www.pwc.de/de/privateequity

Private Equity Trend Report 2019

Powering through uncertainty

13th annual survey on current developments in German and European private equity investment.

pwc

Private Equity Trend Report 2019
Powering through uncertainty

13th annual survey on current developments in German and European private equity investment.

Private Equity Trend Report 2019

Published by PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft

By Steve Roberts and Elena Naydenova

February 2019, 80 pages, 72 figures, softcover

All rights reserved. This material may not be reproduced in any form, copied onto microfilm or saved and edited in any digital medium without the explicit permission of the editor.

This publication is intended to be a resource for our clients, and the information therein was correct to the best of the authors' knowledge at the time of publication. Before making any decision or taking any action, you should consult the sources or contacts listed here. The opinions reflected are those of the authors. The graphics may contain rounding differences.

© February 2019 PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft.
All rights reserved.
In this document, "PwC" refers to PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft, which is a member firm of PricewaterhouseCoopers International Limited (PwCIL). Each member firm of PwCIL is a separate and independent legal entity.

Preface

Dear friends,

With the backdrop of a year in 2018 where global deal volumes reached an all-time high, valuations rose to at least pre-crisis levels and the amount of dry powder continues to grow seemingly indefinitely, it is worth standing back from the euphoria and taking stock of the underlying fundamentals and dynamics of this industry whose progress appears relentless.

As the consistently best performing asset class, it isn't surprising that private equity continues to attract fresh capital. In the low interest environment, LP's are seeking to deploy their funds at even higher levels within the industry, both through higher commitments as well as increasing direct co-investments. With broadly stable debt to equity ratios, this presents a significant challenge as proportionally less of the equity cheque comes from the fund, meaning that the GP's have to work even harder across more deals to deploy their capital.

The funds are therefore continuing to further diversify into credit, real estate and infrastructure. The larger funds are even creating more strategic funds with lower returns but longer holding periods, as well as parallel funds addressing lower or mid-cap sized transactions – all is driven by the immense levels of capital available.

As noted in our trend reports over recent years, and this one is no exception, the high multiples driving higher entry prices result in value creation requiring much more operational involvement over a longer holding period. GP's are therefore having to diversify, upskill as well as increase the headcount of their deal professionals, another challenge in a fast maturing market that is adapting to the impact of digital and AI to name just two major recent influences on investment decisions.

Germany, historically Europe's third-largest PE market and the core of the DACH buyout industry, performed well in 2018. This is evidenced by this region posting its most active year for new deals since the global financial crisis, and second-best year in terms of capital invested.

By contrast, it was a quiet year for the region's exit market. Rather than a sign of dysfunction, however, this is a consequence of the fundraising cycle and reflects a broader trend across Europe. Having spent recent years securing record distributions for their LPs, and with investors recycling capital back into the asset class in the pursuit of high returns, GPs have pivoted. Last year, they focused more of their attention and resources on new investments rather than on realisations.

However, on the face of it there are reasons to exercise caution heading into 2019, with some of the defining characteristics of the final quarter of last year being heightened volatility in capital markets, stock prices undergoing a pronounced correction and high-yield bond markets closing to new issuance. At this juncture, political and economic uncertainty is heightened, accentuated by the pending Brexit.

As the largest PE market in Europe, the UK's withdrawal from the EU appears to be having a significant impact. Buyout activity in 2018 was dampened, especially on a value basis, driven primarily by a lack of large deals. The country was also home to a number of large exits in 2018, as it appears that PE sponsors were eager to crystallise returns ahead of the scheduled departure date in March. There have been signs of weakness in Europe's growth too, including in Germany, the continent's largest economy. This has largely been associated with a deceleration in China, with which Germany, one of the world's leading exporters, has close trading ties.

All this may well lead to a heavy scepticism and fear of a pending correction. However, we note that the average private equity fund appreciated by over 8% in 2018, while most major public market indices experienced double digit declines. The macroeconomic and political concerns that led to the volatility in 2018 remain in the year to come, and private equity will need to continue to outperform public markets.

To achieve this the industry will need to continue to adapt, to drive deep value creation through their portfolio companies in highly focused and continuingly more innovative ways, whilst still finding the time and capacity to deploy capital on new deals. The potential damage of a reduction in number of attractive target companies doesn't, however, currently appear to be manifesting itself. In contrast to previous periods of economic softening, we are observing a decoupling of the deals market and developments within the debt restructuring market. These are usually counter-cyclical but are currently showing a similar rising trend, driven certainly in part by the levels of capital but also by the increasing maturity of the deal market itself and the private equity industry within it.

In conclusion, the fundamentals of the PE market not only remain intact but also continue to evolve. Record dry powder, driven by investors' desire for exposure to the asset class's public market outperformance, means that funds are fully equipped and are primed to transact. Private equity has always proved resilient in adapting to an ever-changing world, with the aforementioned factors continuing in the face of an asset scarcity driving further competition. The challenges are clear, however, the track record of both performance and adaptability bodes well for another successful year.

As always, our thanks go to all those who participated in this year's survey and shared their opinions. We look forward to working with you again in 2019!

Steve Roberts
Private Equity Leader

Table of Contents

Table of Figures ... 8

A Market Overview ... 14
1 Private Equity in Europe ... 15
Deep dive: DACH Spotlight ... 22
Deep dive: Benelux Spotlight ... 25

B Key Findings ... 28

C Methodology ... 31

D Detailed Findings ... 33
1 2018 in review ... 34
2 The year ahead ... 39
3 Focus on value creation ... 54
4 Global hotspots ... 62
5 Focus on Germany ... 66

