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MID-MARKET
Report 2023

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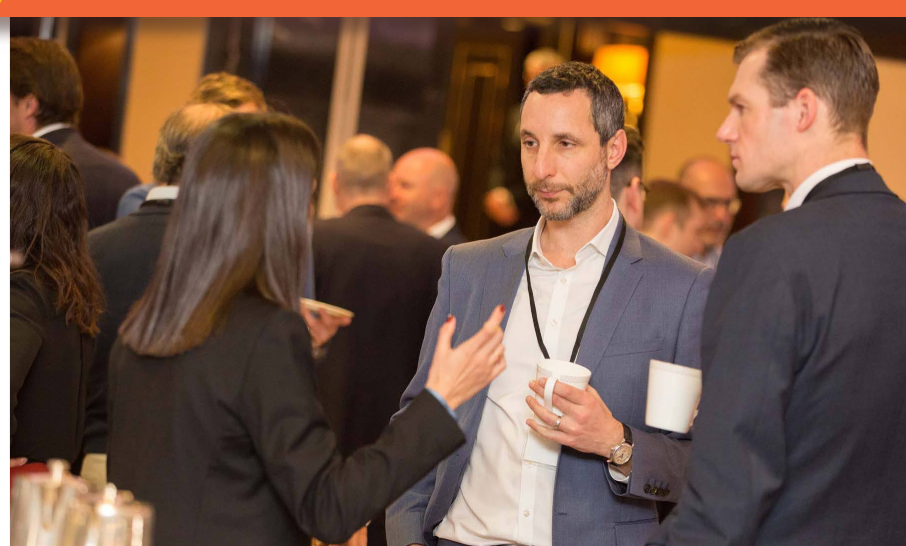

LEADER *Taku Dzimwasha*

Welcome

A temporary, inflation- and Ukraine-driven blip? Or a more fundamental cycle shift for private markets? The jury is still out, following a bruising year in which larger deal flow suffered a significant slowdown, and even flagship names found the fundraising trail more arduous than ever.

To help investors and advisers make sense of the challenges and opportunities ahead in this tumultuous market, *Real Deals* brought together more than 170 private equity practitioners in London in early February for the 14th *Real Deals* Mid-Market conference.

Through a series of panel discussions, keynote addresses and fireside chats, the event offered unparalleled insight from leading industry players on key issues including how best to fundraise in the current geopolitical climate, understanding LP perspectives amid a shift in allocation patterns, helping portfolio companies navigate the bumps in the road that lie ahead, and many more.

The *Real Deals* editorial team has now gathered the most critical takeaways from the event – along with the results of a poll we ran during the day to gauge market sentiment among a highly relevant cross-section of the PE community – to produce this special report.

We hope this will provide much food for thought and help you consider the opportunities ahead, and we look forward to welcoming you to our upcoming events to benefit from your insight in these fascinating times.

CONTENTS

THE EVENT

RealDeals
MID-MARKET

The 14th annual *Real Deals* Mid-Market Conference was held at The Royal Lancaster, London on 9 February 2023.

More than 150 GPs and LPs were in attendance, with talks by over 40 speakers across 10 sessions.

THE SPEAKERS

Vahit Alili
Schroders Capital

Maria Andrisani
Bain Capital

Tassilo Arnhold
AnaCap

Scott Barham
Connection Capital

Eric Bloom
Re:Co Insights

Martin Calderbank
Agilitas

Simon Cottle
Stanley Capital

Omiros D. Sarikas
Brookstreet Equity Partners LLP

Mirza Delibegovic
Limerston Capital

Walid Fakhry
Soho Square Capital

Jennifer Flood
Investindustrial

Ralf Flore
Ufenau

Filippo Gaggini
Progressio

James Hales
Northedge

Ulrich Hardt
Headway Capital Partners

Adam Harrison
Titanbay

Claire Hedley
17Capital

Jenny Collins
Mayfair Equity Partner

Wol Kolade
Livingbridge

Edgar Kolesnik
Abris Capital Partners

Serge Koniski
Montana Capital

Jeremy Lawson
ABRDN

Charlie Linacre
Finatal

Neil MacDougall
Sophora Unternehmerkapital

Merrick McKay
ABRDN

Scott Moeller
Bayes Business School

Nazo Moosa
Energy Impact Partner

Ipek Mutlu
Esas Holding

Marco Natoli
European Investment Fund

Olav Ostin
TempoCap

Philipp Patschkowski
Neuberger Berman

Stephen Pike
Macfarlanes

Vytautas Plunksnis
INVL Baltic Sea Growth Fund

Imogen Richards
Pantheon

Henry Sallitt
FPE Capital

Nicolas Schellenberg
Cambridge Associates

Claudio Siniscalco
Fiduciary Co-Investments Partners

Elena Smirnova
Glendower Capital

Henry Smith
Control Risks

Ellen van den Broek
Capital Dynamics

Stephanie Wall
Palatine

David Wilmot
Apera Asset Management

Garry Wilson
Endless

Charly Zwemstra
Main Capital

TECH INNOVATION

RealDeals | THE DRAWDOWN

29-30 March 2023
The King's Fund, 11 Cavendish Square, London

INDUSTRY-LEADING SPEAKERS INCLUDE:

