PE M&A Report
2024

CONTENTS

Executive summary

A look at PE deal-making in the UK reveals a mixed picture but there are grounds for optimism.

A return to the Covid era boom of private equity-backed deal making in the UK is not anticipated in 2024, but we do expect deal volumes and values to pick up as the year goes on.

In 2023, the overall picture was one of lower deal volumes and values than we had seen **in 2022**, but our experience was of a market split very much in two.

The predominant position was of "stodgy" market conditions: deals taking longer than we would normally expect to complete and requiring bespoke structuring to reconcile the gap between buyer and seller valuations, or failing to materialise as negotiations broke down.

Those features of the market were influenced by high inflation and the cost of finance. This served to make some investors more risk averse and influenced the price they were willing to offer and the attractiveness of management terms on offer. A lack of competition between investors for deals due to uncertainty in the market also meant buyers could drive a harder bargain and led to due diligence and decision-making processes being prolonged.

On the other hand, there were pockets of the market that were buoyant. Businesses with high levels of recurring revenues, good cash flows and a consistent record of growth, such as healthcare and tech-enabled businesses, remained hot tickets. This was particularly true of technology assets, such as software-as-a-service companies, given the undiminished appetite across the economy for technology-enabled innovation and the efficiencies they drive.

Opportunities for investment in those businesses were seized upon by investors, which enabled sellers to run competitive auction processes to drive deals, shorten deal timetables and achieve better terms for vendors and management teams alike.

With investors dropping offer prices across many sectors and with high interest rates on senior debt serving to dampen value expectations as well as impacting the proportion of sweet equity offered to management, we nevertheless saw some creative deal-making in 2023.

Ratchet mechanisms, for example, were popular in incentivising senior management – often so integral to the growth of those companies – to remain in position post-investment and drive future performance.

Where they were used, they were more generous than in previous years, serving to bridge the gap between the proportion of day one sweet equity on offer and reward for overperformance on future exit. The exception to this was where there was a competitive and aggressive sales process for the minority of highly-sought-after assets. In those instances, management terms were of secondary consideration as the sale price was driven upwards.

Despite lower deal volumes, we also saw a surge in warranty and indemnity insurance (W&I) claims notifications pertaining to issues that have surfaced within businesses post-investment. This is a common trend we see in economic downturns, as investors and buyers turn to their insurance policies for increasing liquidity and to limit any adverse financial impact that may be suffered. However, the significant rise in the volume of notifications has not had a material impact on the price of W&I premiums, as the insurer market remains competitive and deal volumes are yet to bounce back.

For 2024, the pipeline of deals across the market that advisers are talking about is significantly larger than a year ago, but it is still a challenging market to get deals over the line.

Deal-making takes longer now than it used to. There is a lot to consider, from M&A and equity terms, insurance, commercial performance and positioning, and of course the underlying financial results, for example, and the economic uncertainty in the market has meant investors are understandably keen to take their time to ensure they encounter no surprises post-investment. Due diligence processes are more extensive than they have ever been as a consequence – even for the highest quality assets. While the proliferation of data that exists can help investors get comfortable with the risk they are taking on and make data-led decisions, the data also takes a lot of unpicking – even with AI and other technologies that can now help.

One specific trend we have seen that is serving to slow down deal-making is increased uncertainty and scrutiny of the risk of historic tax liabilities arising from the issuance of equity by the selling company. Many investors and their diligence teams are spending a lot of time probing whether or not any equity that's been issued has been issued at fair market value or at undervalue. We have seen a definite trend in investors taking out specific tax risk insurance to address the risks that have arisen from diligence. This has also increased the level of diligence around the pricing of any new sweet equity being issued on a deal, with a growing need for tax valuations to support appropriate management elections.

ESG reports provide some of the data points investors will examine too. These reports, in particular, give investors an insight into what sellers are doing to address the climate and sustainability agenda in their own operations and play into a company's value – something that will continue to be the case notwithstanding the lingering uncertainty around how elections in the UK, US and Europe this year might affect the speed at which the drive towards net zero targets will be pursued by policymakers in the years to come.

As we look ahead to the rest of 2024, the 'dry powder' in the mid-market is higher than it's ever been, with a significant pipeline of deals. With economic forecasts more optimistic towards the end of the year and with market conditions less turbulent than they were, there is cause to believe that deal-making activity will pick up pace as 2024 progresses, but to what extent is unclear given the willingness by many investors to sit on funds until the right opportunity arises.

In many instances, the focus of investors remains on running robust businesses within their existing portfolio, but we do continue to see opportunities for PE-backed takeovers of public companies that are trading at below value due to prevailing challenges in the market they are operating in, such as in consumer goods or hospitality.

In some sectors, we might expect PE-backed consolidators to remain popular as a way of deriving growth – and therefore value – through aggregation. We have seen this trend in the financial advice and wealth management sectors recently.

We also continue to see a rise in secondary transactions where investors sell to succession funds which allows limited partners (LPs) to achieve an exit. In the current market, many investors feel they are unable to get the value they want from a full exit, and so they are exploring selling assets to associated funds to unlock liquidity to invest in other assets or return funds to existing LPs, with a view to achieving a full exit for the succession funds when the market is more buoyant. We expect this trend to continue in 2024.

Co-written by Tom Leman and Kieran Toal of Pinsent Masons, Simon Cope-Thompson and Jamie Hutton of Arrowpoint Advisory, and Ella Shillingford of Howden M&A.

As we look ahead to the rest of 2024, the 'dry powder' in the mid-market is higher than it's ever been, with a significant pipeline of deals. With economic forecasts more optimistic towards the end of the year and with market conditions less turbulent than they were, there is cause to believe that deal-making activity will pick up pace as 2024 progresses, but to what extent is unclear given the willingness by many investors to sit on funds until the right opportunity arises.

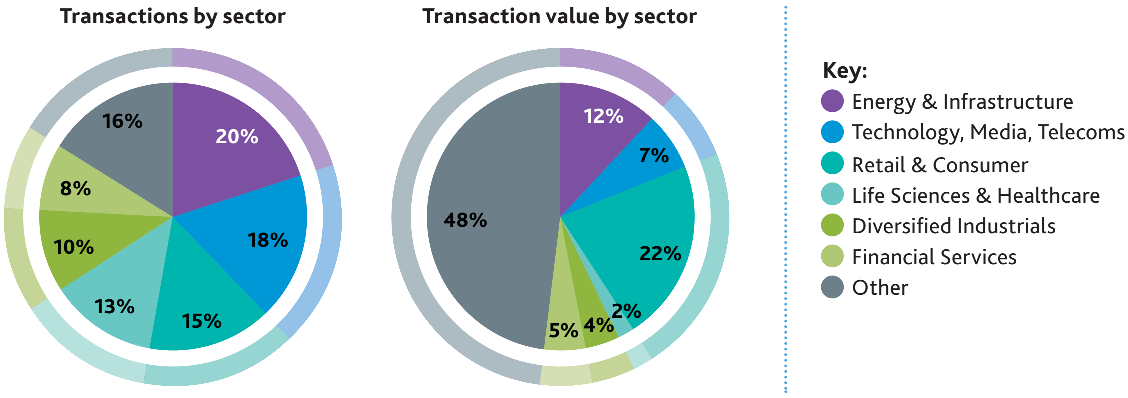
Survey methodology

This report represents our analysis of the pooled transaction data of Pinsent Masons and Arrowpoint Advisory in 2023. We analysed data from 102 transactions (compared to 112 in 2022) with a combined transaction value of £5.7bn.

Our data comprised of 40 private equity backed transactions (39% of transactions) and 62 trade led transactions. The private equity transactions accounted for 47% of the total transaction value compared to 50% in 2023.

At £68 million the average private equity transaction was £10 million higher than the average in 2022 and in the range of our prior Surveys.

The Energy & Infrastructure sector led on deal volumes accounting for 20% of the total, just above the 18% contribution of Technology, Media and Telecoms. While TMT has traditionally accounted for the largest proportion of deal volume previously, Energy and Infrastructure's lead this year reflects the heightened interest we are seeing in assets that support the energy transition.

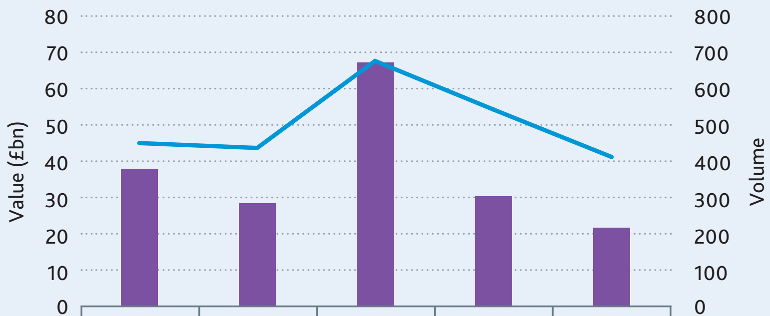


> **The Energy & Infrastructure sector led on deal volumes accounting for 20% of the total, just above the 18% contribution of Technology, Media and Telecoms. While TMT has traditionally accounted for the largest proportion of deal volume previously, Energy and Infrastructure's lead this year reflects the heightened interest we are seeing in assets that support the energy transition.**

Market view

2023 won't be remembered as a vintage year for transactions with volumes falling below those seen in the first year of the pandemic and total transaction value down by 30% year on year.

UK private equity transaction volume and value



	2019	2020	2021	2022	2023
Value (£bn)	37.7	28.2	67.2	30.5	21.3
Volume	450	436	676	542	411

Source: S&P Capital IQ

Although over 400 PE transactions completed in the year, a number of others aborted at an early stage – and we certainly saw this across the transactions we advised on.

As the year progressed activity levels reduced with buyers playing a waiting game on valuations – with many observers believing private valuations have not corrected enough, especially considering movements in public markets.

The disparity in price expectation has arguably been compounded by the depressed multiples seen on the public equity markets being used by buyers as proxies for private company valuations and the restricted leverage levels accessible across the debt markets.

This has been particularly true in secondary transactions – a market of significant growth in recent years – but one where private equity buyers were more nervous of engaging in a game of pass the parcel in 2023.

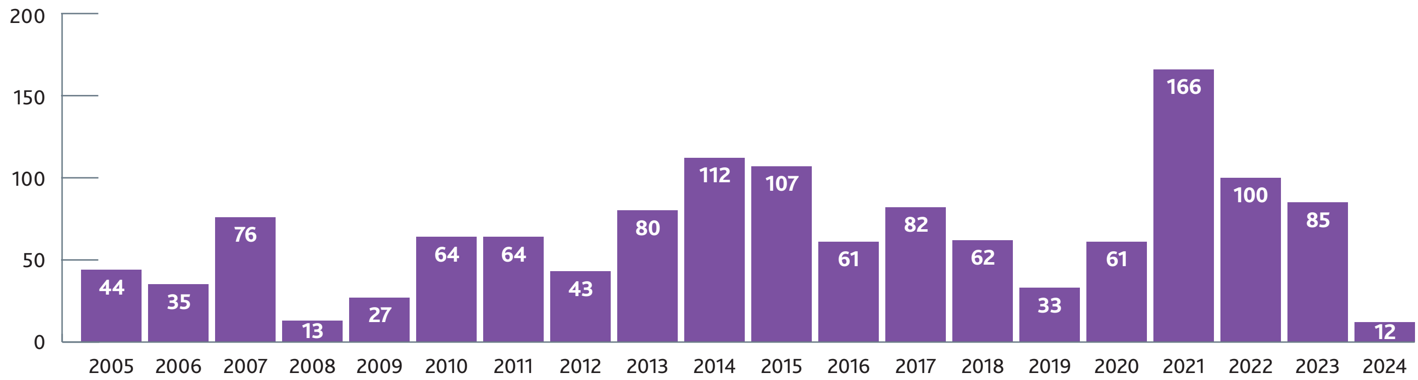
However, recent activity suggests this standoff appears to be nearing an end with valuation gaps narrowing and still plenty of dry powder looking to be allocated.

In terms of exit routes, the UK IPO market continued to have a moribund year, arguably not helped by the poor relative performance of the PE backed IPOs from 2021. Indeed a trend for PE to buy-back recent listed companies that were trading significantly under their float price emerged in the 2nd half of the year.

