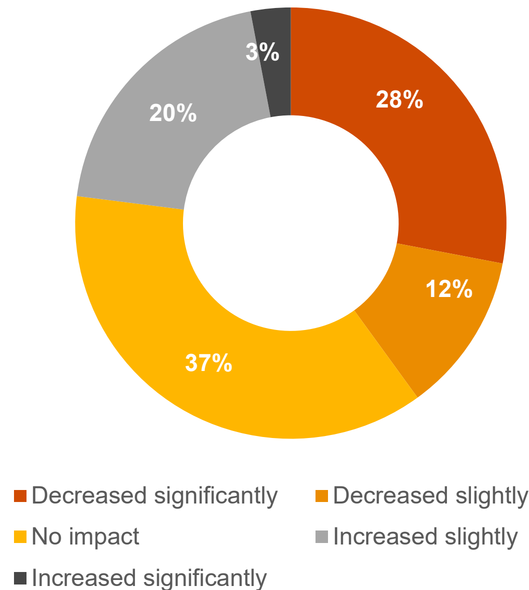
Fig 21 | Firstly, compared to 2019, has de number of potential transactions which you have reviewed in an average month this year…?



The number of exits takes a tumble

Exit volume was down by 17% last year for the same reason that new deals were: earnings volatility and the difficulty in reaching the fair value of assets. In keeping with this, 40% of respondents say the number of exits from their portfolio companies decreased in the past year due to the COVID-19 pandemic. Perhaps surprisingly, as much as 37% of our survey sample say they have seen no impact whatsoever and 20% say the number has increased slightly. Certainly any PE fund with a portfolio well stocked with digitally enabled companies whose business models were positioned well to succeed amid the health crisis were in a strong position to sell these off and return capital to their investors should they have wished.

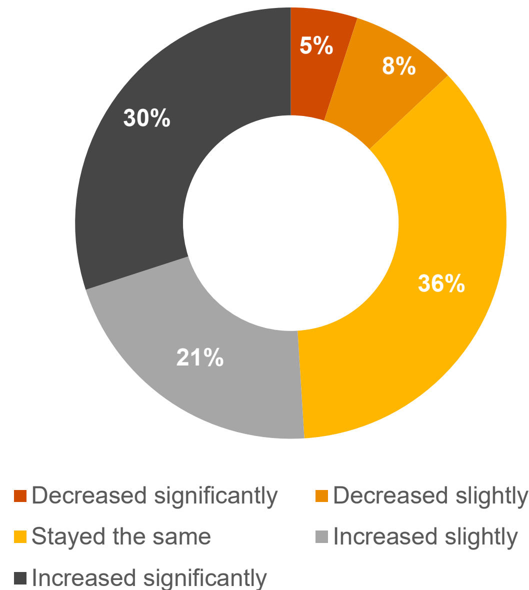
Fig 22 | How has the global pandemic of COVID-19 in 2020 impacted the number of exits of your portfolio companies?



Competition increased say small majority

Over half (51%) of respondents say that competition among PE firms increased in 2020 compared with 2019. This may run counter to expectations, however there was a flight to quality last year. This was most obvious in the skyward march of tech and tech-enabled assets in public markets, the NASDAQ Composite Index achieving an eye-watering annual return of 44%. Sectors such as software, pharma, telecoms, content streaming and food retail and delivery had an exceptional year. PE funds sought out companies with business models such as these that flourished amid COVID conditions, driving up competition.

Fig 23 | Compared to 2019, would you say that competition for investments among private equity firms has…?

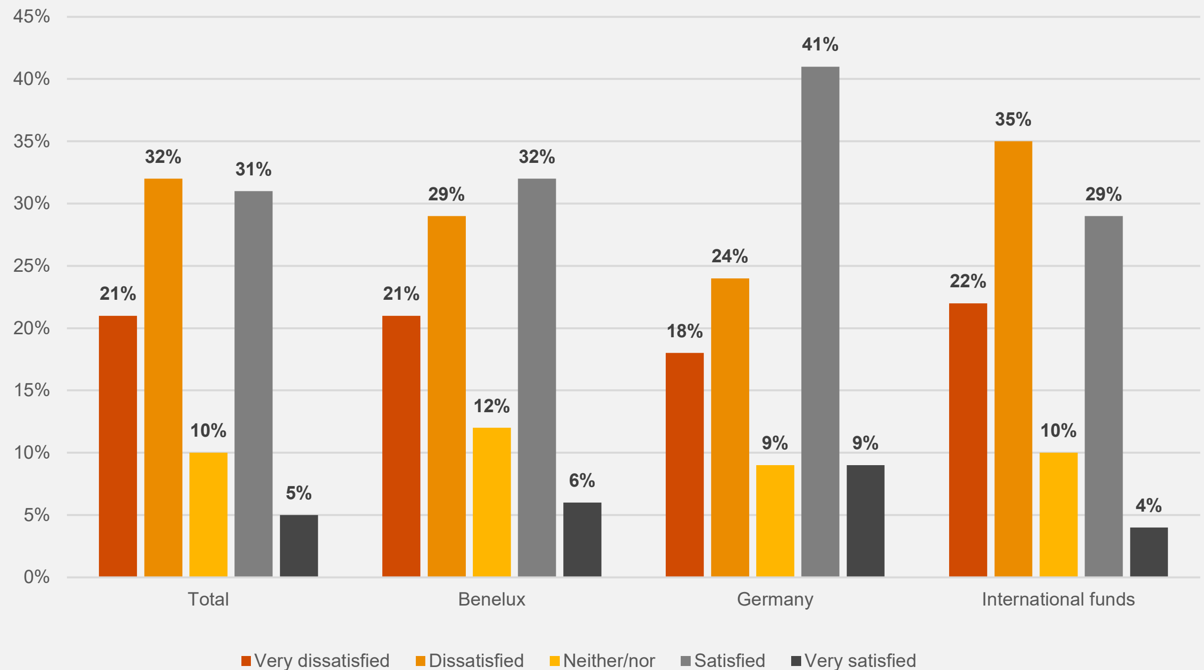


Majority are unhappy with the development of their portfolios

Over half (54%) of respondents are dissatisfied with the development of their portfolios in 2020, although German PE fund managers are notably more sanguine than their Beneluxian and international peers. Of these GPs, 50% are satisfied while 42% are unhappy with their portfolio company performance, making the German cohort net optimists.

A strong manufacturing and export base combined with decisive fiscal action stood Germany in good stead during the first year of the pandemic. According to official figures, GDP is forecast to have contracted by just 5% in 2020, one of the smallest declines across Europe as the world fell into the deepest recession in close to a century.

Fig 24 | How satisfied or dissatisfied are you with the development of your portfolio companies in 2020? Would you say you are…?

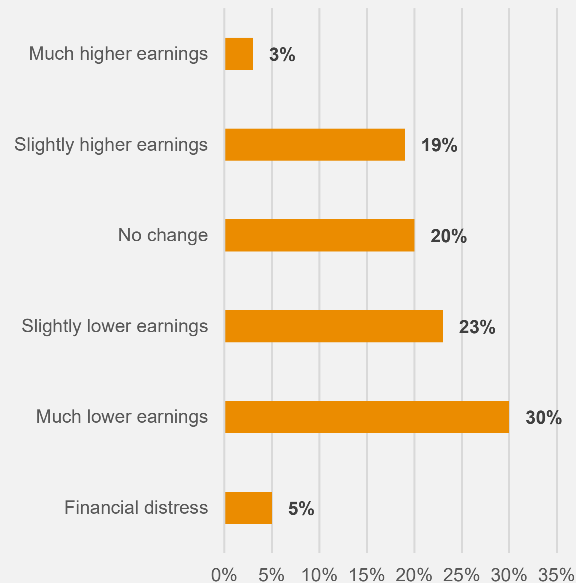


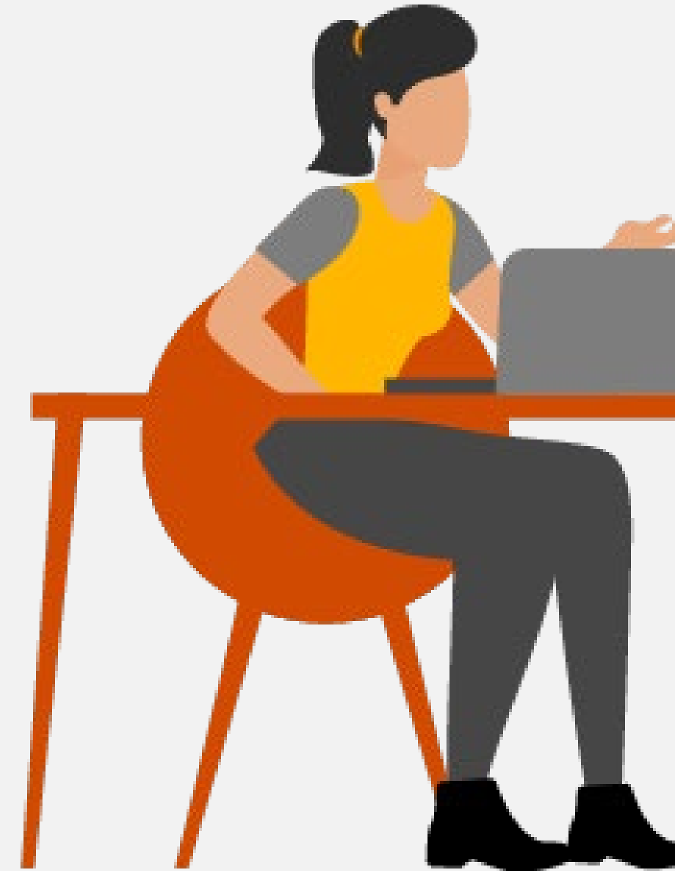
Lower earnings hit the industry

There have been winners and losers over the past 12 months, company performance bifurcating strongly along sectoral lines. This can be observed in the divergent recent performance of Germany and the UK. The former, with its strong manufacturing base, saw GDP decline by a relatively benign 5% in 2020. In the UK, which has more of a service-based economy, GDP contracted by 10%, the biggest fall of any G7 country, as face-to-face interaction was curbed by distancing measures.

For European PE managers, the net impact of the pandemic on their portfolios in 2020 was negative. 58% say their portfolio companies had lower earnings or experienced financial distress in 2020 due to COVID-19, with only 22% benefitting from higher portfolio earnings. Undoubtedly, lessons have been learned and these will inform where funds choose to invest their capital going forward, with a preference for COVID-resilient businesses.

Fig 25 | In 2020 how were your portfolio companies' earnings affected by the COVID-19?





A higher proportion of PE companies broke bank covenants in the past year

This earnings underperformance is a clear threat to private equity's investment model. As profits fall at the portfolio company level, leverage ratios rise and if net debt/EBITDA levels tick up high enough then loan covenants are breached. This issue appears to have become endemic in European PE, with no respondents in this year's survey saying none of their portfolio companies broke one or more bank covenants. Further, 84% respondents have seen 10% or more of their portfolio companies break one or more bank covenants in this year's survey, compared with 71% a year prior.

There is limited difference between regions on this point. 82% of German respondents say more than 10% of their portfolio companies broke one or more bank covenants, while 88% of Benelux-based respondents and 84% of international funds say the same.

Fig 26 | Percentage of companies that broke one or more bank covenant, or otherwise needed to enter negotiations with their financing providers during the previous year.

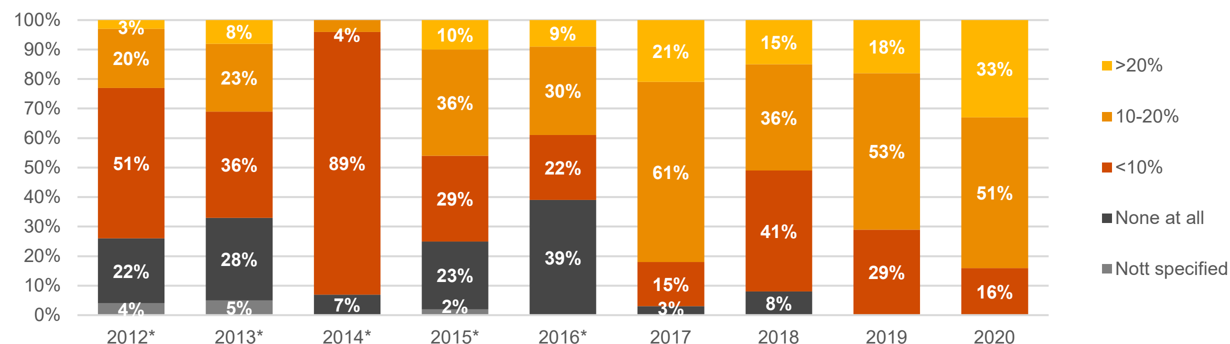
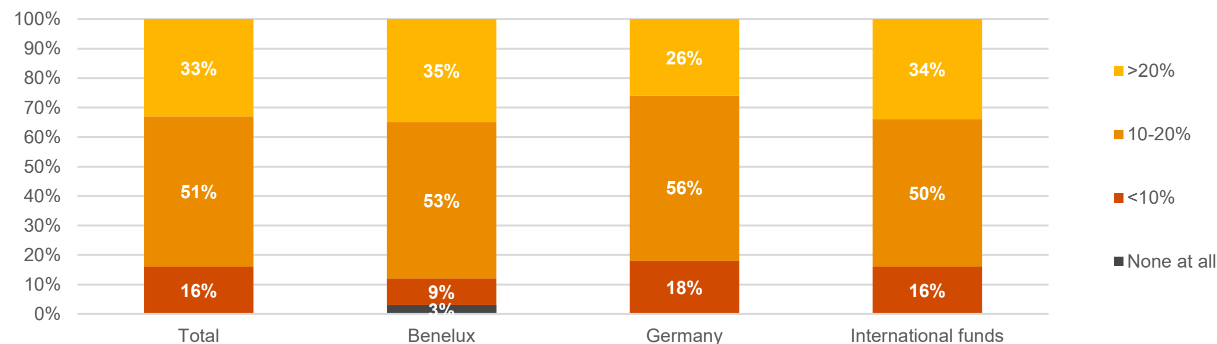


Fig 27 | Percentage of companies that broke one or more bank covenant, or otherwise needed to enter negotiations with their financing providers during the previous year.