Appendix ... 68

List of Abbreviations ... 77

Contacts ... 78

Table of Figures

Fig. 1 European Private Equity Trends, 2013–2018 15

Fig. 2 European Buyout Trends, 2013–2018 15

Fig. 3 European Buyouts, Split by Deal Size, 2013–2018 16

Fig. 4 European Exit Trends, 2013–2018 17

Fig. 5 European Buyout volume, split by region 19

Fig. 6 Buyout value, split by region 20

Fig. 7 DACH Private Equity Trends, 2013–2018 22

Fig. 8 DACH Buyout Trends, 2013–2018 23

Fig. 9 DACH Buyouts, Split by Deal Size, 2013–2018 23

Fig. 10 DACH Exit Trends, 2013–2018 24

Fig. 11 Benelux Private Equity Trends, 2013–2018 25

Fig. 12 Benelux Buyout Trends, 2013–2018 26

Fig. 13 Benelux Exit Trends, 2013–2018 26

Fig. 14 Respondent country 32

Fig. 15 Capital under management of resdpondents 32

Fig. 16 Compared to 2017, has the number of new investments made by your organisation this year …? 34

Fig. 17 Firstly, compared to 2017, has the number of potential transactions which you have reviewed in an average month this year …? (Please select one response only.) 35

Fig. 18 Compared to 2017, has the number of exits made by your organisation this year …? (Please select one response only.) 35

Fig. 19 Compared to 2017, would you say that competition for investments among private equity firms has …? 36

Fig. 20 How satisfied or dissatisfied are you with the development of your portfolio companies in 2018? Would you say you are …? (Please select one option only.) 37

Fig. 21 Percentage of companies that broke one or more bank covenants, or otherwise needed to enter negotiations with their financing providers during the previous year 38

Fig. 22 Percentage of companies that broke one or more bank covenants, or otherwise needed to enter negotiations with their financing providers during the previous year by geography 38

Fig. 23 Do you believe that the next financial crisis will occur in the short to mid-term period (i.e. 1–3 years) from now? 39

Fig. 24 How do you expect the European deal market for private equity to develop in 2019? Do you think it will …? 40

Fig. 25 How do you expect the European deal market for private equity to develop in 2019? Do you think it will …? 40

Fig. 26 Compared to 2018, do you expect the number of new investments made by your organisation in 2019 to …? 41

Fig. 27 Compared to 2018, do you expect the number of exits made by your organisation in 2019 to …? (Please select one response only.) 41

Fig. 28 Compared to 2018, do you expect competition for investments among private equity firms in 2019 to …? (Please select one response only.) 42

Fig. 29 Looking ahead to 2019, compared to 2018 do you expect the availability of credit for leveraged buyouts to …? (Please select one option only.) 42

Fig. 30 Looking forward to 2019 which of these factor, do you consider will be the most important influence on equity stories on acquisitions for your organisation? 43

Fig. 31 Please rank the following in terms of importance, regarding their influence on your return on investment. 44

Fig. 32 Which of the following changes, if any, have occurred to your organisation's business model over the last three years? (Please select all that apply.) 45

Fig. 33 Have expectations and requirements of your Limited Partners (LPs) changed during the prior three years? 46

Fig. 34 Which of the following best describe the changes in expectations and requirements from your Limited Partners …? (Please rank top three, where 1 = biggest change.) 47

Fig. 35 Thinking about the next fund you will raise, which of the following investment partners, if any, will you expect to significantly contribute to your Limited Partner (LP) structure? (Select all that apply.) 48

Fig. 36 Thinking about the next fund you will raise, which of the following investment partners, if any, will you expect to significantly contribute to your Limited Partner (LP) structure? (Select all that apply.) 49

Fig. 37 In your opinion, which of the following industries is your organisation most likely to invest in over the next 2 to 3 years? (Please name a maximum of 3 industries.) 50

Fig. 38 Has your firm invested in any of the following asset classes? (Select all that apply.) 51

Fig. 39 Does your firm currently plan to invest in any of the following asset classes? (Select all that apply.) 52

Fig. 40 Again looking ahead, what are the key issues which the private equity industry in Europe will face in the next 5 years? (Please rank top three, where 1 = most important issue.) 53

Fig. 41 Looking forward to the next three years do you expect the number of Private Equity (PE) houses in Europe to …? (Please select one option only.) 53

Fig. 42 During the past three years has the impact of operational improvements (excluding digitisation), multiple arbitrage, financial leverage and digitisation on your return on investment increased, decreased or stayed the same? 54

Fig. 43 Looking forward, do you expect the impact of operational improvements (excluding digitisation), multiple arbitrage, financial leverage and digitisation on your return on investment to increase, decrease or stay the same? 55

Fig. 44 Which levers are most important to value creation within the equity/investment story? 55

Fig. 45 Has digitisation/industry 4.0. changed the way you look at new investments and do you model it into your equity story already at entry? 56

Fig. 46 Do you believe that digitising portfolio companies will speed up the realisation of the equity story and thus decrease the holding period of the portfolio?.... 57

Fig. 47 To what extent do you believe that the level of digital transformation is important to the future exits from your current portfolio companies and the subsequent return to be achieved? 57

Fig. 48 Have you made investments in digitally transforming your own firm or portfolio company business models in the past year?.... 58

Fig. 49 Which of the following areas will you be investing in? (Select the most important.) 58

Fig. 50 Which part of the company business model do you think is impacted the most from digital transformation? 59

Fig. 51 Will you be investing in digitisation over the next year?.... 60

Fig. 52 Which of the following areas will you be investing in? (Select the most important.) 60

Fig. 53 In which of the following areas of the investment cycle has your organisation used data analytics in 2018? (Please select all that apply.) 61

Fig. 54 In which of the following areas of the investment cycle do you anticipate your organisation will use data analytics in 2019? (Please select the most important.) 61

Fig. 55 In your opinion, which countries or regions will become more attractive for private equity investments over the next five years? 63

Fig. 56 What is the impact of Brexit on the attractiveness of the UK for private equity investments in 2019? 64

Fig. 57 What is the impact of Brexit on the attractiveness of the UK for private equity investments in 2019? 65

Fig. 58 Please specify which EU country you think is most attractive for private equity investments (Select one.) 65

Fig. 59 In an international comparison with other countries, how would you assess the attractiveness of Germany as a location for private equity investment? (Please select one option only.) 66

Fig. 60 Does your firm currently have any investments such as portfolio companies in Germany? (Please select one option only.) 67

Fig. 61 Do you think that the assets that you allocate to Germany over the next five years will … (Please select one option only.) 67