While we don't expect to see an explosion of IPOs, we have recently received a number of IPO related enquiries and believe the market will see a gradual recovery through 2024. We note that the LSE is certainly banging the drum for London, as indeed Pinsent Masons has been (**Why companies should consider the London Stock Exchange**), but it will need to close the gap with the more vibrant US markets which continue to outperform their smaller European cousins.

While we don't expect to see an explosion of IPOs, we have recently received a number of IPO related enquiries and believe the market will see a gradual recovery through 2024. We note that the LSE is certainly banging the drum for London, as indeed Pinsent Masons has been (Why companies should consider the London Stock Exchange), but it will need to close the gap with the more vibrant US markets which continue to outperform their smaller European cousins.

Global PE backed IPO volumes



Source: S&P Capital IQ

Looking forward there are grounds for optimism but in a year when almost half of the world's population goes to the voting booth, armed conflicts continue and inflation and interest rates look set to stay higher for longer than we had anticipated at the time of our 2023 report, the market will be challenged by lingering uncertainty.

In election terms we see both potential upside and downside. In the UK the Labour Party has previously committed to removing the carried interest tax 'loophole' should they be elected, which looks increasingly likely. However, Labour has said it will not make changes to CGT so we may not see a rush of sellers keen to go to market pre-election to crystallise gains as we have done previously.

Another Trump victory in the US would likely see a further reduction in US corporation tax to 15% (the Democrats also have a 15% target for companies meeting certain criteria within the Inflation Reduction Act). Such a tax cut would likely be a stimulus to dealmaking but whether that would be offset by the disruption of another Trump term remains to be seen.

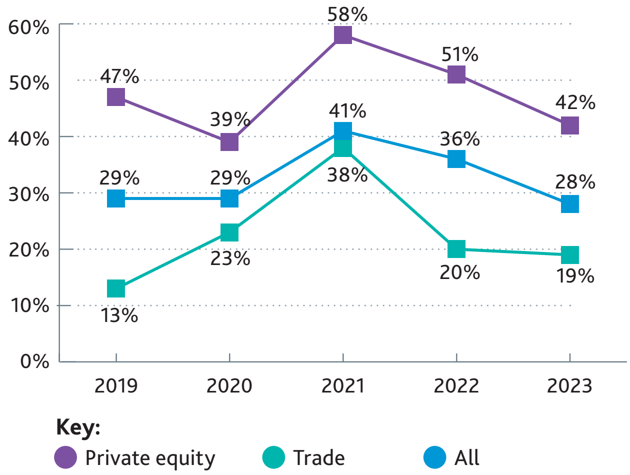
Looking forward there are grounds for optimism but in a year when almost half of the world's population goes to the voting booth, armed conflicts continue and inflation and interest rates look set to stay higher for longer than we had anticipated at the time of our 2023 report, the market will be challenged by lingering uncertainty.

Deal process trends

Auctions continued to feature more strongly in private equity transactions rather than trade, although the use of an auction process for private equity related transactions fell for the third consecutive year. This reflects the lack of multiple buyers prepared to compete aggressively for assets and the need for sellers to take more time to build a relationship with, and explain the value proposition to, potential buyers. We have also seen more bilateral trade deals, often via more of a "no process process", which may not officially count as an auction(!).

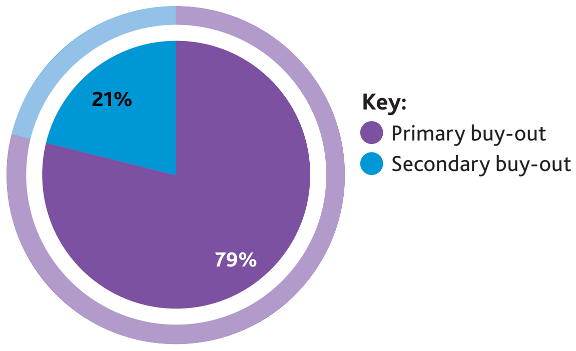
Auction processes continue to generate higher proceeds than non-auction processes, either reflecting the result of their competitive dynamic, or the fact that more larger deals are still ending up in auctions than at the lower end of the mid-cap space. Transactions involving an auction accounted for 60% of the total transaction value.

Transactions via an auction process



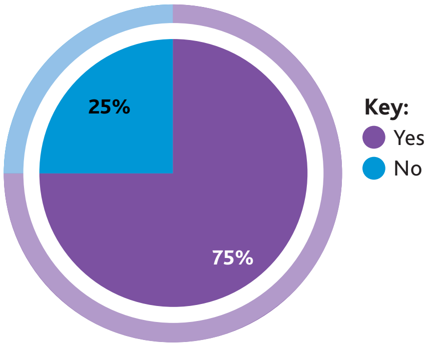
Secondary transactions have increased in popularity in recent years, though our 2023 data saw little movement on the previous year. We note that private equity managers have to take care when selling from one fund to another. They risk criticism from the selling LPs and the buyside LPs depending on the ultimate price at a future third party exit. As a result, the process around secondaries seems to be more involved than it has been in previous years with the need for investment committee approval, consultation with LPs and fairness opinions being used to head off this risk.

Was the deal a primary or secondary buy-out?



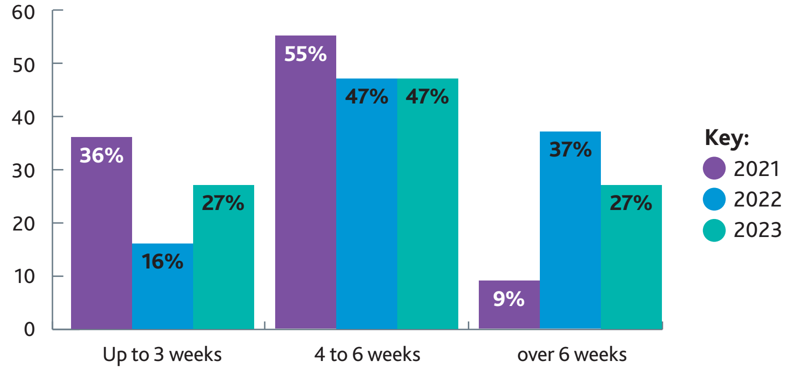
We saw a slight decrease (from 83% to 75%) in transactions where a period of exclusivity was granted and speculate that this may be as a result of buyers trying their luck – putting in low offers that they suspect sellers will not accept – and convincing the sellers to open up their books to see if they can increase their offer. Sellers won't give exclusivity in those circumstances but are hopeful that they can negotiate the price up.

Was a period of exclusivity granted?



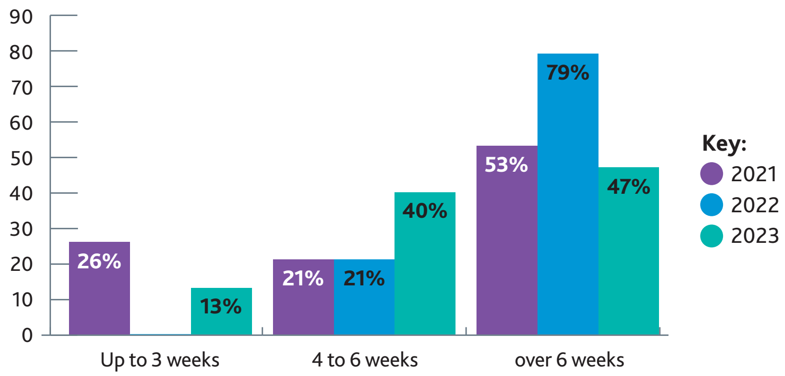
An exclusivity period of 4-6 weeks remains the norm for around half of all transactions. We saw a drop in shorter length exclusivity periods last year but this seems to have partially corrected this year. Transactions specifying periods of six weeks or more moderated.

What was the length of the initial exclusivity period?



In previous surveys we'd seen a gradual increase in the length of time between granting exclusivity and exchange and completion, and had speculated this would continue, yet our 2023 data has bucked the trend. We expect this is a blip and the trend for lengthier periods will continue.

How many weeks were there between granting exclusivity and ultimate exchange and completion?

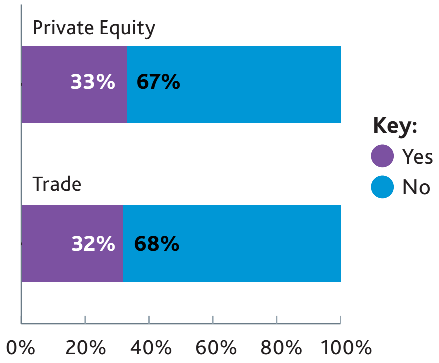


Split between exchange and completion

There was a split between exchange & completion in a third of deals – with the metric applying to both private equity and trade transactions. Historically we'd tended to see a higher figure in private equity than in trade.

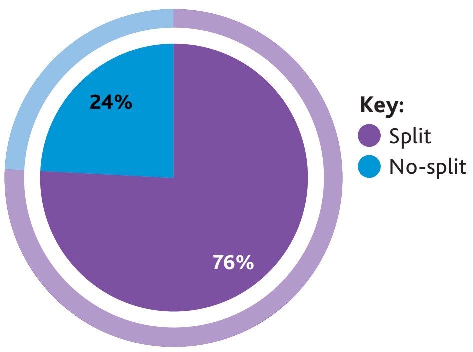
Last year we commented that savvy buyers were increasingly seeking a split to reduce execution risk for themselves as they sought to resolve potential issues in the interim period. In an increasingly unpredictable market this appears to be a trend that has caught on.

Was there a split between exchange & completion?

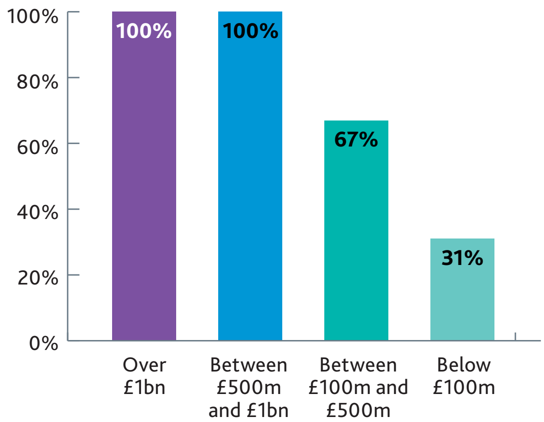


In terms of total transaction value, 76% of total value was subject to a split compared to the 52% seen in 2022. The data is somewhat skewed by an outlying large transaction that was subject to a split, but also reflects a return to previous norms. Essentially, the higher the value the more likelihood of a split as the next chart demonstrates.

Transactions involving a split (by transaction value)



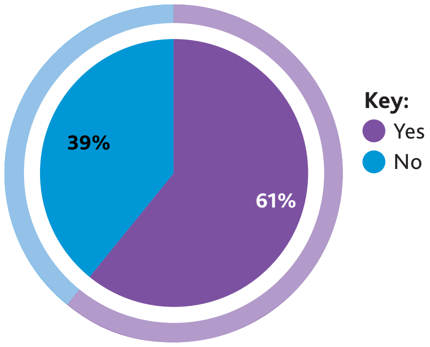
Transactions subject to a split (by value)



Last year we commented that savvy buyers were increasingly seeking a split to reduce execution risk for themselves as they sought to resolve potential issues in the interim period. In an increasingly unpredictable market this appears to be a trend that has caught on.

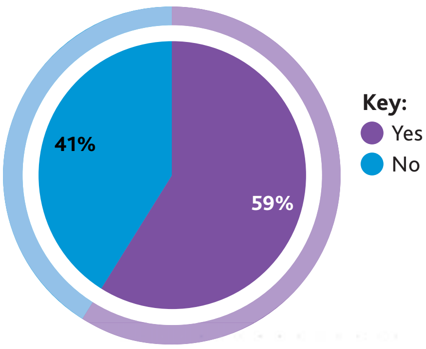
Warranties given by sellers at exchange were repeated at completion in 61% of transactions, above the 49% seen in 2022 but in line with our previous surveys.

Were the warranties repeated at completion?