Supply chains face mass disruptions

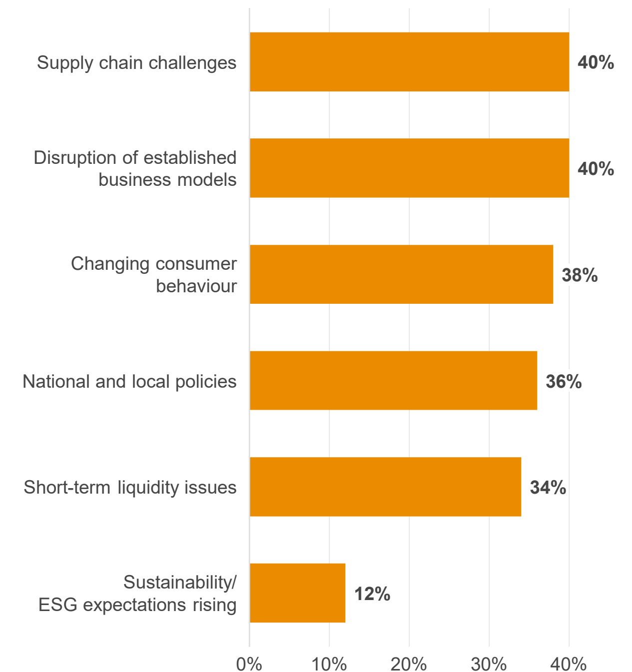
PE investors were forced to learn some difficult lessons in 2020, pivoting into triage mode and attending to the needs of their portfolio companies. Almost overnight the pandemic disrupted supply chains the world over and completely shifted consumption and demand trends.

For 40% of respondents, both supply chain challenges and the disruption of established business models are the top two effects of the pandemic on respondents' firms and portfolios. A consistent theme among respondents is the role that digitisation can play in solving logistical issues and adapting business models to suit the realities of the pandemic business environment.

The investment director of a UK firm says: "Managing the supply chain and coordinating with multiple teams in different locations is not an easy task. It requires optimum management skills and reliable communication tools. This is where digital transformation can really help."

Another significant impact of the pandemic for PE investors, cited by 38% of respondents, is the rapid changes it has made to consumer behaviour. Distancing measures have pushed economic activity online and companies have been forced to adapt. "Changing consumer behaviour will have an effect on all of our investment decisions," says the partner of a German PE firm. "As far as portfolio companies are concerned, we have to review customer behaviour and make the necessary operational or digital changes."

Fig 28 | Looking back at 2020 and the effects of the global COVID-10 pandemic, which of the following have had the strongest impact on your firm as well as your portfolio



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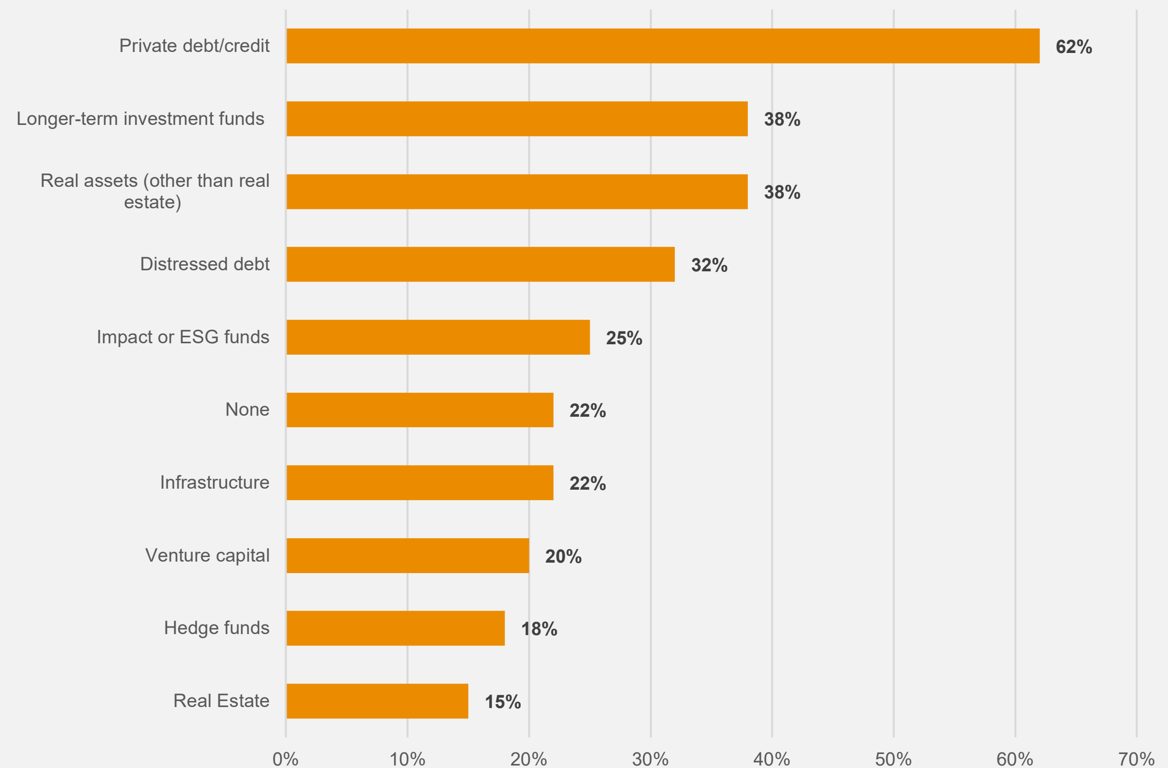
Private debt is the alternative of choice

In recent years, private equity managers have been expanding their arsenals to meet investor demand. Our research has shown that the first port of call after buyouts is building out a private credit investment team. In Europe, the private debt industry gained ground in the wake of the global financial crisis amid tighter banking regulations. Ultra-low interest rates also ensured investor demand for the high yields that alternative debt funds can offer.

Now, with the pandemic forcing government stimulus and monetary easing, the search for yield persists and this continues to make debt a highly attractive strategy for GPs to add to their capabilities. Competition in this space is hotting up. Our survey shows that 62% of firms have either already expanded into private credit or plan to do so, up from 58% a year prior.

Another increasingly popular strategy is for GPs to launch longer-term investment funds unbound by the typical five-year investment, five-year harvesting cycle of many standard limited partnership structures. By extending the life of a fund, managers are able to hold on to well-performing assets for a longer duration and build more value by scaling the company up, compounding their cash multiple. Well over a third (38%) of respondents have expanded into longer-term funds or have their sights sets on the strategy.

Fig 29 | Has your firm expanded into or is it considering expanding investment any of the new asset classes?

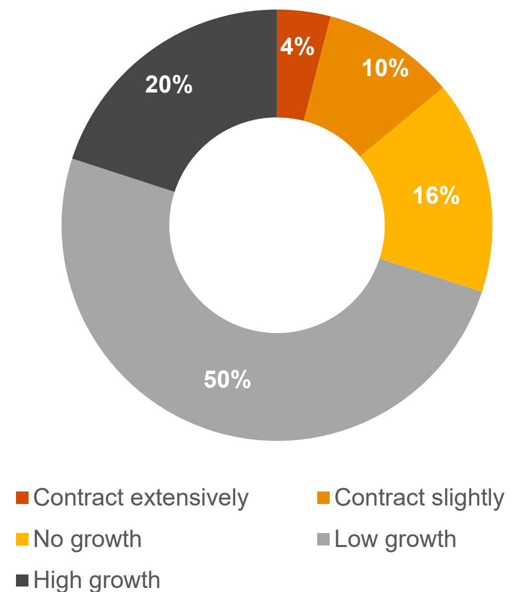


Global economic growth expected

Following the biggest peacetime contraction since the Great Depression, the world economy is on course for a significant rebound in 2021. In its most recent outlook, the International Monetary Fund (IMF) forecast an expansion of 5.5% on the strength of a vaccine rollout that is expected to gain traction in the latter half of the year. Europe, which has been beset by low growth for a number of years already, is expected to lag this by approximately one percentage point.

Exactly half of respondents expect low growth in the year ahead, with 20% anticipating high growth. Compared with last year, fewer PE firms expect an economic contraction on the horizon. Only 14% are pessimistic and see negative growth ahead versus 21% who shared this view in 2019, following a decade-plus bull run and just before the reality of the pandemic had pulled into focus. These findings indicate that PE sees the worst of the economic impacts of the pandemic as being behind us, although it's worth noting that the IMF has said that “exceptional uncertainty” hangs over the growth outlook.

Fig 30 | How do you expect the world economic situation to develop in 2021?



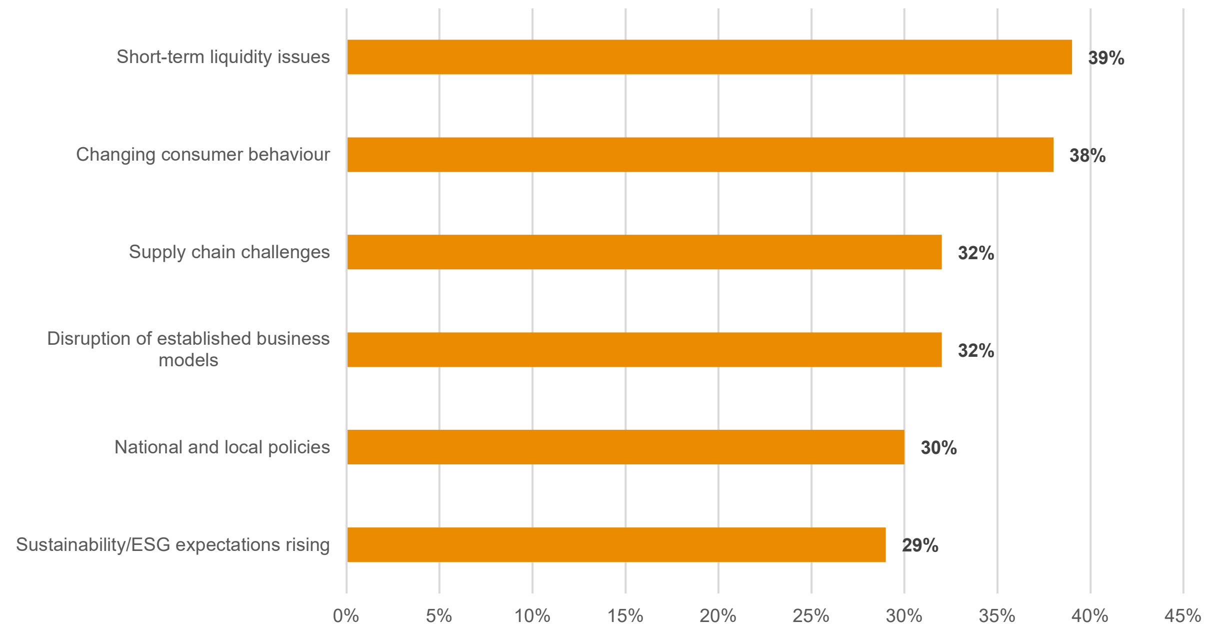
Chapter 2:
The year ahead

Pandemic impacts: short-term liquidity issues and changing consumer behaviour

“Cash is king” and that much is true for PE funds investing in Europe. When considering the biggest impacts of the pandemic on both their portfolios and their own firms in 2021, 39% of respondents pointed to short-term liquidity issues. What has been made clear in recent months is that strong balance sheets and access to finance have been paramount for companies whose business models have suffered the most in 2020. And even profitable companies can become insolvent if they run into cash flow problems.

Other major pandemic impacts in 2021 include changing consumer behaviour (38%), supply change challenges (32%) and disruption of business models (32%). In many ways, the disruption to consumption and the need for companies to adapt had long been in play, however the urgency of this change was magnified by the pandemic. Demand among PE firms for assets that have well-adapted business models that cater to new and emerging consumption trends will be elevated for the foreseeable future. At the same time, there is a real opportunity for private equity to identify assets in need of stewardship to address business models that may need updating or revising entirely to ensure they have a place in a post-COVID world.

Fig 31 | Looking forward to 2021 and the effects of the global COVID-19 pandemic, which of the following do you expect will have the strongest impact on your firm as well as your portfolio.



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Majority optimistic about the PE market

Everything is pointing towards a robust year for European PE and optimism is running high. A year ago, only 38% expected market conditions to improve slightly and that has now risen to 47%, with a further 11% anticipating a significant improvement. That means 58% of respondents view the outlook for the European PE market as bright. Once again, there is a greater optimism among German investors, with as many as 80% of respondents based in the country sanguine about PE market prospects in the year ahead.

Even if market issues persist, many funds are eager to deploy capital. The CEO of a German PE fund says: “Compared to 2020, there will be a significant increase in activity for us. We cannot delay our investment plans forever. Even if the markets are unstable, we have to weigh up alternative strategies and implement them.

Moreover, 75% expect to make more investments in 2021 than they did in 2020 and 68% believe they will increase the number of exits over the next 12 months as conditions improve. With vaccine uptake potentially reaching critical mass towards the end of the year, which would limit the need for further lockdown measures and build demand in the economy, earnings are likely to stabilise for many businesses. As economies open back up and restrictions on movement are lifted, this would also make deeper due diligence processes more achievable and fair valuations easier to establish, opening up a buying opportunity for PE funds equipped with ample reserves of dry powder. The stabilisation of earnings and the narrowing of the bid/ask spread will also support portfolio company realisations.

Fig 32 | How do you expect the European deal market for private equity to develop in 2021? Do you think it will…?

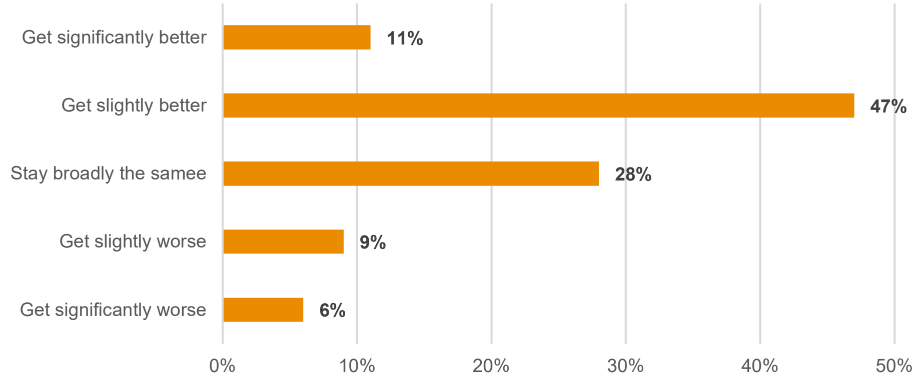


Fig 33 | Compared to 2020, do you expect the number of new investments made by your organisation in 2021 to…?