Gilad G Amir
Digital Operating Partner,
Pollen Street Capital

Lyndon Arnold
Head of technology,
Triton Partners

Hind El Gaidi
Head of Financial Information
& Valuation, Astorg

Henrik Berg
CTO,
Verdane

Suzanne Pike
Partner & Head
of Origination, ECI

Christopher Conradi
Chief Digital Officer,
FSN Capital

Walid Fakhry
Co-Managing Partner,
Soho Square Capital

Ahmed Khamassi
Chief Digitalisation Officer,
Stirling Square Capital
Partners

Jean Schmitt
President &
Managing Partner,
Jolt Capital

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The *hot* takes

From returns expectations to ESG overload and fewer cultural barriers for young entrepreneurs – the team gathers key insights from the *Real Deals* Mid-Market conference, hosted in London on 9 February

You've got to bet, given the amount of dry powder in the market, that dealmaking has to come back. Because sitting there saying to LPs 'we've done nothing for a year' is quite a tough sell, no matter how conservative your due diligence has been. If you can't find quality assets, why are LPs paying you 1.5%-2%?

Wol Kolade, managing partner at Livingbridge

DACH is the economic powerhouse of the continent. If you want to be in European assets, you need to be there. And when you add the Nordic countries together, it's also a significant power. So if you are in Europe but not looking at these two regions, I'm not sure what you are doing.

Neil MacDougall, chairman at Sophora Unternehmerkapital

So much is getting piled into ESG, I forever feel as though I'm firefighting. It worries me that people might be overwhelmed and may be put off from even making a start on ESG, given the concerns about greenwashing, the demands coming from all sides, etc.

Stephanie Wall, sustainability director at Palatine

I do believe returns are going to be significantly lower over the next five years when it comes to mid-market private equity funds – bearing in mind they have been phenomenally good over the past five years, through great work from GPs and a very positive environment.

Merrick McKay, head of private equity Europe at Abrdn

> A lot of mid-market firms get stuck in thinking whether they need to have a full-time ESG person in-house. They can, but if the firms have a strong governance process internally already, there are ways to map the needs of ESG to different people within the organisation in ways that integrate the process, and that integration is going to make your life easier down the road, rather than taking ESG and tacking it onto the CFO role or the compliance role.

Eric Bloom, CFO and head of client solutions at Re:Co Insightsw

> In the technology space, we are going to see much more similarity between European countries – everyone looks to the US and there are much fewer barriers between the cultures. British entrepreneurs under 35 are very similar to French, German, Spanish entrepreneurs in the way they see the world and opportunities. If you are not in tune with this big change in our market, you will struggle to connect with them.

Olav Ostin, managing partner at TempoCap

> No successful private equity firm can really be a generalist in a way of being all things to all people – that's just impossible. You need to have an angle and you need to be a specialist in something. Be it a strategy, approach, sector, a multitude of sectors, region, whatever.

Mirza Delibegovic, partner at Limerston Capital

> When we look at past recessions, those vintage of deals have tended to do very well. So, this is an opportunity for us. Dealmaking is more complex, financing is more scarce and it takes longer. But you tend to do better deals, better-priced deals, if you focus on asset quality. We're trying to not miss opportunities. We have a big regret that we didn't invest enough in 2008.

Maria Andrisani, head of capital markets Europe at Bain Capital

> We need to be able to tell a company what value we can bring to them, as much as what value they can create for us. Otherwise we don't deserve to be their controlling shareholder.

Martin Calderbank, managing partner at Agilitas Private Equity

RealDeals MID-MARKET

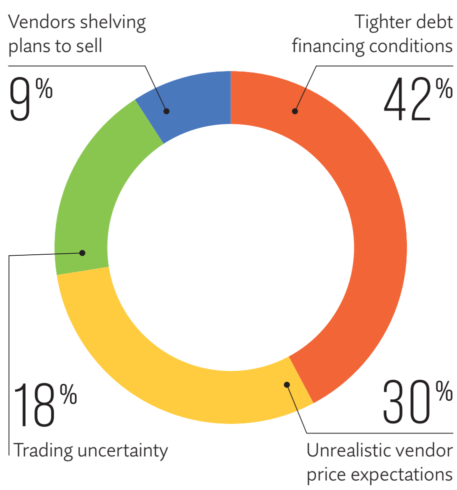
MID-MARKET BAROMETER

Throughout the *Real Deals* Mid-Market event programme, a series of polls were conducted to delve more deeply into opinions on the key areas discussed in the day's panels on dealflow, fundraising, ESG, investment strategies and value creation. *Julian Longhurst* summarises the mood in the room

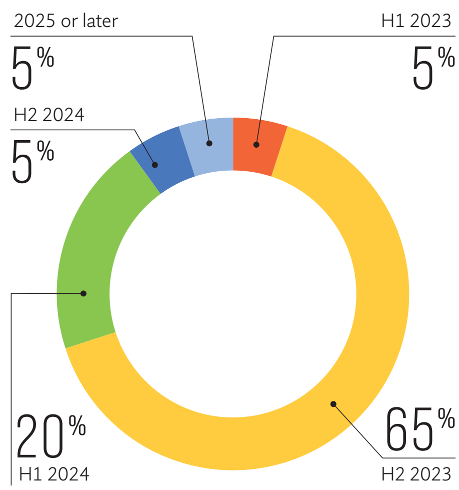
H2 rebound?