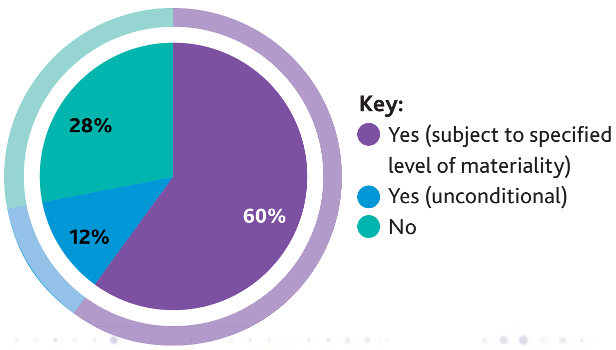


Where warranties were repeated at completion a second round of disclosure was allowed in almost two thirds of transactions which is a notable change from the previous year when a second round of disclosure was allowed in only a third. This may reflect the reduction in auction processes – usually in competitive scenarios, only the fundamental warranties are repeated at closing, with the general principle being that no disclosure against the fundamental warranties is permitted.

Was a second round of disclosure allowed?



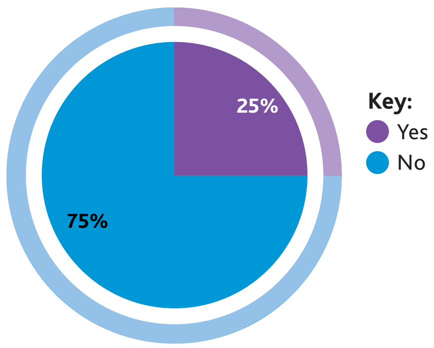
Was the buyer contractually permitted to terminate for a breach of warranty/ interim covenants during the gap between exchange and completion?



MAC clause

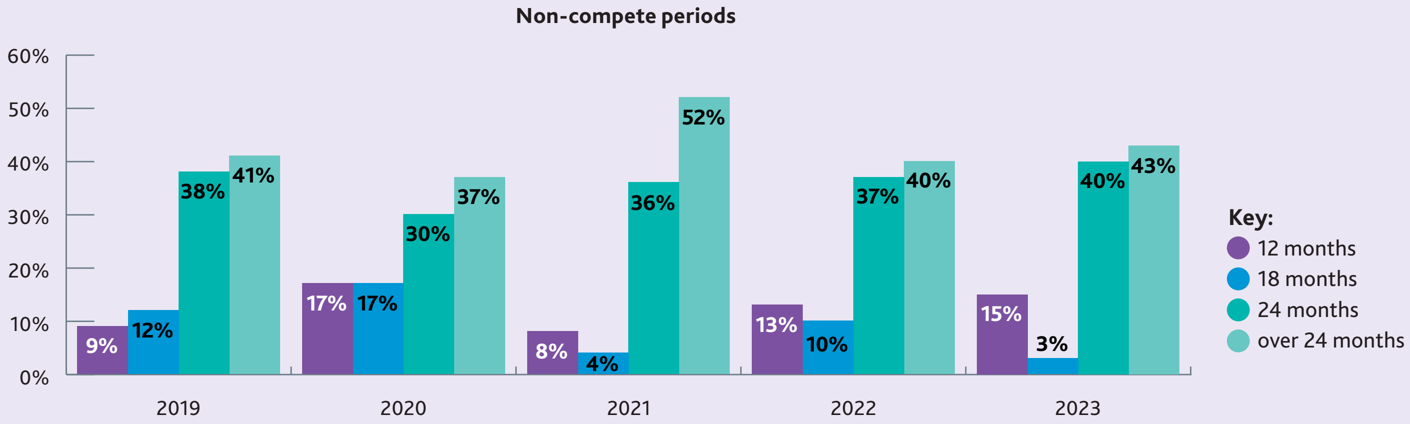
In last year's survey (with a nod to 90's R&B star Mark Morrison) we wrote that 'looking forward we expect buyers to harden their stance over the coming year given economic and pricing volatility – and on that basis we expect 2023 to see the return of the MAC' and this proved true with MAC clauses seen in a quarter of transactions compared to just 7% in the previous year.

Was there a MAC clause?



Restrictive covenants – non-compete

There has been a slight reduction in the proportion of transactions where the non-compete period was set at 24 months or more but overall the data on this metric has remained relatively consistent over the years.

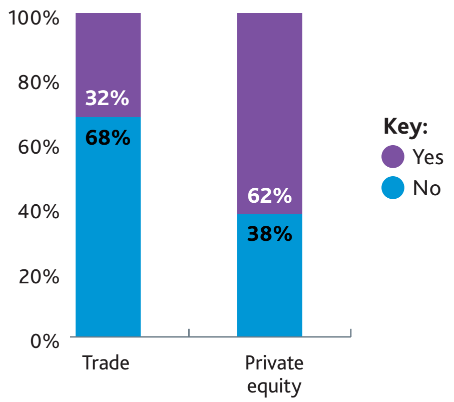


> There has been a slight reduction in the proportion of transactions where the non-compete period was set at 24 months or more but overall the data on this metric has remained relatively consistent over the years.

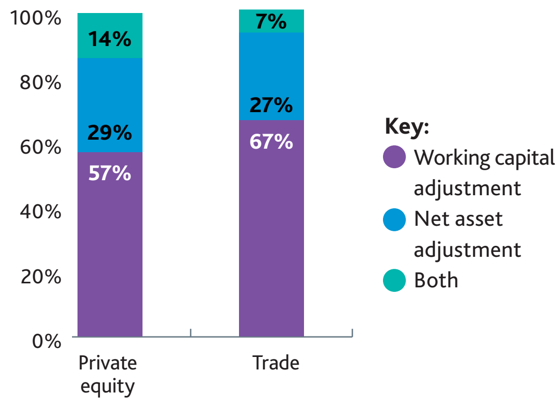
Locked box, completion accounts and deferred consideration

The data for all three charts is consistent with previous years, with private equity tending to favour the more seller-friendly locked box mechanism (seen in exactly the same % of transactions as last year) and trade leaning towards a more buyer-friendly completion accounts adjustment.

Proportion of transactions using a locked box mechanism

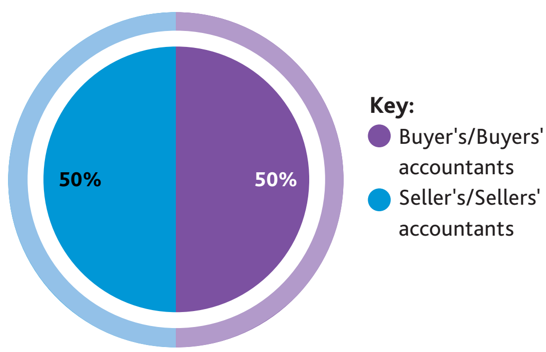


Type of post-completion adjustment clause specified in SPA



In this year's data preparation of the first draft of the completion accounts was evenly split between buyer's accountants and seller's accountants. In the previous year the split was weighted more towards the seller's accountants (59%). Again, this is consistent with the reduced % of auction processes, where sellers are more commonly well prepared with VDD ahead of a process commencing.

Who will prepare the first draft of the completion accounts??



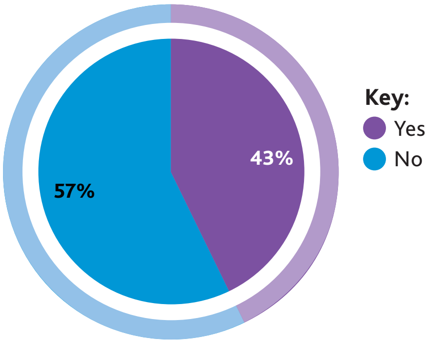
The data for all three charts is consistent with previous years, with private equity tending to favour the more seller-friendly locked box mechanism (seen in exactly the same % of transactions as last year) and trade leaning towards a more buyer-friendly completion accounts adjustment.

Deferred consideration

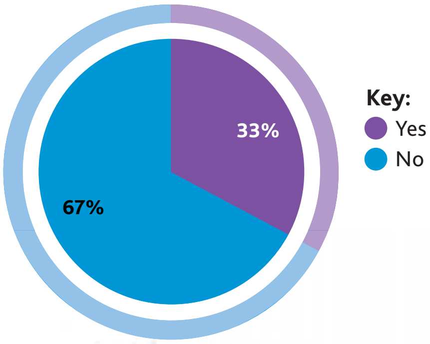
Our data for the use of deferred consideration is in line with previous years, though we note that in a slower market the use of deferred consideration is still a popular method of bridging the gap in value expectations. If the seller believes that the target will perform better than the buyer's projections then the parties agree that the additional consideration for such overperformance is only paid on achieving the seller's plan.

All figures in this section are consistent with 2022.

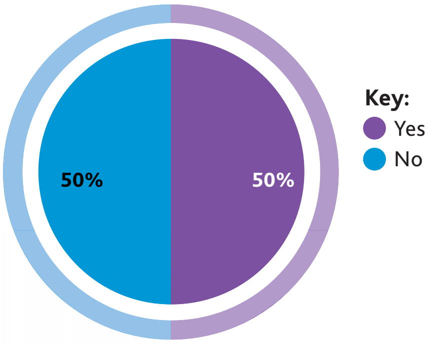
Was payment of the consideration structured to include some or all by deferred payment?

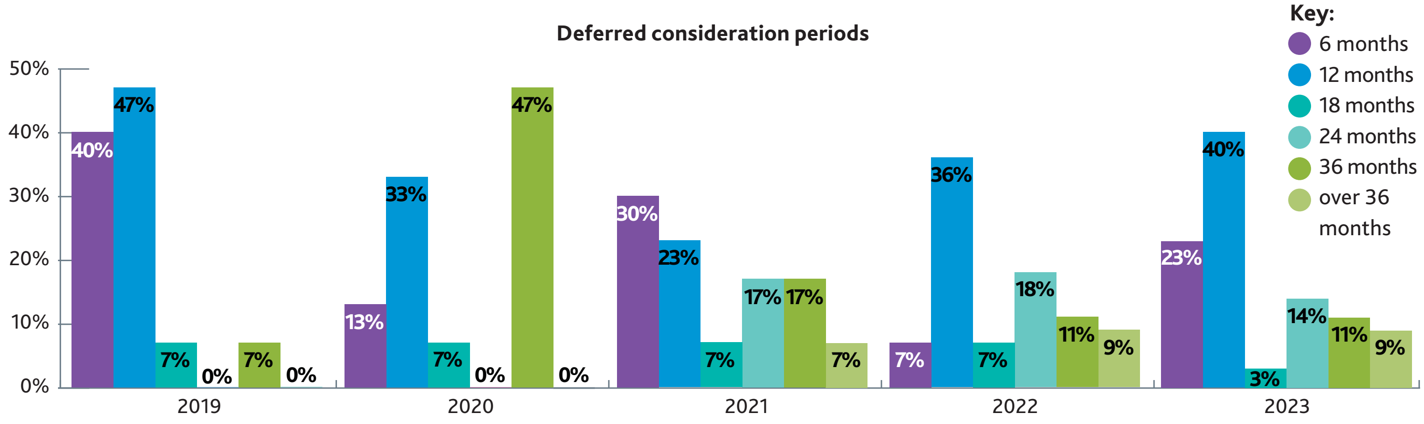


Did transaction include an element of deferred consideration? (private equity)

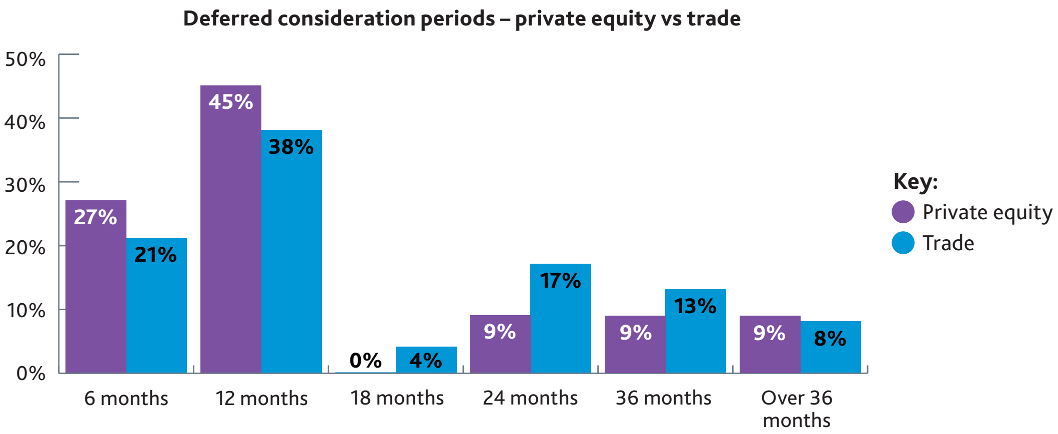


Did transaction include an element of deferred consideration? (trade)





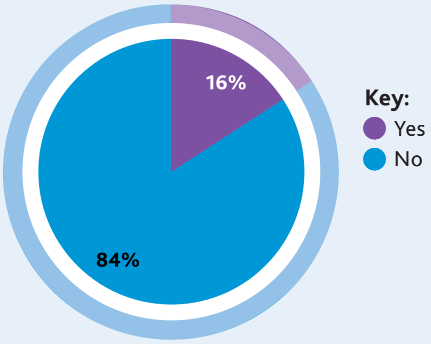
In private equity transactions the deferred consideration periods were typically under a year in 73% of transactions which is up from 59% of transactions in 2022. This is in line with historical data.



