EUROPEAN PRIVATE EQUITY SURVEY 4TH EDITION – FULL REPORT

9 NOVEMBER 2023

INVEST EUROPE

ARTHUR D LITTLE

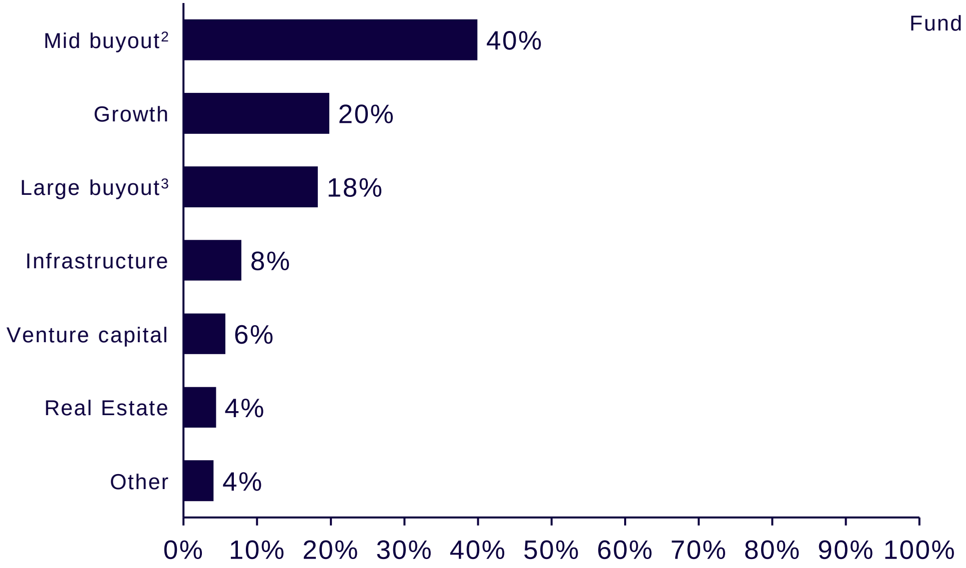
Contents

INTRODUCTION

The survey was conducted June – August 2023 and involved 303 participants[1], out of which 199 were GPs and 104 were LPs

Most important investment stage for respondents

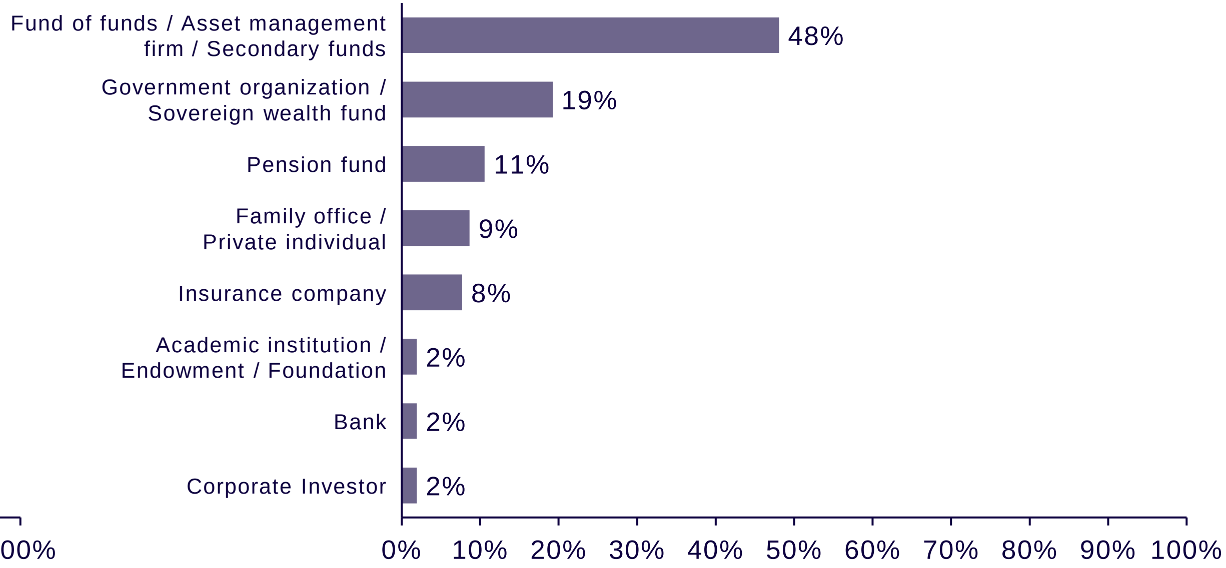
GP #199



Average number of portfolio companies **33.4**

Type of investor

LP #104



Share of European assets managed by private equity **58.2%**

Source: Arthur D. Little, Invest Europe

Note: 1) Not all 303 respondents completed the surveys, the completion rate for GPs is 71.9% and the completion rate for LPs is 85.6%. Consequently, the number of GPs / LPs answering respective question differs throughout the surveys, 2) Mid buyout <€150M equity per deal, 3) Large buyout >€150M equity per deal

The overall sentiment in PE markets has become more pessimistic, with fundraising losing momentum, fewer investment opportunities, and an unfavorable climate

Executive summary

Fundraising expected to be weaker going forward
- Almost half of GPs expect weaker fundraising in the next 12 months compared to last year
- GPs express a growing interest to market funds to HNWI[2] and retail investors

Investment opportunities have continued to decrease
- Investors are less positive about the future investment climate than before
- The secondary market is expected to become a relatively more important source for deals

Attention to ESG and SFDR regulation drive expectations on "green fund" registration and resources
- 59% of funds express an expectation from LPs to register as "green fund"
- 50% of the funds express that SFDR has created a need for dedicated resources

Divestments climate is uncertain, but trends point in a positive direction
- There is still pessimism for upcoming divestments, almost twice as many people expect a weaker climate than stronger
- However, the numbers have improved since last year

High interest rates and inflation con-tinue to dominate operational concerns
- GPs and LPs consider the high interest rates and inflation as the most negative factors for operations and performance
- ESG issues are still on top of the agenda for both investment processes and operations

Digitalization and growth continue to be the top improvement initiatives
- Digitalization and growth continue to be important improvement initiative for portfolio companies – 65% and 57% respectively of GPs have it as the most important action

Despite a weak outlook, the **large amount of Dry Powder available (€350bn)** at European PE funds provides some comfort that once conditions improve, then the return to normal can be rather fast

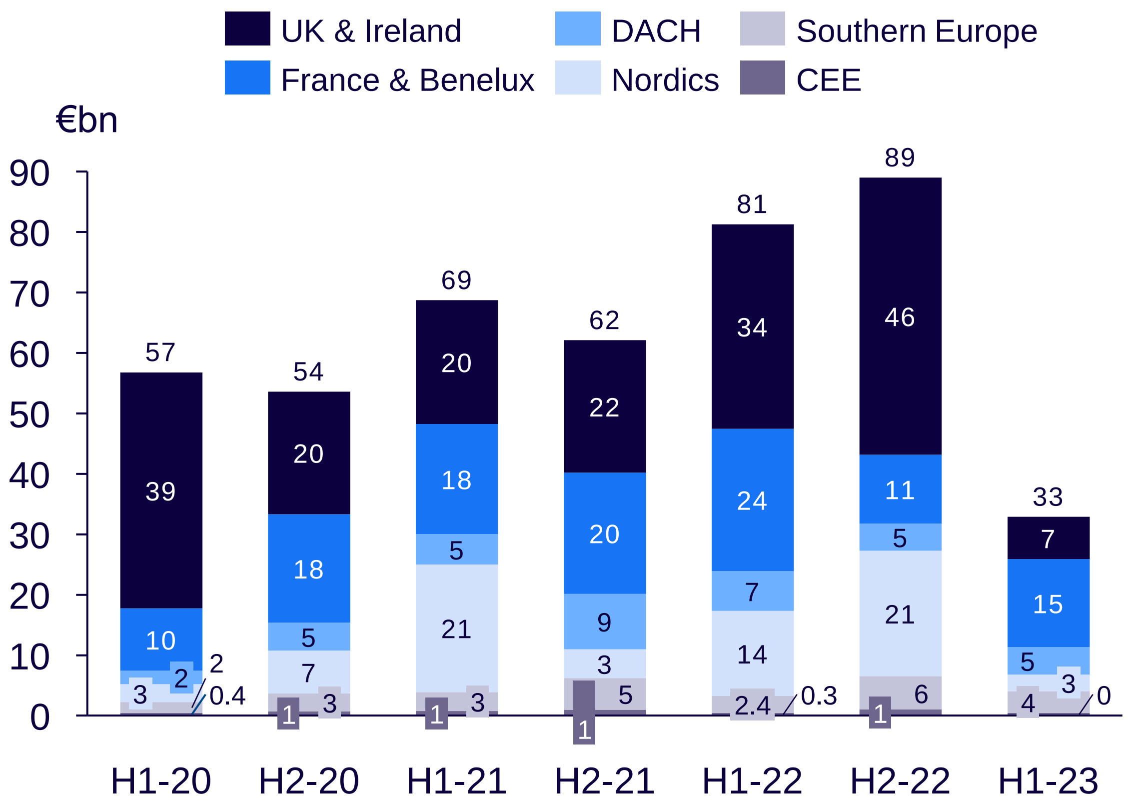
Source: Arthur D. Little, Invest Europe

Notes: 1) Next Twelve Months; 2) HNWI = High Net Worth Individuals

FUNDRAISING LOSING MOMENTUM

Overall fundraising experienced a notable decline in the first half of 2023, with UK & Ireland and the Nordic region being the most affected

Funds raised by European Private Equity and Venture Capital funds, (€bn)



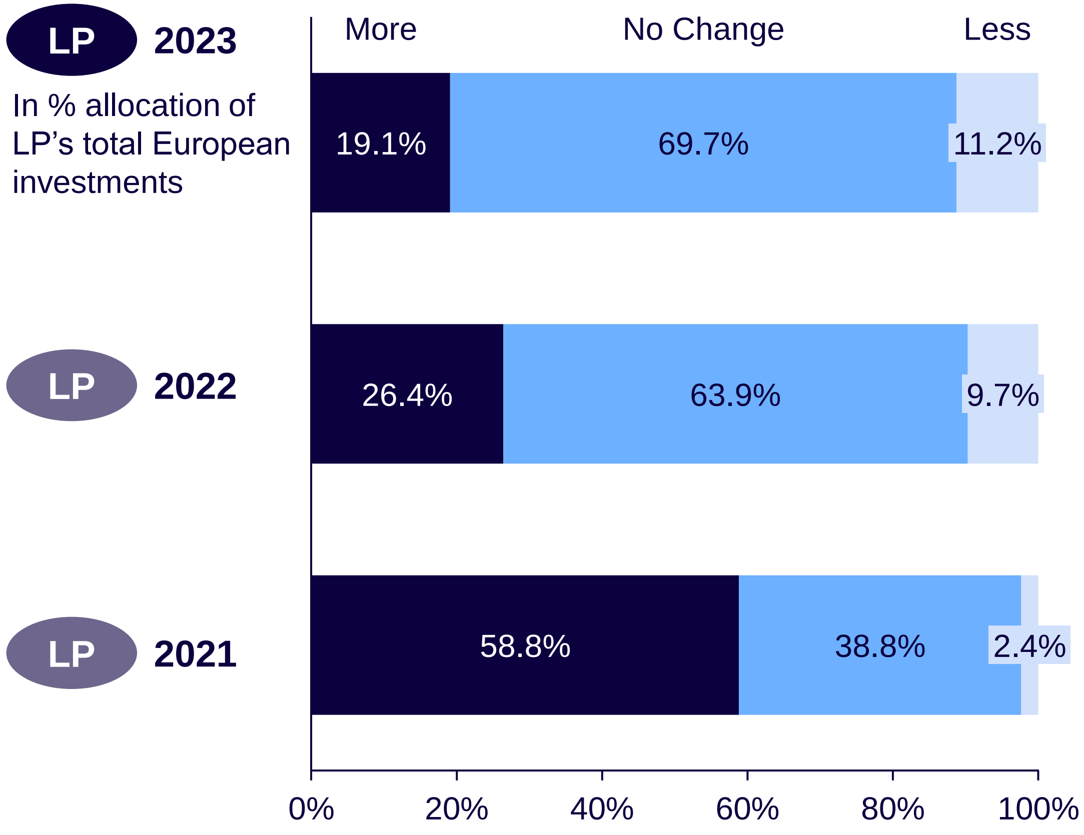
Comments

- The total value of funds raised in H1-23 saw a decline of approximately 63% compared to H2-22
- The decline in overall fundraising was primarily driven by UK & Ireland and the Nordics, with both regions experiencing a fundraising drop of >80% between H2-22 and H1-23
- France and Benelux have remained resilient, even managing to expand amid the backdrop of declining fundraising activities across Europe

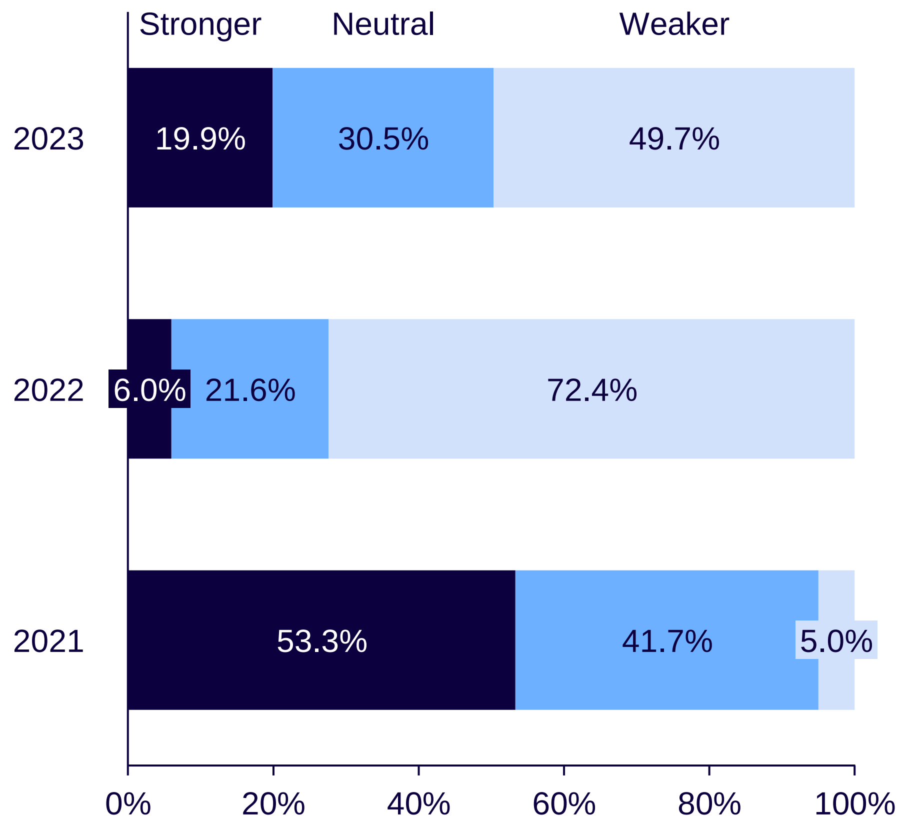
Source: Investing in Europe: Private Equity Activity H1 2023, Invest Europe