The downturn that has unfolded during the last 12 months has increasingly impacted deal-doing from a number of different angles, with rapidly rising energy costs and supply chain issues all affecting businesses and consumers alike. As 2022 progressed, dealflow became increasingly squeezed, especially at the upper end of the mid-market and the larger-cap space. We put two questions to the RDMM audience to help understand what the key impacts have been and how long they are likely to last.

Most significant negative effects on dealflow

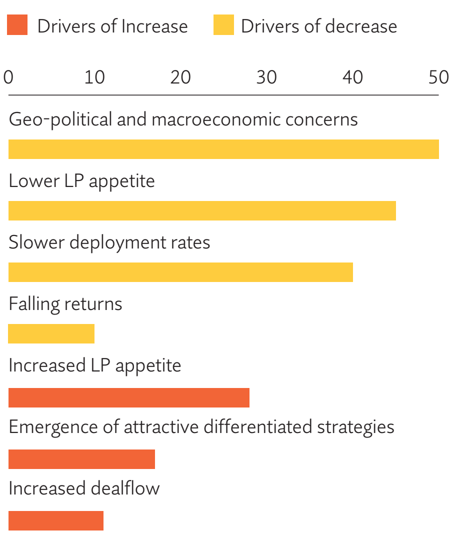


When will mid-market deal activity pick up?

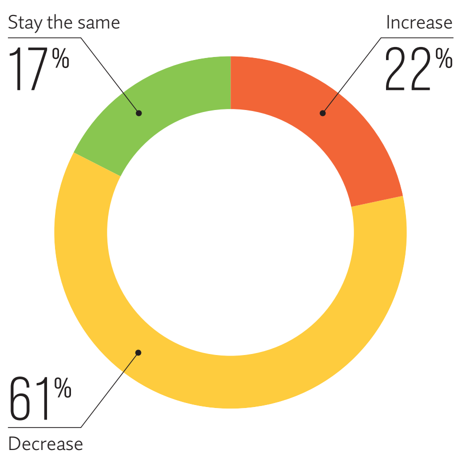


Fundraising squeeze

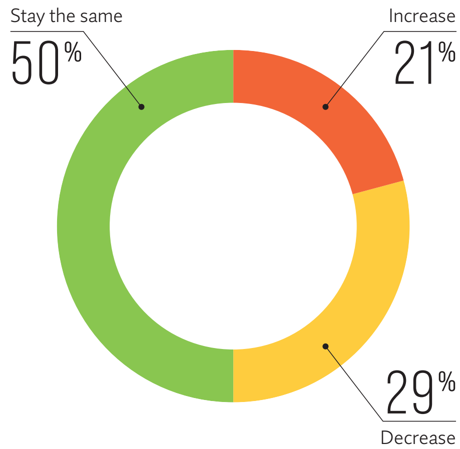
Although the predictions of the audience surrounding dealflow were cautiously optimistic about a quick return to better investment conditions, the mood relating to fundraising was notably less bullish, with well over half of respondents predicting a downturn in fundraising volumes during the next year.



Fundraising Outlook



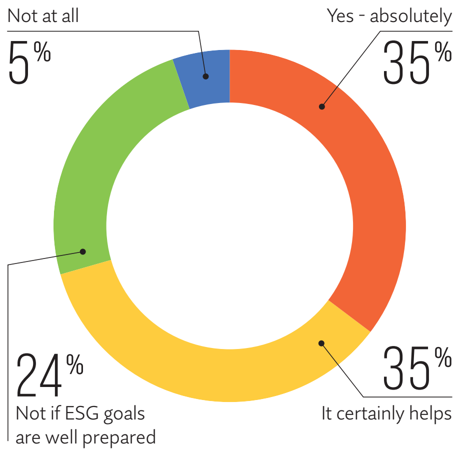
Returns (next five years)?



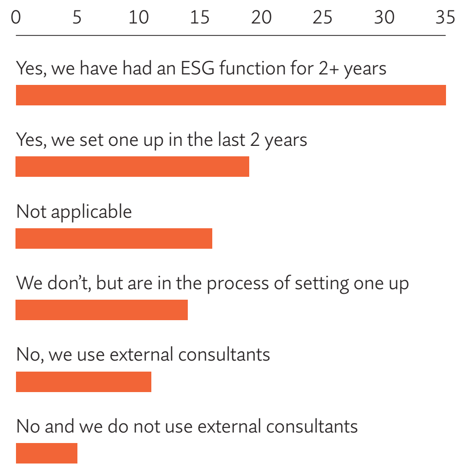
ESG: part and parcel

Asked if a dedicated ESG function is necessary for GPs to attract new LP commitments, 70% of those answering agreed that it is either essential or very helpful. Given the growing focus of investors, investees and advisers on this area, it is something that will only become more ingrained in the private equity playbook.

Is a dedicated ESG function necessary for GPs to attract new LP commitments?