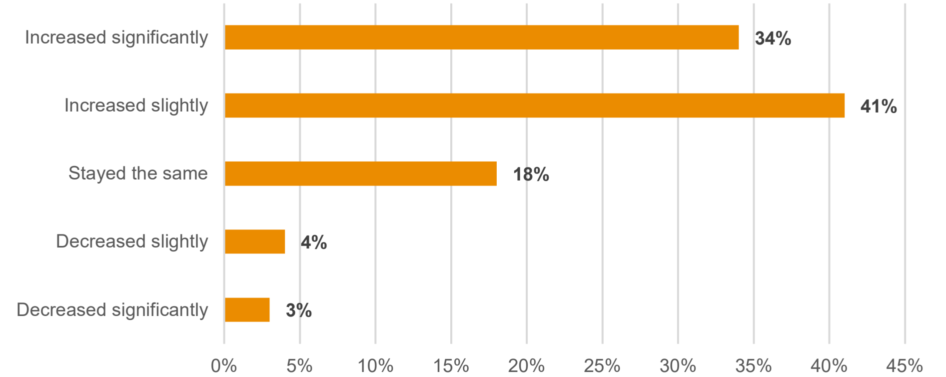


Fig 34 | How do you expect the European deal market for private equity to develop in 2021? Do you think it will…?

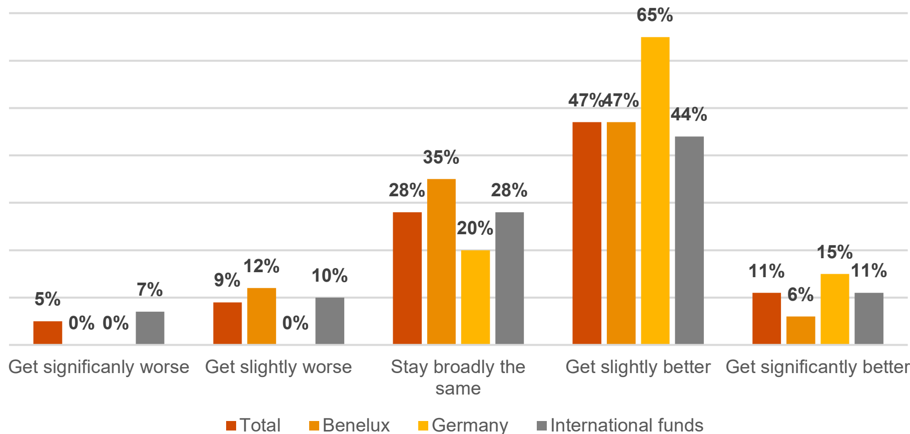
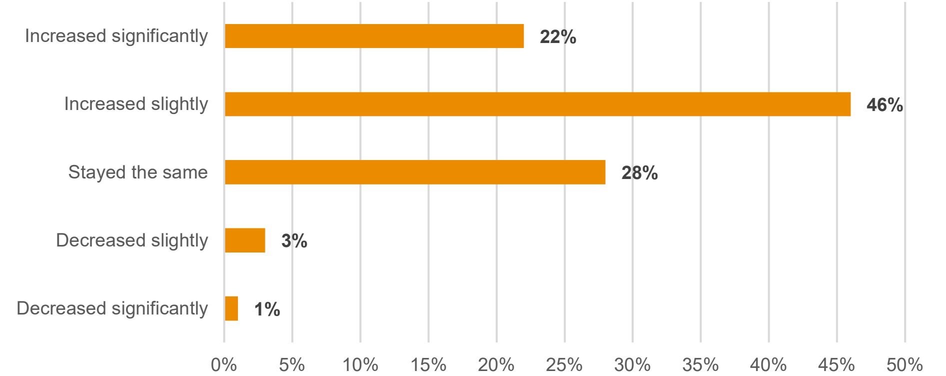


Fig 35 | Compared to 2020, do you expect the number of exits made by your organisation in 2021 to…?



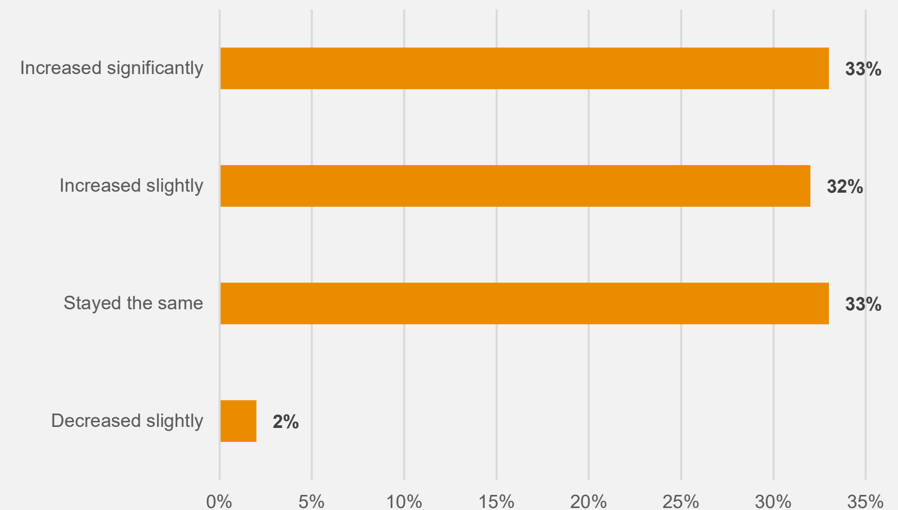
Increased competition for investments expected

The broad consensus in our research is that PE funds will have to fight harder to secure deals in 2021. 65% of respondents say they expect competition for investments among PE firms to increase, including 33% who say they expect it to increase significantly. As little as 2% expect competition to fall.

Europe had a standout year for PE fundraising in 2020 even as global fundraising was down. A total of 248 funds reached a final close in the year amassing US$165.8bn – up from the US$102.6bn raised from 280 funds in 2019, as fewer but larger funds were raised. This also says nothing of the dry powder sitting in funds from previous years. All told, there is now close to an estimated US$2trn of committed but undrawn capital at the disposal of the industry worldwide, much of which will reach Europe. This war chest is inevitably driving competitive tension, as it has done for a number of years already. Now, with the added disruptive effects of the pandemic on business models, funds will gravitate towards companies and sectors that have demonstrated operational resilience and growth through the toughest of periods.

“Business services and e-commerce have been really strong performing sectors,” says the managing director of a Portuguese PE fund. “Their productivity and returns are increasing rapidly. M&A activity in these sectors is also on the rise, along with competition levels.”

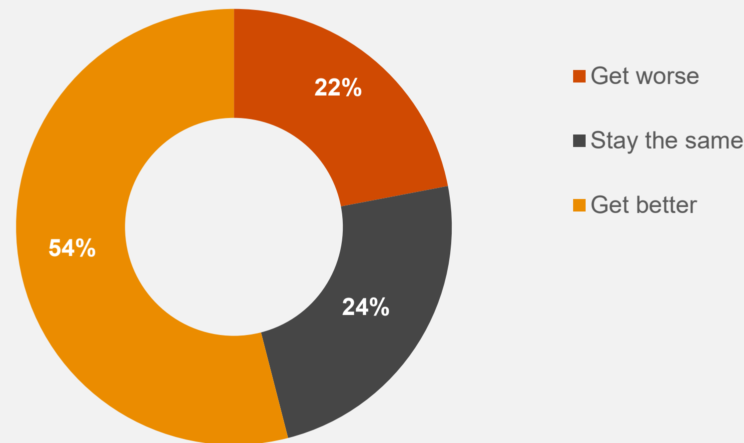
Fig 36 | Compared to 2020, do you expect competition for investments among private equity firms in 2021 to…?



Small majority expect the availability of credit for leveraged buyouts to improve

54% of respondents in this year's survey say they expect the availability of credit for leveraged buyouts to improve in 2021 compared with the previous year. The search for yield as interest rates were once again cut to buoy economies will underpin demand for leveraged loan and high-yield bond issuance. However, it should be expected that lenders will be more discerning than they were prior to the pandemic. There will be no shortage of appetite for high-quality credits in sectors that have performed well through the pandemic, such as technology and healthcare. These will benefit from borrower-friendly terms. COVID-exposed sectors, however, will have to pay for access to financing in the form of stricter covenants and higher coupon rates as lenders are more cautious in pricing risk. For instance, travel and aviation assets will not find the terms they were able to borrow on in 2019.

Fig 37 | Looking ahead to 2021, compared to 2020 do you expect the availability of credit for leveraged buyouts to…?

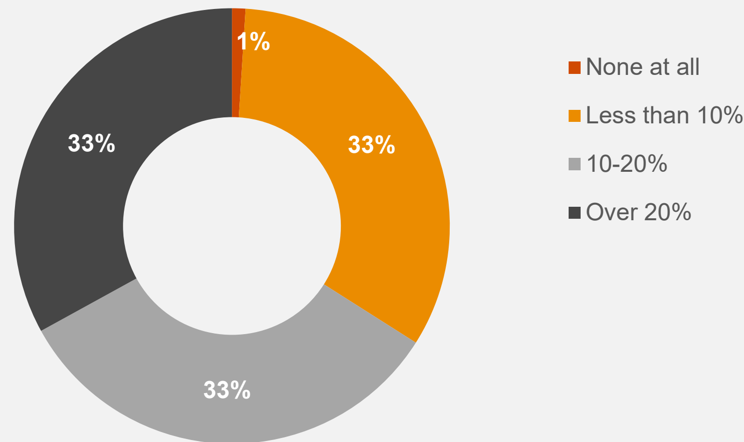


A third expect over 20% of portfolio companies to break covenants

Earlier in this report we showed that loan covenant breaches have risen in the past year for European PE investors, unsurprising given the tumultuous trading conditions portfolio companies faced through 2020.

There are expectations of further leverage issues ahead, with only 1% of respondents anticipating zero loan breaches in 2021. A third of respondents say they expect over 20% of their portfolio companies to break one or more covenants and another third say 10-20% of their portfolio companies will trip covenants. Naturally, these breaches will be concentrated in companies and sectors that have been hardest hit by the crisis and potentially in businesses that may have otherwise performed relatively well but were simply over-levered going into the pandemic. GPs should have spent 2020 in dialogue with creditors to renegotiate loan terms where possible or restructure the debt in their portfolios where necessary.

Fig 38 | Looking ahead to 2021, what percentage of your portfolio companies do you expect will break one or more bank covenants, or otherwise need to enter negotiations with their financing providers? Would you say…?



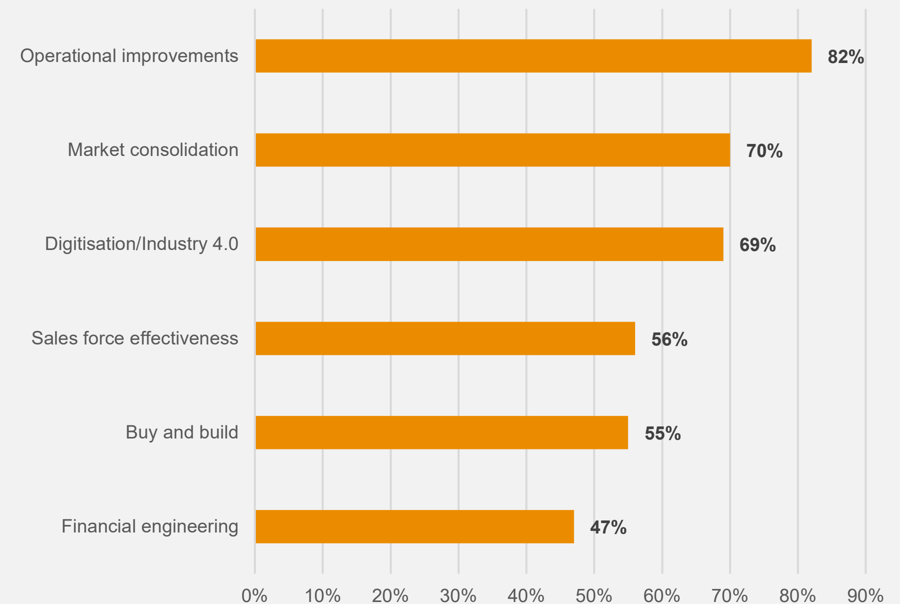
Operational improvements set to be key

Operational improvements became PE's calling card in the wake of the global financial crisis as fund investors viewed financial leverage with scepticism and paid closer scrutiny to how GPs actually create value in their investments. Now, with the challenges posed by the pandemic environment, this is a fundamental strategic theme for PE.

This will go beyond simply streamlining and optimising operations, to helping them understand their modus operandi and how they need to pivot to grow through what remains an uncertain environment that favours digitalised businesses and business models.

In our research, 82% say operational improvements will influence equity stories on acquisitions for their organisations, while 69% point to digitisation. Market consolidation, meanwhile, will be among the biggest factors influencing equity stories and there should be plenty of opportunities here as corporates review what is core to their operations and spin-off assets.

Fig 39 | Looking forward to 2021, which of these factors do you consider will influence equity stories on acquisitions for your organisation?



Digitisation/Industry 4.0 are key to equity stories

When asked to choose a single factor that will be most influential to equity stories in 2021, digitisation came out on top with 31% of the vote, ahead of operational improvements, cited by 25%. The digital imperative has been brought into sharp focus, with companies that were slow to embrace digitisation in recent years being the net losers amid mandated shutdowns. Digital laggards with poor access and reach to customers and clients have disproportionately suffered. PE long ago added digitisation to its value-creation toolkit and funds have an opportunity to yield positive results by helping companies to accelerate this process and beat out their competition, potentially taking market share in the process.

The benefits of digitisation range from improving efficiencies and output to revealing greater insights into the inner workings of a business with the application of data analytics.

The managing partner of an Irish PE firm explains that digital investment can also help to meet the rising expectations of customers for faster and more personalised services: “Artificial intelligence and machine learning increase the capabilities of managing customer service requests, which means their increasing expectations can be easily met post-digital transformation.”