Short-term momentum in fundraising is expected to slow down – both LPs and GPs expect relatively lesser attention to the PE asset class

Capital allocations to PE asset class next 3 years



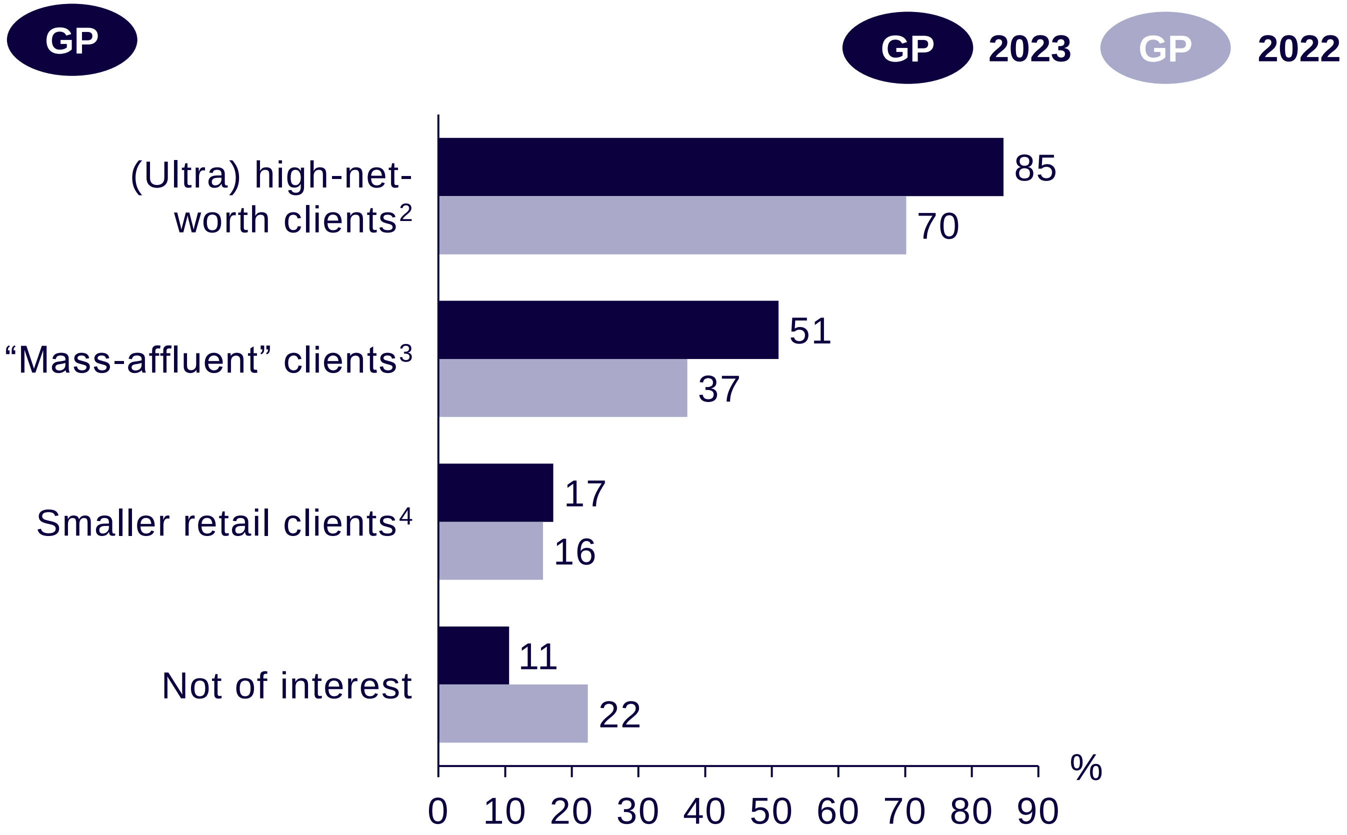
GP fundraising next 12 months comp. to the last 12m



Source: Arthur D. Little, Invest Europe

Strong interest from fund managers to expand fundraising to individual investors, a majority of respondents would like to target wealthy individuals

Interest to market future funds to the below investors in the coming years, irrespective of regulatory barriers[1]



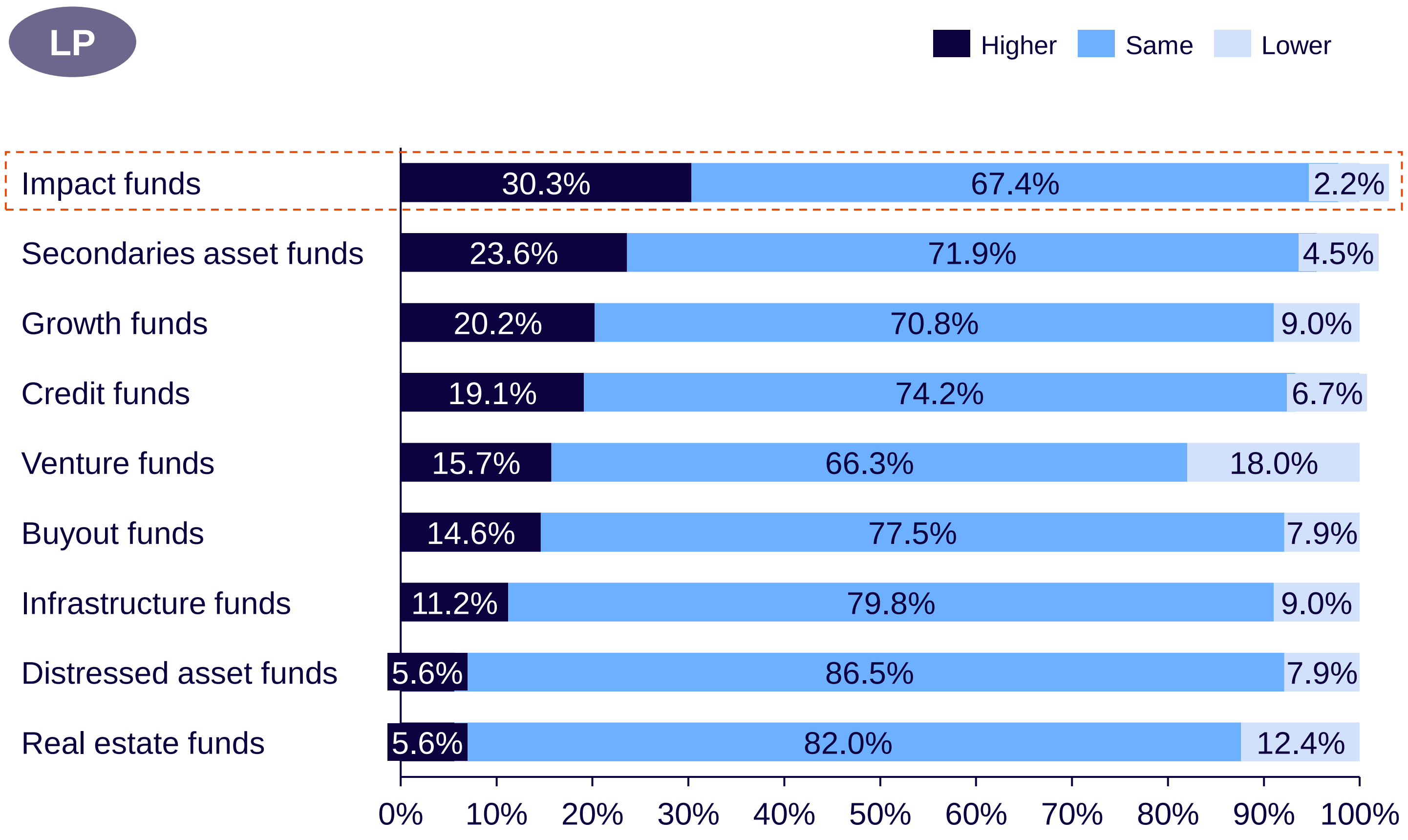
Comments

- GPs express an interest to also raise capital from wealthy individual investors
- High net-worth individuals are fewer and easier to manage than a large number of retail investors and therefore of higher interest to target than the ordinary retail client – 85% of fund managers believe it would be interesting to target them
- However, also individuals with a wealth of $100,000 - $500,000 are or interest to more than 50% of all fund managers

Source: Arthur D. Little, Invest Europe
Note: 1) Multiple choices possible, 2) Investors with typically more than €500 000 wealth, 3) Investors with wealth ranging from €100 000 to €500 000, 4) Below €100 000

Impact funds are expected to receive more interest as well as allocations over the next 12 months

Expected changes in investment strategy allocations over the next 12 months compared to the last 12 months, (Europe, 2023)



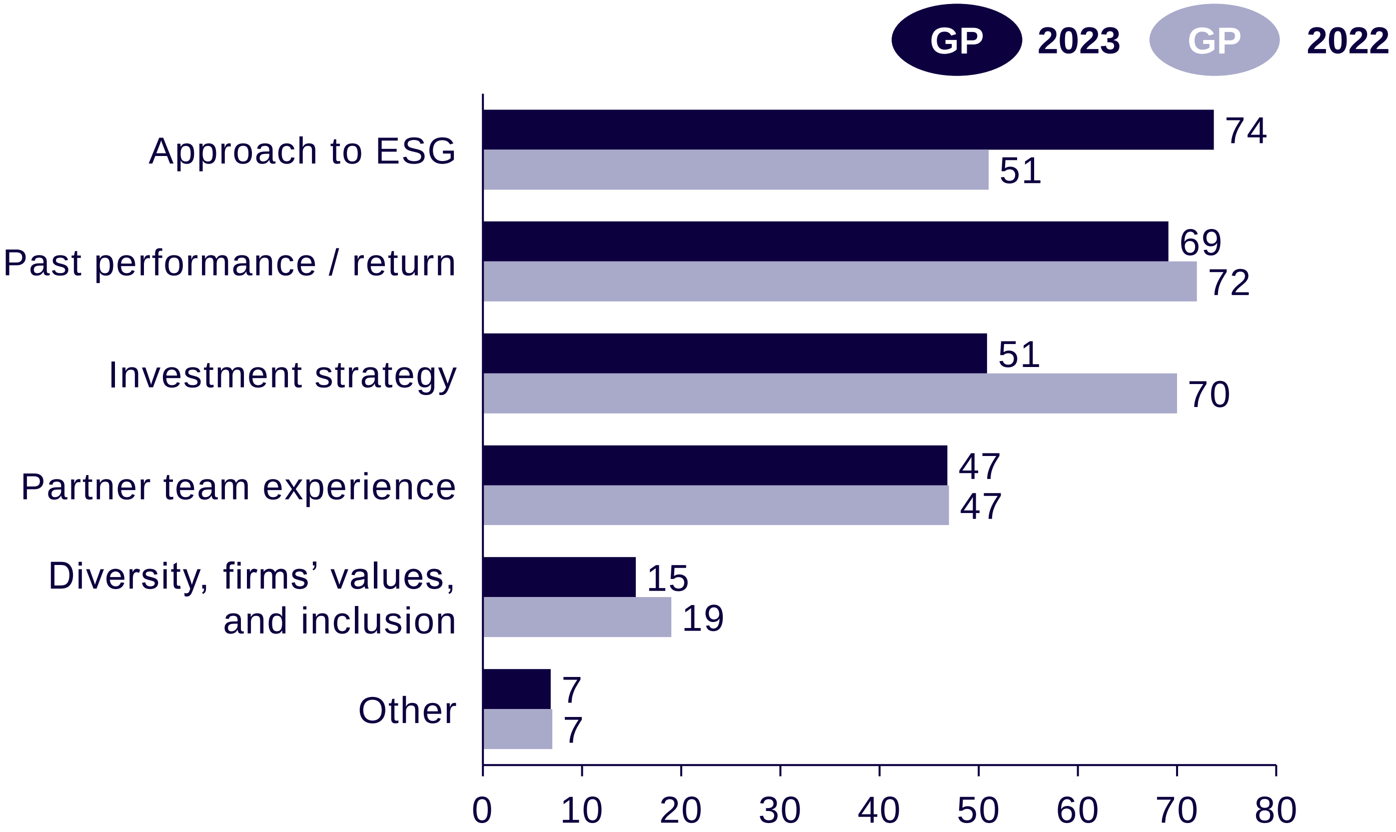
Comments

- For all fund types, most LPs see a continuation in their investment strategy allocations over the next 12 months
- An increasing interest in social and environmental causes in the coming year is observable
  - 30.3% of LPs expect a higher investment strategy allocation in impact funds
- Only a minority of LPs anticipate a lower investment strategy allocation
  - That is for all fund types

Source: Arthur D. Little, Invest Europe

In the next 2-3 years, a Private Equity firms’ differentiation will largely hinge on their focus on ESG, a view held by ~75% of GP respondents

Most important factors for a Private Equity firm to differentiate itself within the market in the next 2-3 years (multiple choices possible) (Europe, 2023)