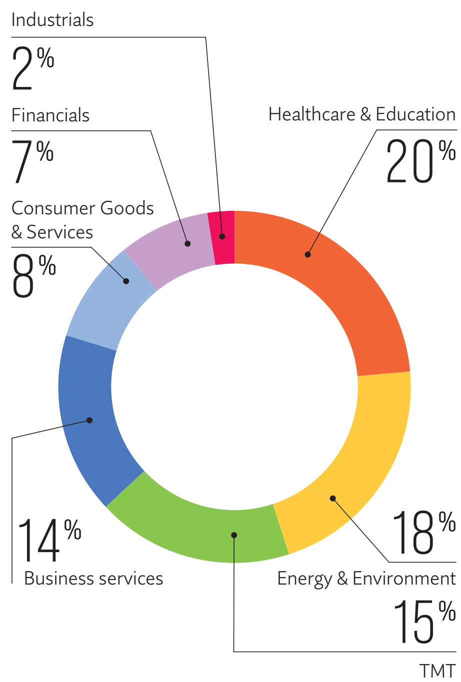
Do you have an integrated ESG/DEI function in your business?



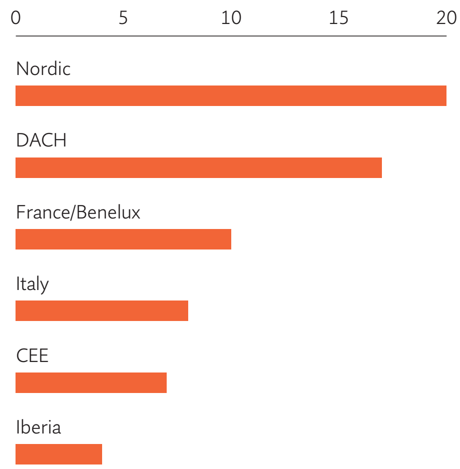
Northern lights

The audience's preference for countercyclical sectors such as healthcare and education is unsurprising. A perhaps more unexpected result came when voters clearly highlighted the Nordics and DACH countries as presenting the most attractive opportunities – even though both regions typically rank highly in the average entry multiples that are paid to secure assets.

Most promising sectors, next 12-24 months



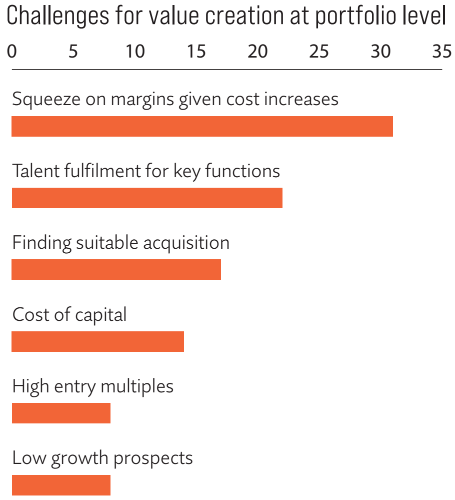
European regions with the most attractive opportunities in current conditions



Margin headaches

While issues surrounding the rising cost of capital were highlighted earlier in the day as a significant barrier to dealflow, it ranked relatively low among the challenges to value creation. Instead, the chief concerns of investors surrounded the squeeze on margins experienced by portfolio firms as energy and supply chain costs have risen.

Challenges for value creation at portfolio level



RealDeals
MID-MARKET

State of the mid-market union

Leading GPs and LPs ponder the outlook for mid-cap PE, and how investors intend to deploy capital in the current climate

Having emerged from a brutal 2022 where both dealflow and fundraising faltered in the face of exceptional macro shocks, most delegates at the 2023 Real Deals Mid-Market conference were in a suitably cautious mood. "There are fewer buyers on the market and, in some cases, even fewer sellers, because people think now is not a good time to sell," said Vytautas Plunksnis, a partner at INVL Baltic Sea Growth Fund.

In spite of this, there are market players who see this period as an opportunity to build their portfolios. Maria Andrisani, head of capital markets in Europe at Bain Capital, said she wants to avoid repeating mistakes in another recession: "When we look at past recessions, those vintages of deals have tended to do very well. So, this is an opportunity for us. Dealmaking is more complex, financing is scarce and it takes longer. But if you focus on asset quality, you tend to do better deals that are better priced. We have a big regret that in 2008 we didn't invest enough, so we're trying to not miss opportunities."

Others, however, warned against drawing firm conclusions from previous data, noting that the world has fundamentally changed since the last recession. Wol Kolade, managing partner at Livingbridge, said: "Go back to 2017-2018: no pandemic, no war in Russia. So, I get nervous when people go over past conditions and think it's going to present itself today. Yes, the data probably says this is the best time to buy, but it doesn't tell you what to buy, does it?"

Panellists noted that market conditions have resulted in a mismatch in valuation expectations between buyers and sellers, with a unanimous view that valuations have overall decreased to varying degrees. As a consequence, Plunksnis noted that firms may need to be more "creative" when structuring deals, citing a recent deal completed by INVL that involved a "significant" amount of vendor financing. With public-market valuations having adjusted more than private valuations, Andrisani pointed out the significant uptick in public-to-private transactions.

As market operators are hesitant to sell assets in a reduced valuation environment, Imogen Richards, partner at Pantheon, expects exits to be down this year, with little expectation of an IPO rebound, as GPs instead refinance or hold onto their assets for longer if they feel there is still value and room for growth. Kolade alluded to opportunities to sell to strategic buyers, but also noted that this may be contributing to the market slowdown: "One of the reasons that the exit process is extending is because strategics are just very slow. In hot markets, they were never able to compete; today, they're pretty effective and quite compelling buyers for assets, as a lot of the cash-rich don't have the same debt and leverage problems that we have in private equity."

