finnCap GROUP

Private Equity Outlook

APRIL 2023 NEWSLETTER | UK

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Following a record-breaking 2021, the UK M&A market experienced a decline in activity in 2022, with private equity becoming less active in acquiring new portfolio companies and initiating exits. Whilst valuations dropped in certain sectors they remain high for strong assets with a differentiated proposition.

Despite this, the UK remains an attractive location for M&A, especially in energy, technology, and healthcare sectors.

Private equity investment is expected to continue driving M&A growth during 2023.

The market is expected to remain relatively slow in the first half of the year, but, with organisations, and global markets becoming accustomed to the new reality, reports suggest an increase in M&A activity in the second half of 2023, as there is still an enormous rationale for consolidation, strategic moves, and a drive to realise returns.

> *Historically all of the best private equity vintages have come off of the back of volatile times. As long as private equity can ensure that their portfolio assets are well capitalised for what is coming. It should be a fantastic environment for bolt on activity and I expect the market to be very busy in H2 2023.*
>
> - Leigh Webb, Head of PE Sponsor Coverage, finnCap Group

UK M&A update

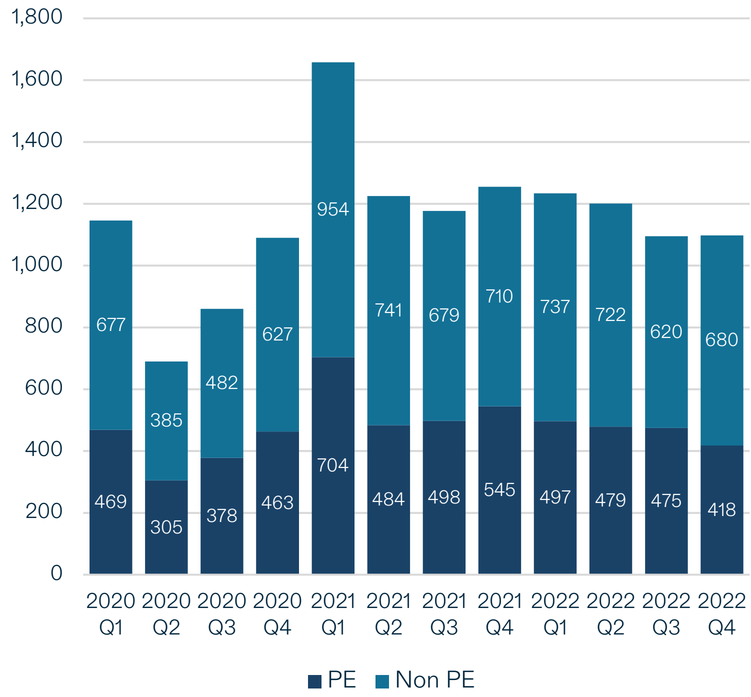
As a whole, the UK M&A market in 2022 experienced a decline compared to the previous year, with 7,080 deals in 2022 as opposed to 7,210 in 2021.

When analysing 2022 at a quarterly level, it is clear that the significant majority of these deals occurred in the first half of the year. The second half saw a steeper decline in activity which represented an initial continuation of 2021 momentum into the start of 2022, but then a steeper decline in activity towards the back end of the year. This decrease in activity can be attributed to several factors, including increasing interest rates, inflation, instability in Russia-Ukraine, and volatile global commodity and energy prices, creating an uncertain macroeconomic environment. Q3 & Q4 of 2022 both demonstrated steeper declines in activity which is partially reflective of fewer private equity deals, caused by surging interest rates, making debt more expensive.

Despite this decline, the TMT sector remains strong within M&A, accounting for 24% of UK M&A deals. This continued drive within tech M&A activity is due to the increasing demand for businesses to digitalise, innovate and respond to changing market dynamics. In line with the same trend, the Business Services industry within the UK also remained strong, whilst consumer shrunk as consumer confidence dropped.