When it comes to the greatest influence on return on investment, however, it is not digitisation but operational improvements and multiple arbitrage that come out on top, cited by 38% and 36% of respondents respectively. This may reflect the cost of digitisation capital expenditure programmes and the time it takes to work through the J-curve of these outlays. By comparison, operational improvements may come from simply cutting costs and divesting assets, delivering immediate value gains. Multiple arbitrage, meanwhile, is market-driven and costs nothing.

Fig 40 | Looking forward to 2021, which of these factors do you consider will be the most important influence on equity stories on acquisitions for your organisation?

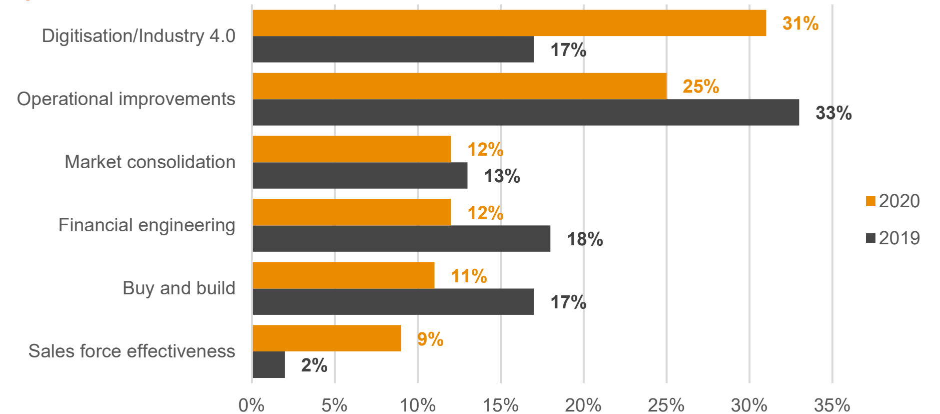
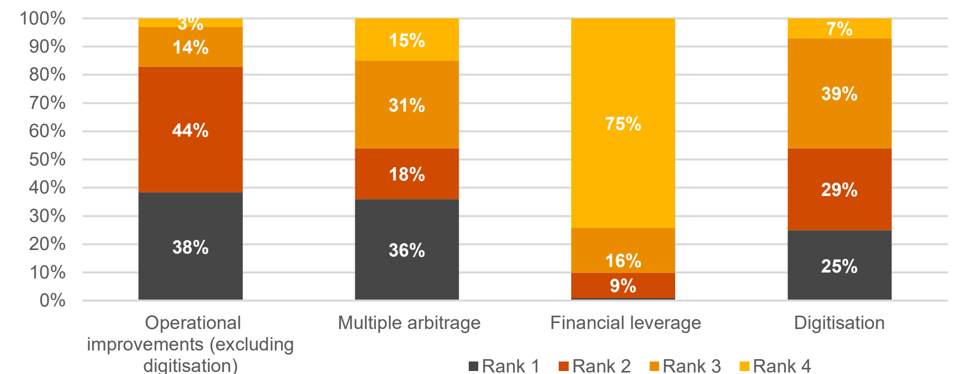


Fig 41 | Please rank the following in terms of importance, regarding their influence on your return on investment.



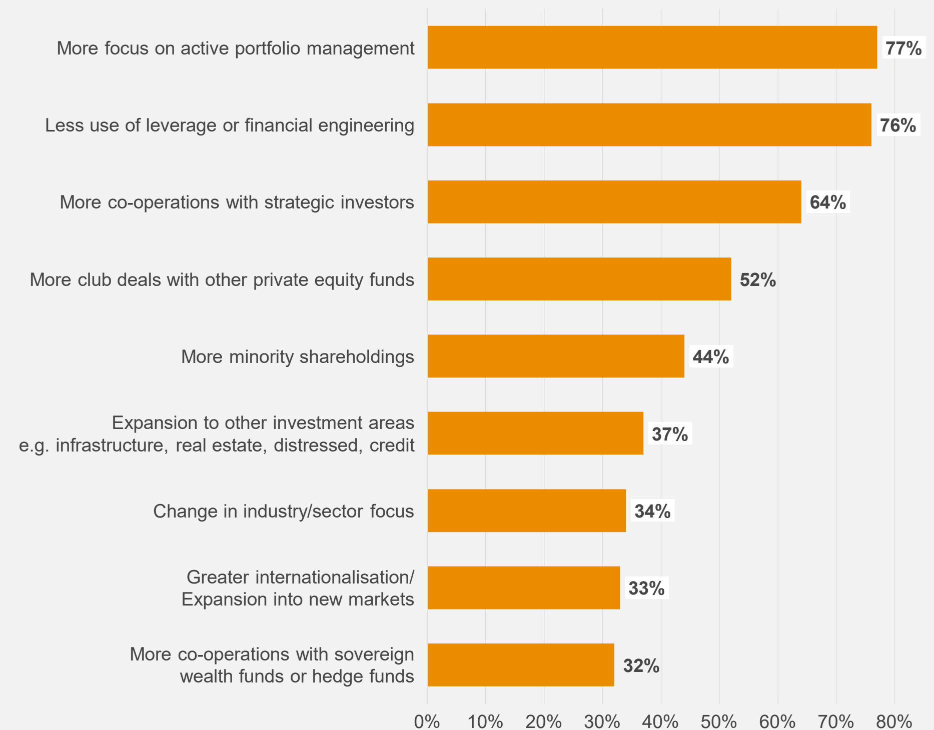
Increasing active portfolio management

An overwhelming majority of respondents (77%) say they have been focusing more on active portfolio management over the past three years. Looking ahead, this hands-on approach is likely to remain a point of strategic focus for funds as portfolio companies look to their PE owners for support and guidance. In any PE deal, members of the fund will sit on the board to offer strategic advice in quarterly meetings and will review financials on a monthly or even weekly basis. In the early days of the investment, they will help senior management to devise a 100-day plan and using their proprietary networks can source professionals that will help the business to grow or navigate bumpy terrain.

Another leading change that GPs have made in the past three years is to reduce their dependence on financial leverage, cited by 76% of respondents, which again speaks to the greater scrutiny paid by institutional investors in recent years to how GPs deliver return on investment. Financial engineering is not a differentiator – funds have to do more than simply load debt onto companies with strong cash flows and sit back and reap the rewards. LPs need to see more value-add.

Meanwhile, nearly two-thirds (64%) of respondents say that among the biggest changes to their approach over the past three years has been to make more use of co-operation with strategic investors. Both LP co-investments and corporate partners have become important sources of capital for PE funds in recent times. This was evident in the second-biggest buyout of 2020 when KKR teamed up with Fastweb to acquire Fibercop, a joint venture (JV) that holds Telecom Italia's digital fibre optic network assets, the Italian telco incumbent being a shareholder in the newly formed JV.

Fig 42 | Which of the following changes, if any, have occurred to your organisation’s business model over the last three years?



LPs and expectations

Perhaps unsurprisingly, 86% of respondents say the expectations of LPs have increased over the past three years. Among the top three changes to expectations of fund investors is the increased frequency of individual co-investment, cited by 71% as a top-three change, while increased disclosure requirements are cited by 66%. Not far behind with 64% of the vote is pressure on management fee levels.

These last two are closely related. Co-investing is not only a way for LPs to increase their exposure to selected deals that they believe hold the most promise – co-investments typically involve lower and in some cases zero management fees. Investors have spent recent years consolidating their GP relationships and bringing direct and co-investment experience in-house in order to average down fee costs and therefore improve returns.

On the disclosure front, LPs have become more demanding than ever. As mentioned, investors want to see exactly how GPs are creating value in their deals so they can benchmark managers to determine which follow-up funds to commit to. Another area that is subject to greater disclosure demands is subscription lines of credit, whereby GPs put in place loans at the fund level to make acquisitions and then call down equity from investors to pay down the debt at a later date.

The benefit of this is that it helps to boost internal rates of return (IRRs) by compressing the time which LP capital is actually put to work, a major bonus for LPs. However, there is some concern that this can create returns distortion and LPs want to understand their fund-level leverage exposure. In 2017, the Institutional Limited Partners Association (ILPA) began to promote transparency on SLCs by publishing guidelines for what GPs should be expected to report to their LPs on their use of fund-level debt.

Fig 43 | Have expectations and requirements of your Limited Partners (LPs) changed during the prior three years?

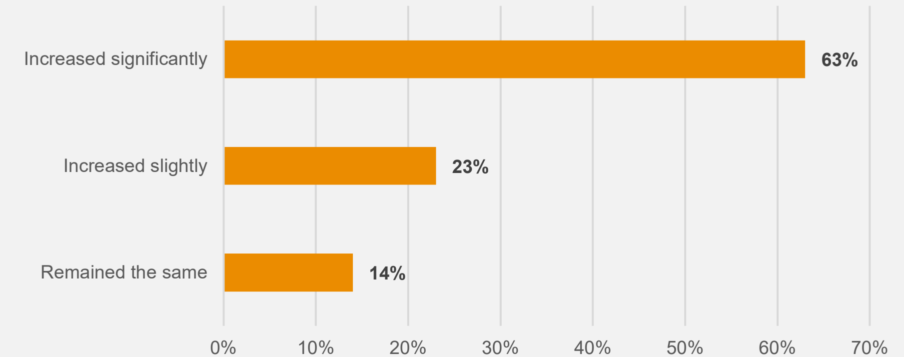
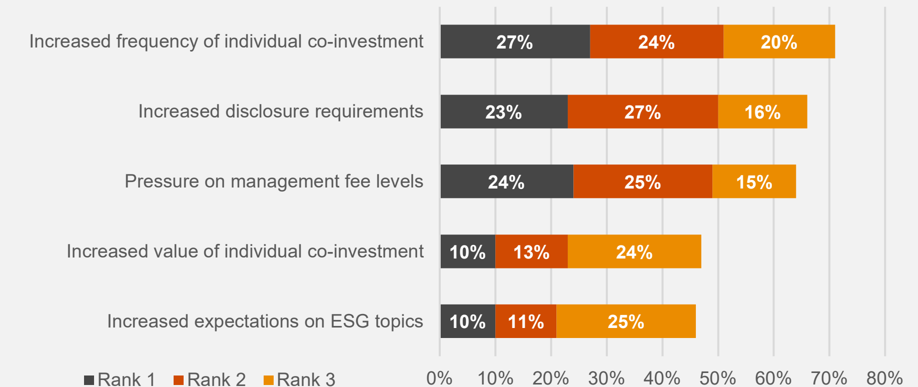


Fig 44 | Which of the following best describe the changes in expectations and requirements from your Limited Partners…?



PE in Europe in the long term

Private equity has understandably been forced to take a short-term view of the world in the past 12 months, concentrating on the performance – and in some cases the survival – of their existing portfolio companies. As well, the chance to seize upon a buying opportunity means that funds have been looking at what is directly in front of them.

With the likelihood of successful vaccines being rolled out en masse in 2021 and with a year of the pandemic now in the rear-view mirror, funds are able to consider what the proceeding years may hold in store and where their capital should be invested as the pandemic abates.

From a sector perspective, 34% of respondents believe e-commerce is set to emerge from the pandemic in the strongest position, followed by technology (21%), pharmaceuticals (21%) and life sciences (20%).

When asked about the top three sectors for investing in over the next two or three years, the top choice is business services – 40% point to this area. Industrial production/manufacturing is in second place (38%). Technology is the third most popular this year with 33% citing it.

“Given the current employment trends, staffing and training solutions providers will be more popular in the business services industry. There is more need for expertise and niche talent to fulfil organisations' main goals. The consumer industry will also emerge as one of the strongest because there has been consistent demand for essential products,” says the investment director of a UK PE firm.

Healthcare and pharma will be an obvious draw for investors given the critical role that these sectors have played in the health crisis. Renewed investment from governments and demand among the population for access to healthcare, including through emerging media such as tele-health, as well as drugs will ensure growth in these areas.

“The healthcare sector will emerge strongly, because it was actively involved in curbing the effects of the crisis. It is still very crucial and will remain so,” says the managing partner of a Swedish fund. “Other than that, business services are also strong. The industry has provided optimum services in the past and assisted in the growth objectives of organisations as well.”

When reflecting on the challenges that the European PE industry is likely to face over the next five years, 58% of respondents highlight the economic consequences of COVID-19 on portfolios and deal flow as among their top three issues. Undoubtedly, the pandemic will leave a lasting impression on investors and companies.

The global financial crisis cast a long shadow in terms of GPs’ attitudes towards excessive leverage and increased the regulatory burden for fund managers. The experience of that down-cycle brought home the need for PE investors to truly develop their assets and prepare them for long-term growth, not just lever up assets and wait. The 2008 crisis pales in comparison to the events of 2020 and many portfolio companies have been irrevocably impacted.

Meanwhile, 46% of respondents point to increasing regulation as a concern over the next five years and 45% point to a scarcity of investment opportunities. This latter point is, of course, relative. While there is not likely to be a shortage of private business in which to invest during this new economic cycle in absolute terms, there continues to be a superabundance of dry powder. Whether there are enough deal opportunities to absorb this record sum of capital is what will be on the minds of GPs.

Fig 45 | Which industries will emerge from the COVID-19 pandemic in the strongest position?