Warranties

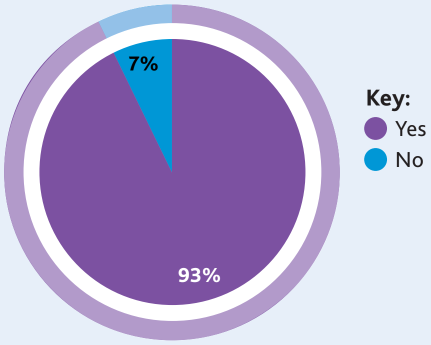
There was some movement on warranties in this year's survey. In a slight move towards US-style warranty terms, the buyer was entitled to recover for breach of warranty on an indemnity basis in 16% of transactions compared to just 6% in 2022. This is unusual although we are satisfied this does not point towards the emergence of a new trend.

Was the buyer entitled to recover for breach of warranty on an indemnity basis?



Transactions excluding a cap on the seller's liability under the warranties also increased slightly from 3% to 7%.

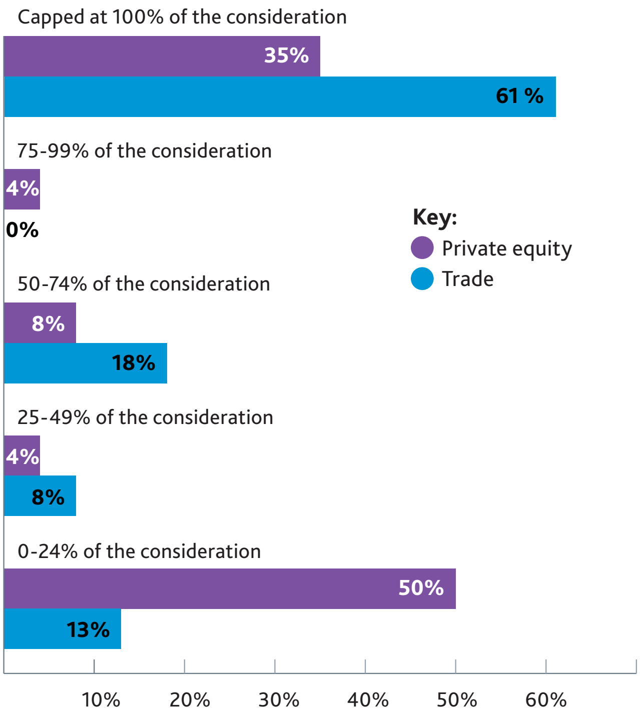
Was there a cap on the seller's liability under the warranties?



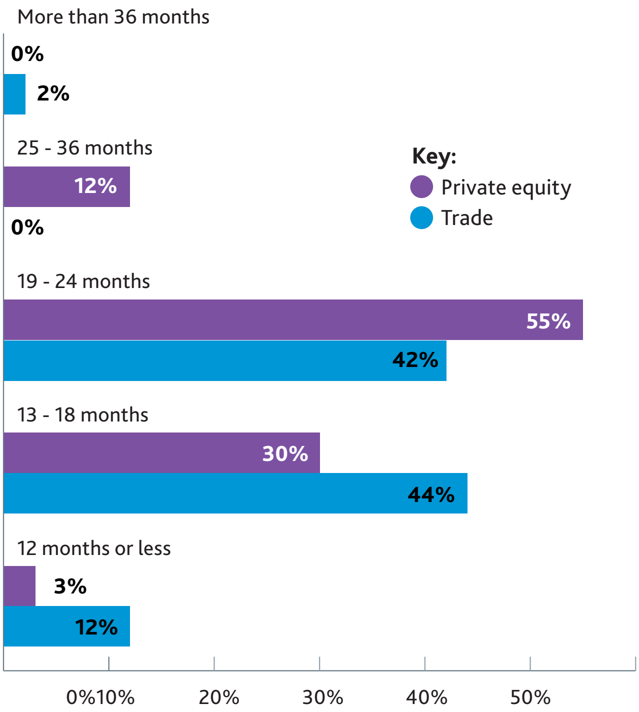
We saw a sharp increase in the number of trade transactions where the cap on warranty exposure was at 100%, with 61% capped at this level in 2023 compared to 36% in 2022. As trade faces less competition from private equity they have a stronger negotiating position. A trade buyer's traditional instinct to obtain higher warranty caps starts to filter through into the data. The data for private equity transactions remained broadly consistent.

The limitation period for commercial warranty claims remained broadly consistent, though in private equity transactions 12% were set at over 24 months which is double that of 2022.

What was the amount of the cap on the seller's liability under the warranties?

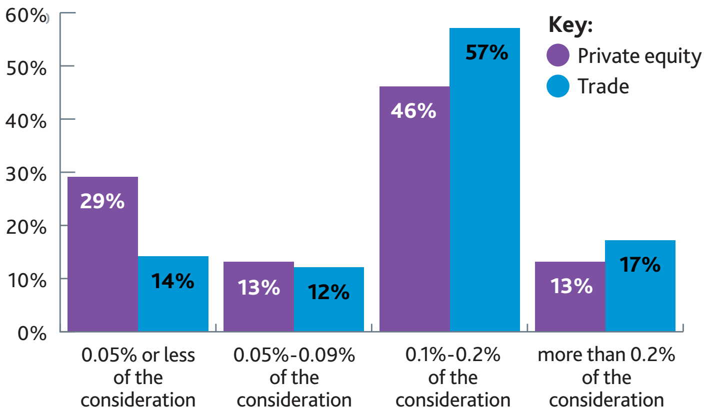


Limitation periods for commercial warranty claims



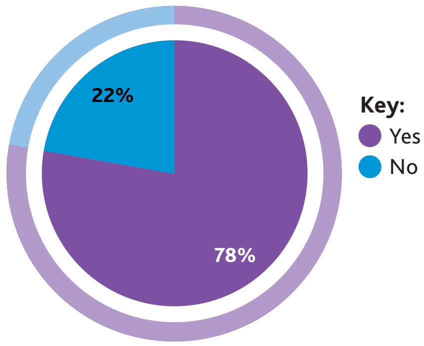
Data for private equity transactions remained broadly consistent with the main change being a higher level of throw-away de minimis for warranty claims in trade transactions where the minimum was set at 0.1% to 0.2% of the consideration in 57% of transactions, up from 43% in 2022. This movement was largely from the 0.05% or less bracket which dropped from 30% of transactions in 2022 to 14% in 2023.

Throwaway de minimis for warranty claims as a % of consideration



Data here is little changed from the prior year and is consistent with previous years, where around three quarters of transactions contain a basket.

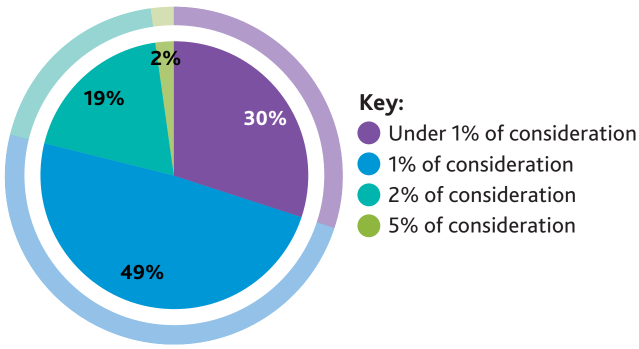
Did the transaction use a basket/ threshold for claims?



There appears to be a gradual raising of the consideration level for the basket, with 49% set at 1% of the consideration (up from 46%) and 19% at 2% which is up from 12%.

> **Data for private equity transactions remained broadly consistent with the main change being a higher level of throw-away de minimis for warranty claims in trade transactions where the minimum was set at 0.1% to 0.2% of the consideration in 57% of transactions, up from 43% in 2022. This movement was largely from the 0.05% or less bracket which dropped from 30% of transactions in 2022 to 14% in 2023.**

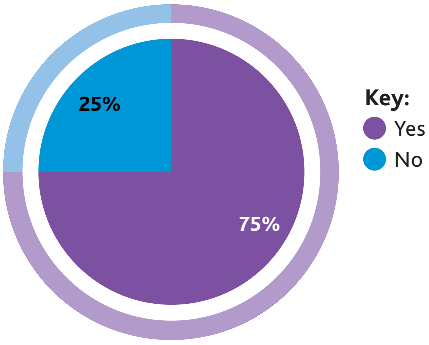
Transaction basket amount as a % of the consideration



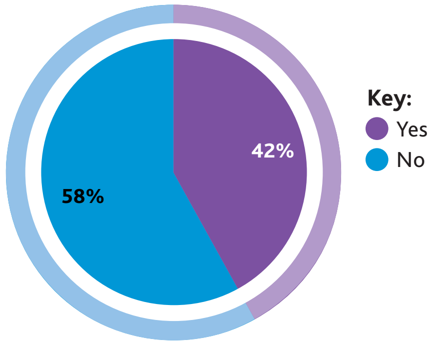
The buyer agreed to disclosure of the data room in 75% of transactions, slightly lower than 2022, but broadly consistent with our long term data.

The buyer gave a reverse warranty on 42% of transactions which is a little ahead of the level seen in 2022 (36%).

Did the buyer agree to general disclosure of the data room?



Did the buyer give a reverse warranty?

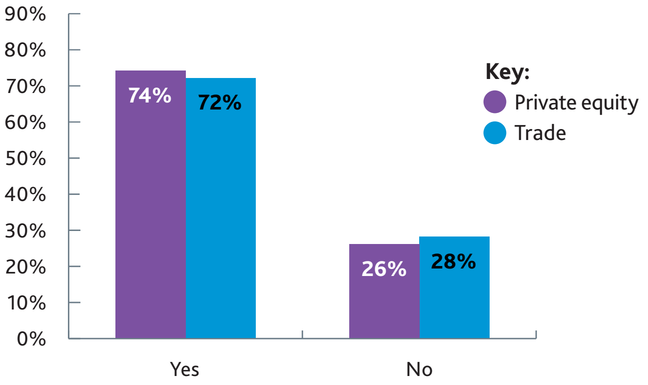


Tax

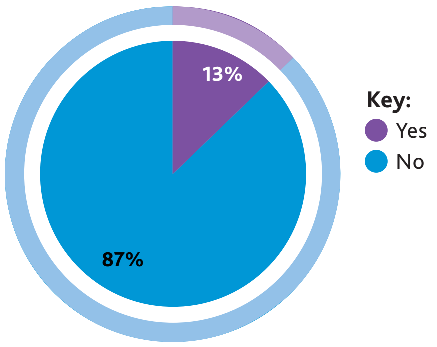
Fewer transactions utilised a tax covenant this year compared to the previous year, down from 87% in private equity to 74%, with a similar fall in trade transactions. Given the increasing numbers of businesses which are being scrutinised by tax authorities around the world it is not surprising that most buyers continued to seek protection in the form of a tax deed against historic tax risks.

There was also a decline in transactions where a separate cap on liability was used, down to 13% from 24%, which is in line with past years.

Was a tax covenant used?