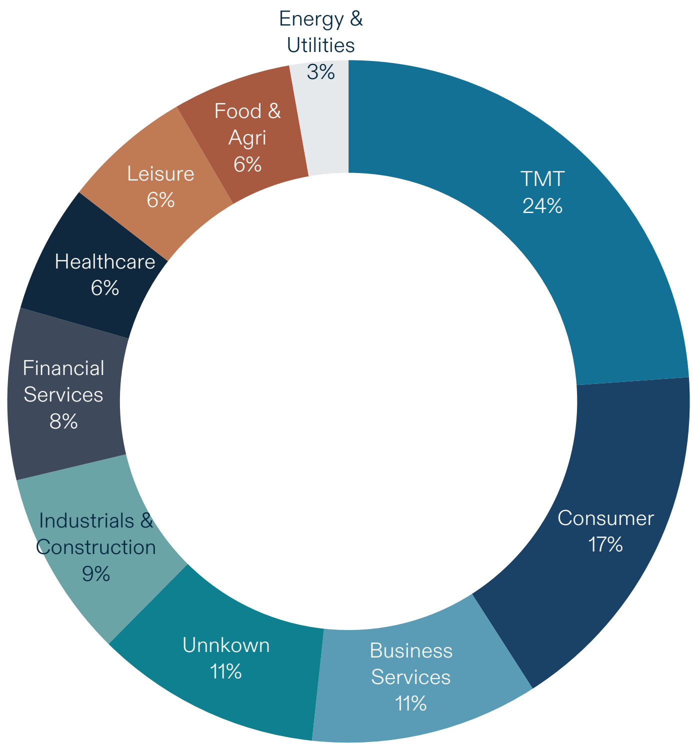
The increase in interest rates in recent months had a profound effect on the loan markets, both in terms of primary activity and ongoing management of existing facilities. This increased cost of financing is likely to affect valuations, particularly for businesses prioritising high-growth revenue and customer acquisition over bottom-line profitability.