Comments

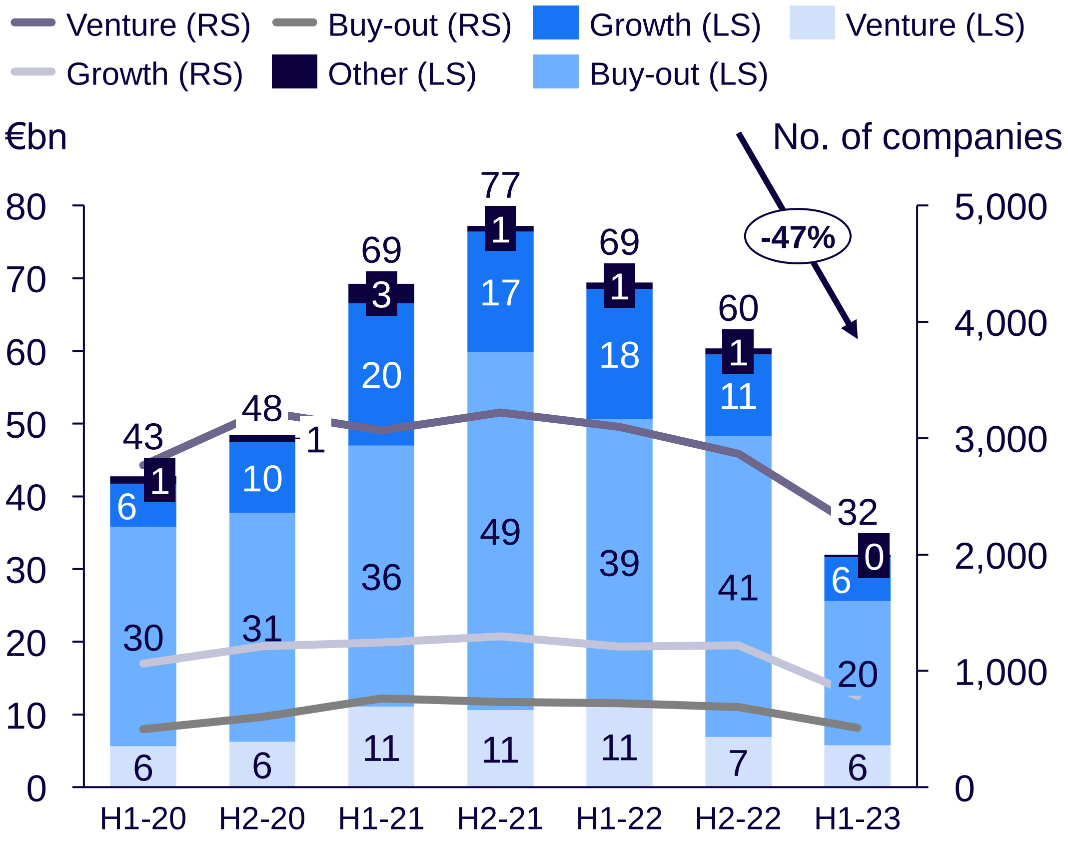
- About ¾ of GP’s believe that a solid approach to ESG will be one of the most important differentiation factors in the coming years
- ESG’s perceived importance has grown significantly from 2022, and for the first time ESG surpasses both “Past performance” as well as “Investment strategy”

Source: Arthur D. Little, Invest Europe

INVESTMENT PROCESSES MORE CHALLENGING

Investments in general and especially by Buyout funds started to decline in 2022 and the trend has further intensified in 2023

Investments by stage in value and volume



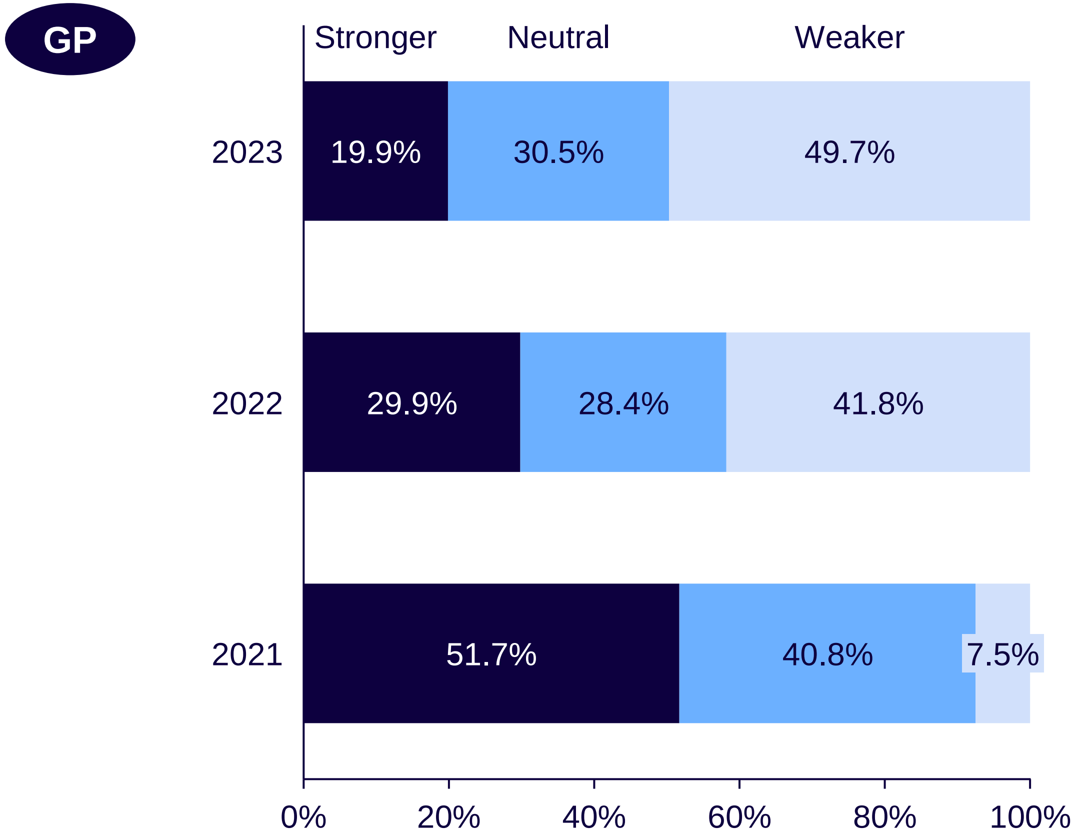
Comments

- The value of total investments dropped by 47% in H1-23 compared to H2-22
- The drop is most significant in Buyout funds, with a YoY decrease of 52%
- As in the period H1-22 to H2-22, the drop in number of deals did not decrease as much as the value, indicating that larger deals are continuing to be the most affected

Source: Invest Europe
Note: *LS = Left scale; RS = Right scale

GPs have grown less optimistic regarding potential investment opportunities…

Perception of investment opportunities in the market within the next 12 months compared to the last 12 months, (Europe, 2023, 2022 & 2021)



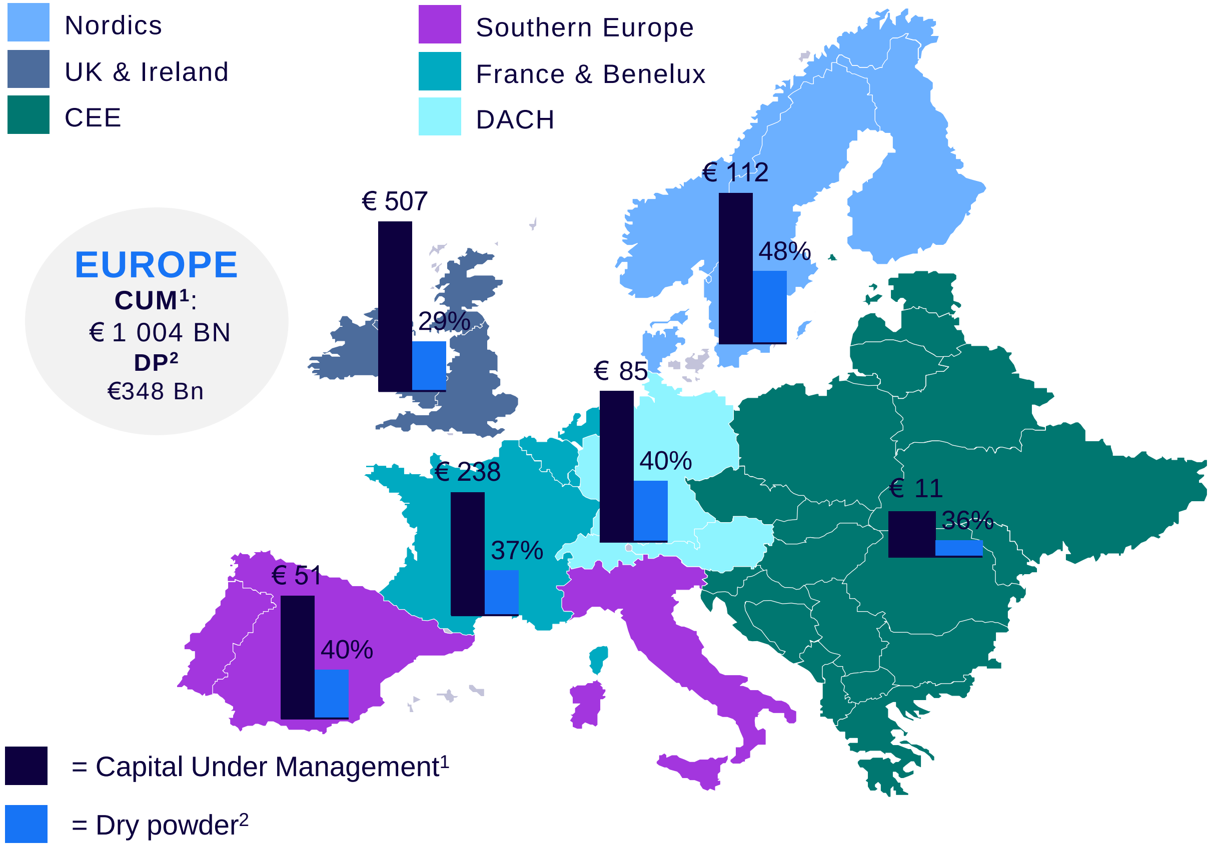
Comments

- GPs are less positive regarding investment opportunities than the previous years' PE survey
- Only 19.9% of GPs consider that investment opportunities will become stronger over the next 12 months compared to the last 12, a decrease by 10 and ~32%-ppt from 2022 and 2021 respectively
- Similarly, increasingly more GPs state that the investment opportunities are expected to be weaker – 49.7% in 2023 vs 41.8% and 7.5% in 2022 and 2021 respectively

Source: Arthur D. Little, Invest Europe

A rise in Dry Powder signals a more cautious approach by PE firms, possibly maintaining capital reserves for when the market bounces back

Capital under management in Europe 2022



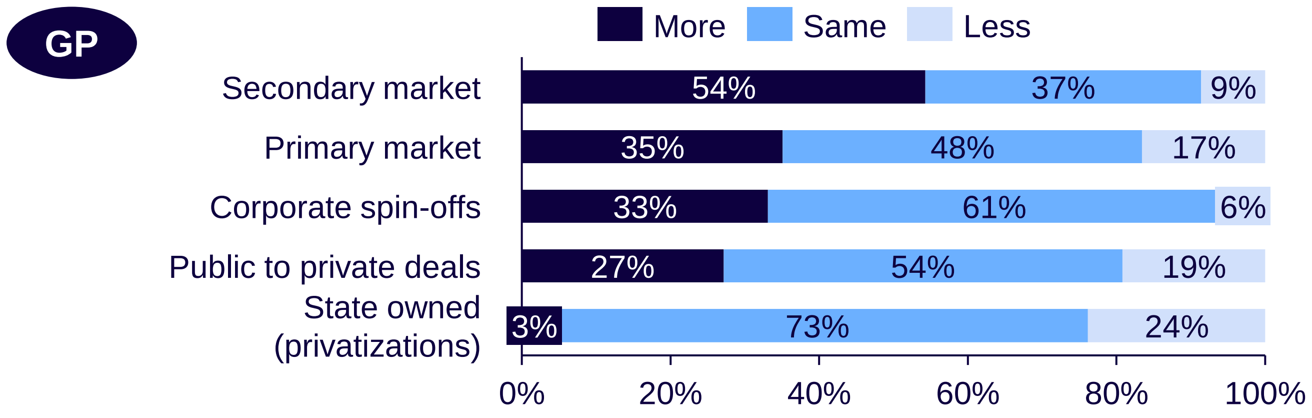
Comments

- European PE firms had **€ 1 004 bn** capital under management, out of which **~35%** was dry powder
- A large share of **Nordic PE** firms' capital consisted of dry powder, closing in on 50% of total capital under management
- Unlike their peers, **UK & Ireland** have less dry capital, having a larger share of their capital positioned at cost
- UK & Ireland are by far the biggest market, representing **50% of total capital under management** in Europe

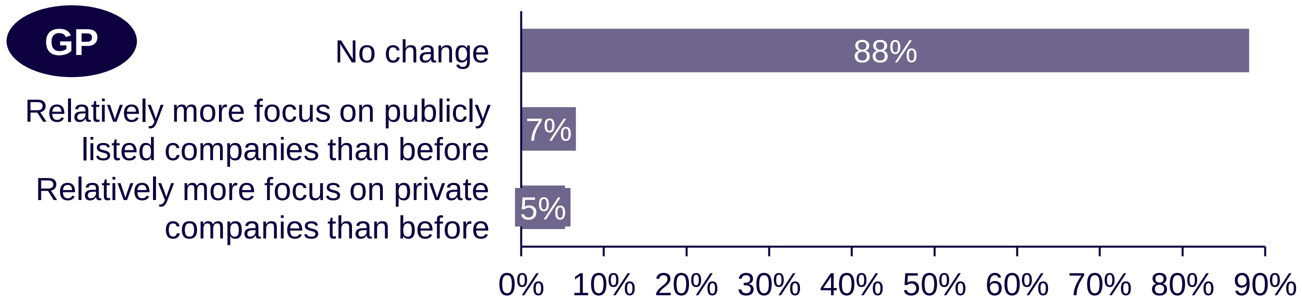
Notes: 1), Capital under management is defined as the total amount of funds managed by fund managers valued at cost (as opposed to Asset under management (AUM), which refers to the total market value of all financial assets managed by a PE firm); 2) Dry powder is defined as the amount of funds (valued at cost) not yet invested and available for future investments
Source: Invest Europe, EDC