Fig. 62 What was the average debt to equity ratio used by your organisation on new investments made in 2018? 68

Fig. 63 How do you expect the world economic situation to develop in 2019? 68

Fig. 64 European Buyout volume, split by industry 69

Fig. 65 European Buyout value, split by industry 70

Fig. 66 DACH Buyout volume, split by industry 71

Fig. 67 DACH Buyout value, split by industry 72

Fig. 68 Benelux Buyouts, Split by Deal Size, 2013–2018 73

Fig. 69 Benelux Buyout, 2013–2018 73

Fig. 70 Benelux Buyout volume, split by industry 74

Fig. 71 Benelux Buyout value, split by industry 75

Fig. 72 Do you plan to make any investments in Germany over the next five years? (Please select one option only.) 76

In conversation with Steve Roberts, Private Equity Group Leader at PwC in Germany

Mr. Roberts, European private equity companies are actually in a good place. In 2018, buy-outs and exits totaled € 262.1bn, the highest value since the financial crisis. The outlook for 2019 is also optimistic. Nevertheless, you say that the industry is facing major challenges, possibly even a transformation. Why do you think that?

For years we've been witnessing raising capital inflows into the private equity industry. At the same time, private equity houses increasingly have difficulties to invest this capital. At the end of 2018, GPs around the world were sitting on dry powder amounting to more than €1tn. This is almost exactly six times the total European buyout volume in the past year (€175bn).

Why do fund of funds, pension funds, insurers or family offices then invest capital in private equity when a considerable part of the funds initially ends up as "dry powder"?

The general liquidity overhang – a consequence of the world's extremely low interest rates for years – does not stop at any asset class, including private equity. In addition, the industry is in a way the victim of its own success. For many years, most private equity investment funds have generated returns that are well above the market level. Of course, this incites interest. This applies in particular to the major European investment companies such as Apax, Cinven, CVC, Permira or the Partners Group. These alone state that they are currently collecting more than €30bn for new flagship funds.

A trend in recent years has been co-investing, a model whereby LPs act as co-investors in large transactions beyond their actual fund investment …

Correct. And of course, this trend is intensifying investment pressure. In interview sessions with 250 European private equity managers, we explicitly asked them about the relationship with their investors. 71% said the LPs were getting more demanding. And even 82% explicitly referred to the LP's expectation of being a co-investor in selected transactions.

The co-investing model was initially heavily promoted by the private equity houses themselves. Finally, thanks to the additional financial resources, they could also bid for companies that otherwise would have been out of their reach. Does that mean that the investment funds would rather leave the co-investors out of the picture?

No, of course, the co-investing model remains valid, especially in the DACH region with a large number of small and medium-sized private equity firms that rely on additional investors for larger transactions. Nevertheless, the bottom line is: due to the presence of co-investors, there is more capital in the game than before. In times of volatile equity markets and an expected correction, I believe that the number of public-to-private transactions will increase in the nearest future. I would expect that private equity managers focus their views on undervalued listed companies, which have robust business models. The equity tickets are also much higher – and large private equity houses can put a lot of capital to work in one go.

> *“Private equity has continuously matured and transformed itself and in volatile times – it is powering through uncertainty!”*

Is it just about the demand – or is the overhang also a consequence of the lack of supply?

While the private equity managers will say there are never enough targets in the market, the current pipeline across Europe is relatively healthy, in particular the big carve-outs from large conglomerates. However, private equity companies not only compete with each other, in most bidding processes they also have to deal with strategic investors. And they are often prepared to pay a higher price, because they have a longer investment horizon or because in cases of some acquisitions they can leverage synergies, which a financial investor cannot realise throughout the holding period. Strategic players sometimes pay prices that no private equity manager could defend in front of the investment committee. In addition, there is another factor: more and more companies put up for sale are already in the hands of financial investors. In other words, many of the improvements and “low hanging fruit” an investment fund normally does to boost returns have already been done by previous owners. Also in such cases, financial investors are often unwilling to offer the price that a strategic bidder is ready to pay.

… which brings us back to the point mentioned earlier. The private equity industry currently has more money than it is able to invest.

Exactly. That’s the challenge the industry is facing. It is worth remembering that the private equity industry has already reinvented itself in the recent past – after the financial crisis, when it suddenly began to give much more weight to the operational development of the portfolio companies than to the so-called “financial engineering”. In a way, private equity is in the middle of a retake of its business model transformation.

What does that mean in concrete terms?

In our discussions with private equity managers, we observed that more and more PE houses are looking for investment targets that they have not had on paper so far. An example: Some investment funds are focused specifically on business units that are sold as a result of large mergers by request of the antitrust authorities. The strategic competition in such transactions is usually less tough.