PRIVATE EQUITY VS NON PRIVATE EQUITY DEALS UK



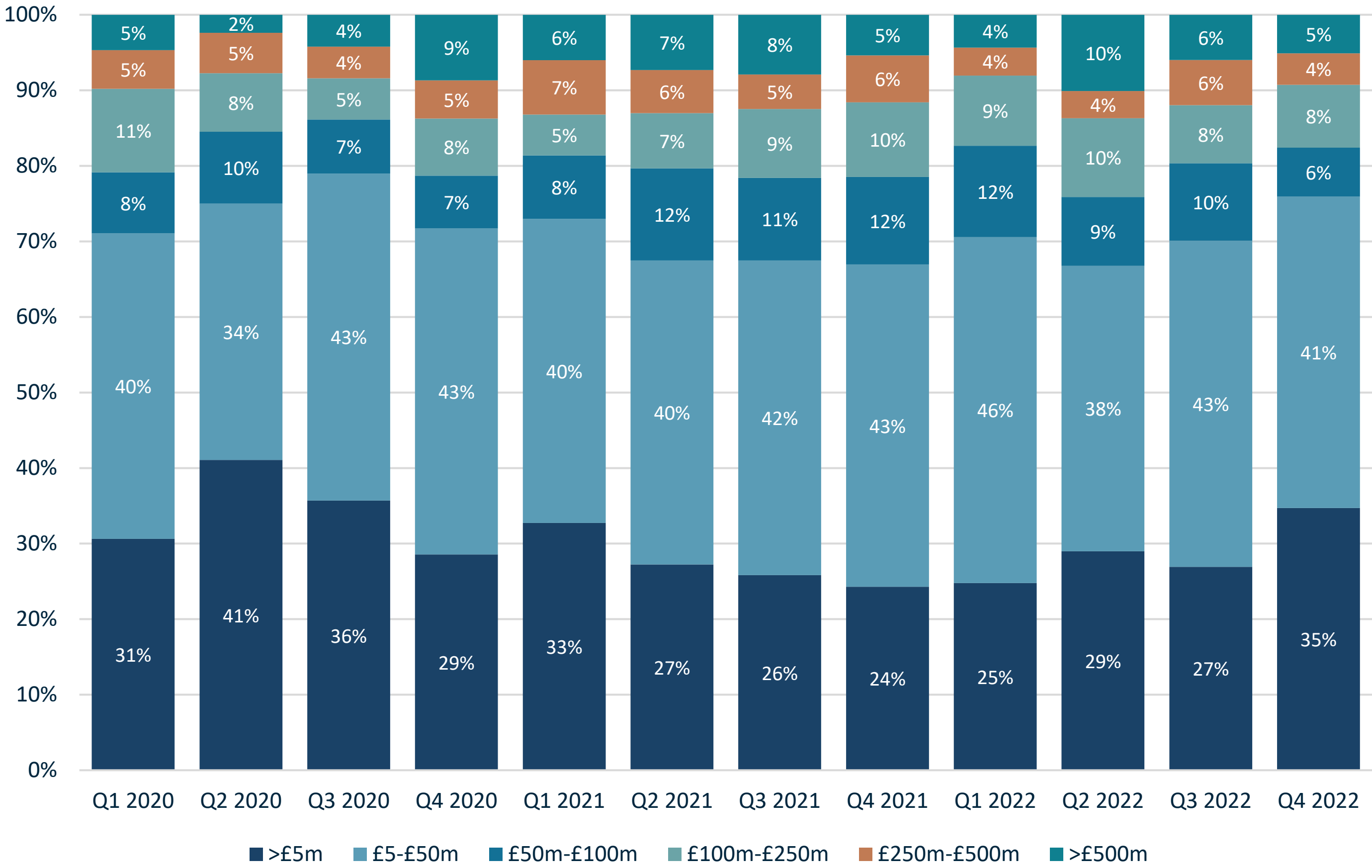
Source: Pitchbook data, 2023

M&A BY SECTOR



UK M&A update cont.

DEAL PER SIZE CATEGORY IN THE UK



Source: Capital IQ 2023

When examining M&A activity by deal size, Q4 2022 shows a notable increase in the number of <£5m deals, up from 27% to 35%. The increase in this category is reflective of a flurry of activity amongst the lower-mid market which is attributable to an increased number of assets on the market which are sub £5m EBITDA, a greater number of minority investments, and increased bolt-ons across the private equity landscape which has been a favourable means of capital deployment amongst the unsettled macro environment. In contrast, there was a 4% decrease in the number of £50-100m deals which resonates with the quieter lower mid market environment we've experienced over the last few months.

The outlook for 2023 is cautiously optimistic. While Q1 of 2023 is expected to remain subdued as we emerge from several tumultuous months, we anticipate a more buoyant market in Q2-Q4 of 2023 as acquirers and investors shift from cash preservation initiatives to more aggressive M&A strategies. While some sellers are holding onto prior year EBITDA multiples, they are slowly realising these numbers are less realistic in the current environment, which should see more sellers willing to transact throughout the year.