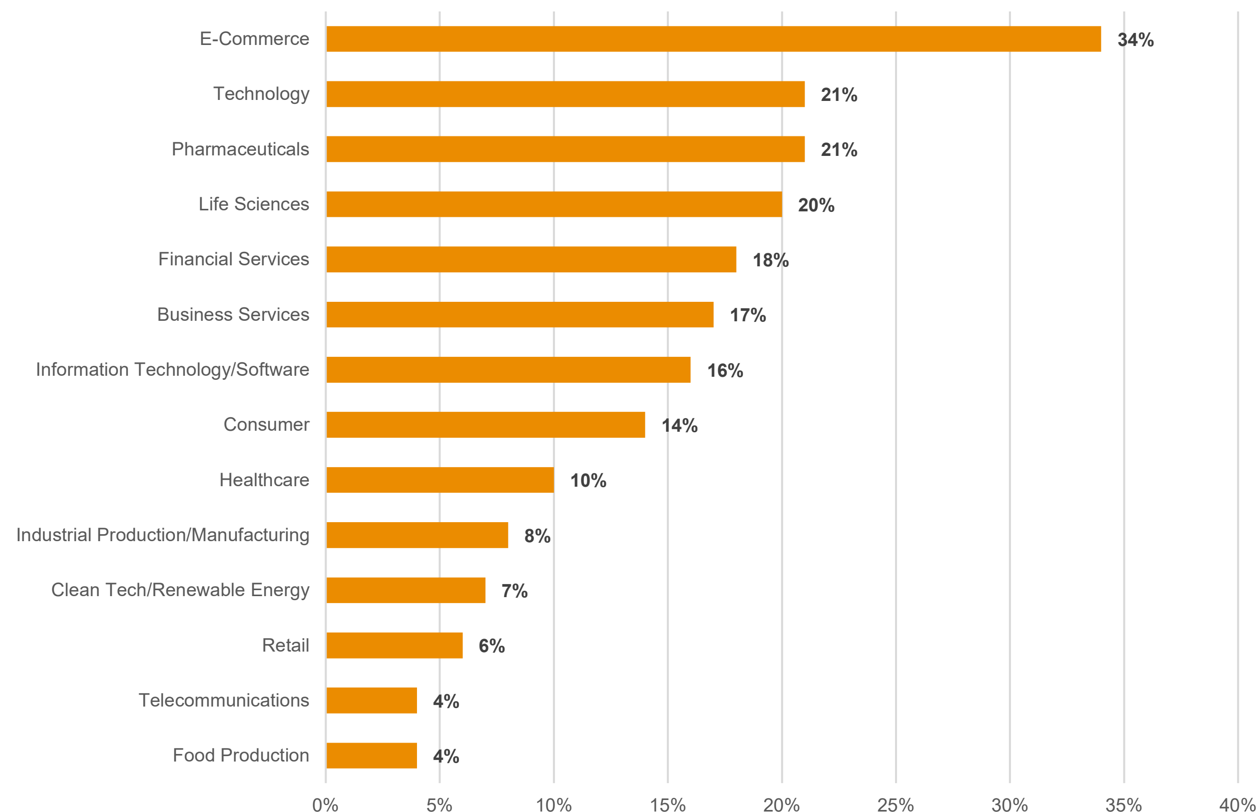


Fig 46 | In your opinion, which of the following industries is your organisation most likely to invest in over the next 2 to 3 years? Please name a maximum of 3 industries.

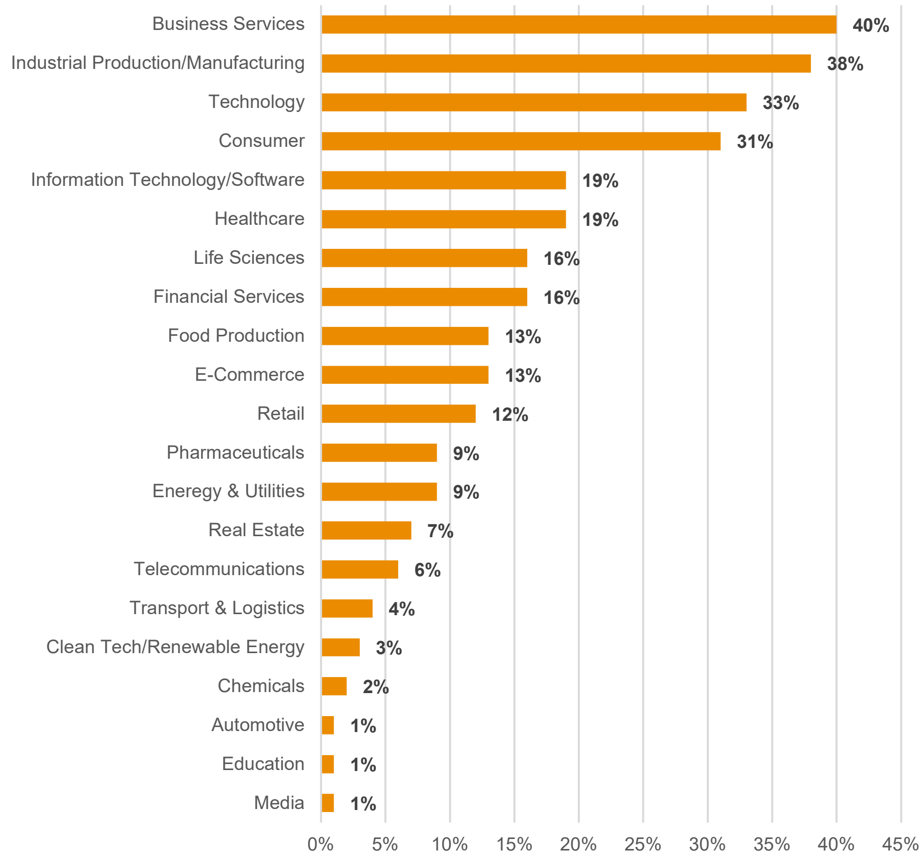
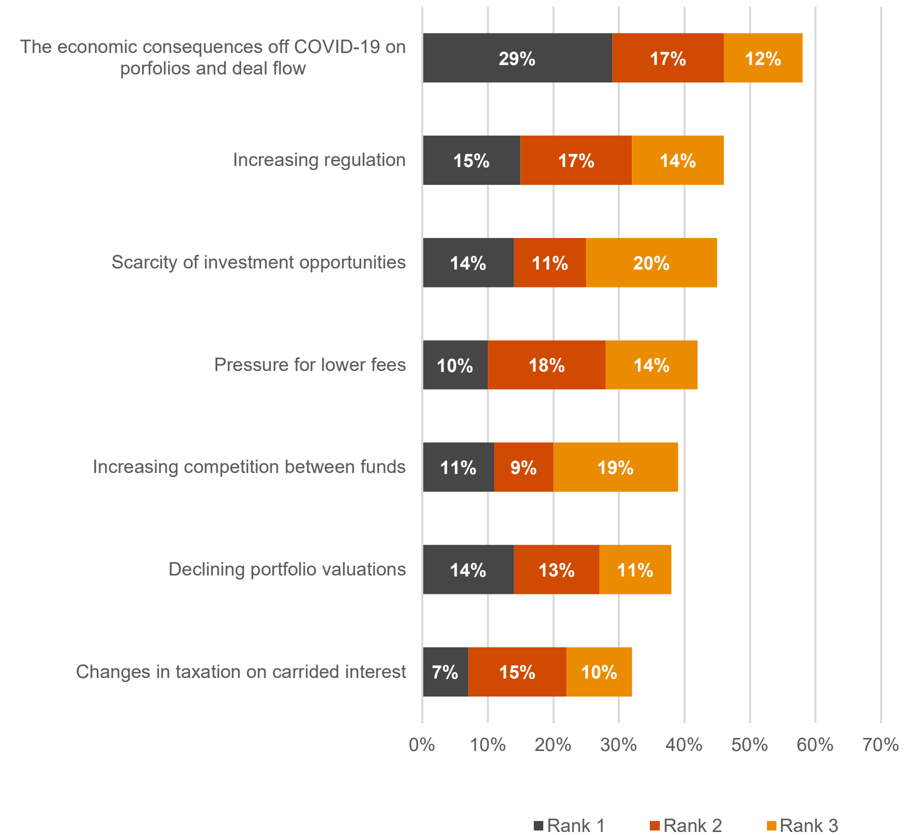


Fig 47 | Again looking ahead, what are the key issues which the private equity industry in Europe will face in the next 5 years?



Digitisation and working capital management

Chapter 3:
Value creation

Digitisation and working capital management/cash flow optimisation regarded as most important to value creation

Value creation comes in various guises and there are numerous levers that PE funds can pull, not only to improve EBITDA but also transform businesses such that they command a higher multiple on exit. Digitisation clearly plays a central role in this. As companies seek operational optimisation, improved reach of distribution and business models that cater to the digital consumer, private equity can demonstrate what has worked in previous investments and repeat these past successes with a winning formula.

In determining which levers will be most important to value creation, digitisation came out on top with a mean score of 8.72. With the pandemic having been especially punishing for businesses with analogue business models, GPs will be looking to develop their digital expertise and to apply this to their forthcoming investments in any way possible.

“In 2021, there will be more digitisation, a trend we have already seen in the past couple of years. There are significant development opportunities here across Europe,” says the investment director of a UK PE fund. “Private equity will prioritise niche markets because of the higher anticipated gains and apply digitisation value creation methods to these assets.”

More traditional approaches also remain popular. Not far behind is working capital management / cash flow optimisation with a mean score of 8.66. This value creation lever has stood PE in good stead for decades already. Indeed, included in any credible due diligence process and 100-day plan is an identification of how repeatable a company's cash flows are and ways to improve capital efficiency.

Ultimately, financial leverage is central to PE's business model and that is not going to change even if digitisation and other operational improvements have taken centre stage. Optimising cash flows improves a company's ability to pay down debt and so will forever be a core consideration in any PE buyout.

More generally, operational improvements excluding digitisation have increased over the past three years in respect of return on investment, with 56% of respondents agreeing on this point. Not only that, the importance to financial returns of upgrading operations is expected to increase looking forward, say 72% of respondents. This shift in focus has come at the expense of relying on financial leverage, which 56% say has had less impact on returns in the past three years, while as many as 60% of PE investors see the role that leverage will play on returns decreasing in future.

Digitisation and working capital management

Fig 48 | Which levers are most important to value creation within the equity/investment story?

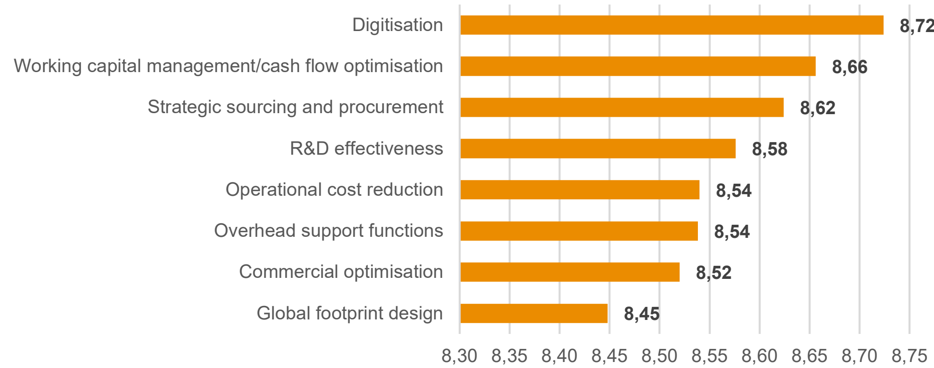


Fig 50 | Looking forward, do you expect the impact of operational improvements (excluding digitisation), multiple arbitrage, financial leverage and digitisation on your return on investment to increase, decrease or stay the same?

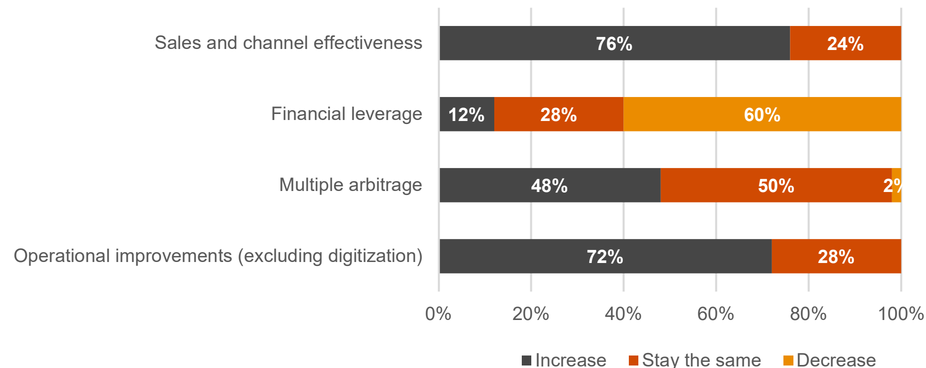
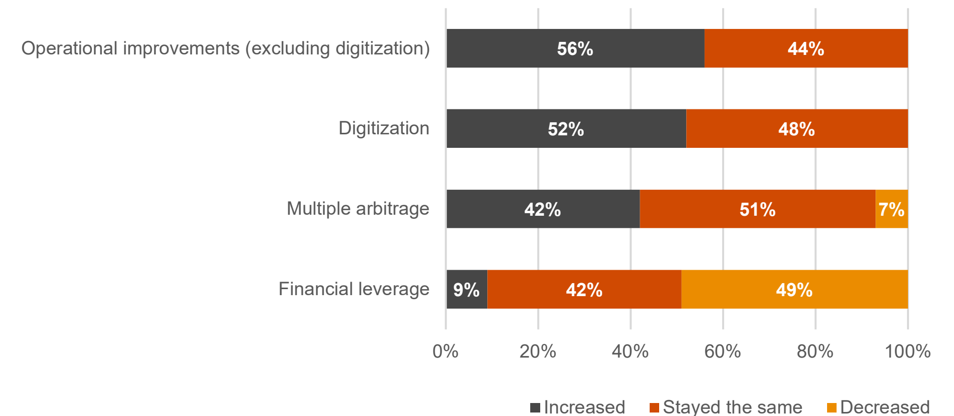


Fig 49 | During the past three years has the impact of operational improvements (excluding digitisation), multiple arbitrage, financial leverage and digitisation on your return on investment to increase, decrease or stay the same?



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Digitisation

Digital transformation is best applied to R&D and innovation

There is no part of a business that cannot benefit in some way from technology adoption and integration. For this reason, PE funds have to be selective in determining where their digitisation efforts and investment are best spent and where the biggest value gains can be achieved. While all corporate functions scored highly in our survey in terms of the extent to which they could be improved by digitisation, the R&D and innovation department is top with a mean score of 8.83. The second-highest scoring function is marketing, sales and customer service with 8.82.

Says the partner of a German PE firm: "We have seen that R&D and innovation has been the most positively impacted area of businesses by digitisation. The procedures for research, analysis and valuations were improved significantly by the investments and considerable cost savings were achieved in the long run."

The ultimate goal of these investments, of course, is to build better, more efficient, more durable and higher-growth companies. When it comes time to exit, PE owners can demonstrate the improvements that have been made, which can justify higher price multiples on exit, as well as make a stronger case for future growth under its new owners. Consistent with this, we find that 85% of respondents say they agree that the level of digital transformation is important to the future exits from their current portfolio companies and the subsequent return to be achieved.