So it’s about finding niches …

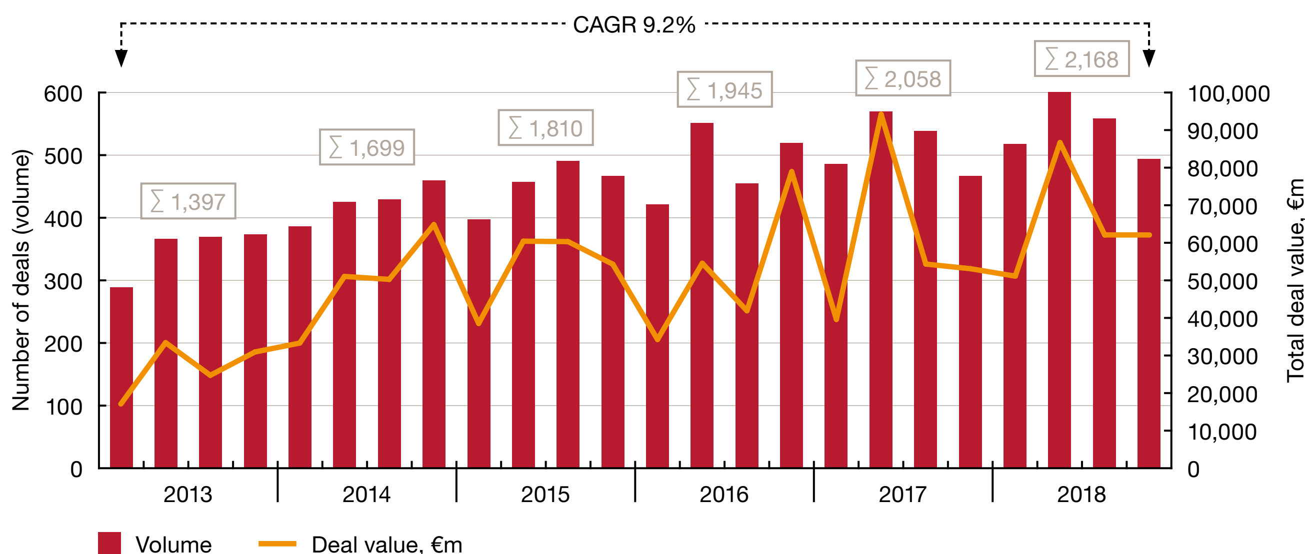
That is correct. Whereby these niches can also be outside the established business model. One of the key findings of our survey is that significantly more private equity companies are now investing – or at least planning to invest – in alternative asset classes than they did two or three years ago. It may surprise people to know that 44% of the interviewed private equity firms are already invested in private debt or credit, 40% even in distressed debt. Also mentioned are asset classes such as infrastructure (39%), venture capital (36%) and real estate (28%), in which now traditional private equity houses almost naturally invest. This trend is not reversing, but has been in place for some time and is showing no signs of slowing down. For example, every fourth interviewed investment manager is considering investing in real assets besides the real estate sector this year. And even hedge fund investments are no longer taboo for many financial investors. Every sixth GP plans to invest in hedge funds. Therefore, the transformation of the private equity industry is no longer a vision – it is in full swing.

A Market Overview

1 Private Equity in Europe

In total, the European PE market (buyouts and exits) reached a post-crisis high on a value and volume basis in 2018. Transaction value climbed 8.6% to €262.1bn year-on-year, while volume increased by 5.3% up to 2168 deals.

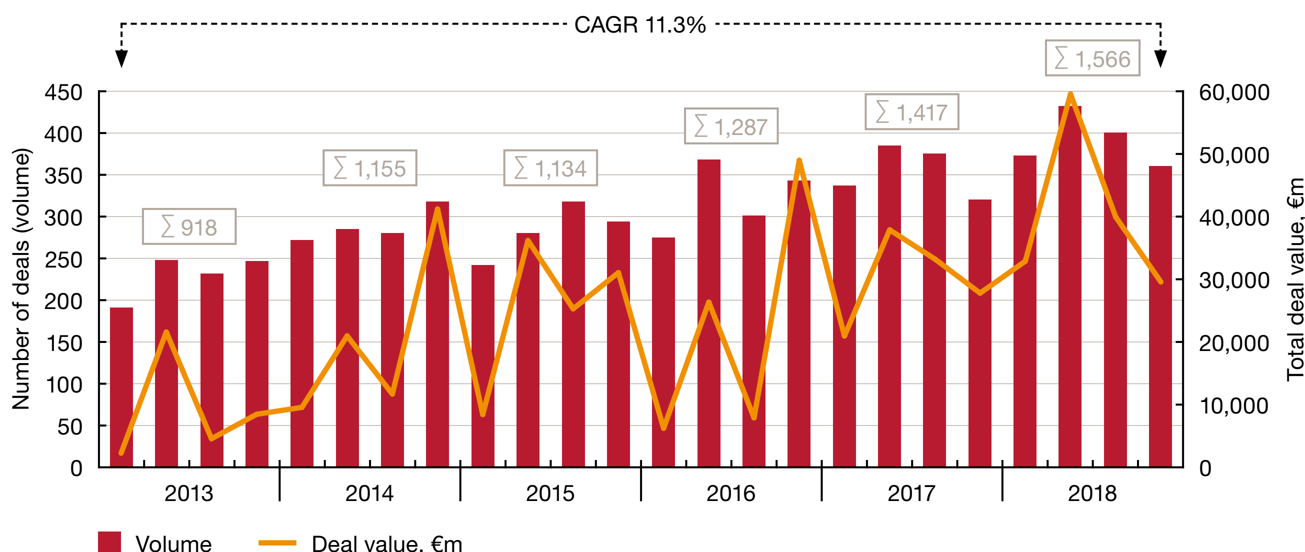
Fig. 1 European Private Equity Trends, 2013–2018



Buyout trends

This uplift was entirely driven by buyouts rather than exits, a trend that can be observed in Europe's constituent national markets. 1,566 transactions were made, representing an annual increase of 11% to set yet a new post-crisis record. On a value basis, buyouts surged by 25% year-on-year to €175bn, again the highest figure since the global financial crisis, as there was a stronger weighting towards larger deals.

Fig. 2 European Buyout Trends, 2013–2018



This can be seen as a continuation of last year's trend: the return of the megadeal. There were 47 buyouts valued at more than €1bn in 2018, the highest total since the financial crisis and an annual uplift of 57% on the 30 European megadeals recorded in 2017. The top ten buyouts alone were valued at €51bn, again a post-crisis high.

The largest buyout of the year was in the Benelux market and accounted for one-fifth of this figure: Carlyle Group and Singaporean sovereign wealth fund GIC's €10.1bn takeover of Dutch chemicals group Nouryon, formerly the specialty chemicals division of AkzoNobel. The second-largest deal of the year saw CVC Capital Partners, Public Sector Pension Investment Board and StepStone Group acquire Italian pharmaceuticals group Recordati for €6.3bn.