The PE transaction market is expected to see more secondary market deals, but few GPs foresee changes in investment focus regarding public vs. private companies

Expected changes Private Equity transaction market over the next 12 months compared to the last 12 months, (Europe, 2023)



Expected changes in investment focus over the next year in terms of private vs. public companies, (Europe, 2023)



Comments

- Over half of respondents anticipate more secondary market deals compared to last year
- Corporate spin-offs and primary market transactions are expected to present more or similar levels of investment opportunities for the responding GPs' funds
- Similarly, 88% of GPs do not expect a shift in investment focus in public versus private companies in the coming year

Source: Arthur D. Little, Invest Europe

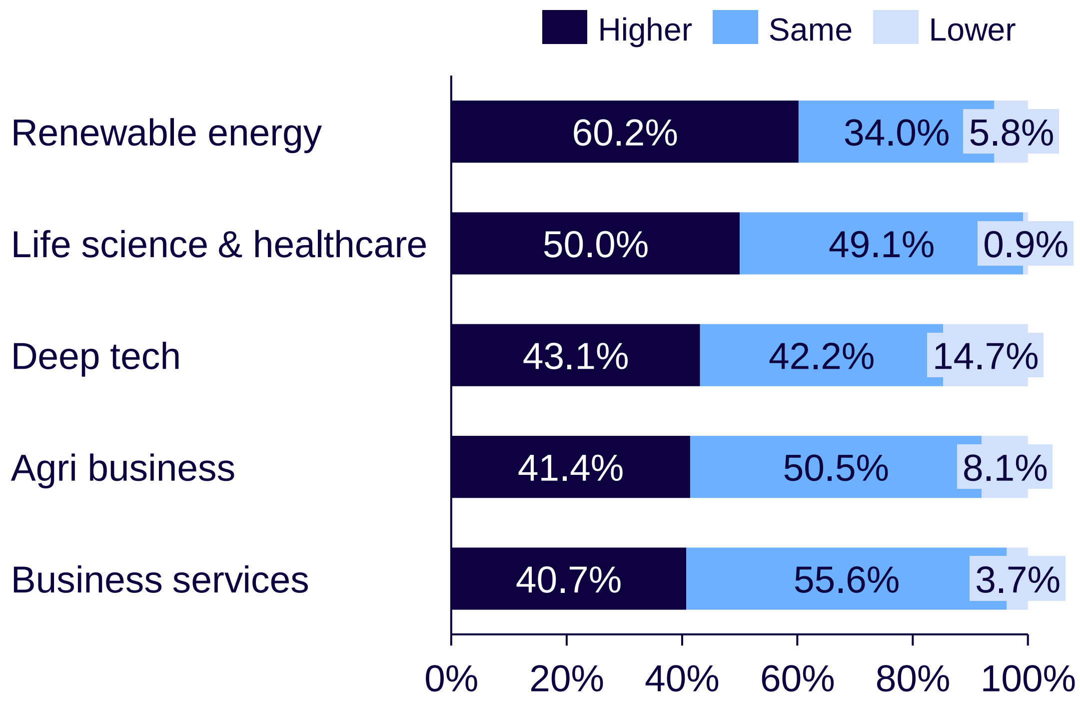
Certain industries are perceived to be relatively more attractive than before – Renewables and Life Science are in top, similar to last year

Expected investment operation activity levels in 2023 top 5 target sectors compared to the last 12 months

(Europe, 2023 & 2022)

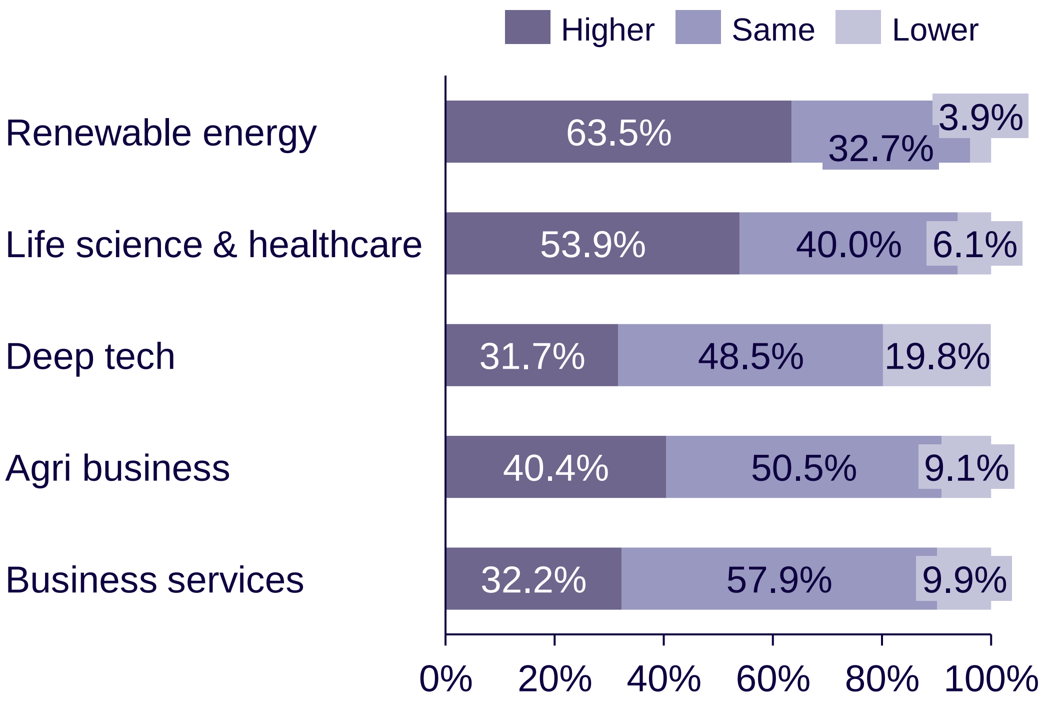
GP

2023



GP

2022



Source: Arthur D. Little, Invest Europe

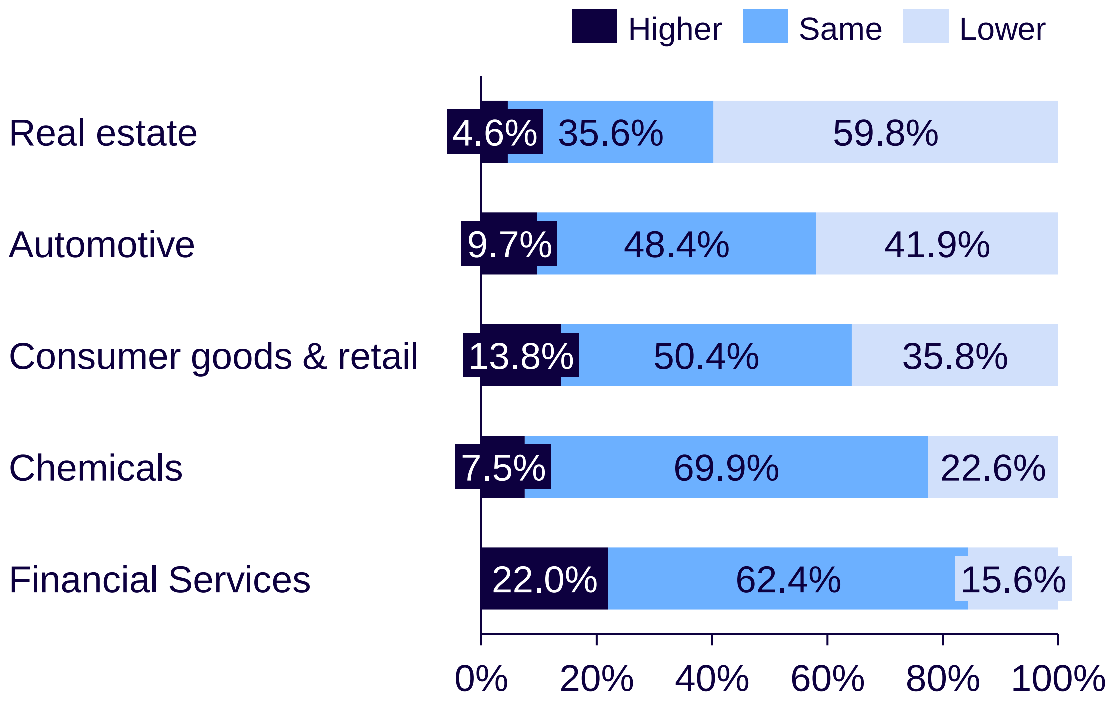
…while others are still perceived to be of low interest – the five sectors with lowest interest in 2023 are the same as in 2022

Expected investment operation activity in 2023 bottom 5 target sectors compared to the last 12 months

(Europe, 2023 & 2022)

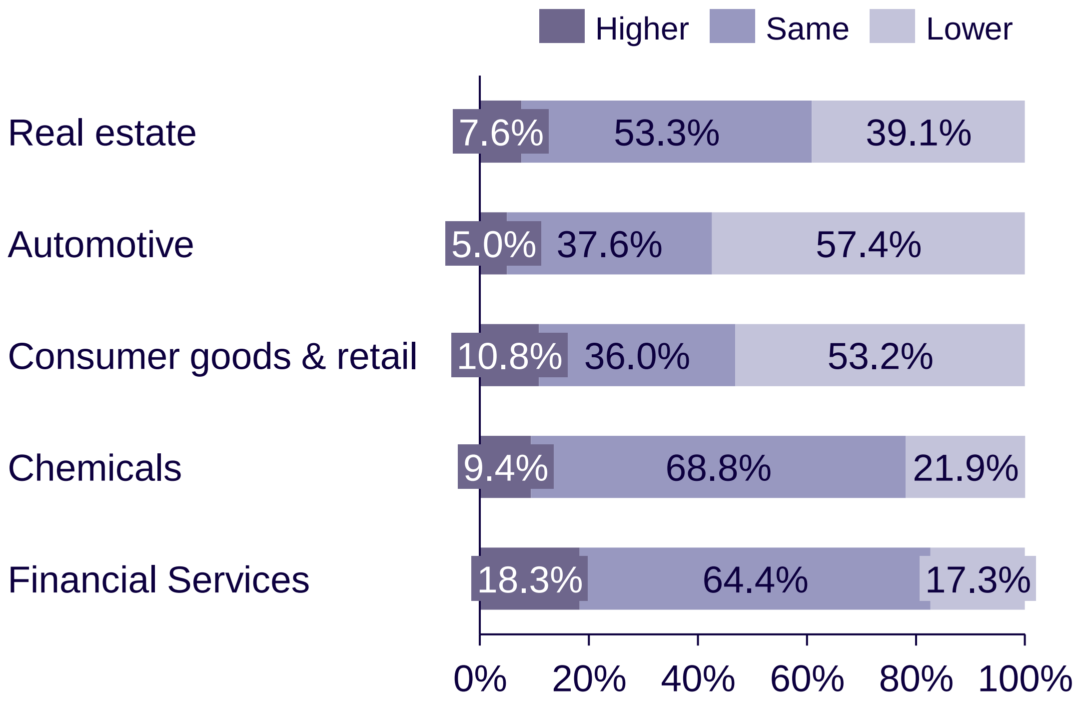
GP

2023



GP

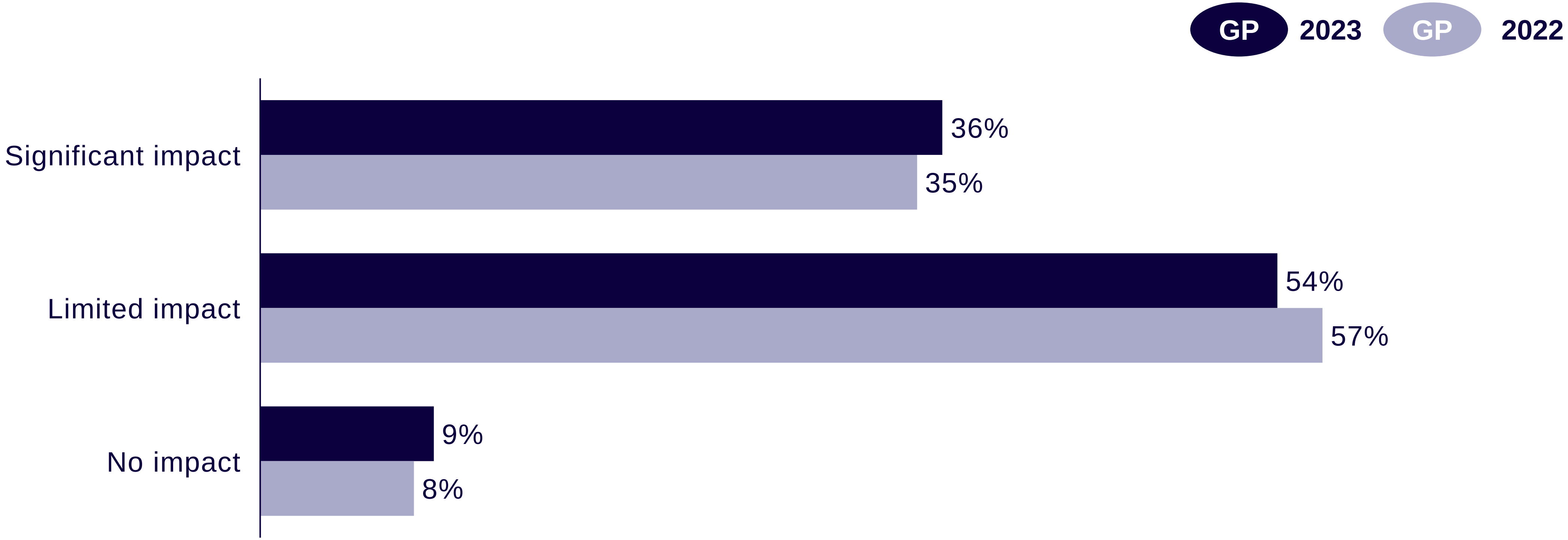
2022



Source: Arthur D. Little, Invest Europe

High interest rates in general impact the overall economy, but a majority of GPs consider it to be manageable for financing upcoming investments