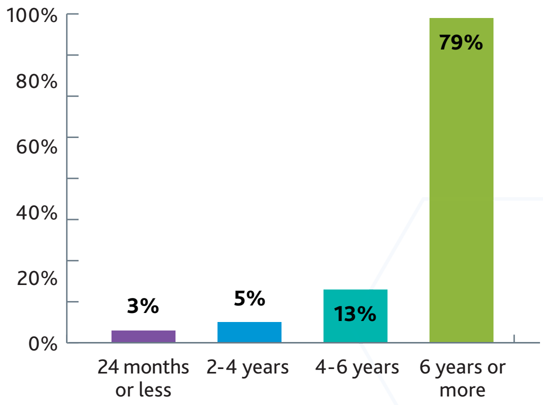
Was there a separate cap on liability under the tax covenant/deed?



While we see some annual variation in the use of various transaction clauses – the limitation period for tax warranty claims is not one of them. Six years or more remains the default period in the vast majority of transactions.

> Fewer transactions utilised a tax covenant this year compared to the previous year, down from 87% in private equity to 74%, with a similar fall in trade transactions. Given the increasing numbers of businesses which are being scrutinised by tax authorities around the world it is not surprising that most buyers continued to seek protection in the form of a tax deed against historic tax risks.

Limitation period for tax warranty claims



Warranty & Indemnity insurance trends

2023 was the softest year Howden has ever seen in the W&I insurance market, with base premiums for deals concerning the sale of operational businesses dropping below 0.7% in some instances. The same factors we referenced in the 2022 report that led to increased competition remained a feature of 2023. These were:

- **Reduced deal flow:** as documented elsewhere in this report, this continued into 2023 as Howden serviced 19% fewer completed transactions in the year compared to 2022.
- **Large underwriting teams:** insurers' team sizes remained a similar size to prior years, so maintaining the pressure on teams to make budget and remain profitable.
- **New entrants:** as predicted, three new insurers entered the W&I market.

The softening of the market is somewhat contradictory to insurers' claims experience. Howden experienced a 58% increase in claims notifications received in 2023, and the majority of insurers also saw an increase in claims notifications or payouts in the last year. We expected this as, generally, insurance claims increase when the economy slows down, albeit we did not expect the increase to be quite so material. The most common warranties breached continue to be tax warranties and financial statements warranties, which is in line with prior years so the category of claim does not appear to be the main driver of the increase. Of the claim notifications received, 51% came in the first 12 months of policy inception, and 17% in the 12-24 month period following inceptions.

As claims reserves increase whilst claims are negotiated and finalised, it would be logical to assume that base premiums would also be on the rise, but it is clear that, currently, competition has a greater level of influence on W&I pricing than claims experience. We expect that, in time, underwriters will be pressured by reinsurers and underlying capacity providers to increase pricing to balance out the rise in claims but we do not expect pricing to rise materially any time soon.

A byproduct of this second year of extremely high competition levels has been certain insurers' eagerness to differentiate themselves by offering broader coverage, a more commercial process and expanding their appetite. This manifested in several different ways:

- **Deductibles:** most insurers became willing to offer deductibles which "tip" to nil (whereby the policy will pay from the first £1 once a loss or series of losses reach the deductible threshold) and towards the end of 2023 certain insurers expressed a willingness to offer nil deductibles, an enhancement that historically had only been available on corporate real estate transactions.
- **Increased sector and structure appetite:** insurers are now increasingly willing to provide competitive quotes for deals in sectors which historically had been deemed high risk in nature, such as pharma, medical services and financial services. Such quotes are offered for a reasonable price and previously mandated exclusions (i.e. professional services liability on a financial services deal) are now increasingly being removed where positive due diligence findings can be provided.
- **Synthetic warranties:** insurers and brokers alike have been discussing for a number of years the concept of synthetic warranties (whereby the policy contains an appendix of warranties that do not feature in the transaction documents but are simply agreed between the insurer and buyer.) These were historically only offered by a small pool of insurers and only in scenarios where there was a clear rationale for the seller not providing warranties. In 2023, we saw a significant uptick in insurers' willingness to offer synthetic warranties (either a full suite or a pack of warranties to supplement a lighter warranty suite offered by sell side). We see this enhancement being used most effectively in competitive auction processes, where a bidder is looking to differentiate itself from competitors by demonstrating itself to be an accommodating negotiating party.

Offering optional enhancements to cover positions allows insurers to justify charging additional premiums (an "**APs**"), and when base premium levels are at an all time low it becomes more palatable for buyers to purchase these enhancements to make full use of what the W&I insurance market has to offer. This is demonstrated in our pricing stats. Whilst anecdotally we saw base premiums for UK headquartered businesses priced between 0.7% and 0.95% of the policy limit, our final premium figures for deals of this nature averaged out at 1.1%, suggesting a greater level of willingness from buyers to pay APs. Last year, we predicted that buyers would be taking advantage of a competitive W&I market and this data supports that prediction.

Earlier on in this report, there is reference to an increase in the number of transactions made on US style terms, as US investors increase their focus on UK and European investments. This experience was echoed in the W&I market, and Howden saw an increase in the number of requests for US-style coverage for English law governed transactions. This style of coverage can be offered either in line with the transaction documents (i.e. the W&I policy will follow any US-style mechanics negotiated between the parties) or synthetically, whereby the transaction documents remain in line with UK standard terms but the policy offers enhancements that bring the document in line with what a US investor would expect from a US transacting partner, and in turn from the US Representations and Warranties Insurance ("**RWI**") market. These enhancements include removal of the exclusions for matters disclosed in due diligence and the data room, indemnity basis of loss, no de minimis and no (or minimal) warranty comments. US buyers can elect to purchase these enhancements for APs on a "menu" basis, or alternatively look to purchase a full scope US-style RWI policy.

We expect the competitive environment of 2023 to remain a feature during 2024 as, whilst pipelines for H1 look healthier than in recent years, they remain much lighter than we experienced in 2021. A further three insurers are entering the marketplace this year and insurers remain interested in bolstering team sizes notwithstanding smaller gross written premiums. That being said, the end of 2024 will mark a third year of low deal volumes, low premiums and high claims, so we expect pricing to rise slightly in Q4 irrespective of whether competition remains high and deal volumes low.

By Ella Shillingford, Executive Director at Howden M&A

Private equity

Sweet equity allocation

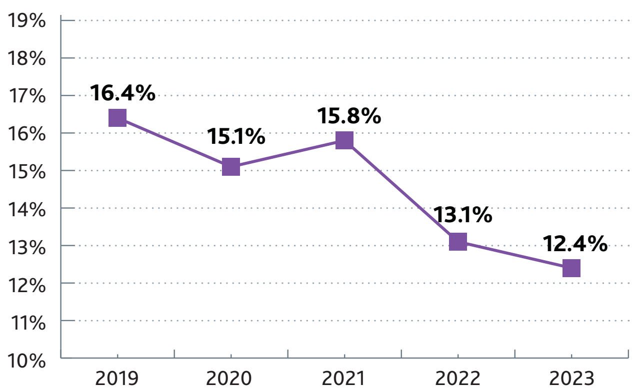
The enduring interest in trends around sweet equity, percentages of 'sweet' offered, and the proportion made available at completion, ensures that this remains a key area of focus particularly for management teams. It is fundamental to any private equity investment that those responsible for driving growth are appropriately incentivised and management are aligned with the objectives and interests of investors. What constitutes appropriate incentivisation and alignment will differ from deal to deal, and will be subject to a number of variables, including level of investment and modelled potential return, vendor or management reinvestment, cost of bank debt with the consequential increase in the cost of shareholder debt and any anticipated future funding requirement e.g. for strategic M&A. The level of sweet equity could also be a factor in deciding on a preferred investor, though this often turns on how influential management are in any transaction process and the leverage they may have, which could be more limited if a transaction is vendor, rather than manager led.

Over the last decade or more, management across all deal sizes have managed to secure relatively strong incentive deals, with sweet equity allocations generally holding up between the 10% to 20% range. More recently, since the relative heights of 2018, where the average proportion of equity available as sweet stood at 18.1%, we have seen a gradual decline in this average over the last 5 years to the point where it now stands at only 12.4%. Whilst the deal environment has certainly displayed a level of volatility over recent years, now is perhaps an appropriate point to consider what may be driving this undoubted downward trend. As markets and deals became increasingly frothy in the period between 2019 and 2021 (save for the hiatus in deal activity during the first few months of the global pandemic in 2020) deal values were increasing and bidders were very much combining price and conviction to execute deals, with the priority on value paid perhaps putting pressure on other parts of the deal funding and structuring equation. As the deal environment became more challenging over the course of 2022 and through 2023, and buyers and sellers tried to bridge a value expectation gap, in many cases management's position has become more squeezed.

In parallel, we have seen investors insisting that vendors and management roll a higher proportion of their proceeds back into the new deal. Whilst this is partly to ensure greater alignment with the incoming investor and provide more confidence that existing shareholders stand behind the future upside, in some cases investors are also taking more of a cautious approach to the kind of assets they are investing in – favouring businesses where key vendors remain active in the business and looking to ensure they stick around and play an important role in delivering returns during the next phase of the growth story, rather than investing in management teams who are either untested or do not hold a meaningful proportion of the equity in the target group and so require therefore a larger sweet equity pot provide appropriate incentivisation.

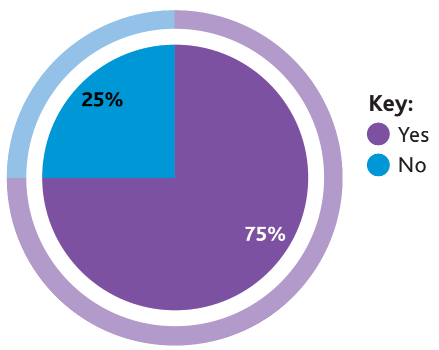
Notwithstanding this trend and potential reasons for its emergence, we are seeing investors accommodating management's interests in other parts of the equity structure – see commentary on ratchets later in this section of the report.

Average proportion of equity available as sweet equity



There's further bad news for management teams in terms of the proportion of sweet equity which is allocated to Chairs or other NEDs. At the term sheet stage there is often a stand-off between the investor and management as to who should bear the dilution on the issue of these shares. Management will insist on sweet equity being ringfenced for executive management and employee incentivisation and that as the appointment of a Chair or NED will usually be at the discretion or direction of the investor, any equity to be issued to them should come from the investor pot. In our experience management more often than not tends to lose the argument. The 2023 data supports this outcome, showing that the Chair or NED's allocation came from the sweet equity pot in 75% of relevant transactions (up from 58% in 2022).

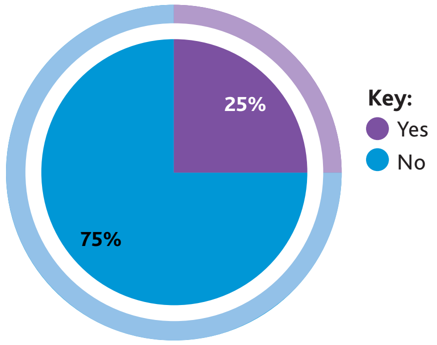
Did the sweet equity pot include the Chair/NEDs?



Ratchets

Perhaps to offset the downward trend in the proportion of equity earmarked for sweet equity on day one, as mentioned above, in 2023 we saw an increase in the percentage of deals which included a ratchet – that is, a mechanism which reallocates proceeds on a future sale from the investor to management, provided specified performance hurdles are achieved on an exit. We saw ratchets agreed in 14% of relevant transactions in 2022 and noted then that this perhaps reflected the challenging market conditions at that time. The inclusion of ratchets in 25% of relevant transactions in 2023 therefore debunks this theory somewhat. The reality is this is a new deal metric which we only started to record data for in 2022 and so it is too soon for us to take a view on what may be 'market'. The data over the last two years however may suggest that investors prefer to recognise and reward overperformance on the realisation of value on exit via a ratchet mechanism than to concede on a higher percentage of sweet equity allocation at the outset of an investment in an environment where the economic outlook and therefore performance and returns may not be as certain as in previous years. Alternatively, the reduced data set we have for this year's report may have skewed the results and that the trend for ratchets may be closer to that seen in 2022. Time will no doubt tell.

Was there a ratchet?