"We are trying to invest with a more specific focus on the added value, which goes beyond the financial returns

Marco Natoli, European Investment Fund

On the rebound

Although dealflow dramatically reduced last year, panellists predicted that the industry will see a "strong" return of dealmaking from the second half of 2023 through to 2024. Supporting this view, Kolade stated: "You've got to bet, given the amount of dry powder in the market, that dealmaking has to come back. Because sitting there saying to LPs 'we've done nothing for a year' is quite a tough sell, no matter how conservative your due diligence has been. If you can't find quality assets, why are LPs paying you 1.5%-2%?"

Looking ahead, speakers honed in on how best to navigate the "impending" recession, with an emphasis on finding management teams with agility, resilience and experience in managing assets through difficult times. Kolade noted the importance of testing a manager's scenario planning through granular and challenging questioning, while Andrisani emphasised having a "tighter control" on portfolio companies by being closely involved with the business.

Pantheon's Richards recognised the significance of good judgement in this environment: "On paper, a lot of investment opportunities and funds look the same. Lots of firms have great performance, 12 investment professionals and experience in different sectors. But how do you differentiate between these opportunities? That comes from experience-driven intuition, where you've got that extra knowledge around what's going on." Kolade concurred that "extreme diligence is no substitute for really good judgement".

Given the unpredictable nature of recent months, few panellists were keen on clear-cut, crystal-ball takes on future developments. "As investors, we've got to invest capital wisely and continue to invest over the cycle. If you try and time the market, you're inevitably going to fail," said Richards. With this in mind, panellists asserted that focusing on the quality of individual deals is what matters for a long-term asset class like private equity. "Our game's a micro game in which you look at each individual asset," Kolade summed up. "The macro stuff probably affects, to a certain degree, your exit timing and your exit result. But actually, if you've got a great company with good cashflow that's growing and developing, whether you're in a recession or not, generally speaking you should be fine."

The LP perspective

In a separate panel, leading LPs offered their own take on the challenging environment. Merrick McKay, head of private equity Europe at Abrdn, did not sugarcoat his views on performance in the coming years: "I do believe returns are going to be significantly lower over the next five years when it comes to mid-market private equity funds – bearing in mind they have been phenomenally good over the past five years, through great work from GPs and a very positive environment."

Meanwhile, Marco Natoli, head of lower mid-market at the European Investment Fund, said the adaptation in the organisation's investment strategies is not reflective of a contingent situation but rather of its longer-term views. "Green transformation, digital transition, the support to healthcare and to the sectors which are strategic for Europe, for example energy independence… we are trying to invest with a more specific focus on the added value, which goes beyond the financial returns."

Natoli's co-panelist Claudio Siniscalco, founder of Fiduciary Co-Investment Partners, and the panel's moderator Ipek Mutlu, Esas Holding's head of international PE, also observed that a tactical approach in allocation and investment has gained more importance in the current scenario. Mutlu added that looking at different parts of the capital structure has become a new strategy for a lot of LPs: "Some are just changing their allocations, whereas we are starting to look at more structured deals."

Her firm is a Turkish family office engaged in fund investments as a co-investor. She noted that the LP tries to focus on funds that have stronger operational capabilities, something that will become "very important" in the next couple of years. In these turbulent economic times, the firm is focusing more on resilient sectors, she said.

While discussing valuations in the asset class and if PE participants can time the market, Siniscalco took a contrarian view and said it's "absolutely possible" to do that from a co-investment perspective. He explained: "Since co-investments are not broad macro bets or blind-pool allocations to hundreds of top-tier managers and consisting of billions of capital, their small size, ranging between €10m and €20m at a time, allows investors the luxury of constructing a far more concentrated and customised portfolio. At times like these, the availability of such co-investments is much greater."

The LPs on the panel also reflected on the things they are more focused on in the "new normal". Natoli said his firm has begun to pay more attention to how GPs are able to explain what differentiates them, and that helps win transactions and create value for the companies they back.

On the topic of ESG, which is fast becoming a key part of private equity players' approach, he stressed: "Everybody on the institutional side is paying attention to ESG, but it is very important to differentiate between GPs who have a genuine approach, and those who are simply ticking the box because it is a requirement to get an appointment with an investor."

Mutlu mentioned how Esas has started to pay more attention to operating capabilities, noting that a large and strong operating team is helpful. "That's one criterion we have added to our diligence list, in addition to sector specialisation – both of which are becoming more valuable in today's market from the originating perspective but also the value-creation perspective," she said. ●

EASY DOES IT

Speakers suggested cautious optimism is the right approach for the coming year when it comes to fundraising.

Following a sobering year on the fundraising front, panellists discussed the nuances around identifying real capital, and the difficulties of fundraising in a recessionary and turbulent market.

GPs coming back to market for their next fund need to hone in on their differentiation strategy, panellists agreed, in order to stand out in a hyper-competitive environment for tapping investors. As LPs are becoming more fault-finding in their allocations, GPs that look to diversify their strategies and stand out in a crowded market are more likely to secure investment from both their existing and new LP bases.

"To address that with our own LPs, we focus to a large degree on independent sponsor co-investments, which is a market that's partially been impacted by the tough fundraising environment," said Ulrich Hardt, partner at Headway Capital Partners. "A lot of GPs might be struggling to raise new funds, senior MBAs become disappointed about their career progression and so start their own firms, although raising a first-time fund is nearly impossible if you don't come with existing LP relationships."