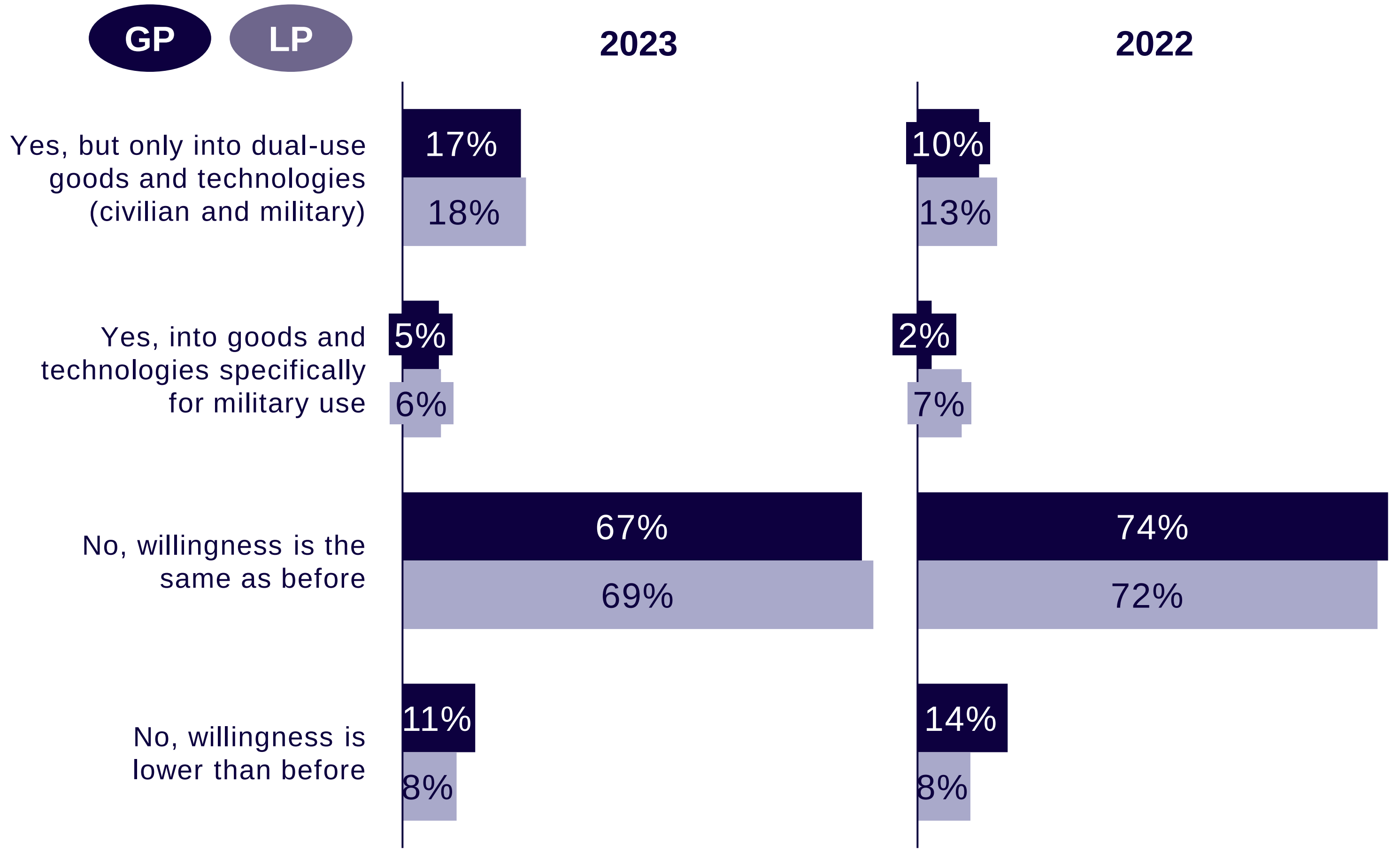
Impact of interest rate changes on ability to finance upcoming acquisitions
(Europe, 2023)



Note: On slide 27 GPs also discuss the impact of high interest rates, however in that case it relates to existing operations as opposed to upcoming investments

The outlook on investing in military and defense-related sectors has grown increasingly favorable, likely as a result of the ongoing Russia-Ukraine conflict

Change in willingness to consider investments into military- or defense-related sectors, (Europe, 2023)



Comments

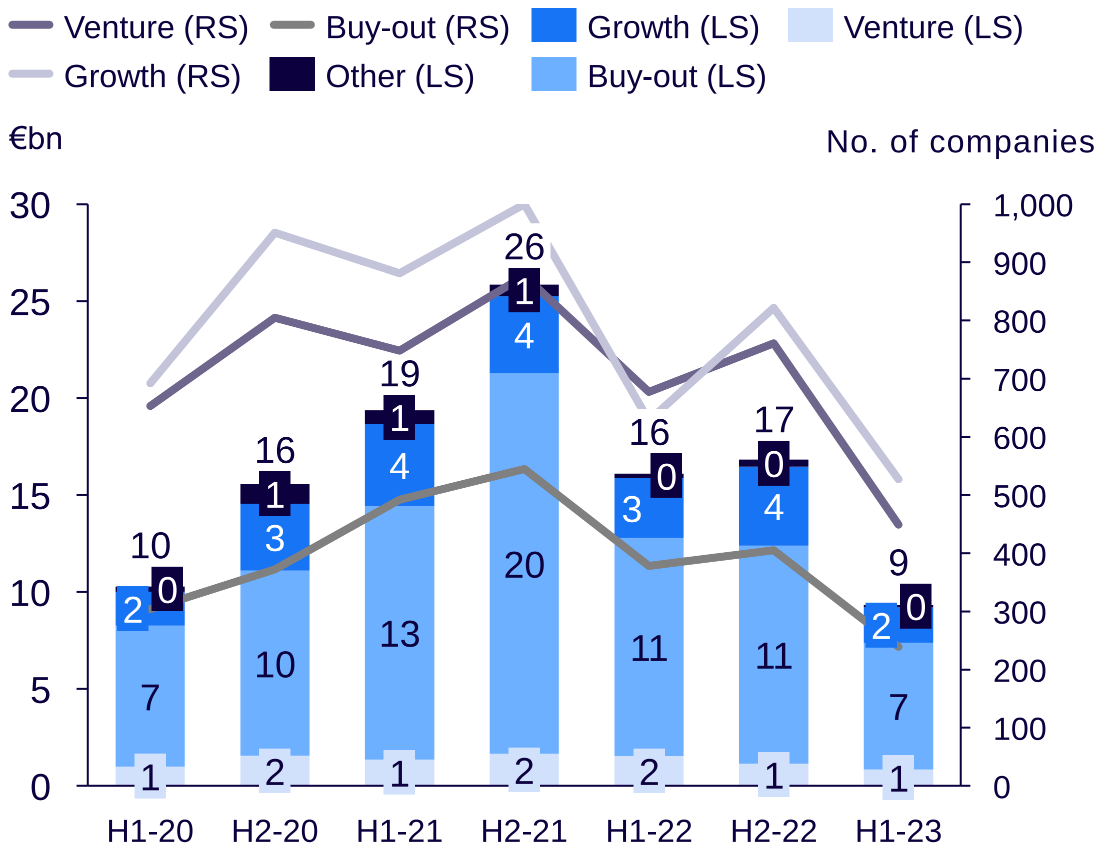
- The majority of both GPs and LPs do not express a change in willingness to consider military- or defense-related investments
  - I.e., 67% of GPs, 69% of LPs
- 17% and 18% of GPs and LPs respectively mention that they are more willing to consider investments by their GP(s) into military- or defense-related sectors
  - Only 5-6% of respondents are willing to consider military-specific investments
- Both more GPs and LPs expressed being prepared to consider investments into military or defense sectors, than those who reported a lower willingness then before
  - I.e., 17% and 18% vs 11% and 8%, respectively

Source: Arthur D. Little, Invest Europe

DIVESTMENTS ROUTES CHANGING

Divestment activities have slowed down considerably in 2022 and like investment activities, the trend has intensified during 2023

Divestments by stage in value and volume



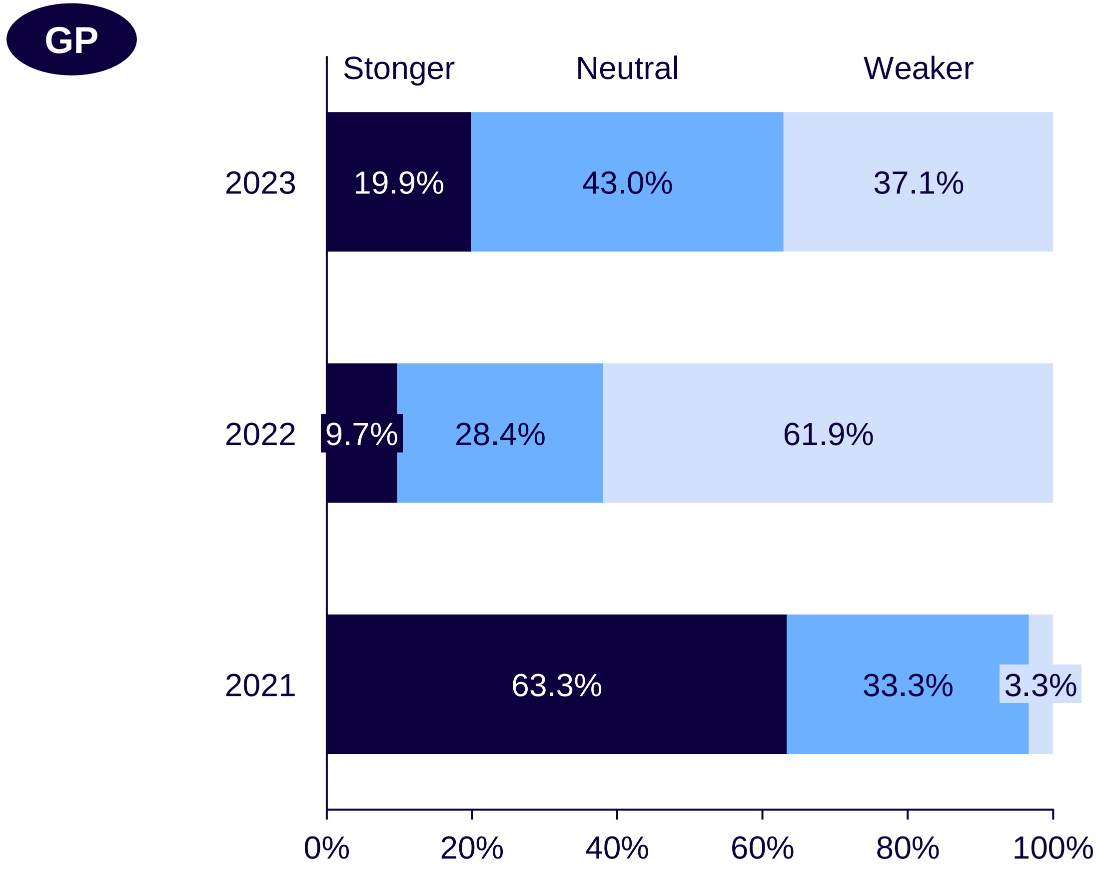
Source: Invest Europe
Note: LS = Left scale; RS = Right scale

Comments

- Divestments decreased by 45% from H2-22 to H1-23
- Divestments are very dependent on the general valuation multiples in the market
- Several factors are continuing to have negative impacts on valuation multiples such as the unstable geopolitical arena, higher inflation and higher interest rates

Improved optimism for short-term divestment plans during the last 12 months, however, still relatively negative

Expected changes in divestment of portfolio companies over the next 12 months compared to the last 12 months, (Europe, 2023, 2022 & 2021)



Comments

- In 2023, most GPs express that they expect a neutral or weaker divestment of portfolio companies over the next 12 months compared to the last 12 months
  - I.e., 43.0 and 37.1% of GPs respectively
  - This is equally supported by the few GPs (20.0%) that believe divestments will be stronger
- The view of GPs in 2023 is slightly improved compared to the view of GPs in 2022
  - Most GPs expressed that the expected changes in terms of divestment would be weaker

Source: Arthur D. Little, Invest Europe

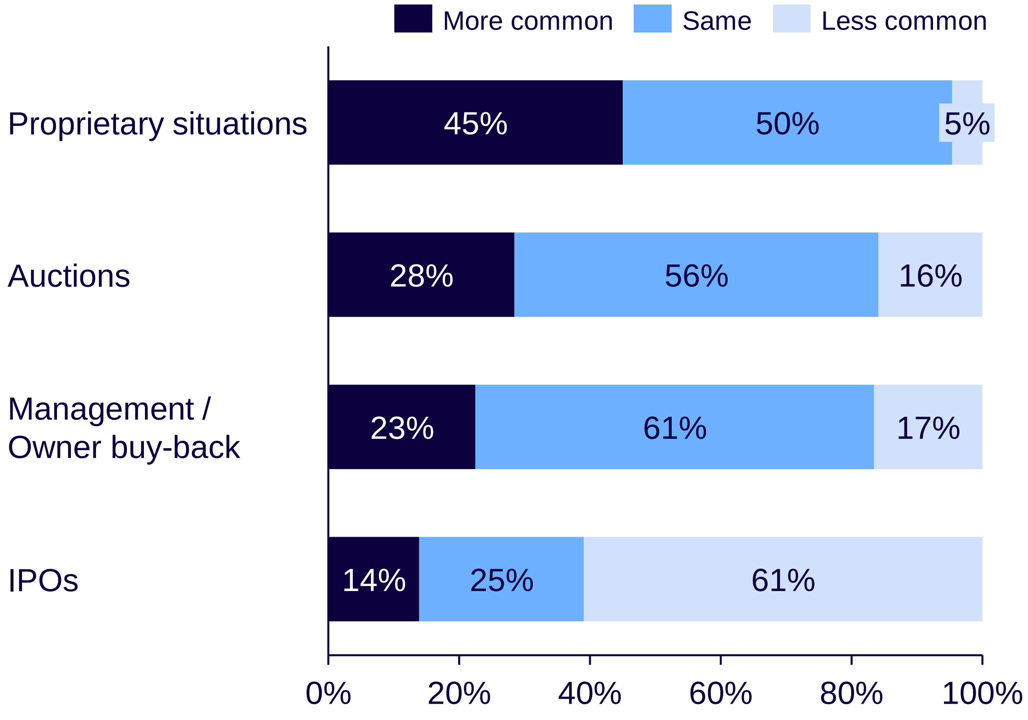
Divestments

Proprietary situations and Auctions will be more common going forward, whereas IPOs will be of lesser interest