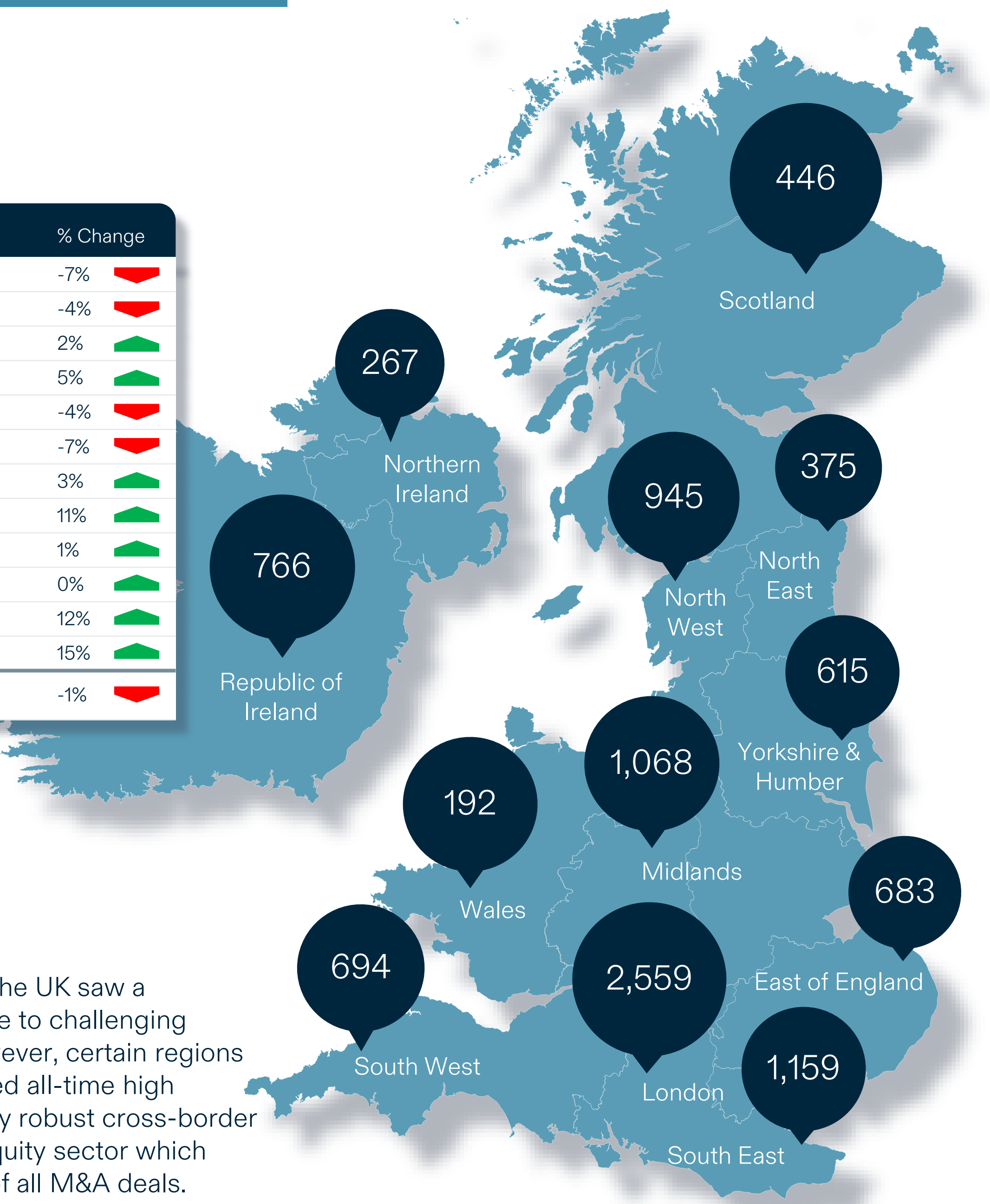
Furthermore, the looming possibility of a change to Capital Gains Tax as highlighted by the Office of Tax Simplification provides an incentive for founders to progress any transaction before a change in policy is implemented. This, together with the wider prospect of a change of government at the next election, should act as an additional catalyst for M&A activity.

Finally, private equity has a significant amount of dry powder to deploy, and, as the valuation gap begins to close and wider economic factors stabilise, funds are expected to increase their wider appetite to deploy capital, albeit with a more thorough due diligence process, which could elongate processes.

M&A by region

Region	2022	2021	% Change
Greater London	2,559	2,746	-7%
South East	1,159	1,209	-4%
Midlands	1,068	1,044	2%
North West	945	903	5%
South West	694	723	-4%
Yorkshire & Humber	615	660	-7%
East of England	683	663	3%
Scotland	446	403	11%
North East	375	372	1%
Wales	251	251	0%
Northern Ireland	267	239	12%
Republic of Ireland	766	667	15%
United Kingdom	7,080	7,129	-1%

Source: Experian MarketIQ Report 2022



Overall, M&A activity across the UK saw a slowdown in 2022, largely due to challenging macroeconomic factors. However, certain regions outside of London experienced all-time high transaction volumes, driven by robust cross-border M&A and a thriving private equity sector which accounted for a record 25% of all M&A deals. Although London remains the primary hub for M&A activity in the UK, several key regions outside of the capital continue to show strong deal activity. According to a recent M&A report by Experian, the South East emerged as the most active region with 1,159 deals, followed closely by the Midlands with 1,068 deals.