Cautious optimism

Macroeconomic issues, however, remained the key driver behind LPs being more bearish with allocations. Therefore, GPs were urged by panellists to proceed with cautious optimism and take fundraising at a slower-than-2021 pace.

Hardt added: "There is still a lot of overhang on the fundraising side, which we have seen in the first half of 2022. That will not be flushed out of the market. In the near term, there are bigger fears on the macro side within the LP community – fears about the potential looming recession but also about distributions slowing down. Both of those facts are likely to have a negative impact on fundraising, even though the funds that invest throughout a recession historically prove to be the best-performing funds."

The state of play on the institutional investor side is also having a knock-on effect on the industry's efforts to attract and retain retail investors. Where democratisation may be the solution to a fundraising slowdown, platform provider Titanbay's head of strategic partnerships, Adam Harrison, told delegates that they can no longer facilitate funds unless they are certain to meet minimum allocations.

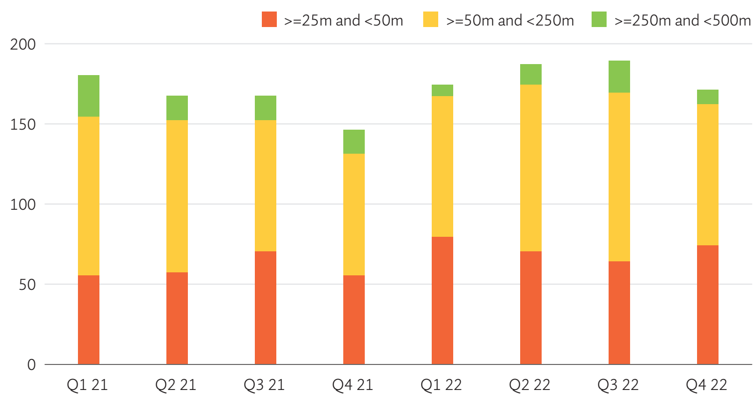
"We wouldn't engage with a GP unless we were confident, as a platform, that we could generate enough demand to meet the bare minimum," he said. "We would then ask for flexibility to effectively increase the allocations that we secure, if we can see that there's significant demand above the minimum, to facilitate us being the first closers."

MID-MARKET: THE DATA

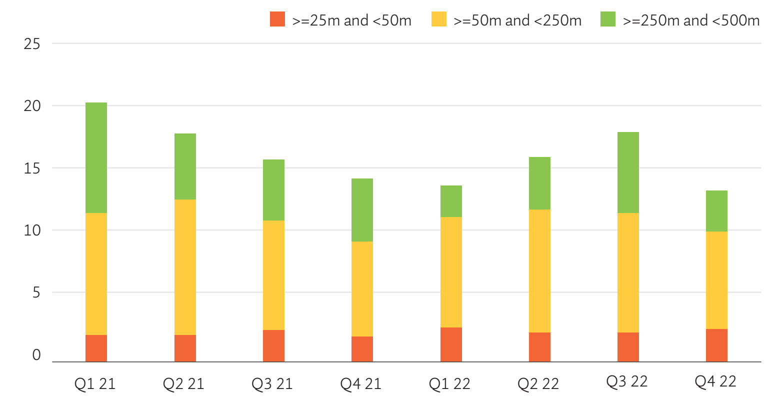
The *Real Deals* Data Hub assesses the fortunes of the three mid-market brackets during the last two full years. *Julian Longhurst* summarises the key top-line trends

1. Volume and value by quarter

Volume of European Mid-market Buyouts



€bn Value of European Mid-market Buyouts



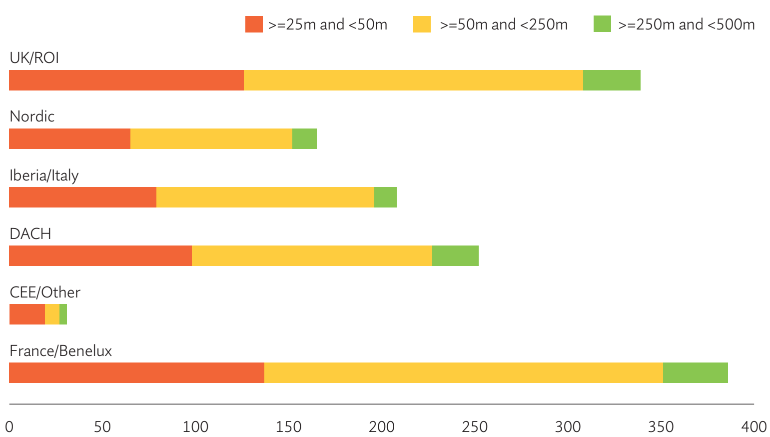
1.1. *In overall volume terms, the European mid-cap buyout market has fared comparatively well in the last year, following a downward trend in 2021. Although there was a marked dropoff in the final quarter of the year – which ties in with anecdotal reports of a slowing pace of dealflow – the 171 Q4 deals worth between €25m and €500m remain comfortably above the 2021 quarterly average (165).*