Fig 51 | Which part of the company business model do you think would benefit the most from digital transformation?

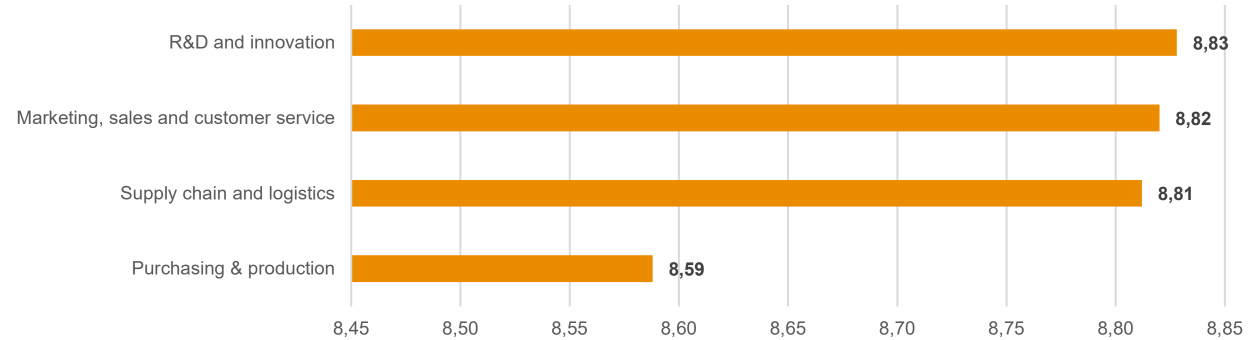
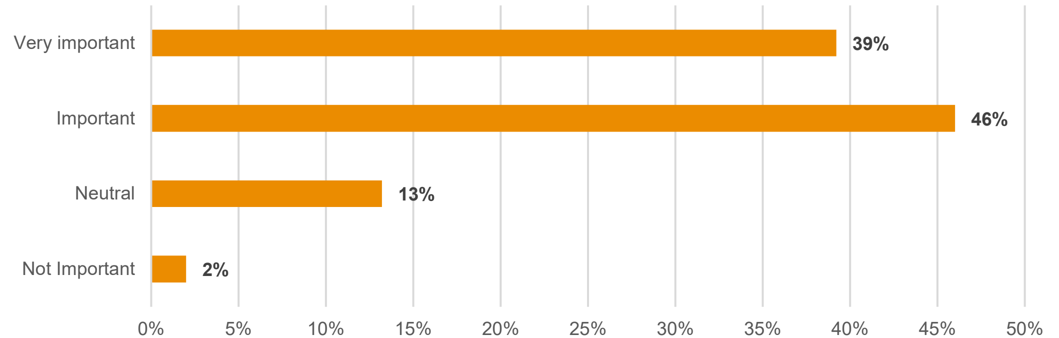


Fig 52 | To what extent do you believe that the level of digital transformation is important to the future exits from your current portfolio companies and the subsequent return to be achieved?



PE firms overwhelmingly invest in digital transformation

Digital laggards have found recent events especially challenging. Analogue business models that depend on physical, face-to-face interaction have been hamstrung by government-mandated lockdown measures. Companies with strong information governance and enterprise resource planning systems in place have been able to look right through their operations and draw analytical insights to help them successfully navigate trading volatility.

While PE funds were already making investments to digitally transform both their own management firms and their portfolio companies pre-pandemic, the health and economic crisis has put the need for such investment under the spotlight. Last year we found that 82% of funds had made such digital investments. This has since risen to 96%.

And it is data analytics that is receiving the most attention from GPs: 84% of those respondents who have undertaken digital transformation in the past year have focused on analytics. This is likely a function of the innumerable use cases of data crunching, which can be applied in any sector and within any business to identify and predict growth segments and make efficiency gains.

The managing director of a Belgian PE fund says: "Data driven innovation and process improvements can increase the productivity of factories. Most companies have seen that their production output has exceeded expectations post-digital transformation."

Fig 53 | Have you made investments in digitally transforming your own firm or portfolio company business models in the past year?

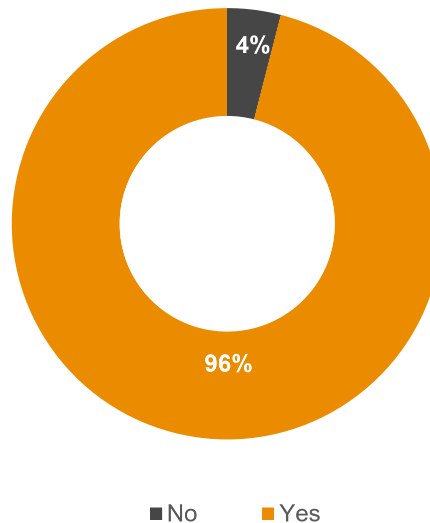
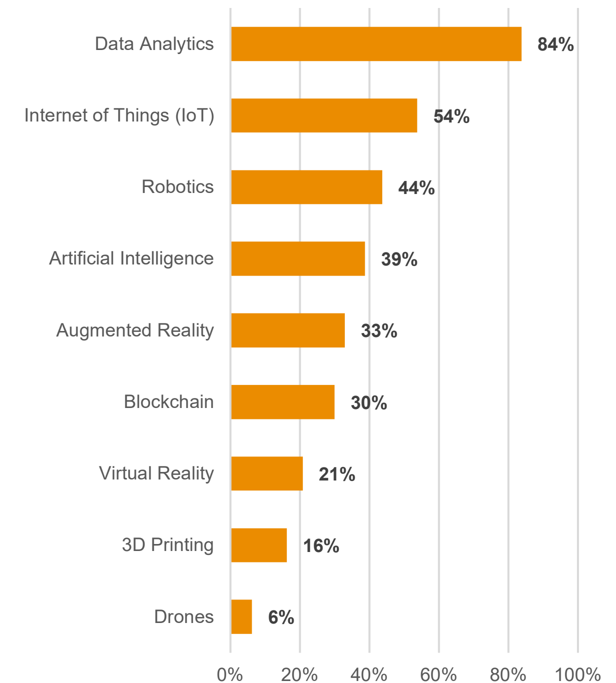


Fig 54 | If so, in which of the following areas of digital transformation have you focused your investment?



Focus on data analytics

Investment in PE firms' own digitisation and data analytics is key

Virtually all respondents (97%) intend to invest in digitisation over the coming year, which should come as little surprise given its accretive impact on returns and in making assets more attractive at exit. Financial sponsors, corporates and public markets will have limited interest in backing companies that they see as having fallen behind the digital curve. This is especially true in the context of COVID and the restrictions it has placed on business activity.

And data analytics has an abiding appeal. Not only is this where digital investment has been concentrated already, 86% are planning to invest in this area moving forward as part of their digitisation efforts. The use cases for analytics within PE are broad, however there are some obvious applications that have huge benefits. 84% of respondents' analytics have been used for due diligence, deeper insights into company performance, growth and risk conferring lead-gaining advantages in what remains a highly competitive deal environment.

This is followed by 72% who say analytics has been used for the aggregation of portfolio company key performance indicators (KPIs) and 59% who have used predictive analytics to better forecast portfolio company performance. Looking at the year ahead, 94% say they will use analytics for due diligence and 86% for portfolio performance forecasting – a clear and obvious signal of where PE sees the greatest value from data insights.

Fig 55 | Will you be investing in digitisation over the next year?

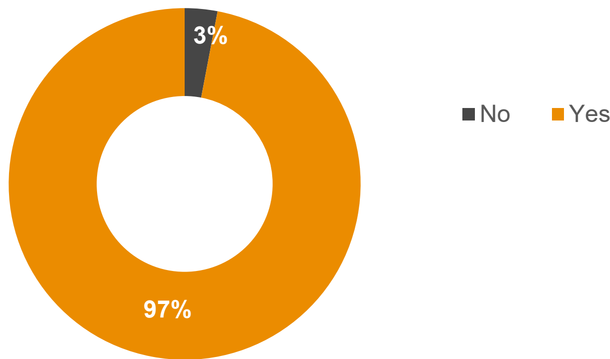


Fig 56 | Which of the following areas will you be investing in? (Please select all that apply).

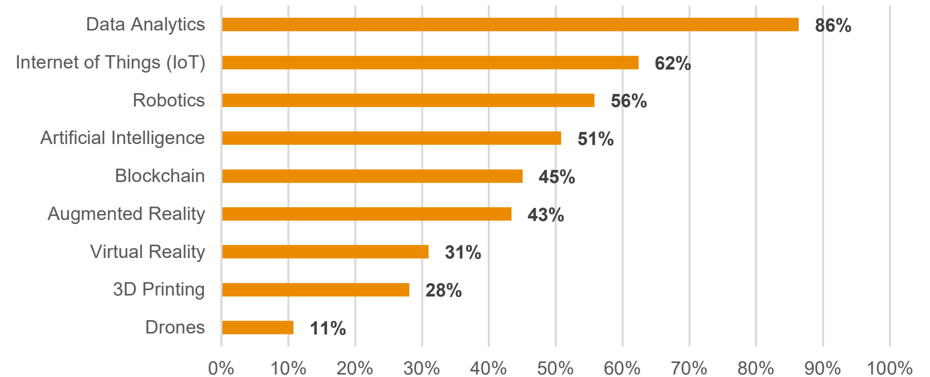


Fig 57 | In which of the following areas of the investment cycle has your organisation used data analytics in 2020?

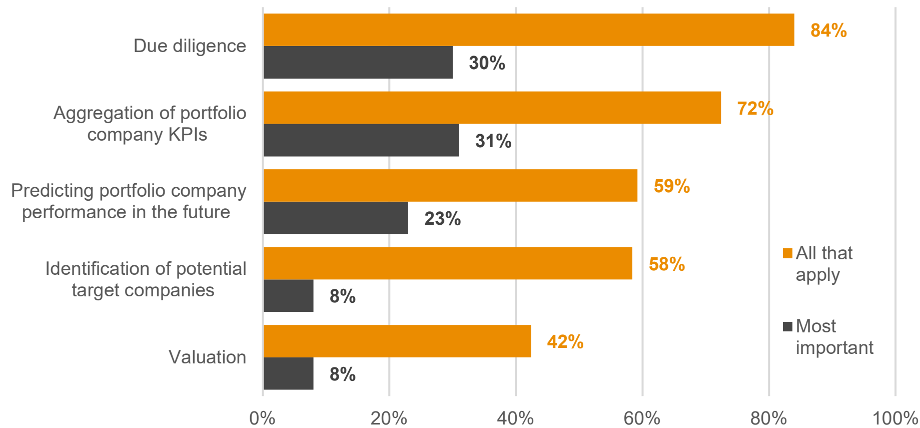
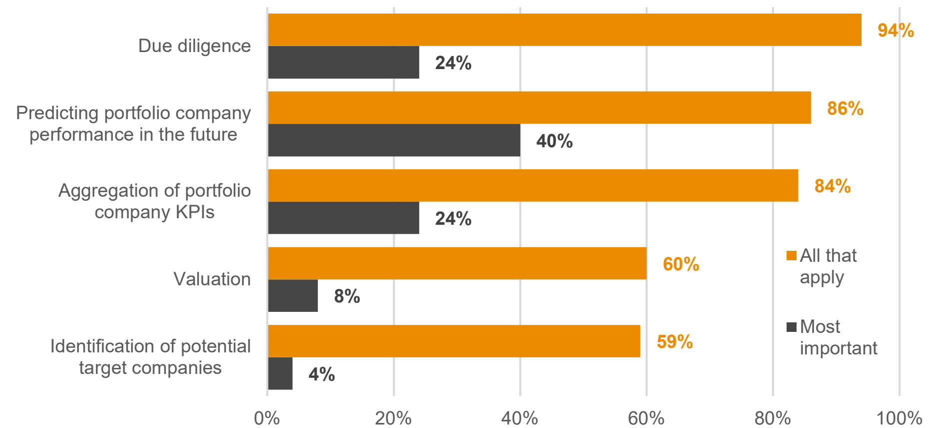


Fig 58 | In which of the following areas of the investment cycle do you anticipate your organisation will use data analytics in 2021?



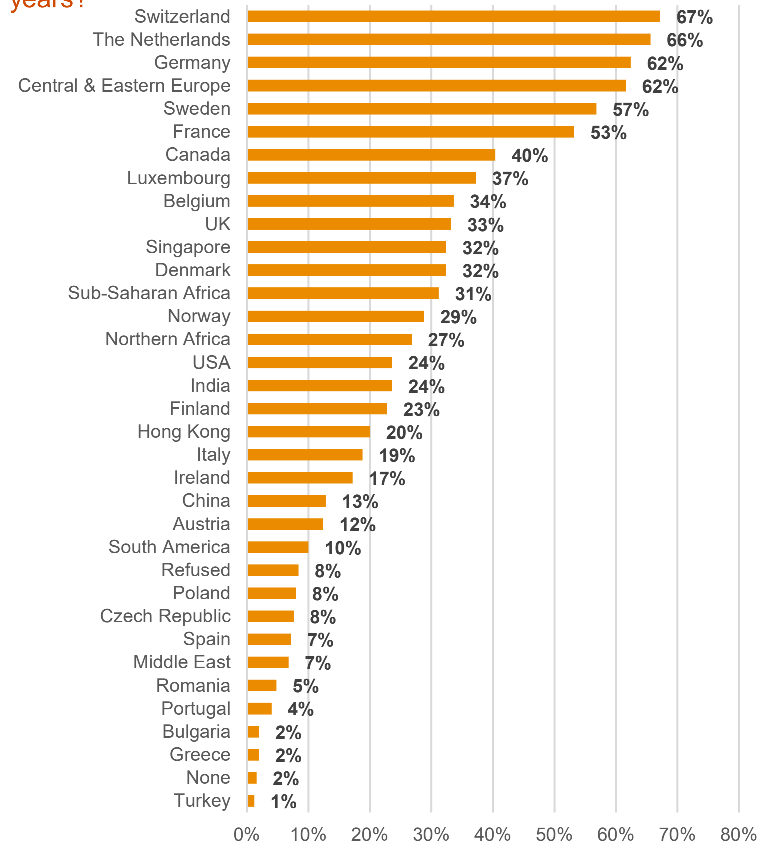
Optimistic about Switzerland, the Netherlands and Germany

Germany, the Netherlands, Switzerland and Central and Eastern Europe (CEE) routinely figure highly in our research as the most attractive national and regional markets for PE investment on a forward-looking basis. Once again, these all come out on top, although this year it is Switzerland that takes the lead with 67% of respondents noting it as the country that will become the best for dealmaking over the next five years. This is followed by the Netherlands (66%), Germany (62%), and CEE (62%).