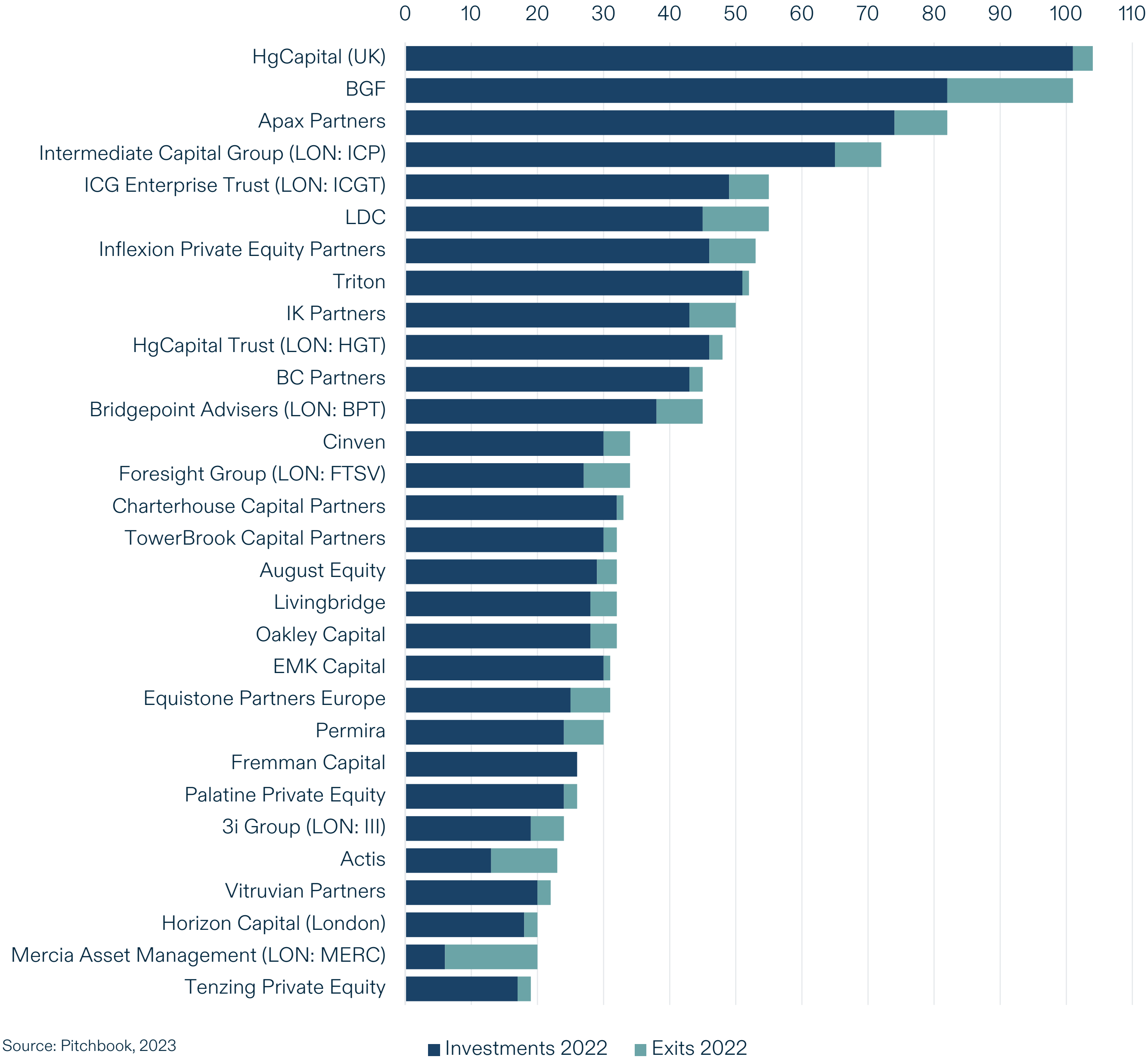
Despite a modest 4% drop in deal volume in the South East region, deal value fell significantly by 18% to £22.5bn. Small cap deals remained stable at 2021 levels, whereas mid-cap deals saw a decrease of around 30% in both value and volume. The IPO market struggled to gain traction, with only three recorded IPOs compared to 12 in 2021.

However, echoing similar trends to London, the Tech sector continued to boom in the South East witnessing a staggering 88% increase in deal value, and accounting for approximately 26% of all deals in the region. Key investors in the region included private equity and Venture Capital firms such as Rockpool, Octopus, Oxford Science Enterprises, and Cairngorm Capital.