1.2. *Analysing the market by size brackets shows that the main strength in 2022 was at the smaller end of the scale: the lower mid-cap space (€25-50m) averaged nearly 72 deals per quarter in the latest year, versus less than 60 in 2021; while the core mid-cap space (€50-250m) averaged 96 deals per quarter in 2022 (breaking the 100-mark twice), versus 88 the year before. Conversely, the upper mid-cap segment saw a sharp drop in activity last year, with only two quarters making it to double figures.*

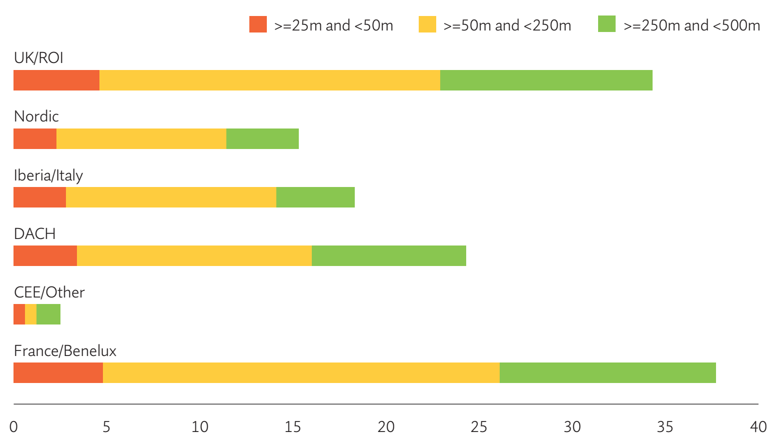
1.3. *Although the top-line pattern in value terms broadly matches the volume trend, the trends within the size brackets were more uniformly downward, with the exception of the lower mid-cap space, which saw €10bn of deals in 2022 versus €8.6bn the year before. While the core mid-cap bracket was down marginally in 2022 (down €1bn at €36bn), the value of upper-mid deals declined sharply from €24bn to €16.5bn.*

2. Volume and value by European region

Volume of Mid-market Buyouts by Region, 21/22



€bn Value of Mid-market Buyouts by Region, 21/22



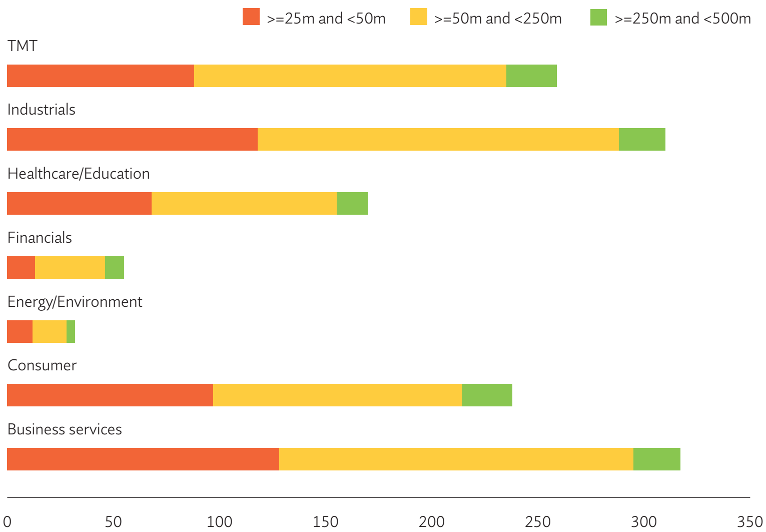
2.1. *Looking at the two-year period as a whole, the France/Benelux market showed a clean set of heels to all other regions in each of the three size categories, driven primarily by the French market and its high volume of leveraged minority buyout transactions. In all, the region saw 386 mid-cap deals worth nearly €38bn. The core mid-market space accounted for 55% of the regional total by volume and 57% by value.*

2.2. *However, the UK remains the single largest market in Europe, with the combined UK/ROI region producing 339 mid-cap buyouts worth €34bn in total. The distribution of 2021/22 dealflow closely mirrored France/Benelux, with the lower-mid and core mid-cap segments producing 37% and 54% of the transactions by volume, while the core-mid and upper-mid brackets created 53.5% and 33% of the market's value respectively.*

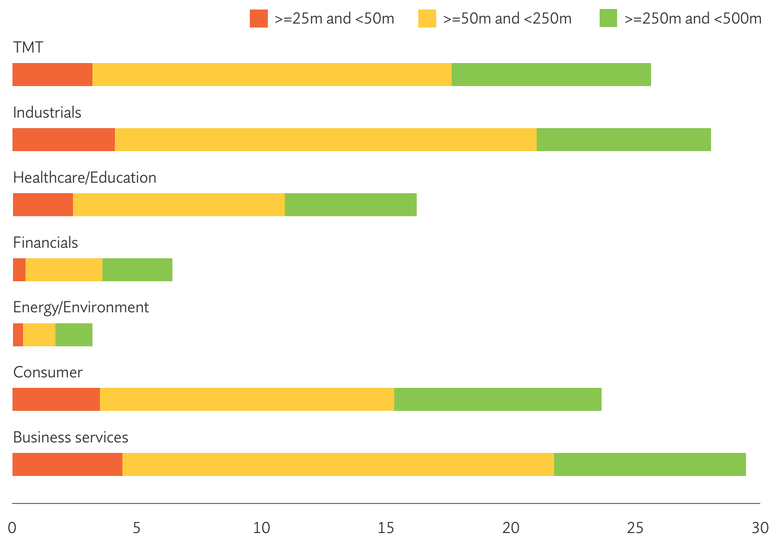
2.3. *The DACH region produced more than 250 mid-cap buyouts worth a little over €24bn, with a similar distribution across the size brackets to the other main markets. The Italy/Iberia region also saw relatively strong activity in the mid-market, with 208 deals worth €18bn in the period, while the Nordic market produced 165 deals valued at €15bn.*