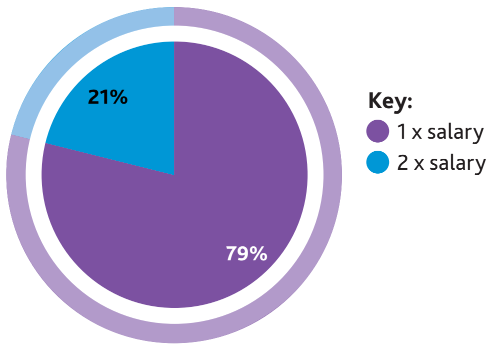


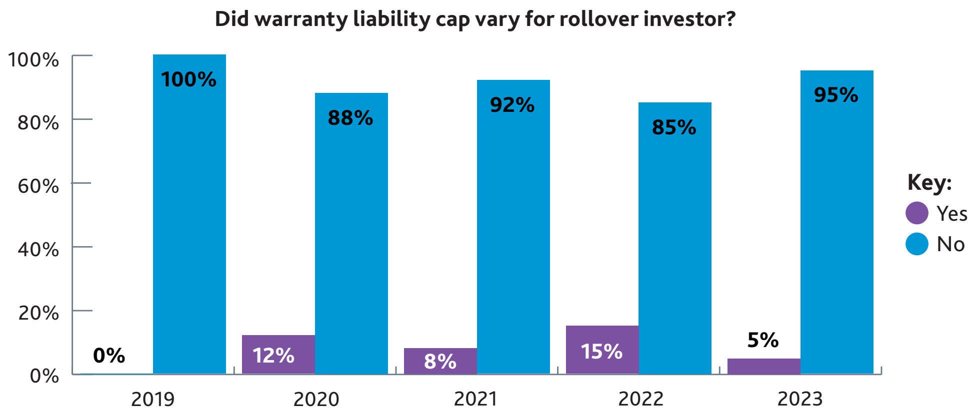
Warranty caps

The trend for lower warranty liability caps for investment agreement warranties for those managers who are receiving sweet equity continued in 2023 with a 1x cap, seen in 79% of relevant transactions, up from 70% in 2022. We noted a drop from 79% in 2021 so the result for 2023 brings the data into line with longer term norms. A prevailing view is that investors may not favour seeking recourse for breach of investment agreement warranties as a principal form of redress where issues with their investment become apparent. It is clearly fundamental to any private equity investment proposition for management to give warranty protection to investors around the business plan, due diligence reports and personal information (including the detail of customary management questionnaires). However, it would appear a 1x salary cap seems to be sufficient for management teams to focus their minds in carrying out a meaningful warranty and disclosure exercise. As stated previously (and which seems to be supported by the data), there is an increasing acknowledgment in the market (across both investors and advisers) that there is limited benefit in investors suing their management teams for breach of investment warranties and instances of this are quite rare. In any event, investors' principal form of comfort should be in undertaking a thorough due diligence exercise across all key risk areas with customary management warranties being more of a confirmatory exercise to underpin the detailed due diligence undertaken.

Where managers are receiving what can be considered to be "life changing" proceeds on a transaction we sometimes see investors pushing for liability caps which exceed caps linked to salary where there is a concern that these managers may not be sufficiently incentivised to undertake a meaningful review of the business plan and reports, for example. That said, most historic data on liability caps points to there being little variation in the level of liability cap required by investors from managers who are rolling over value as against management who are receiving sweet equity only.

What was the warranty liability cap for managers taking sweet equity?



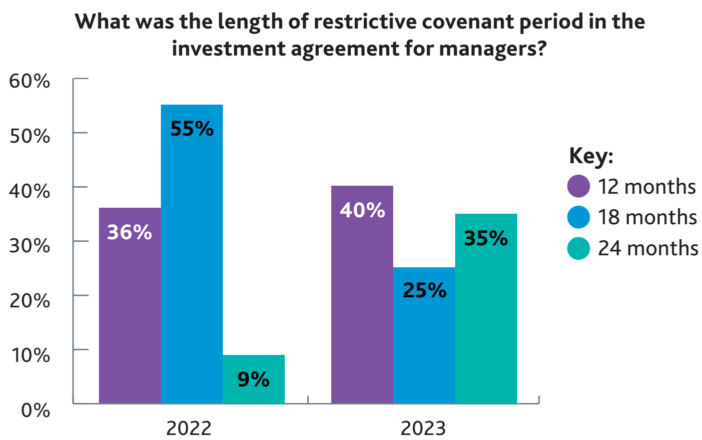


Restrictive covenant periods

We have previously speculated on whether the trend for lower investment agreement restrictive covenant periods could become more established as a market standard position, with a significant reduction over recent years from 36 months to 24 months. Indeed, in last year's report we noted an increase in periods of 18 month or less, which we thought may be due to sellers having the upper hand in negotiations in what was, notwithstanding the economic storm clouds gathering, more of a sellers' market. We wondered whether investors were becoming more comfortable with restricted periods of 24 months for key managers and even shorter restricted periods post cessation of employment for junior sweet equity holders. The position in 2023 seemed to be correcting itself in line with the historic position where we saw an increase in restrictive periods of more than 24 months (in effect, 3 years) from 9% in 2022 to 35% in 2023. As it is widely acknowledged that market conditions for transactions were more challenging in 2023, this correction could be due to investors taking a tougher stance in negotiations with management teams to ensure they had more protective levers to pull, particularly in respect of key rollover managers who may then end up leaving their roles and exposing investee companies to greater risk as a consequence.

Notably, while we saw an increase in restricted periods of more than 24 months, the data also showed an increase in the use of restricted periods of 12 months from 36% in 2022 to 40%. This would suggest investors are increasingly comfortable in moving from a 'one size fits all' approach when it comes to applying covenants across their management teams.

This previous approach often resulted in junior management being barred from working in their sphere of expertise for 3 years post-cessation of employment by the investee business even though they have received modest sums in proceeds. We had predicted the trend of investors being comfortable with lower restricted periods for this group of managers would continue and this seems to be borne out by the 2023 data with investors seemingly displaying more sympathy towards junior managers where there is less of a risk to the investee business by them being in the market and competing sooner than more senior managers.

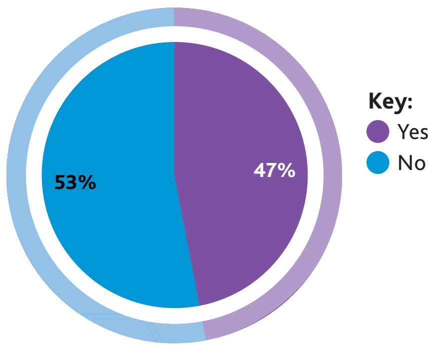


Fees

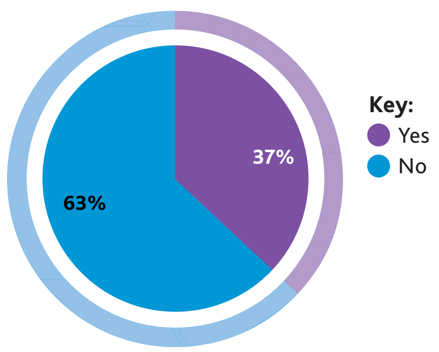
The charging of arrangement fees by investors has been increasing in recent years and while the number of relevant transactions for which these fees were charged dropped from 57% in 2022 to 47% in 2023, the percentage is still significantly higher than we have historically seen. This is even more prevalent across the mid-cap space than with larger institutional deals. This would support the view that arrangement fees are increasingly forming part of the private equity deal landscape, particularly in a more challenging deal environment, where the structuring of deals may have become more reliant on investors committing a higher proportion of equity into a deal, with third party debt becoming more difficult to secure. This increase in arrangement fees in these circumstances is therefore understandable.

The use of a monitoring fees reduced in 2023 (37%) from the level seen in 2022 (44%).

Was there an arrangement fee?



Is there a monitoring fee on top of director's fee?



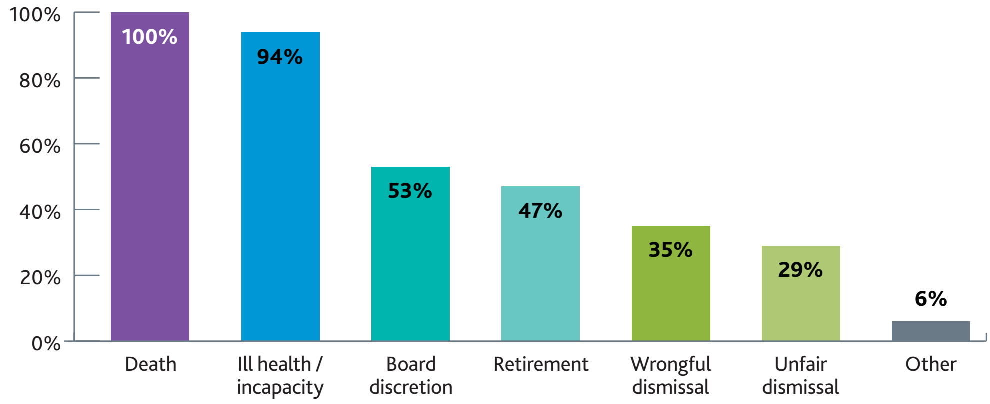
Leavers

The data providing insight on those circumstances for which good leaver applies in 2023 raised more questions than it answered perhaps pointing towards anomalies in the data for the year. The circumstances outside of the evergreen good leaver circumstances of death, ill-health / incapacity and board discretion made a comeback in 2023. The use of retirement increased in 2023 from its 2022 comparator (47% up from 23%) as did wrongful dismissal (35% up from 15%) and unfair dismissal (29% up from 8%), with the miscellaneous 'other' category slightly down on 2022 (6% from 8%). The reasons for this are difficult to explain when you consider the use, for example, of unfair dismissal over the longer term is showing a decline.

This position is further compounded when we consider the significant increase in the use of intermediate leaver, which is commonly treated as a home for those other circumstances which fall between the limited circumstances occupying both ends of the leaver 'spectrum' of good leaver or bad leaver (for which, see more analysis below). So given the increase in the circumstances for good leaver we would have expected for there to be a reduction in the use of intermediate leaver. As we can see the opposite is true. One conclusion from this could be that while management and their advisers have been successful in expanding the circumstances where good leaver applies, they are also managing to secure intermediate leaver treatment for those circumstances where they would previously have been treated as a bad leaver.

The contradictory nature of the 2023 data highlighted above is perhaps symptomatic of the unpredictable market most investors and advisers will recognise. We still however expect that as market conditions settle down and become more predictable (which we certainly hope for 2024!) we would expect the data to reflect a reduction in the use of good leaver circumstances outside of the evergreen events referenced above.

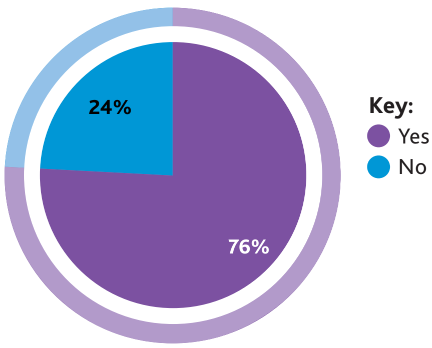
Good leaver circumstances



Intermediate leaver

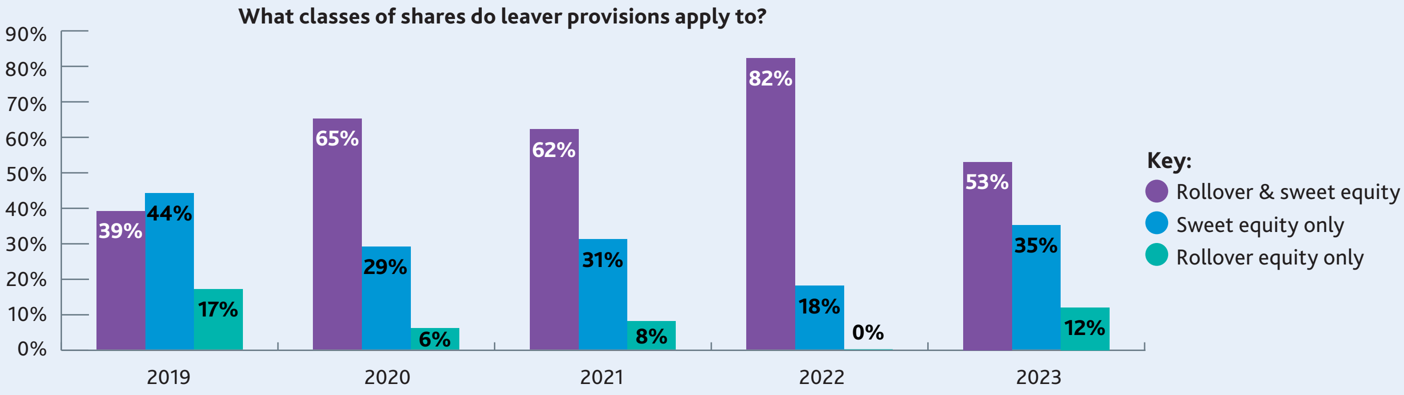
As mentioned above there has been an increase in the use of intermediate leaver after a decline in 2022. This leaver concept occurred in 76% of surveyed deals up from 58% last year. 2023's result stemmed a three year fall in its use for reasons that were not entirely clear as in our experience its use is increasingly common for UK mid-market PE deals as a mechanism for rewarding departing managers for growth in equity value created in the period prior to their termination when in earlier times managers were only permitted by investors to participate in any value created if they were employed at the time of an exit. The increase in the use of intermediate leaver in 2023 would support our view that, at least anecdotally, intermediate leaver is a popular and acceptable middle-ground between management and investors' opposing tensions on entitlement to value for leavers.