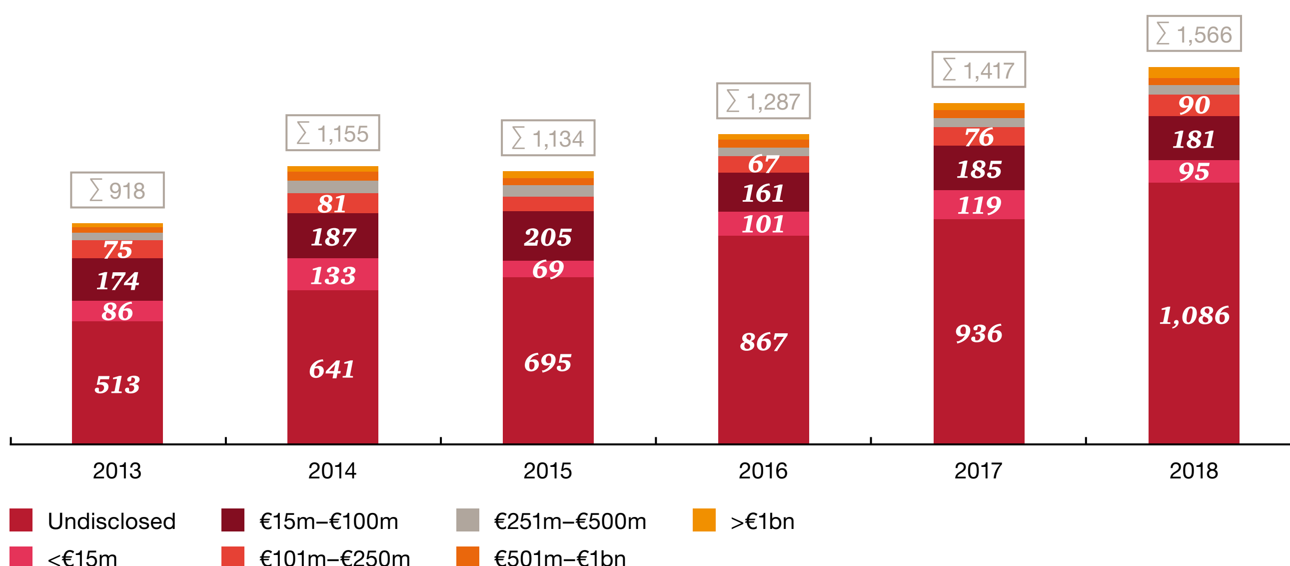
Indeed, Mediterranean megadeals were well represented in 2018. In addition to the Recordati buyout, Spain claimed three of the top ten buyouts: CaixaBank, bought by Lone Star Funds for €5.6bn; Naturgy, a 20% stake in which was acquired by CVC Capital Partners and Corporacion Financiera Alba; and Itinere Infraestructuras, 59.2% of which was purchased by Corsair Capital and APG Group.

Meanwhile, Germany and the UK were the only other countries to have more than one deal in the top ten in 2018. In Germany, Caisse de Depot et Placement du Quebec, Ontario Teachers' Pension Plan and Partners Group bought industrial automation company Techem for €4.6bn.

There is every reason to believe that the upper end of the market will remain active, as a raft of the European industry's largest names prepare or are in the process of raising their next flagship fund. Apax Partners, Cinven, Partners Group and Permira are all understood to be either in soft fundraising mode or have officially launched new products in the market. Based on their past fundraisings and the fact that PE firms typically raise successively larger funds, these four managers alone are expected to amass in excess of €32bn. This is not to mention the many large-cap sponsors outside of Europe seeking deals in the region.

Every other deal size bracket trended down in Europe in 2018, apart from one: the €101m–€250m range, which rose by 15.6% to 90 deals. It is worth noting that, as a private market, a good many firms choose not to disclose the value of transactions and this was the case for more than two-thirds of the 1,566 buyouts in 2018.

Fig. 3 European Buyouts, Split by Deal Size, 2013–2018



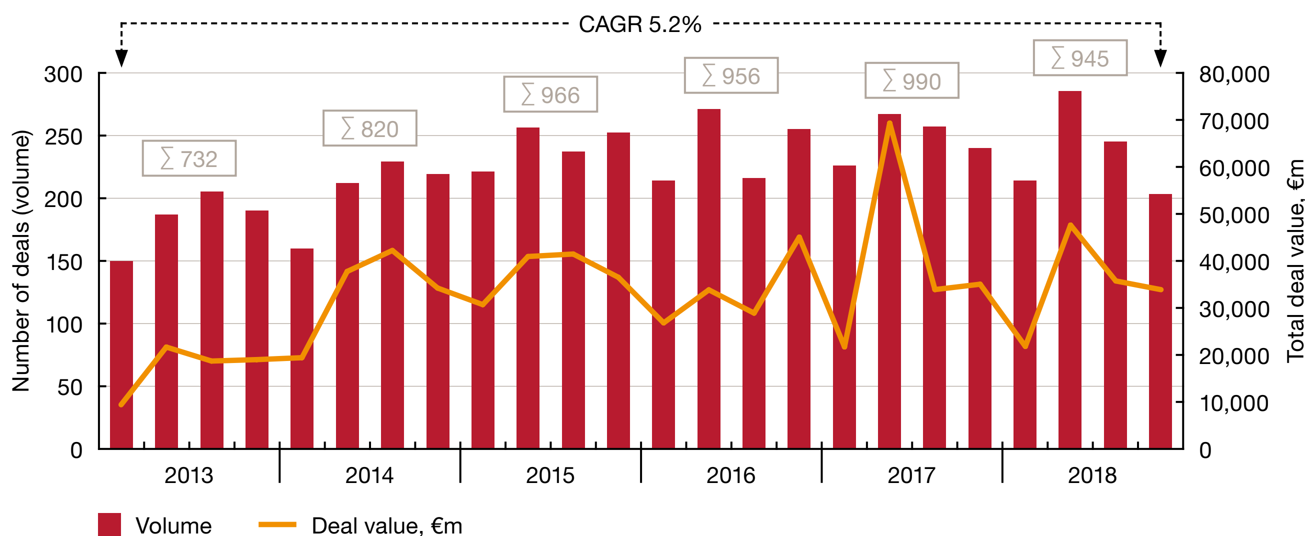
European exit trends

Exits were a different story in 2018, with activity being far more subdued than on the buyout front. There were 945 company sales during the year worth a combined €139bn. This represents annual falls of –4.5% and –13.1% respectively, and the weakest exit activity since 2014. But with dry powder further on the rise and in times of volatile market conditions – private equity seems to have focused all its fire power in new investments. Investment firms are using volatility as chance, whilst not risking exposure through starting exit processes itself in an unstable environment. GPs have returned to watching out for publicly listed assets, which in volatile stock markets may be undervalued and use arising opportunities. These developments as such have taken the focus off from exits in 2018.