3. Volume and value by sector

Volume of Mid-market Buyouts by Sector, 21/22



€bn Value of Mid-market Buyouts by Sector, 21/22



3.1. *The standout sectors in the European mid-market during the past two years have been the business services and industrials areas, between them accounting for 627 deals, or 45% of the market, and 43% of the €132bn cumulative value. What is more, both had a stronger year in 2022 than they had in 2021.*

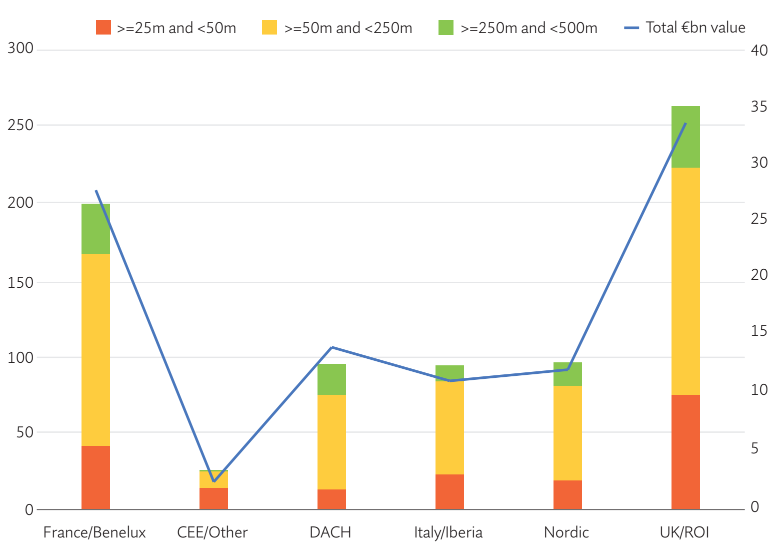
3.2. *Interestingly, despite seeing strong advances in the PE market as a whole (including growth and VC), the third-ranked sector – TMT – only grew modestly in 2022 and overall generated 259 deals worth €25.7bn (19% of the market by volume and value).*

3.3. *Unsurprisingly, given the prevailing economic conditions and the cost-of-living crisis, buyouts involving consumer products and services business have slowed throughout the period: of the 238 total (worth €23.6bn), only 107 were completed in 2022.*

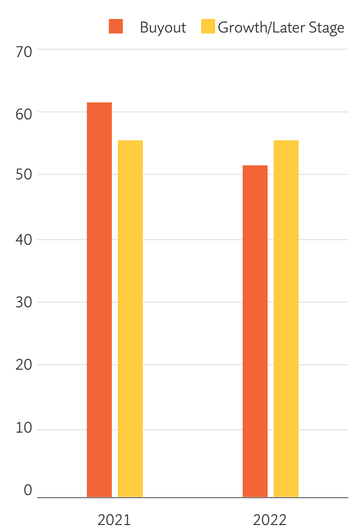
3.4. *In terms of the spread of deals across size brackets, most sectors are broadly in line with each other proportionately. The exceptions are the smaller financials and energy/environment sectors, which were comparatively more weighted towards the larger brackets.*

4. Exits and fundraising

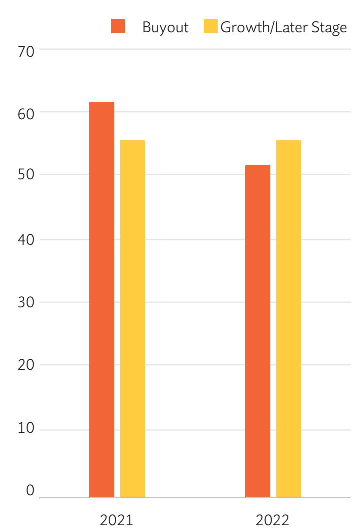
Volume and €bn value of Exits by Region and Exit size



Volume of later stage/buyout fund closes



Volume of later stage/buyout fund closes



4.1. *Unlike the deal statistics, the UK/ROI region recorded comfortably the most exits of portfolio companies valued at €25-500m. In total, the region generated 269 exits, with a total estimated sale value of some €34bn. The only other region to record triple-digit exit volumes was France/Benelux, with 204 exits valued at around €28bn.*

4.2. *The three other significant regions - DACH, Nordic and Italy/Iberia - all saw between 96 and 98 exits. The only significant difference between them was that the DACH market saw a greater proportion of exits in the upper-mid €250-500m bracket (the highest, in fact, of all regions).*

4.3. *In terms of the fundraising environment, 2022 saw a modest decline in the closings of, and amounts raised by, buyout and later stage funds. In 2021 there were 120 fund closings recorded (63 involving buyout funds and 57 by growth/later stage and co-investment funds).*

This dropped to 110 in 2022, driven by a sharp drop in the number of buyout fund closings - down 10 to 53. In value terms, the mid-market saw a drop in the amount of capital raised from €173bn to €153bn.