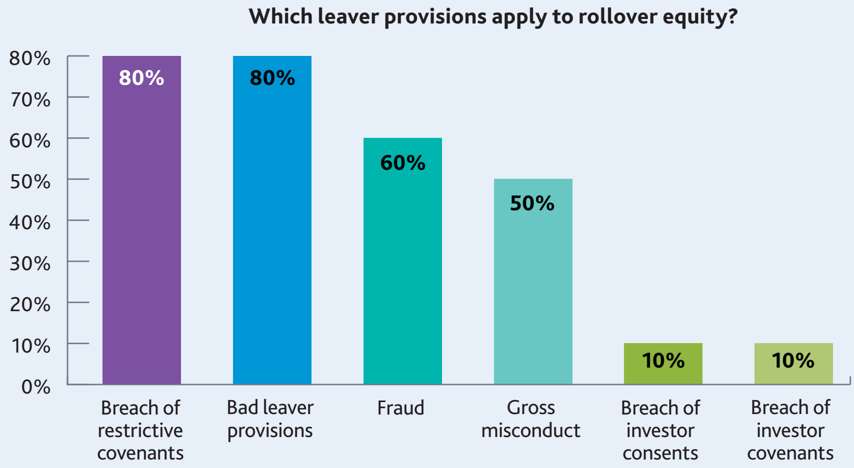
Is intermediate leaver concept included?



Leaver provisions – application to rollover equity

Over previous years we had noted a significant increase in the application of leaver provisions to rollover equity. However, 2023 saw a marked decline in its application reducing to 53% of relevant transactions from 82% in 2022. This is a little surprising although, as can be seen from the graph, the position seen in 2023 seems to be heading back to the level seen in 2019, suggesting that on the fewer deals done, vendors were determined to hold firm on the position that their rolled value is off limits in all leaver scenarios. This could also reflect the trend for higher rollover amounts by founders/management as reported above. We have seen an increase in the percentage of deals where leaver provisions apply to sweet equity only (occurring in 35% of relevant transactions in 2023 as against 18% in 2022), which assists in supporting this view. That being the case, we would be surprised if this reduction reflects a softening by investors in their stance towards rollover equity where, in a limited yet serious set of circumstances, customarily fraud, an act justifying dismissal for gross misconduct or breach of restrictive covenants, rolled equity and loan notes are offered for sale at less than market or par value (as applicable) and sometimes sold or forfeited for £1 in aggregate. We suspect the results for 2023 may reflect a quirk in the data rather than an increasing tolerance from investors and their investment committees towards these kinds of behaviours.



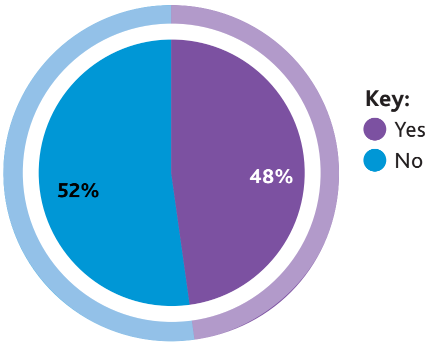


Loan notes & preference shares

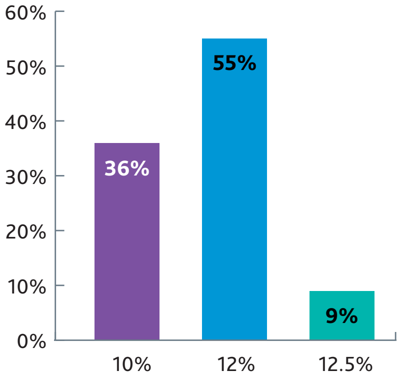
We have typically seen the coupon on loan notes in previous years set at 10% but noted in last year's report, due to recent increases in Bank Base Rates in 2022, that we would expect investors to increase their interest rates to a level in excess of senior debt interest, pushing the coupon for investor loan notes beyond this percentage. As it was, while the proportion of transactions featuring loan notes remained consistent with previous years, occurring in approximately half of relevant transactions (though slightly lower at 48% of relevant transactions from 53% in 2022), our prediction on rate increases for investor debt, unsurprisingly, proved to be correct with a rate of 12% featuring in 55% of relevant transactions where last year 10% was the dominant rate at 57%. Given the rises in Bank Base Rates, we anticipated we would see a greater proportion of deals with increased rates on investor debt in excess of 12%. In reality, interest rates of more than 12% featured in only 9% of transactions (which was, in fact, down from 29% in 2022), suggesting that there was little appetite amongst investors for hiking their rates much beyond 12%. This may have been to maintain competitiveness for those fewer assets looking to attract private equity investment in the challenging deal environment of 2023.

Notwithstanding the above, the dominant coupon for preference shares was 10%, occurring in 50% of transactions, lower than the dominant coupon rate for loan notes (12%).

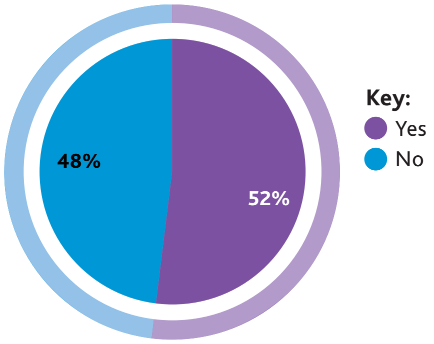
Were investor loan notes issued?



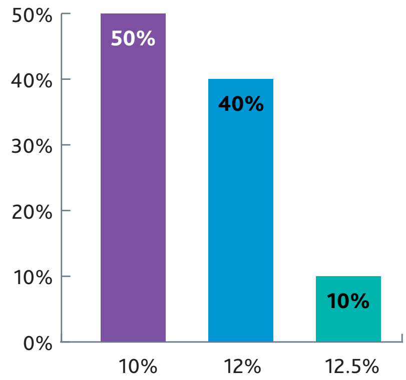
What was the interest rate on investor loan notes?



Were preference shares issued?



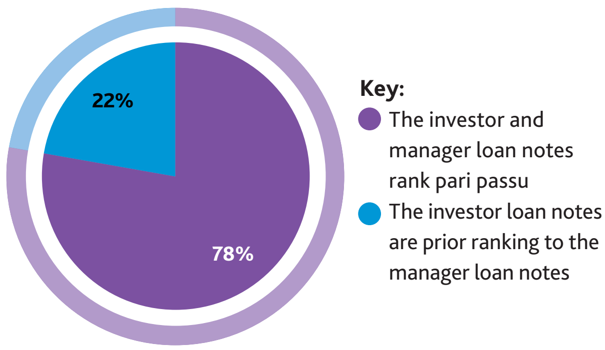
What was the coupon on the preference shares?



Ranking of loan notes

In terms of ranking, management teams have over recent years, perhaps as a consequence of seller and management friendly markets, been pushing for equal ranking of their loan notes alongside investors notes in all circumstances. Historically, the standard investor position was for their loan notes to rank ahead of non-investor loan notes come what may and then as the market for sought after assets became more competitive, investors began to soften this position and agree to equal ranking other than in a 'downside' or 'underperformance' scenario – being where the exit proceeds are unlikely to result in the repayment of all classes of loan notes in full or on an insolvency event. More recently, investors have become a little more comfortable in equal ranking in all circumstances provided the investor is able to control how the loan notes are dealt with, when they can be repaid and when enforcement is permitted on events of default. The principal consideration being that no loan note holder other than the investor can move to effectively 'bring the house down' by suing the group on a default. These control rights will also extend to amendments or variations to their terms (e.g. value write downs or amendments to the coupon) provided equivalent and proportionate amendments are made to the investor notes.

How do the investor and manager loan notes sit for ranking purposes?



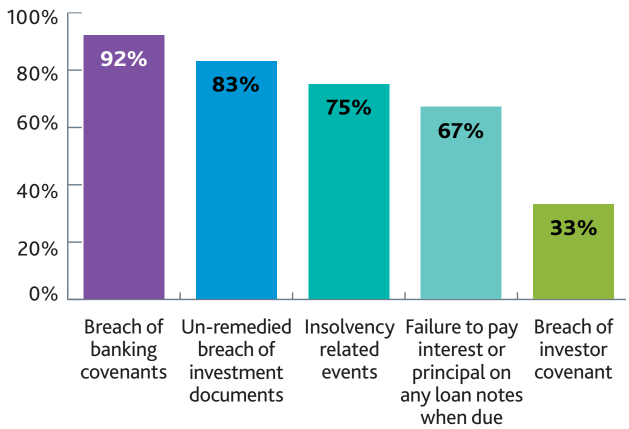
We noted from the 2022 data there was a material reduction in equal ranking from 81% in 2021, the year of almost unprecedented deal activity with a surfeit of competitive sale auctions, to 69% in 2022 and speculated that this was due to a cooling of sentiment from investors with them seeking to protect downside risk in ways they were perhaps less able to do in 2022 when the deal environment was more competitive. As the market undoubtedly became more challenging in 2023 than in the previous year, we saw an increase in the proportion of relevant deals where all loan notes ranked equally, seen in 78% of transactions, and closer to the 2021 high mentioned above.

While no two deals are the same and there may always be legitimate reasons why investor debt should rank ahead in all circumstances or on a downside or underperformance event, it is clear that with the right asset, structure and deal dynamics, investors are becoming increasingly comfortable with equal ranking, provided that the investment documents give the requisite level of control across the loan notes as described above.

Swamping rights

The circumstances which trigger customary investor swamping rights have remained consistent over a number of years and, as stated previously, we would expect this to remain the case for the foreseeable future, whatever challenges the market or deal environment may present to investors and management teams. The data for 2023 follows this trend although we note an anomalous result in the drop from 100% to 92% for breach of banking covenants which always tends to be at 100%. This can probably be explained away by the smaller data set for the year rather than the shoots of a new emerging trend. We noted last year a reduction in the occurrence of insolvency related events and a steep reduction in the inclusion of unremedied breaches of investment documents. We can confirm that both of these circumstances are back to their pre-2022 levels with insolvency related events occurring in 75% of relevant transactions (up from 67% in 2023) and unremedied breaches of investment documents jumping to 83% from the modest 33% seen in 2022.

If the investment agreement contains "swamping rights", in what circumstances can investors invoke these rights?



> **The circumstances which trigger customary investor swamping rights have remained consistent over a number of years and, as stated previously, we would expect this to remain the case for the foreseeable future, whatever challenges the market or deal environment may present to investors and management teams.**

European perspectives

Spotlight on Ireland

Ireland's PE market could be poised for wave of secondary transactions in 2024

Given the volume of private equity (PE) deals in 2021 and 2022 a wave of secondary management buyouts is on the horizon in Ireland.

The question is whether we start to see these businesses come to market in the third and fourth quarters of this year or whether it will be 2025 before the wave hits and we see a year of significant market growth.

While 2023 was about resilience, deal volume is likely to increase during 2024 with justified optimism for PE in Ireland.