The largest sale of the year was a 50% stake in Gatwick Airport, divested by Global Infrastructure Partners to VINCI Airports, in a deal valued at €6bn. The UK is the only country in Europe in 2018 that had more than one top ten exit, claiming four spots. The remaining three were Sky Betting and Gaming, sold by CVC Capital Partners to The Stars Group for €4.5bn; pharma group BTG, sold for €3.5bn; and EMI Music Publishing, acquired by Sony Corporation from Mubadala Investment Company for €3bn.

While caution should be exercised in drawing conclusions from such a small sample, one explanation for the rash of megadeal sales in the UK is that investors were keen to lock in returns ahead of the country's expected withdrawal from the EU on 29 March 2019. Whatever the economic impacts of this development for the UK, uncertainty is rarely conducive to transaction activity and it makes sense for funds to want to crystallise returns ahead of the departure date.

Fig. 4 European Exit Trends, 2013–2018



The largest exit in Germany and Europe's second-largest sale was the aforementioned Techem, a secondary buyout that passed from Macquarie to the CVC-led consortium. The Benelux also claimed a top ten exit with semiconductor company Nexperia, a 76% stake in which was sold by JAC Capital Management and Wise Road Capital to China's Wingtech Technology.

The fall in megadeal exit value and volume comes after a winning streak for PE that has seen it divest record sums in recent years, returning cash to investors who have re-upped to the asset class. Funds now appear to have partially shifted their attention away from exits and placed a greater emphasis on new deal activity.

Geography of European deals

The UK and Ireland has historically been the largest PE market in Europe and this remains the case. However, there has been a pronounced fall in its standing in recent times. On a volume basis, the UK and Ireland has more or less held firm, accounting for 23% of buyouts between 2013 and 2016 and 22% of deals between 2017 and 2018. But in value terms, its dominance has dropped from 31% to 23% over the same time periods. This is almost certainly a direct consequence of Brexit. Either large fund managers, which have broad and diverse geographic remits, are turning their attention towards other markets, or firms are opting for smaller deals to reduce their exposure to a market mired in uncertainty, or a combination of the two.

Like the UK and Ireland, other key PE markets such as Germany, France and the Nordics have seen little change in their share of deal flow in the last five years. However, the UK and Ireland's loss on a value basis has been to the rest of Europe's gain.

For instance, the Nordics has gained six percentage points, with 16% of deal value emanating from the region in 2017–2018, making it the second-highest value buyout market in Europe.

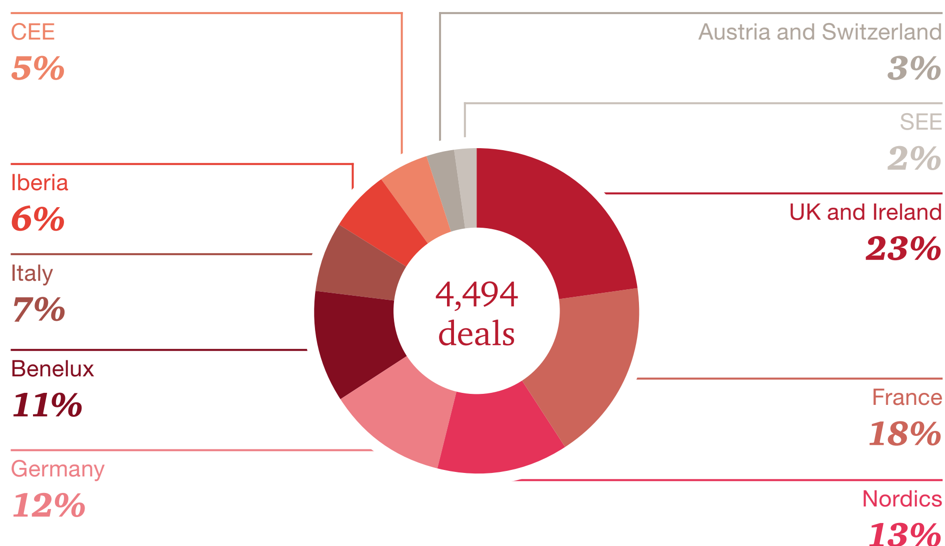
This is followed by France, which has added two percentage points to claim 15% of deal value, and Iberia, which is up by seven percentage points to 13% of European buyout value in 2017–2018.

In terms of rankings, Germany has increased its share on a volume basis by 1ppts in the period 2017–2018. On a value basis, one may conclude that the country has lost more ground, however, this lies in the the local markets reluctance to disclose deal value for around 80% of transactions.

This shift away from the UK and Ireland means that Europe's buyout market looks somewhat different today than it did in previous years.