Meanwhile, the Midlands achieved its strongest year to date in 2022, with a 2.3% YoY increase in the number of transactions and an impressive 22.6% increase in total deal value. Deals over £1bn saw a 20% increase, and smaller deals also experienced an upturn. The Manufacturing sector remained a strong performer in the region. However, private equity deals were relatively subdued compared to the previous year.

UK top private equity funds investments 2022

PRIVATE EQUITY INVESTMENTS AND EXITS



Source: Pitchbook, 2023

"The outlook for 2023 is cautiously optimistic. The mid-market and lower mid-market private equity sphere has proven resilient over the course of the last 6 months, and as we continue to adjust to the new environment, it is expected that the level of positivity should continue."

- Emily Halley, Associate Director, PE Sponsor Coverage, finnCap Group

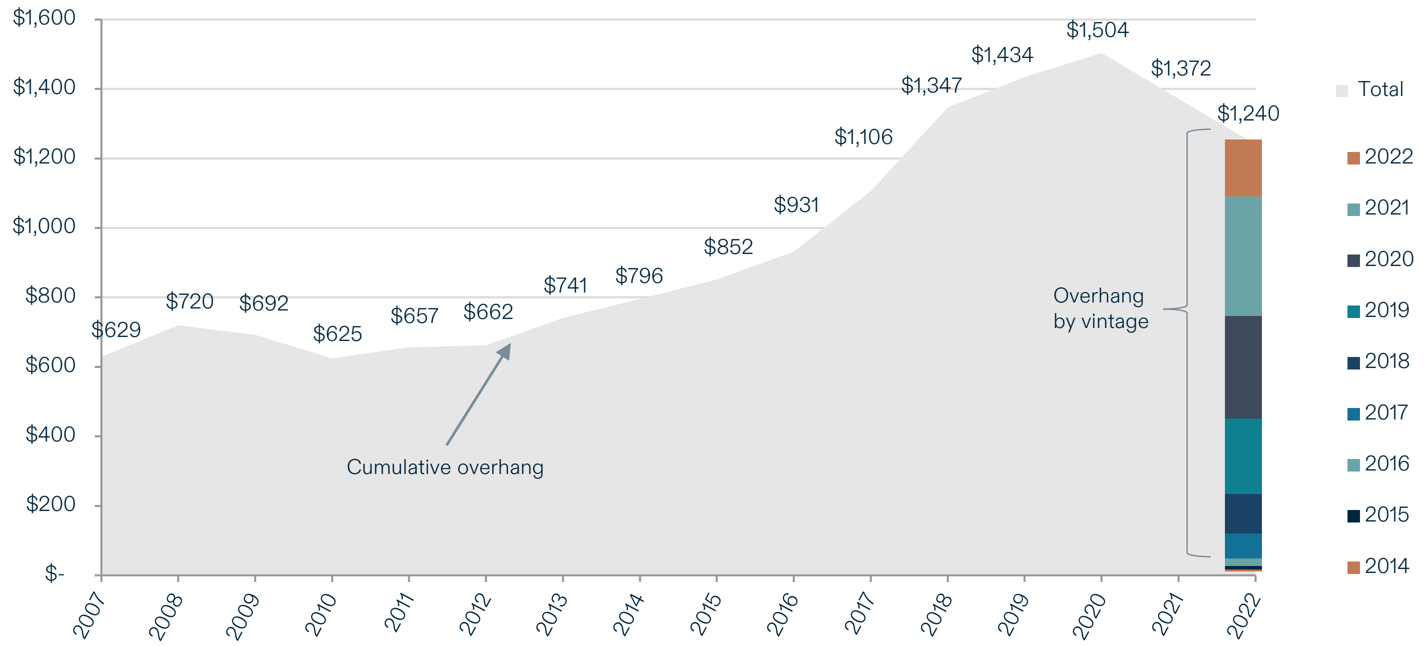
Dry powder levels still high

SIGNIFICANT AMOUNT OF PRIVATE EQUITY CAPITAL POISED FOR INVESTMENT

Private equity dry powder, which refers to the uninvested capital committed by institutional investors to private equity funds, has surged to an all-time high of $1.24 trillion globally. The United States accounts for this sum, with roughly $700 billion, followed by Europe with approximately $250 billion.