Switzerland certainly has attractive characteristics. Like Germany, there are many companies specialising in precision manufacturing and other high-skill niches, while the country was once again the world leader in the Global Innovation Index's high-income country group in 2020.

At the same time, its economy, which is moderately smaller than the Dutch economy, is around one-fifth the size of Germany's. It follows, therefore, that while they are of a high quality, the number of investment opportunities in the Swiss PE market is relatively limited in absolute terms.

Fig 59 | In your opinion, which countries or regions will become more attractive for private equity investments over the next five years?



Chapter 4:
Global Hotspots

The impact of Brexit

After years of deliberation and tense negotiations, Brexit has finally happened. The immediate effects of the UK's departure from the European Union have been increased customs paperwork, longer delivery times, additional tariff costs for UK businesses sourcing from Europe and selling into the bloc and reduced freight volumes. How this plays out over the longer term remains to be seen, however European investors do not look favourably upon the UK's exit from the EU. On the contrary, 58% of respondents say Brexit makes the UK less attractive for PE investments in 2021, although 34% see no impact.

It is not only the UK that has suffered in the eyes of investors as a result of Brexit. While 62% say the secession has had no impact on the attractiveness of the remaining EU countries for PE investments in 2021, nearly a quarter (23%) feel that Europe is now a less appealing place for buyouts. It would seem that fund managers see Europe as having been stronger economically integrated with Britain, which has the fifth-highest GDP in the world and is ranked among the region's innovation leaders, according to the EU innovation index.

Germany stands head and shoulders above its EU peers as the most attractive member state for investment, with 48% favouring the country. It is not hard to see why. Not only is Germany the largest economy on the continent, its strong manufacturing base and export profile typically sustain high levels of growth and this was seen during the first year of the pandemic. As mentioned previously, the country often referred to as the "economic powerhouse of Europe", saw its GDP decline by 5% in 2020 as the Eurozone contracted by 6.8%. The size and momentum of its economy is complemented by the fact that Germany possesses some of the most specialist engineering expertise of any country in the world, making it a compelling PE market for funds with the sourcing nous to uncover hidden gems.

Fig 60 | What is the impact of Brexit on the attractiveness of the UK for private equity investments in 2021?

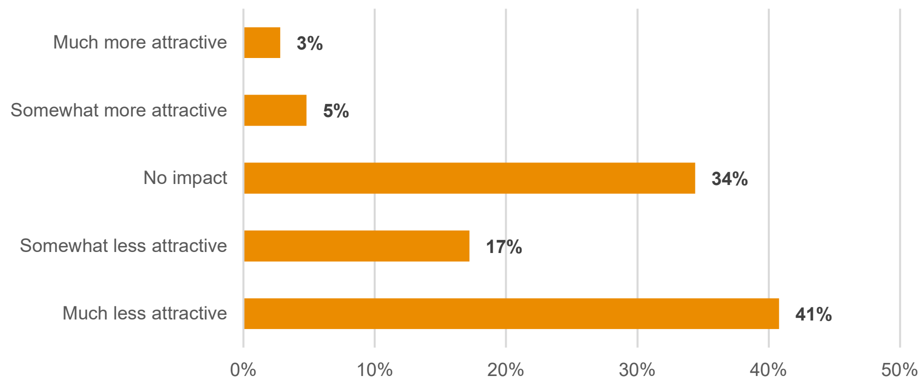


Fig 61 | What is the impact of Brexit on the attractiveness of the remaining member states of the EU for private equity investments in 2021?

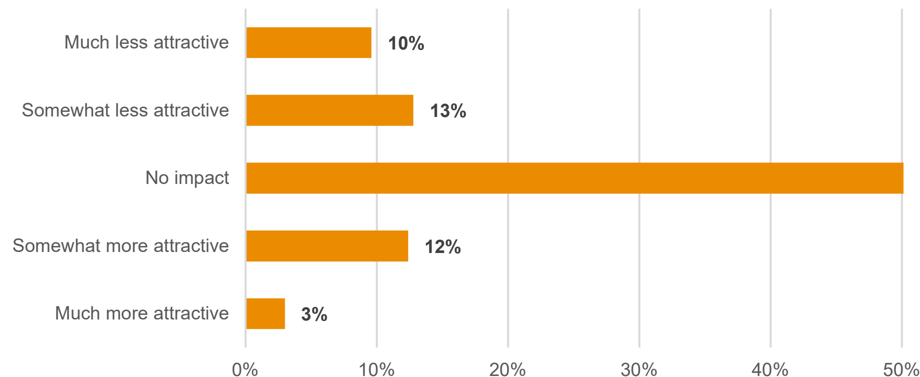
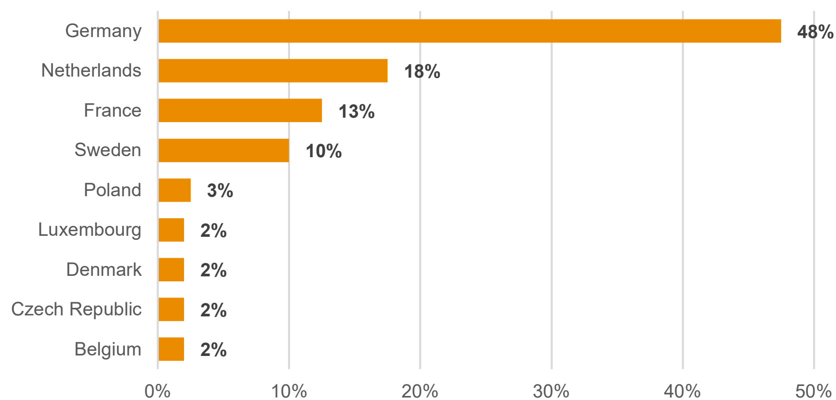


Fig 62 | Please specify which EU country do you think is most attractive for private equity investments



Zooming in on Germany

Germany is a firm favourite among PE investors in Europe, with 46% of respondents reporting that they currently have investments in the country. Of these, 100% intend to continue making investments in the country over the next five years and 85% say they plan on increasing the capital they allocate to the German market over this period.

The country is one of the most compelling mid-market PE propositions anywhere in the world. If Germany is the economic powerhouse of Europe, then its Mittelstand of approximately four million small- and medium-sized (SME) family-owned business is the beating heart of its own economy, contributing around half of its GDP. What makes the Mittelstand so attractive is the highly specialist nature of these SMEs, which typically cater to niche markets and so hold dominant positions. Additionally, being family-owned means there are ample succession issues that private equity is well suited to solve by allowing founding families to cash out of businesses they have built up over many decades. This is not exclusive to Germany either, with Austria and Switzerland forming the wider DACH Mittelstand.

“We are considering a number of new investments in the mid-market segment in both Germany and Austria,” says the investment director of a German PE fund. “Challenges persist right now but our long-term investment approach will be effective under the current circumstances.”

In spite of the broad optimism for Germany, there does appear to be a residual aversion to its PE market for those who have not already invested in the country. While 22% say they plan to make a debut German investment over the next five years, a massive 76% say they have no intention of doing so.

It is not entirely clear why this is, although it is true that private equity has not always had the best image in Germany. The “swarms of locusts” comment made by former Social Democratic Party chair Franz Müntefering in 2005 reverberated for a number of years. But attitudes have changed more recently, demonstrated by rising rates of buyout activity. It seems that company owners increasingly see PE for what it is – an invaluable source of risk capital for business owners, a governance and operational specialist and a valued partner in achieving sustainable growth.

Fig 63 | In an international comparison with other countries, how would you assess the attractiveness of Germany as a location for private equity investment?

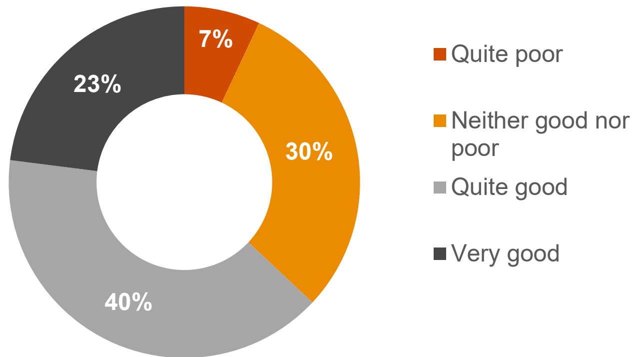


Fig 64 | Does your firm currently have any investments such as portfolio companies in German?

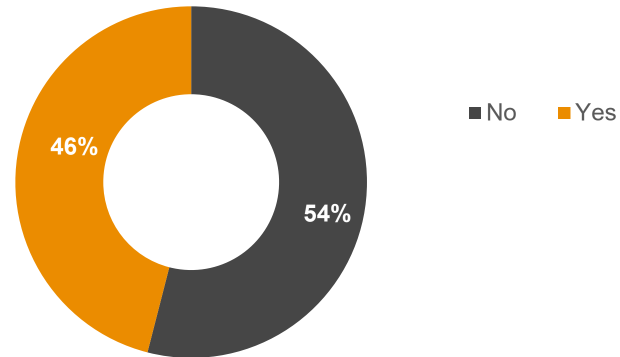


Fig 65 | Do you plan to continue making investments in Germany over the next five years?

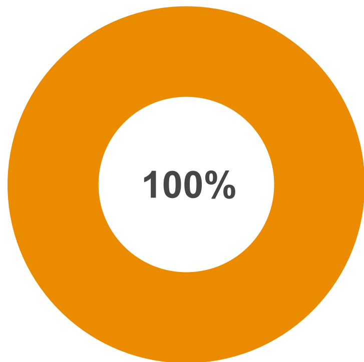
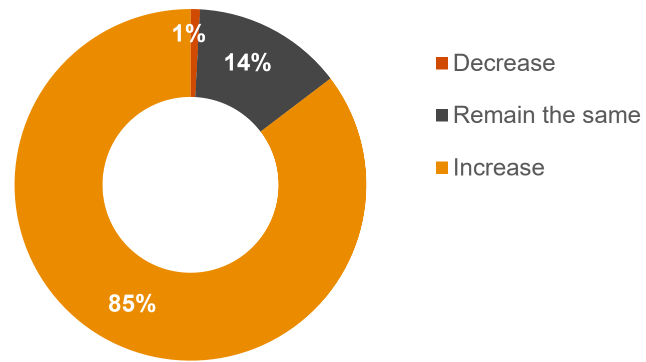


Fig 66 | Do you think that the assets that you allocate to Germany over the next five years will…



4.

Methodology

In Q4 2020 and Q1 2021, Acuris Studios, the research and publications arm of Mergermarket, spoke to **250 private equity principals** on behalf of PwC.

Job titles included: partner and managing director. 14% of these funds are based in Germany and 14% in Benelux countries with the remaining 72% based elsewhere in Europe. Responses were anonymised and aggregated.

All private equity firms of respondents had **a minimum of €250m of assets under management**.

Fig 67 | Respondent country

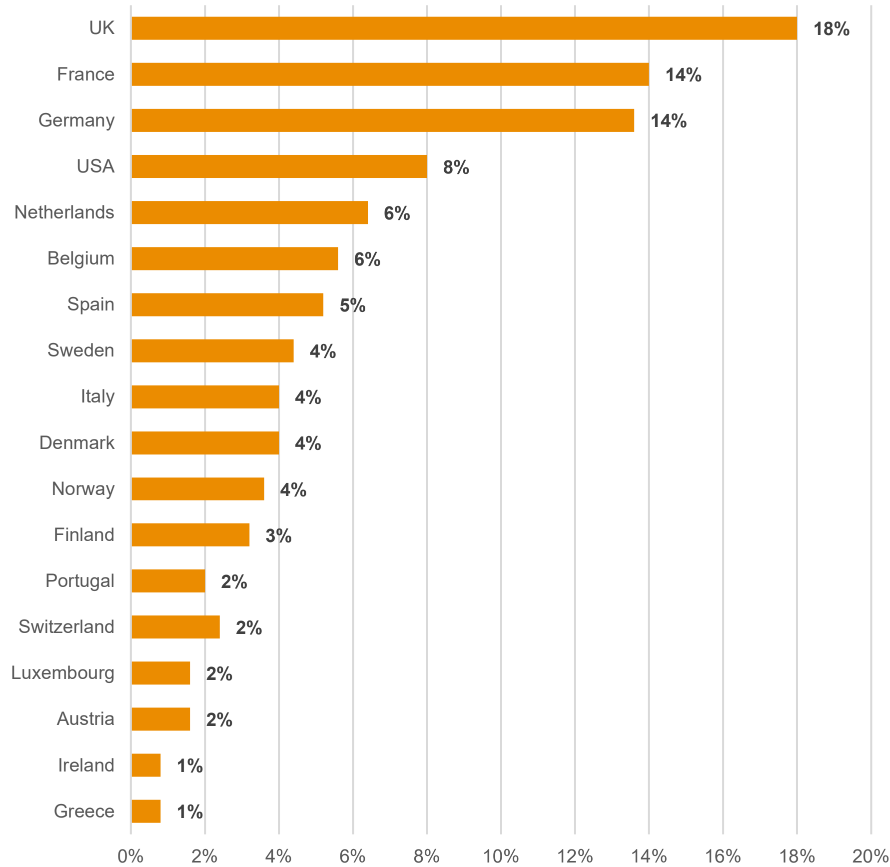
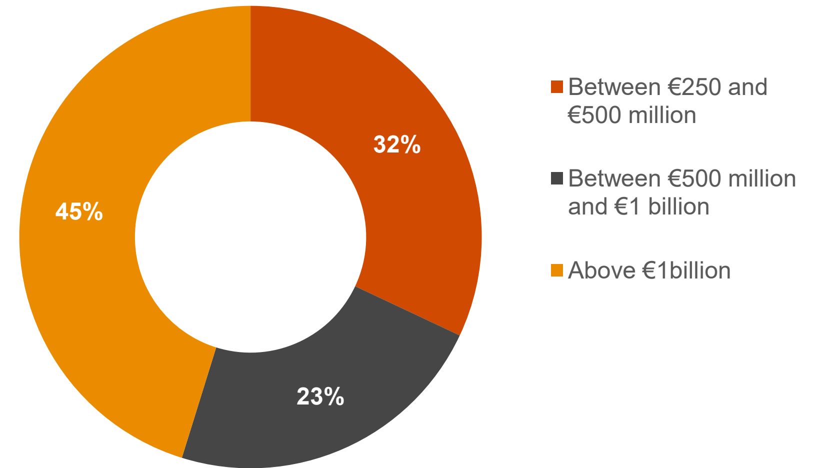


Fig 68 | Capital under management of respondents



5.