Fig. 5 European Buyout volume, split by region

2013–2016



2017–2018

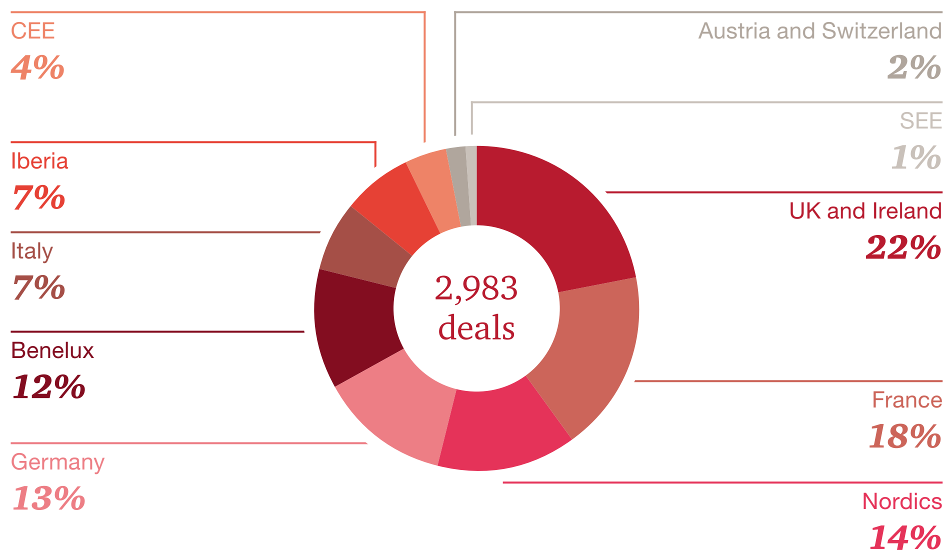
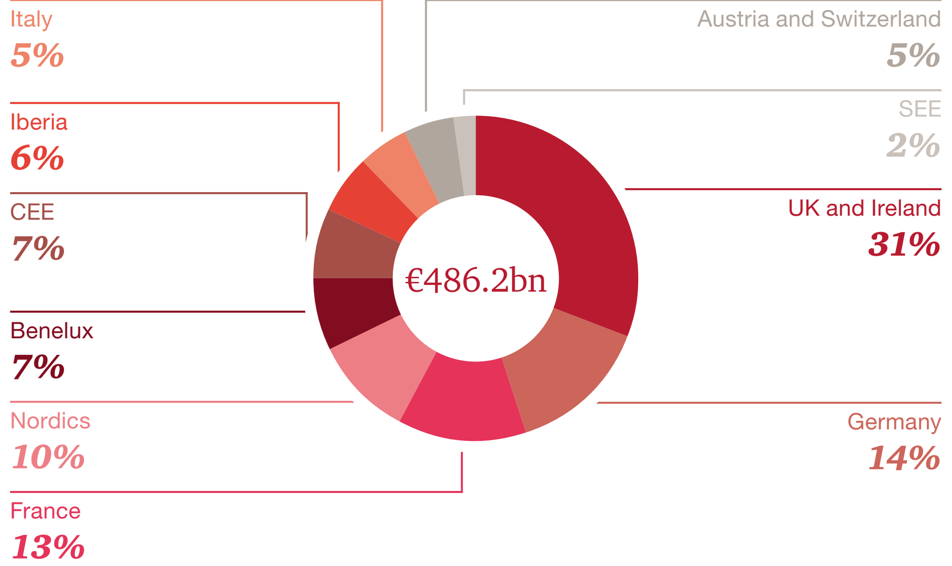
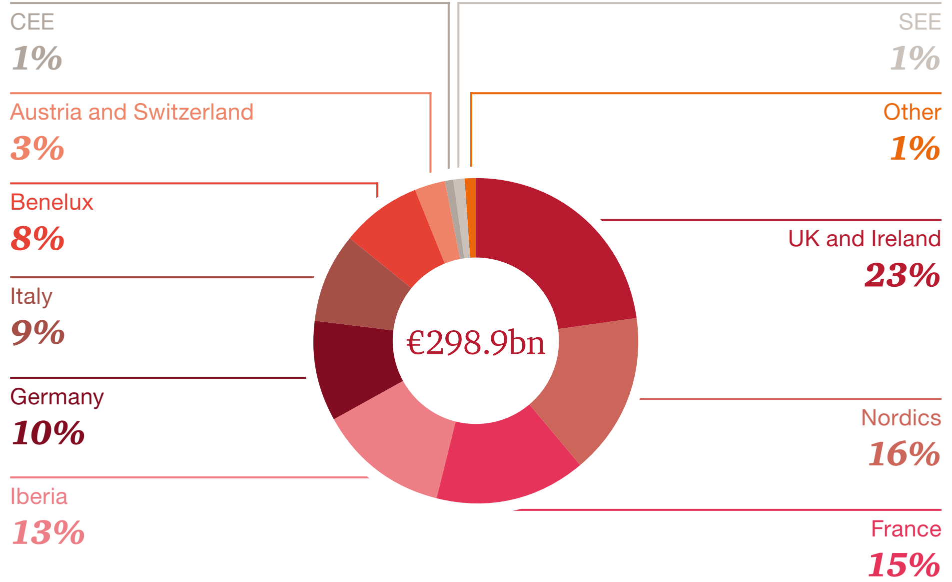


Fig. 6 Buyout value, split by region

2013–2016



2017–2018



Industry focus

The sectoral make-up of PE deal activity remains broadly static in volume terms, with industrials and chemicals, technology, telecommunications and media (TMT) and business services respectively claiming the top three positions in Europe over the last six years.

Industrials and chemicals also continues to be the sector in which PE funds invest the most capital, but the composition of the top five highest-value sectors has changed somewhat when comparing 2018 against prior years. This is to be expected since, on a value basis, a single megadeal can result in large annual sectoral biases.

Nevertheless, business services has climbed from the fifth-highest value sector in the period between 2013 and 2016 to second place, gaining three percentage points to claim 13% of European buyout value. Pharma, medical and biotech (PMB) has moved from eighth place to fifth position, gaining four percentage points to gain 11% of deal value in 2018 (the Recordati and Bayer deals significantly boosting the sector's representation).

Meanwhile, consumer has dropped from third to sixth place, shedding two percentage points to 9%. This coincides with Brexit-related inflationary effects in the UK and Ireland, Europe's largest buyout market. Consumer spending remains tight as the country remains wary of the impact of its departure from the EU. This has made PE funds cautious over backing companies that depend on consumer expenditure, especially where this spend is discretionary or there are low barriers to entry for competing businesses.

Outlook

If the beginning of 2018 was marked by surging stock markets and widespread optimism over future economic growth, the outlook for 2019 is markedly different. Momentum built in 2017 carried on into the first nine months of 2018; however, that reversed in the final quarter of the year. This year began with a sense of uncertainty after key stock indices lost the gains made throughout the first three quarters of 2018. However, one may argue, that the flexibility private equity comes with is a good fit to the opportunities that volatile markets bring. With the corporate world, being currently cautious – private equity can seize the opportunity and focus on undervalued assets – especially publically listed enterprises experiencing stock price decline.