Generally, financial services, life sciences and technology continue to be standout sectors for PE in Ireland, with software, insurance brokerage consolidation, large pharma acquisitions and accountancy roll ups making up a large chunk of mergers and acquisitions during 2023. Healthcare and education are also becoming consistent areas of interest, with an increasing number of private equity deals in these sectors in the past year, in line with what we have seen in the UK market.

Despite a decrease in deals by value during 2023 on the previous 12 months, activity is expected to increase during 2024, with transaction activity increasing as trends continue to edge towards pre-Covid levels. While overall deal values decreased, the deal volume in 2023 was generally consistent with 2022 and still higher than pre-pandemic levels. The potential for a number of exits for PE backed businesses by the current fund selling to another fund is also a positive indicator of likely increased activity levels in the next 12 months.

Secondary buyouts have not been a common feature in the Irish market up until this point. It is only in the last three or four years that we have seen a significant uptick in mid-market private equity deals in Ireland with a greater number of funds investing significant amounts of time sourcing new deals. We expect this trend to continue in the next three to five years.

This poised wave of secondary sales adds to the changing landscape of the overall private equity market in Ireland, bringing a different dynamic to the market in terms of how deals are approached and run.

Continuation funds are also emerging as a new trend allowing shareholders to access some liquidity. This is likely to continue in the next year. This is an option for high performing businesses in the market where the investor is keen to continue to invest and benefit from expected future gains or a better exit down the line.

Continuation fund deals are not without their challenges and require the investor to engage two separate teams of advisers – buy-side and sell-side - to appropriately deal with conflicts of interest and ensure that the deal is negotiated on arm's length terms.

A general increase in competitiveness has also been noted in the Irish PE market. Trade has become a more attractive option in the past year, with new entrants to the market from the UK or US and other promising trends promoting competition. These overseas funds are investing in Ireland as businesses demonstrate good investment return potential, making the Irish market more attractive.

However, there are, of course, continuing challenges faced by the market causing some "stodginess" in deal volume.

Throughout 2023, and continuing into this year, processes are often being run more tentatively with potential challenges to deals in mind. For instance, businesses are sometimes avoiding an official sale process despite preparing for potential sale behind closed doors. This "off market sale" trend may seem unconventional, but offers some protection as businesses, investors or fund managers aim to avoid a failed sale process. A public, failed sale can be damaging down the line and instead a lot more prep work is being done on businesses to "future proof" them ahead of an official "on market" sale process being launched.

This can also offer some reputational protection within the business, such as with employees or customers, meaning the benefits can be two-fold, allowing for confidentiality and continued confidence across the business.

Additionally, the market trends during the last 12 months show a slowdown in pace of deals. The somewhat lethargic market conditions are largely down to finance being more difficult to secure due to costs and the influence of high inflation. Buyers are therefore carrying out more due diligence, spending more time on assets and investigating any potential issues.

The Screening of Third Country Transactions Act 2023, which implements the EU Screening Regulation, is anticipated to take effect in the second half of 2024. This may provide an additional challenge to some deals.

The new legislation means that more corporate transactions will be subject to increased screening measures. Transactions which affect certain core sectors including critical infrastructure, technology and the media involving third country investment. For instance, investment from outside the EEA and Switzerland must be submitted to the Minister for Enterprise, Trade and Employment for review.

Notification must be made at least 10 days before the transaction is completed. It will be a criminal offence to conclude a transaction without minister clearance if the deal meets the outlined conditions.

Investors looking to conclude deals in Ireland will need to factor this legislation into their thinking when considering timings for completion of deals and potential delays.

Germany

Germany remains an attractive market for private equity, but consistent with other jurisdictions in Europe, deal activity dropped in 2023 compared to 2022.

While there are reasons to be optimistic about private equity activity in Germany in the coming year, whether this translates into higher deal activity is far from certain given ongoing uncertainties in external factors, including global economic developments, how long inflation and interest rates stay higher than historically and ongoing unexpected geopolitical crises.

The average time for deals to close significantly increased, which was a contributing factor in lower deal volumes as deals just took longer. In addition, we saw that ongoing transactions were more susceptible to being halted or withdrawn without a successful completion.

We also witnessed fewer competitive auction processes, certainly in the (upper) middle market. This may be driven by investors seeking more certainty and not wishing to engage in competitive auctions. A new trend we did see was competitive auctions being aborted mid-process, something not common in prior high deal activity years.

In terms of legal developments, we are seeing more acceptance of the use of data rooms for general disclosure in Germany. While data rooms have been more widely used in UK and US private equity transactions, this has not been the case historically in Germany. Whether this trend becomes the norm in Germany or not will be driven by the demands of the market and who has more negotiation power. As we move from a sellers' to a buyers' market, it will be interesting to see how this impacts the ongoing use of data rooms.

Compared to the data on UK deals presented earlier in this report, there are more separate caps on liability under the tax covenant in Germany.

Luxembourg

Despite the presence of the major US and UK private equity houses in Luxembourg, 2023 was one of the quietest years in terms of activity, with both the volume and value of transactions falling dramatically. As elsewhere in Europe, the geopolitical destabilisation caused by the Ukrainian crisis, steep price inflation and the sharp rise in interest rates are the main reasons for the general slowdown in private equity activity. All of this has led to economic uncertainty, dampening the enthusiasm of buyers, who were more cautious and opted to sit out and wait for more favourable valuations, while sellers still had high price expectations. Some players also noted the increased ESG requirements from investors (especially funds).

However, thanks to its historical stability, Luxembourg continued to act as a hub for European investment and many acquisitions and equity investments continued to be structured through Luxembourg vehicles. In particular, we saw a number of private equity firms investing through Luxembourg in real estate projects in Portugal, principally in the leisure, retail and logistics sectors.

Although the beginning of 2024 has been relatively slow, there seems to be an uptick in transactions, especially at the beginning of the second quarter, though deal volumes remain lower than in previous years and concentrated in certain sectors, especially technology and finance. However, some market participants expect a continuous growth of around 10% over the next few years.

In general, we are seeing some rebalancing of expectations between buyers and sellers, but the market continues to favour buyers, who are becoming more demanding (due to lower risk appetite), particularly in terms of due diligence, representations and warranties to be obtained from sellers, with increasing use of earn-out or rollover mechanisms to limit the purchase price to be paid upfront.

Netherlands

The Netherlands has always been a strong market for private equity. Although the global trends were also evident in the Netherlands in 2023, the mid-market landscape remained relatively robust, demonstrating the resilience of the Netherlands market. While there were fewer large, multi-billion deals, as the Netherlands market is less dependent on these mega deals than other jurisdictions, such as the US, we would expect the Netherlands market to recover sooner than others.

In 2023, we saw fewer competitive auction processes, demonstrating that it was difficult to attract multiple buyers willing to compete in a competitive auction. Investors seemed to take a more cautious approach, seeking established businesses with steady cash flows over riskier targets in emerging markets. This also impacted the deal terms: less interest from investors seemed to lead to an increase in the use of a deferred consideration to bridge the gap between investors and sellers. On the other hand, investors seemed to be more open to flexible arrangements around leaver provisions on roll-over equity. More relaxed restrictive covenants for junior management also became more common.

Things are looking optimistic for 2024. With the likelihood of a potential recession decreasing and a reset of valuations, the market is showing signs of recovery and there already seems to be an increase in deals in the first quarter of 2024, particularly in the technology sector. A level of uncertainty remains due to the ongoing geopolitical environment.

Despite this, companies need to keep up with developments in the fields of ESG and technology, and M&A is one of the tools to achieve growth and to create value. While private equity is at the forefront in terms of a platform to transform and grow businesses through M&A, this is particularly the case in the Netherlands, where private equity represents a larger part (~60%) of the deals compared to the worldwide average. In addition, many exits were put on hold in 2023 and these might come back to life in 2024.

Spain

2023 saw the lowest level of M&A activity in Spain in a decade, the result of a sharp rise in interest rates, the impact of inflation and geopolitical uncertainty. Private equity houses focused on taking care of their portfolios and looking for levers to create value, beyond debt and multiple arbitrage. Divestments slowed down in a market context in which investment decisions were more complicated and the gap between buyers' and sellers' expectations was wider.

At the start of 2024 we are seeing more liquidity, more fundraising and more investments. The main stumbling block: the difficulties in closing the gap in valuations between buyers' and sellers' expectations, which continues to cause delays in some processes.

The cost of funding has risen by 5 to 6 points, and this is a cost that goes directly to the IRR for private equity. This is undoubtedly affecting transactions, especially those where debt has a significant value component, such as mega-deals. Fortunately, the middle market always has other levers of value creation that make it less dependent on debt. Both banks and funds have the capacity to lend, but rising costs have a direct impact on expected returns, so the market is resorting to other resources to bring positions closer together and close deals, such as earn-outs, equity adjustments and vendor loans.

Furthermore, in this context where divestments are taking longer and debt is no longer a value creation lever as such, investors have to resort to other strategies, such as bolt-ons, to grow investee companies. As we move into 2024, the investment landscape reveals a clear trend towards co-investment. At a point where diversification and risk-adjusted returns become investment mantras, co-investment arrives as an attractive strategy, offering a path to unique opportunities and potentially superior returns.

In summary: the market consensus is that monetary policy is expected to ease in the second half of 2024, and that a moderation in inflation will again boost investment and divestment activity in Spain.

Pinsent Masons' Private Equity Practice

Our award-winning international private equity team works closely with investors, management teams, corporate and individual sellers and providers of debt and equity finance, offering a full range of legal services and strategic advice. We have experience of acting on private equity transactions of all sizes, from early stage investment and portfolio building through to eventual exit, whether by trade sale, secondary buyout, IPO or refinancing.

We take a sector approach, truly understanding the environment in which your business operates, from the competitive landscape to the risks and challenges particular to each industry.

We have offices across all three UK jurisdictions and spanning Europe, Middle East, Africa and Asia-Pacific, offering a global perspective. To find out more about our team or to sign-up for legal updates, please visit **Pinsent Masons**.

Ed Stead
Partner, Head of Corporate UK, Head of Private Equity
+44 (0)7796 336 343
edward.stead@pinsentmasons.com

Tom Leman
Partner
+44 (0)7919 331 072
tom.leman@pinsentmasons.com

Kieran Toal
Partner
+44 (0)7774 336 546
kieran.toal@pinsentmasons.com

Arrowpoint Advisory

Arrowpoint Advisory is the dedicated mid-market advisory team of Rothschild & Co in the UK.

We are one of the most successful M&A, Debt and Special Situations firms, with a 45-year track record of delivering outstanding results for our clients.

We provide expert M&A, Debt and Special Situations advice to publicly-listed, private and family companies, entrepreneurs, sponsor-backed businesses and management teams, investors and lenders.

Over the last 25 years, our team has successfully delivered over 900 transactions. We have dedicated and expert sector teams covering Business Services, Consumer, Retail and Leisure, Energy Transition and Infrastructure, Healthcare, Industrials and Telecoms, Media and Technology.

To find more out about our team and latest transactions, please visit **Arrowpoint Advisory**.

Simon Cope-Thompson
Managing Director, Head of Management Advisory
+44 (0)20 7484 4706
+44 (0)7770 917 468
simon.cope-thompson@rothschildandco.com

Jamie Hutton
Director, Management Advisory
+44 (0)20 7484 4733
+44 (0)7769 224 934
jamie.hutton@rothschildandco.com

Howden M&A

Howden is a leading provider of M&A insurance advisory across Europe and Asia. The solutions we advise upon enhance bids, bolster protection for buyers and sellers and streamline negotiations. We understand the underlying issues and use this knowledge to structure policies that fit the transaction whilst negotiating insurance policy wordings that provide the widest scope of cover. Our experts advise on W&I insurance, Tax & Contingent risks, Environmental Liabilities and Title & Real Estate insurance with specialist non-broking teams providing transactional diligence and an in-house claims service.

For more information, please visit our website: **Howden | Mergers and Acquisitions**.

Guy Wilmot
Director
+44 (0)20 7133 1295
+44 (0)7879 256 242
guy.wilmot@howdengroup.com

Ella Shillingford
Executive Director
+44 (0)20 7133 1295
+44 (0)7530 975 773
ella.shillingford@howdengroup.com

107076