Expected changes of exit route for companies under ownership over the next 12 months compared to the last 12 months,
(Europe, 2023 & 2022)

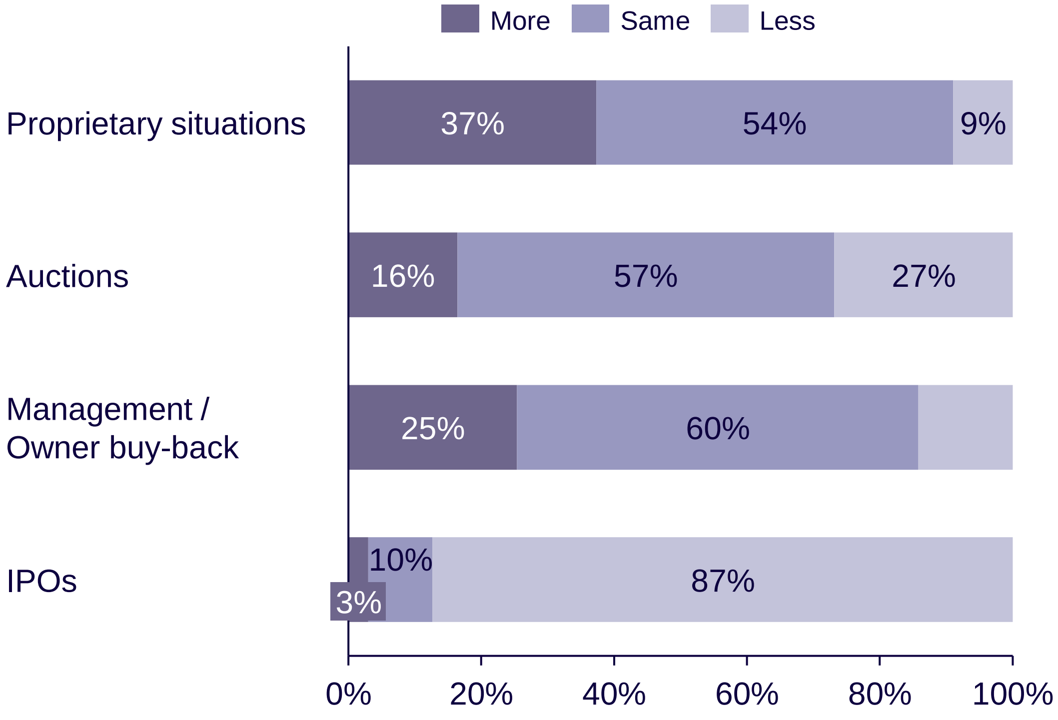
GP

2023



GP

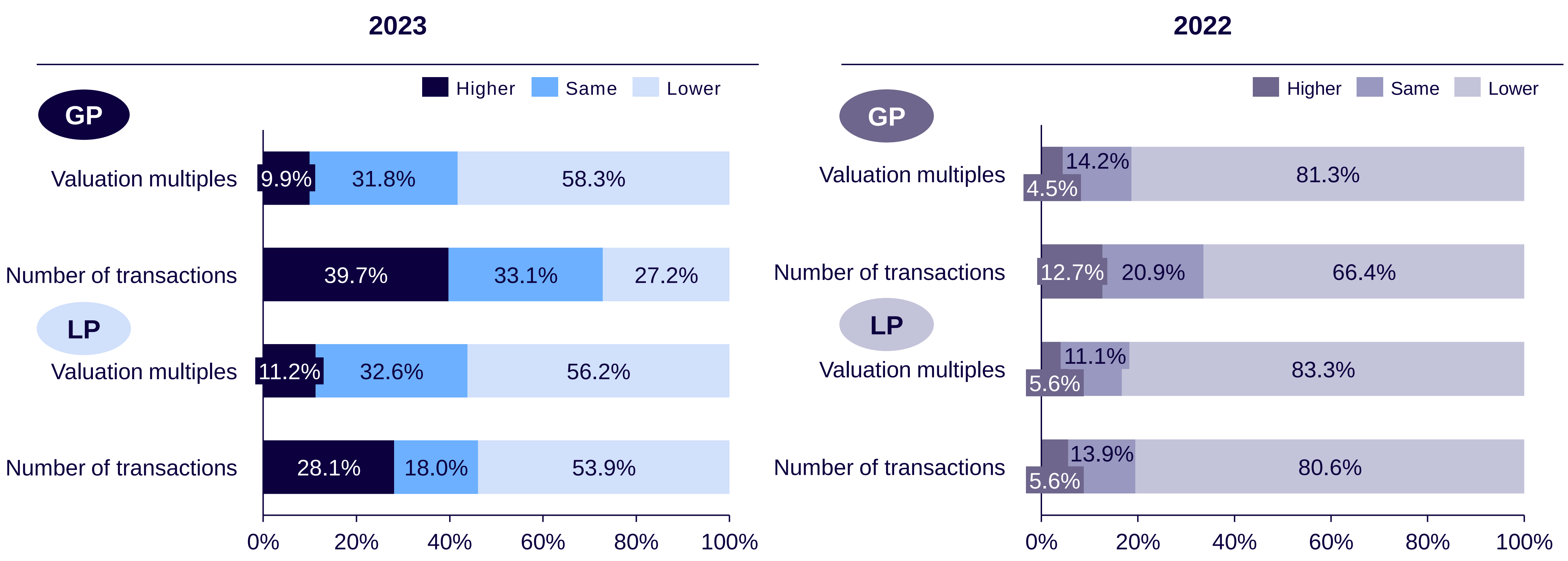
2022



Source: Arthur D. Little, Invest Europe

Anticipated decline in valuation multiples over the next 12 months, yet outlooks are more positive compared to a year ago

Evolution of PE transaction market in the next 12 months compared to the last 12 months by activity
(Europe, 2023 & 2022)



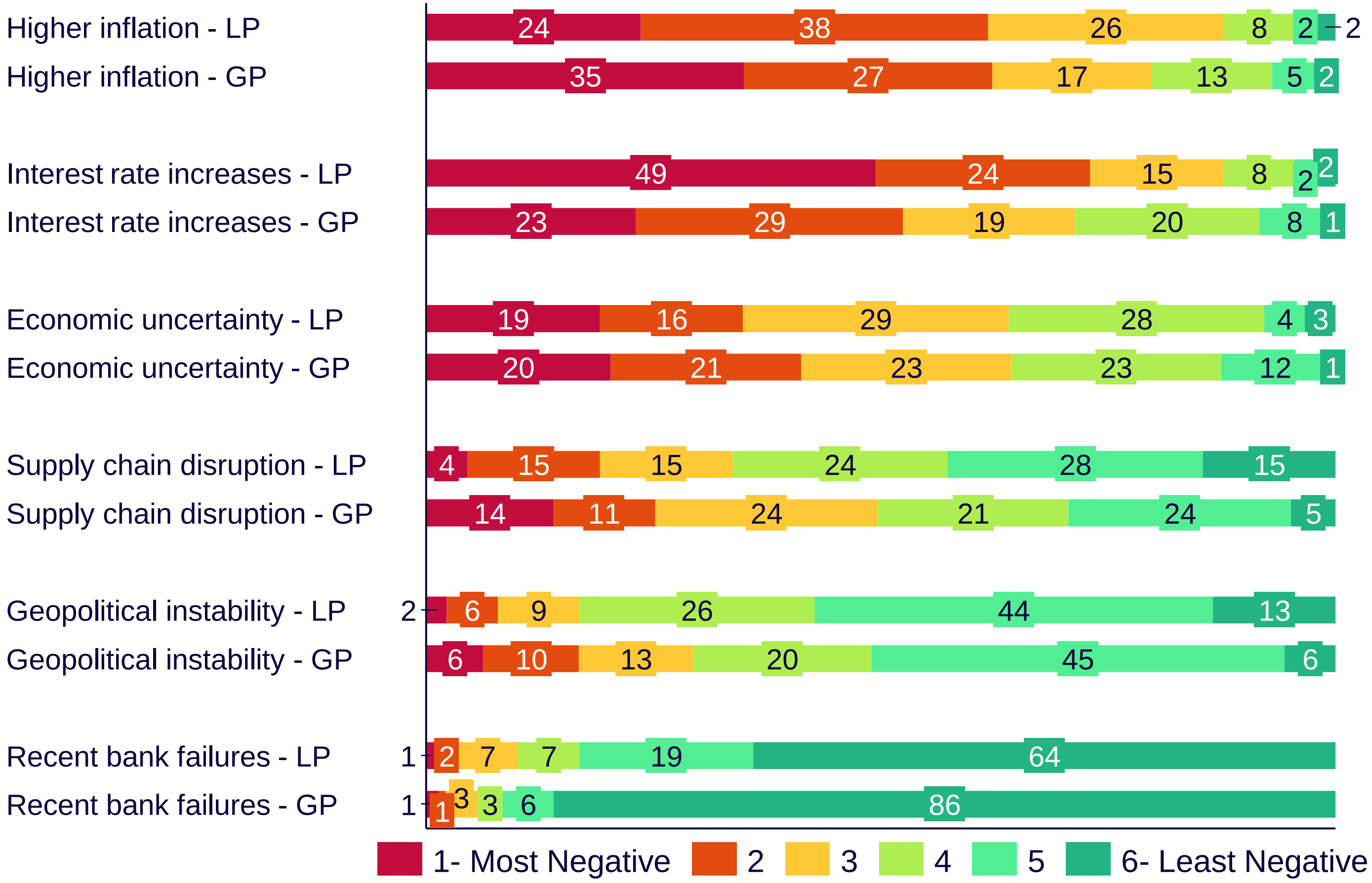
Source: Arthur D. Little, Invest Europe

PRIVATE EQUITY OPERATIONS FOCUS IMPACTED BY GENERAL TRENDS

Out of issues impacting the current economic climate, GPs and LPs consider increased interest rates and higher inflation as the most negative

Negatively impacting factors on business operations and performance (%)

(from 1 to 6, where 1 is the most negative factor, and 6 is the least negative)



Comments

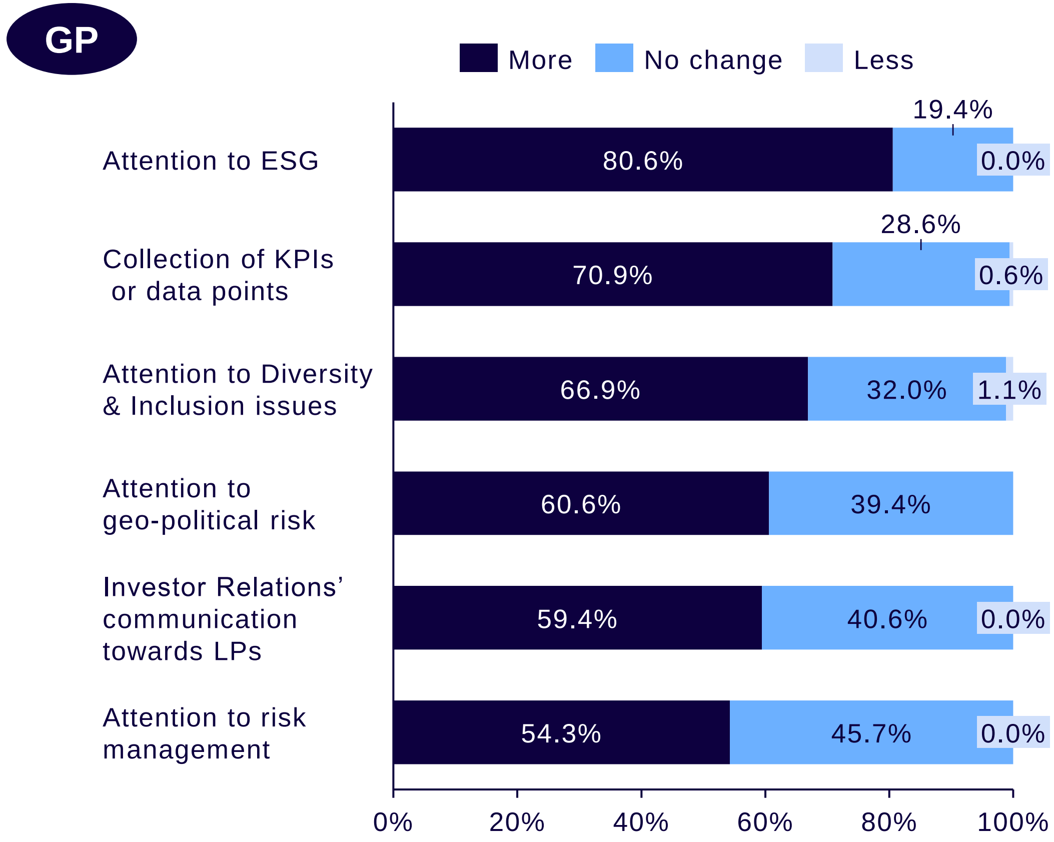
- Out of the issues arising from the new economic climate, higher inflation was ranked as having the most detrimental effects on GPs business operations and performance
  - More than 50% of both GPs and LPs ranked increased interest rates and higher inflation as having the most, or the second most negative impact
- The recent bank failures was of the least concern for both GPs and LPs
- Interest rate increases was of higher concern to LPs than GPs, with 49% ranking it as the most negative impact, whereas GPs deemed supply chain disruptions and geopolitical instability to be more adversely impacting factors than LPs did