Since 2020, there has been a 63% increase in the global dry powder, which is expected to be deployed over the next 3-5 years, with a typical return period of 10 years. The youth of this pool of capital is reassuring for private equity market participants and, in particular, for companies seeking investment. Private equity firms have a strong incentive to deploy their capital, so this represents a significant opportunity for investment.

To put this amount into context, it would take about three years to exhaust the dry powder without further fundraising, although it is unlikely that such a scenario will occur. Thus, this represents a substantial and enduring investment opportunity.



Source: Pitchbook Data Inc, to 30 September 2022

"Last year felt like a tale of two halves with a strong start for M&A markets, but a difficult H2 due to macro headwinds and market instability. This year has been a slow start, but we anticipate an unprecedented level of new opportunities will come to market after the summer period as many processes were put on hold waiting for the debt and private equity markets to stabilise. Completing a transaction before the next general election in 2024 will also be front of mind for many vendors this year."

- Guy Ellis, Partner, Rockpool Investments

Fundraising activity in the UK

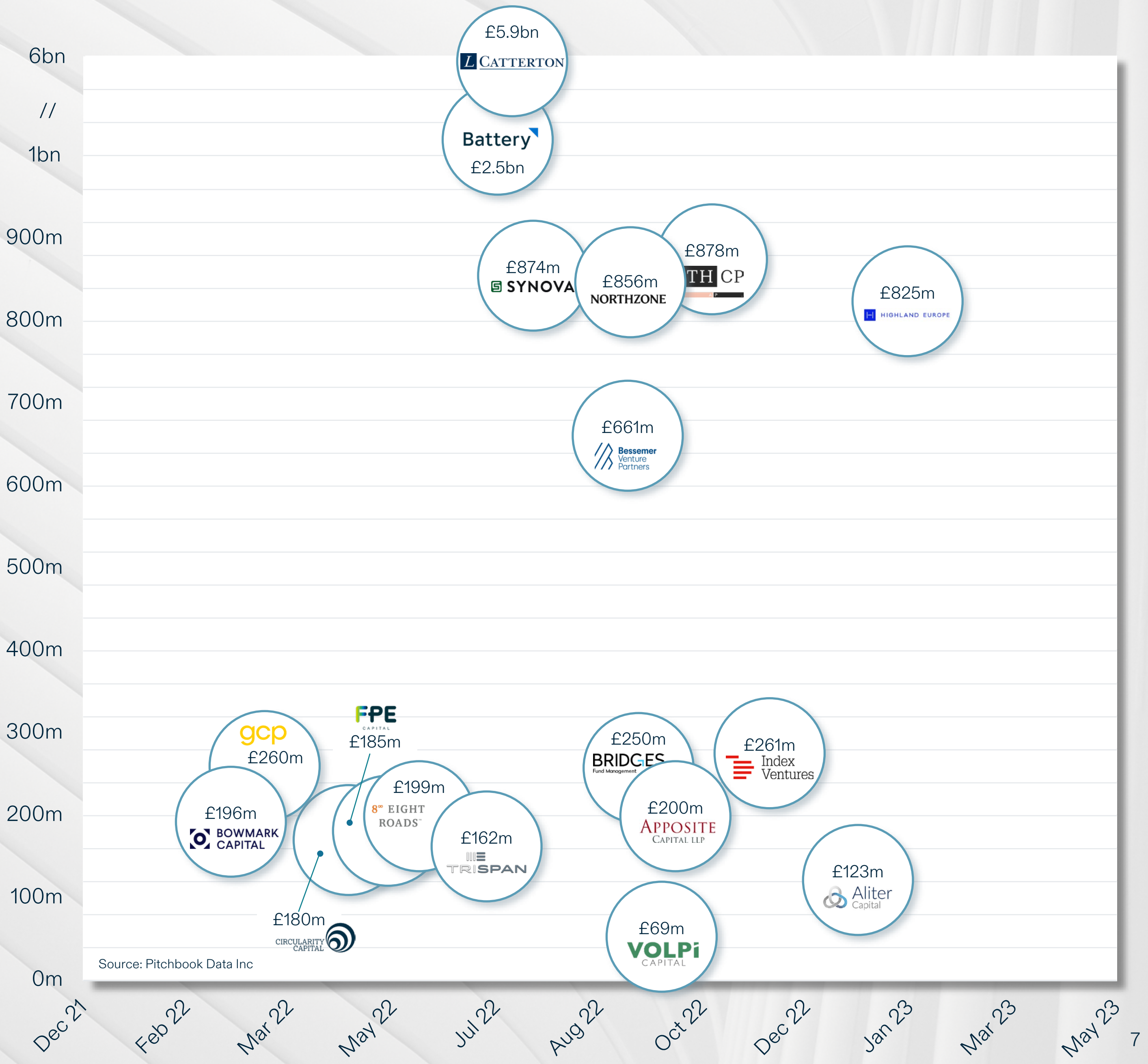
2021 was a buoyant fundraising environment for many, with most institutions upping their allocation to the asset class.