Appendix

Fig 69 | Do you plan to make any investments in Germany over the next five years?

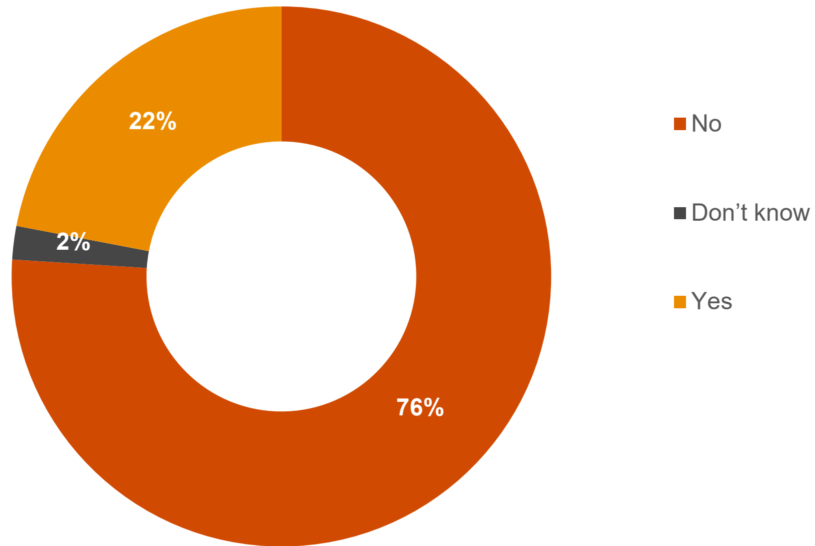


Fig 70 | DACH Buyout Volume, Split by industry | 2015-2018

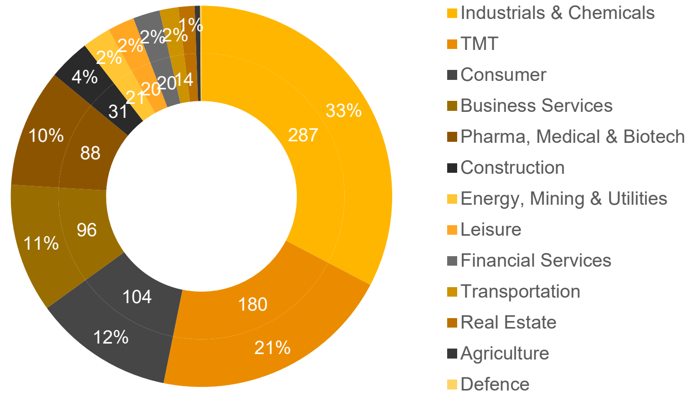


Fig 71 | DACH Buyout Volume, Split by industry | 2019-2020

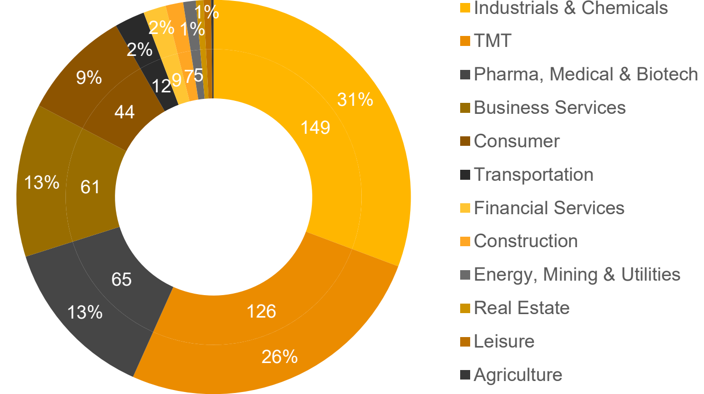


Fig 72 | DACH Buyout Value, Split by industry | 2015-2018

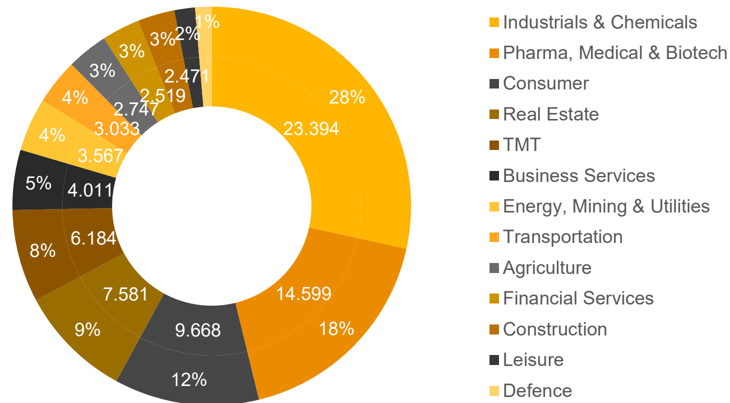


Fig 73 | DACH Buyout Value, Split by industry | 2019-2020

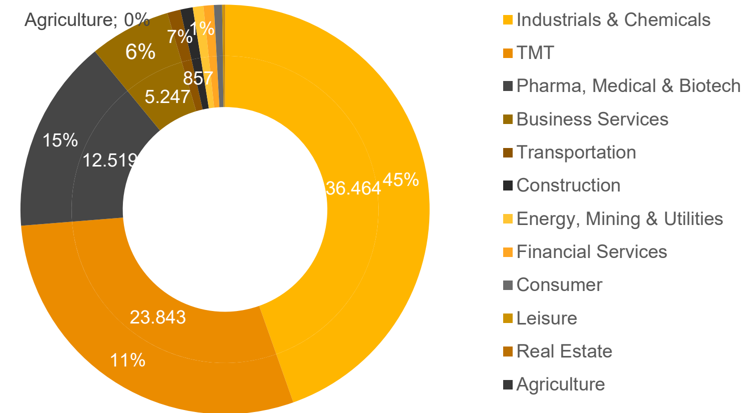


Fig 74 | Benelux Buyouts, Split by Deal Size | 2015-2020

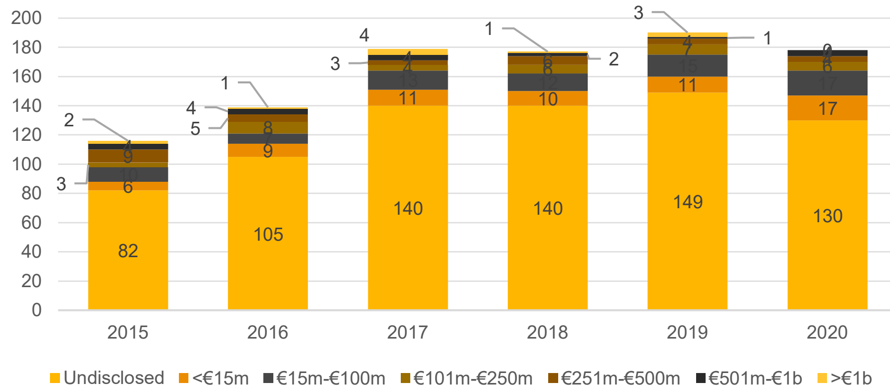


Fig 75 | Benelux Buyout Volume | 2015-2020

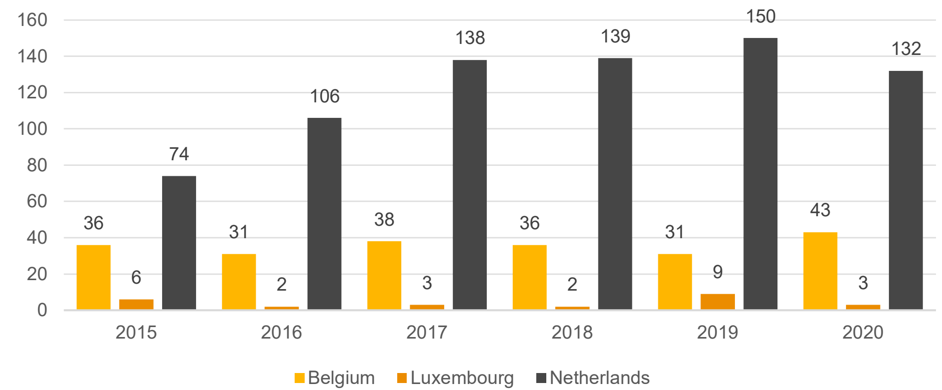


Fig 76 | Benelux Buyout by deal value €(million) | 2015-2020

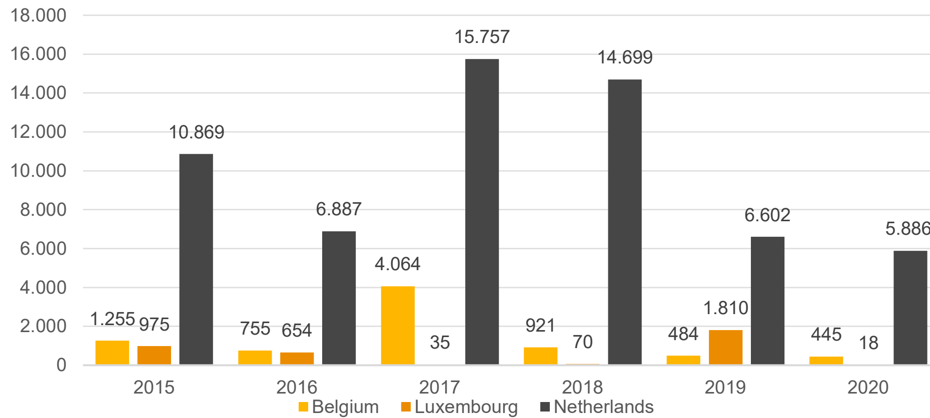


Fig 77 | **Benelux Buyout Volume**, Split by industry | 2015-2018

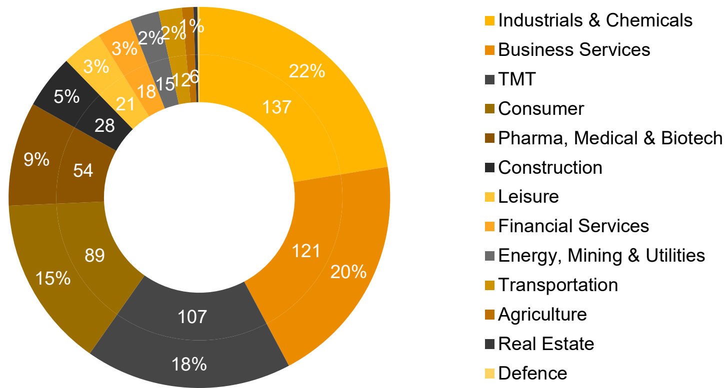


Fig 78 | **Benelux Buyout Volume**, Split by industry | 2019-2020

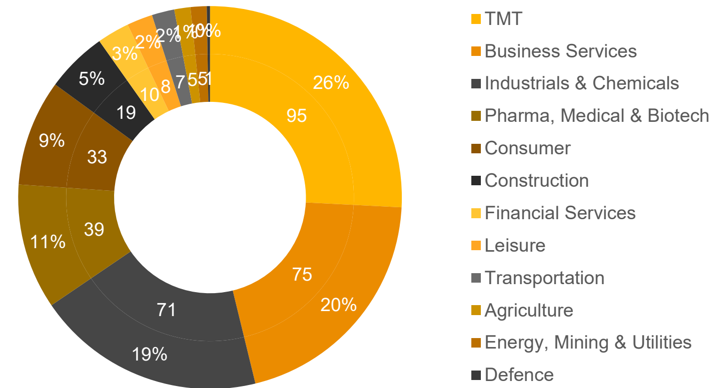


Fig 79 | **Benelux Buyout Value**, Split by industry | 2015-2018

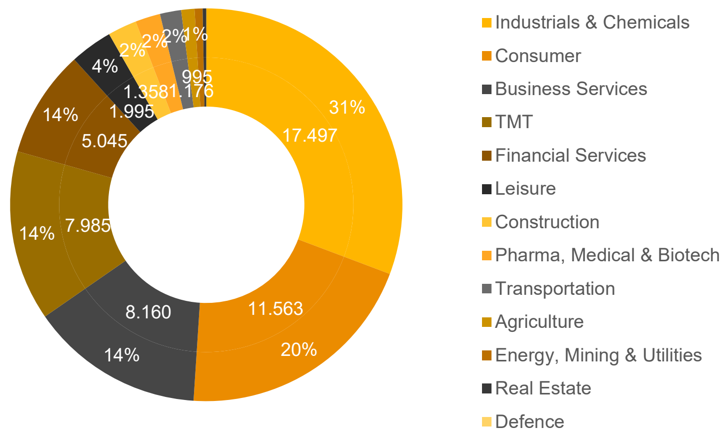
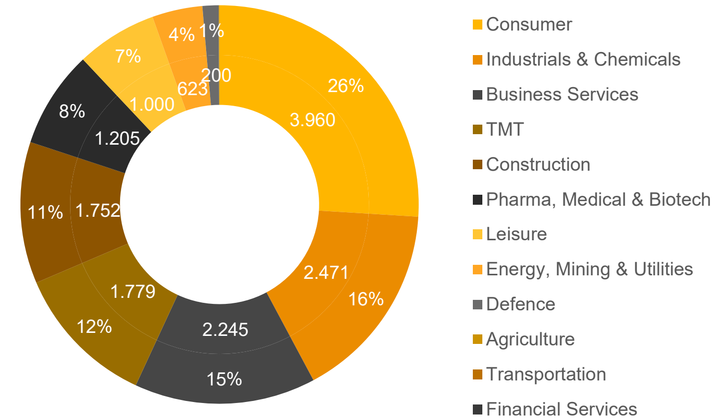


Fig 80 | **Benelux Buyout Value**, Split by industry | 2019-2020



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About us

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