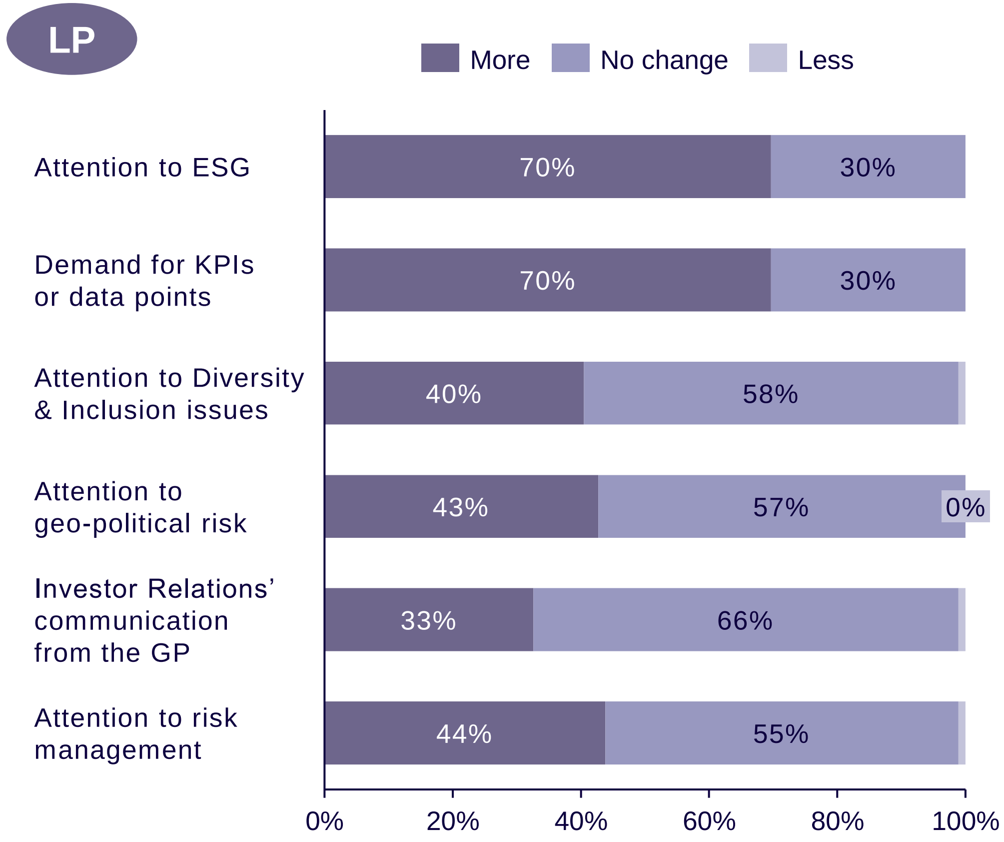
Source: Arthur D. Little, Invest Europe

Note: On slide 18 GPs also discuss the impact of high interest rates, however in that case it relates to upcoming investments as opposed to existing operations

Alongside attention to ESG and KPIs, attention to diversity and inclusion will increase going forward…

Expected changes in near future, daily operations,
(Europe, 2023)



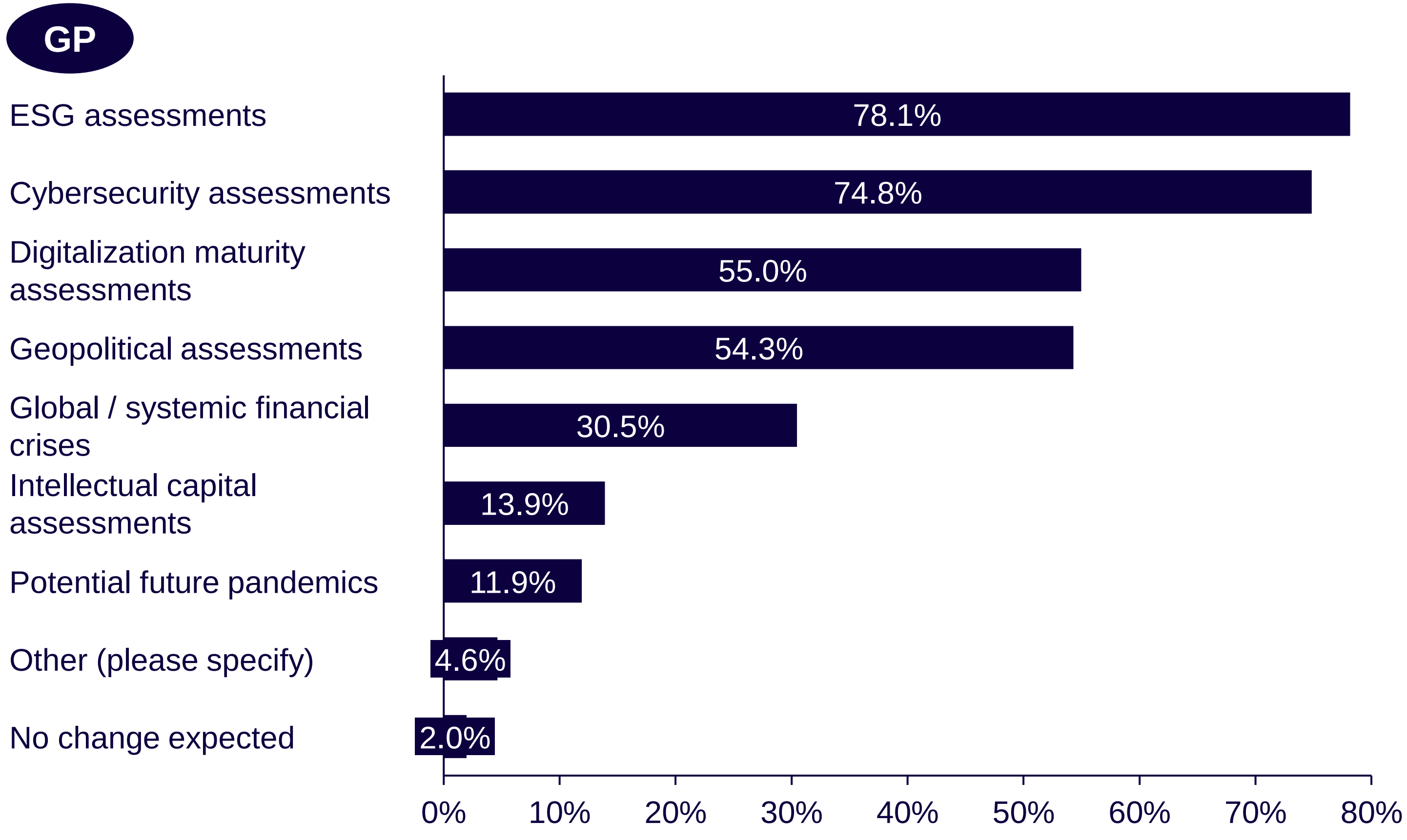


Source: Arthur D. Little, Invest Europe

ESG and cybersecurity assessments: emerging focus areas in due diligence processes

Areas receiving increased attention in future due diligence processes[1]

(Europe, 2023)



Comments

- Over 70% of respondents expect ESG and cybersecurity assessments to be of greater focus in upcoming due diligence processes
- Intellectual capital assessments are not expected to be as heavily considered
- Almost all respondents believe there will be a shift in areas of importance
  - 98.0% of GPs expect a future change

Source: Arthur D. Little, Invest Europe

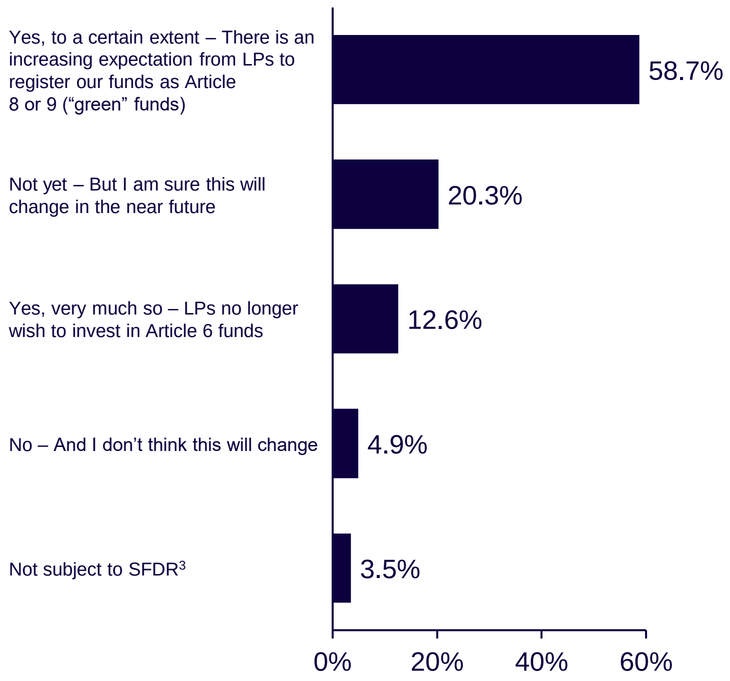
1) Multiple choice answers were available

Regulations

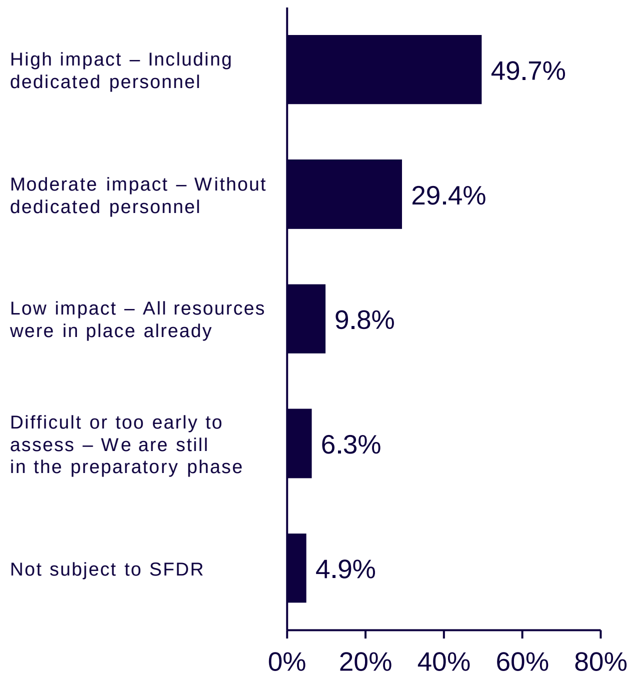
Regulations drive ESG trend, as most GPs observe or expect shifts in LPs' fund categorization expectations under SFDR

Expected impact on fund categorization and resource needs as a result of SFDR regulations (Europe, 2023)

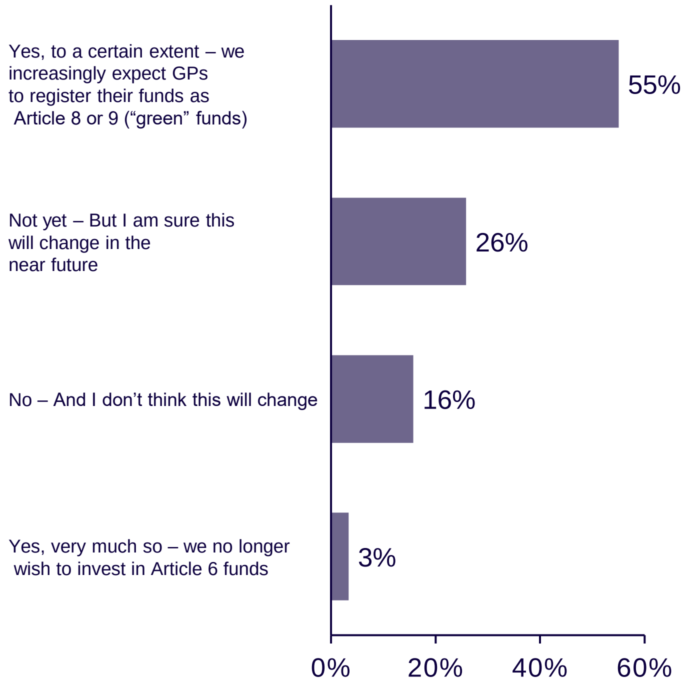
GP — Shift in expectations from LPs as to fund categorization under SFDR



GP — Implementation of SFDR’s impact on firm resources



LP — Implementation of SFDR’s impact on firm resources

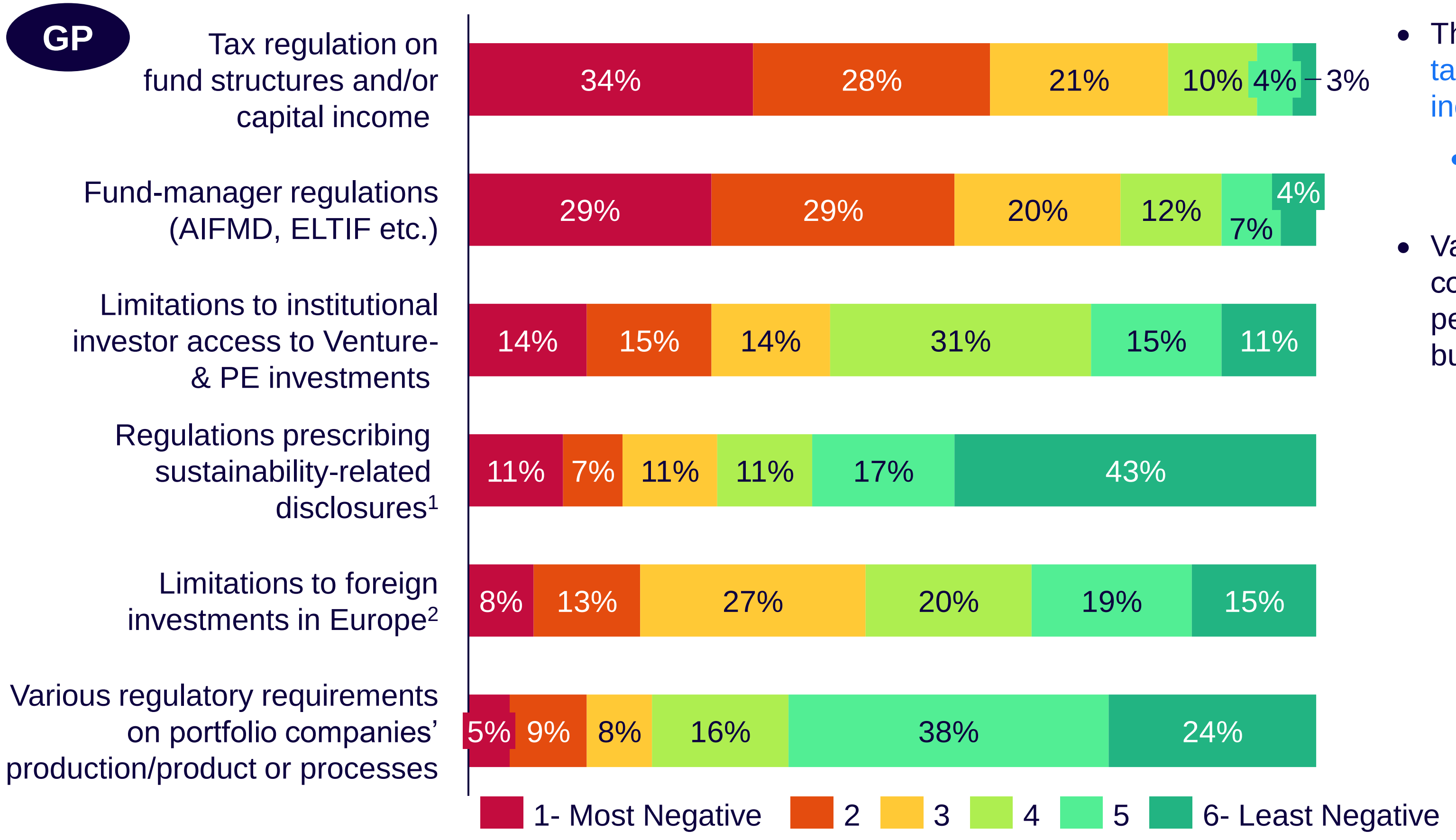


Source: Arthur D. Little, Invest Europe

Other key regulatory issues include tax regulation on fund structure and/or capital income – with clear negative expectations amongst GPs on operations