2022 was a tougher fundraising environment, with macro issues like the war in Ukraine and rising interest rates together with the cost of living crisis all impacting private equity and their portfolios whilst having an affect on the fundraising environment.

Moving into 2023 fundraising is still expected to be slow in H1 with funds taking longer to reach their hard cap and we will see some casualties. Funds that have had mediocre performance over the past 3-5 years will struggle as the market is far more diverse.

Institutions such as pension funds, university endowment funds and sovereign wealth funds have many options when looking at which private equity funds to drive their returns.

FUNDS WHO RAISED IN 2022 - 2023



Our private equity expertise

Rosetta Brands
has sold a significant minority stake to
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M&A SELL-SIDE
Consumer

Ro&Zo
secured £1.5m of private growth capital from
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VC INVESTMENT
Consumer

ROCKPOOL
Target
Finitor Wealth
Debt Provider
THINCATS
ACQUISITION FINANCING
Financial Services

AUGUST
SONDERWELL
has acquired
Libertatem Healthcare Group
M&A BUY-SIDE
Healthcare

Foresight
agar scientific
has been acquired by
calibre scientific
M&A SELL-SIDE
Healthcare

EQUISTONE
Target
Virgin Experience Days
Debt Provider
CORDET CAPITAL PARTNERS
ACQUISITION FINANCING
Consumer

Virgin Experience Days
inflexion
received investment from
EQUISTONE
M&A BUY-SIDE
Consumer

Jollyes
KESTER CAPITAL
Target
PENPARC PET CENTRE
Debt Provider
HSBC
ACQUISITION FINANCING
Consumer

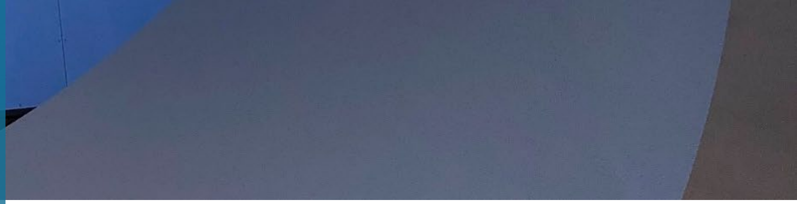
MODE
Connection Capital
Target
eacs
Debt Provider
BlackRock
ACQUISITION FINANCING
Technology/Business Services

BigGreen smile.com
received investment from
Future Business Partnership
M&A SELL-SIDE
Consumer

WT WOOD THILSTED
a minority stake acquisition by
inflexion Enterprise Fund V
M&A BUY-SIDE
Technology/Energy

"Looking forward to the rest of 2023, it will be interesting to see how the private equity industry continues to adapt to the changing landscape. The insights and trends highlighted in this newsletter suggest that there will be continued growth and opportunities for investment, particularly in ESG-focused sectors. However, investors and businesses will need to remain agile and responsive to emerging developments and trends to ensure continued success in the private equity market."

\- John Farrugia, CEO, finnCap Group



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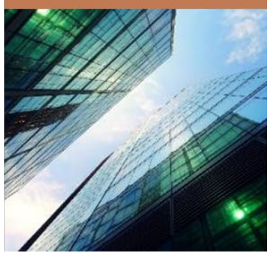

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finnCap is one of largest Nomad and AIM company financial advisers and No. 1 broker on AIM, advising more than 117 clients. finnCap Group advised on deals totalling £3.2bn in the last financial year.

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