Regulatory issues ranked in terms of negative impact of business operations,

(from 1 to 6, where 1 is the most negative factor, and 6 is the least negative)



Comments

- The key regulatory concern amongst GPs are tax regulation on fund structures and/or capital income
  - ~34% of GPs listed this as the issue with the most negative impact
- Various regulatory requirements on portfolio companies' production/product or processes is perceived to have the least negative impact on business operations

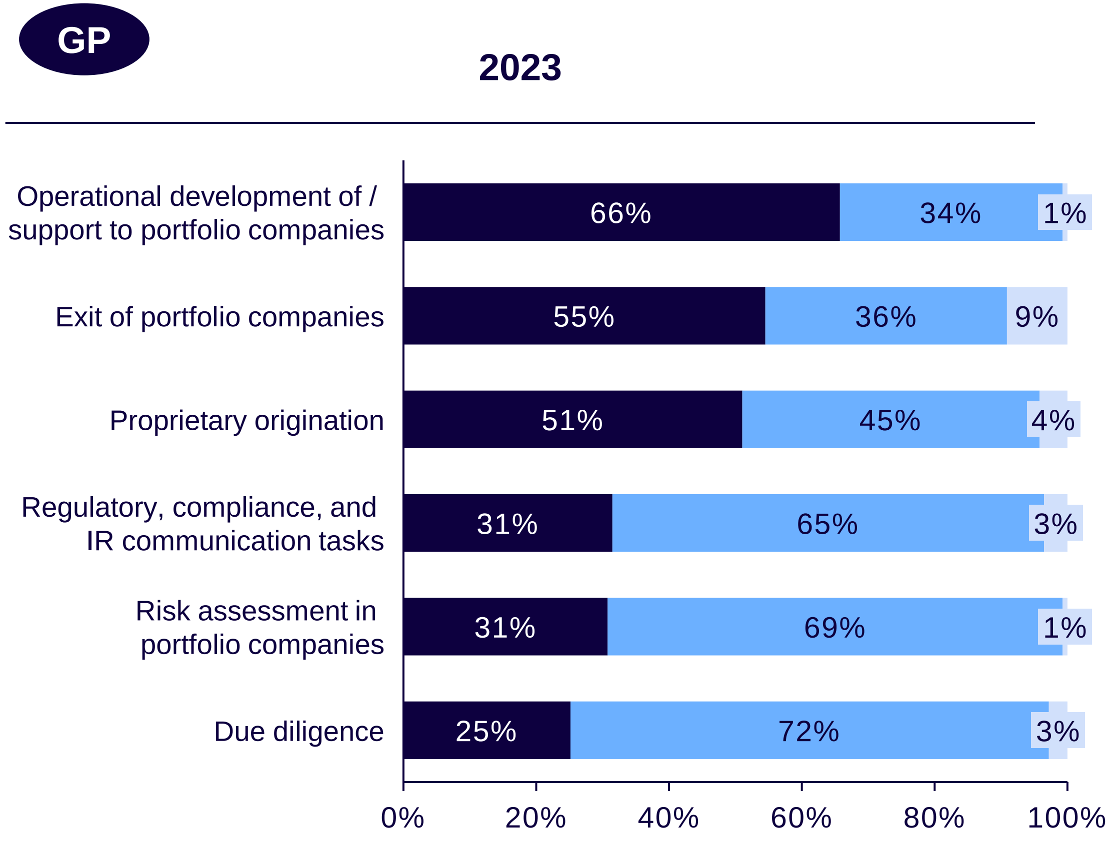
Source: Arthur D. Little, Invest Europe

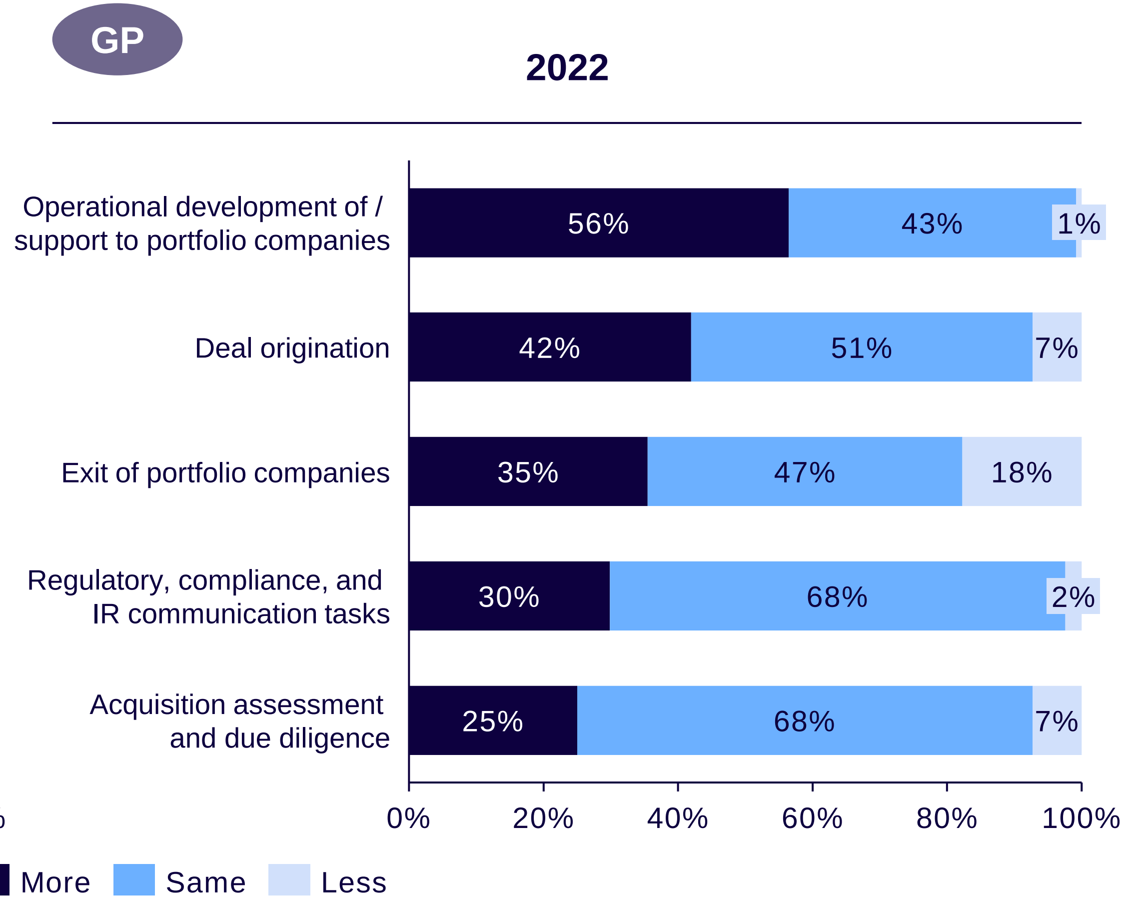
Note: 1) Capital requirements for banks, Solvency-demands for insurance companies, national investment rules for pension funds, 2) National FDI regimes, EU rules on foreign subsidiaries

Operational developments of portfolio companies is the most important activity among PE funds and it has increased in importance since last year

Main focus of your teams in the next 12 months compared to the last 12 months

(Europe, 2023 & 2022)





Source: Arthur D. Little, Invest Europe

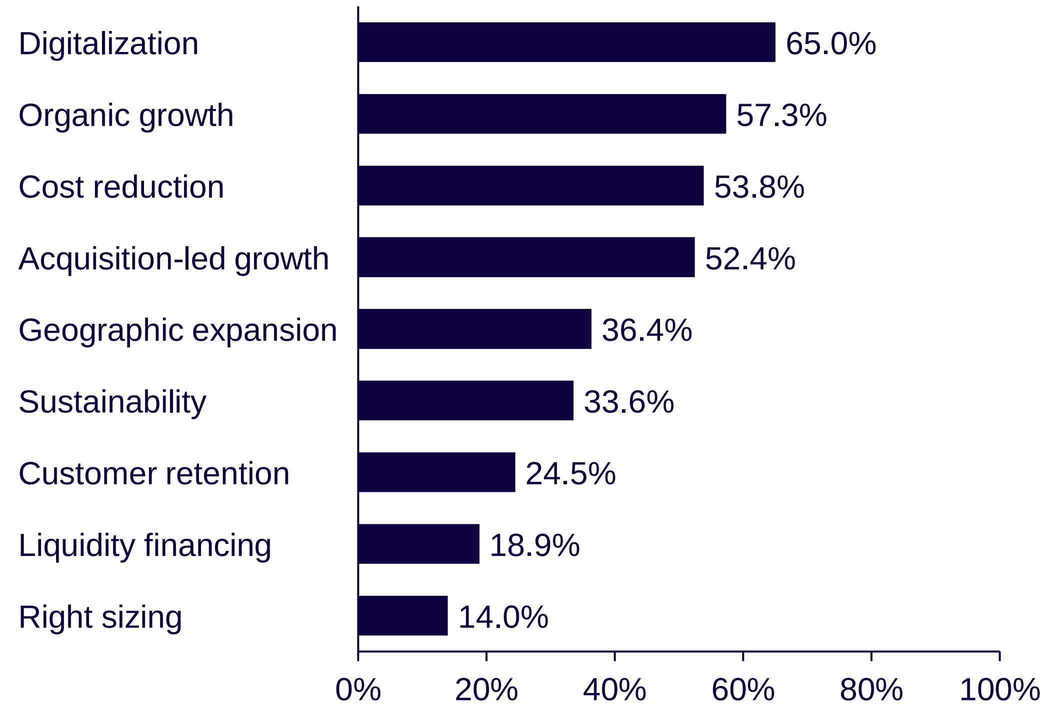
Digitalization continues to be an important improvement initiative amongst portfolio companies

Most important improvement initiatives being run in portfolio companies at the moment[1]

(Europe, 2023 & 2022)

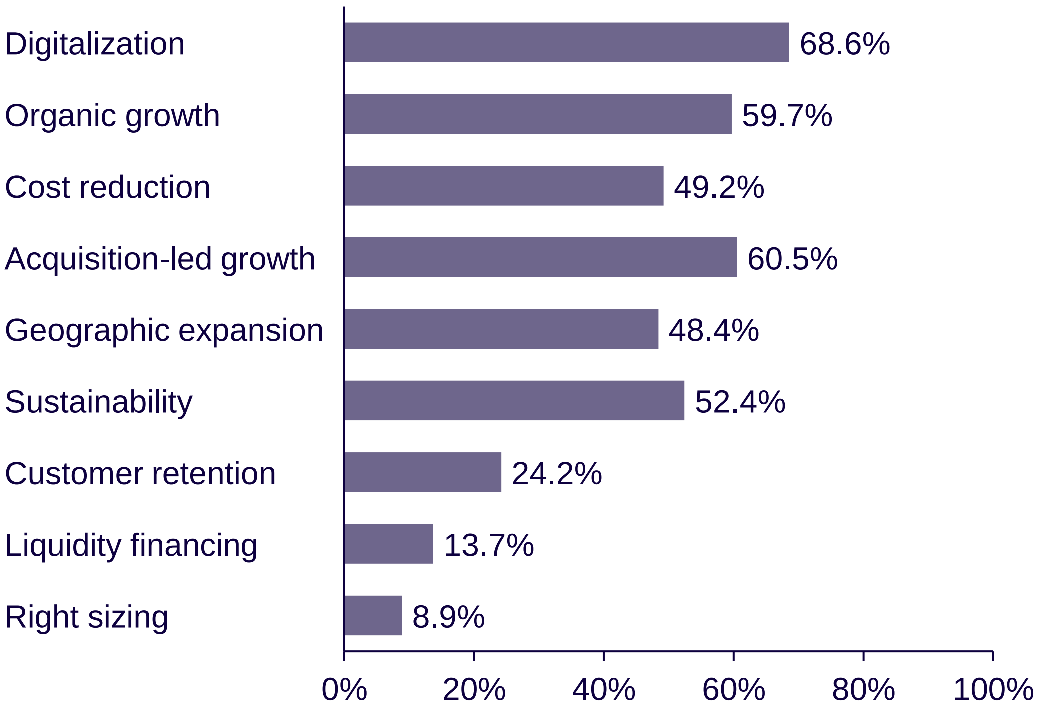
GP

2023



GP

2022



Source: Arthur D. Little, Invest Europe

1) Multiple choice answers were available

Available documentation and key contacts

Available documentation

- [Today's webinar presentation]

- A white paper of the survey will be published today and is available to everyone

- The full results of the survey is available in the form of a full report

The Insight: State of the European Private Equity Industry | Arthur D. Little (adlittle.com)

https://www.investeurope.eu/research/private-equity-market-insight/

Key contacts

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THE DIFFERENCE