One view is that this bearish turn of stock markets reflects weaker economic indicators, recessions often being foreshadowed by the emergence of true bear markets by months; another view is that after years of substantial gains, the stock market correction was an overdue and welcome reset.

Certainly, major economies lost some velocity in the latter half of 2018, including Germany and Europe more broadly. But in spite of these amber warning signs, the euro area labour markets are resilient and income growth is rising, suggesting that Europe's economy is likely to expand by around 1.8% in 2019.

If anything, recent volatility may serve to rein in valuations in the private market and the fact remains that GPs are well-equipped with capital. Fundraising trended down in 2018, in line with a weaker exit market and therefore lower distributions to investors eager to re-commit to PE funds. But the amount of dry powder in the system is at an historic high and must be put to work. This supply/demand dynamic means that dealmaking activity is likely to remain robust through 2019 as managers continue to try and navigate a highly competitive and well-capitalised PE market.

Deep dive: DACH Spotlight

DACH Spotlight

Overall, DACH's PE market has had a solid year, even though in regard to volume it experienced a slight decline, a function of a weak exit market. However, buyout volume stayed at the record breaking level from 2017, seeing 323 buyouts. A total of 414 deals (buyouts and exits) were made in the year, close to the post-crisis high of 436 in 2017, falling 22 deals short of that. An aggregate €38.3bn was invested across these deals, above the five-year trailing average of €34.8bn. This constitutes an annual gain of 10%, however not close to the record levels of 2016 or 2014.

Fig. 7 DACH Private Equity Trends, 2013–2018

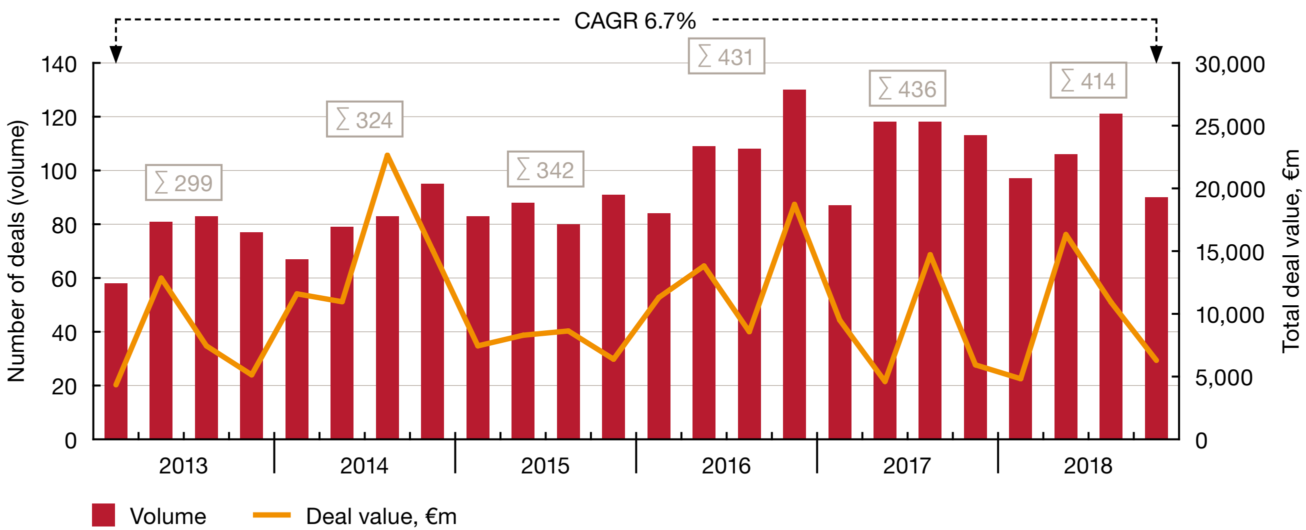
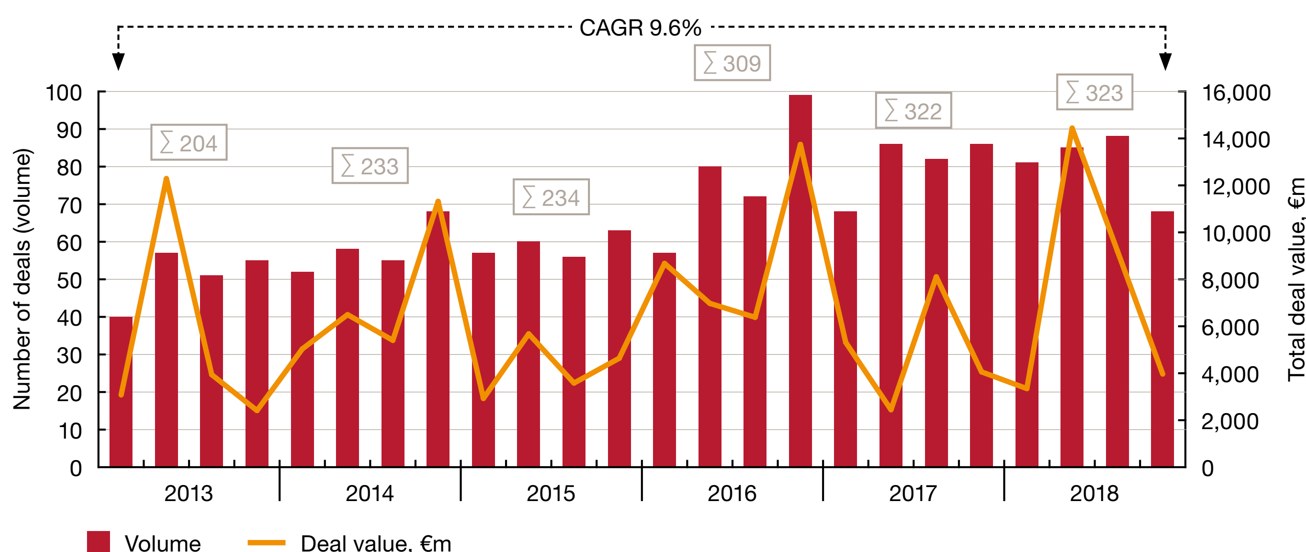


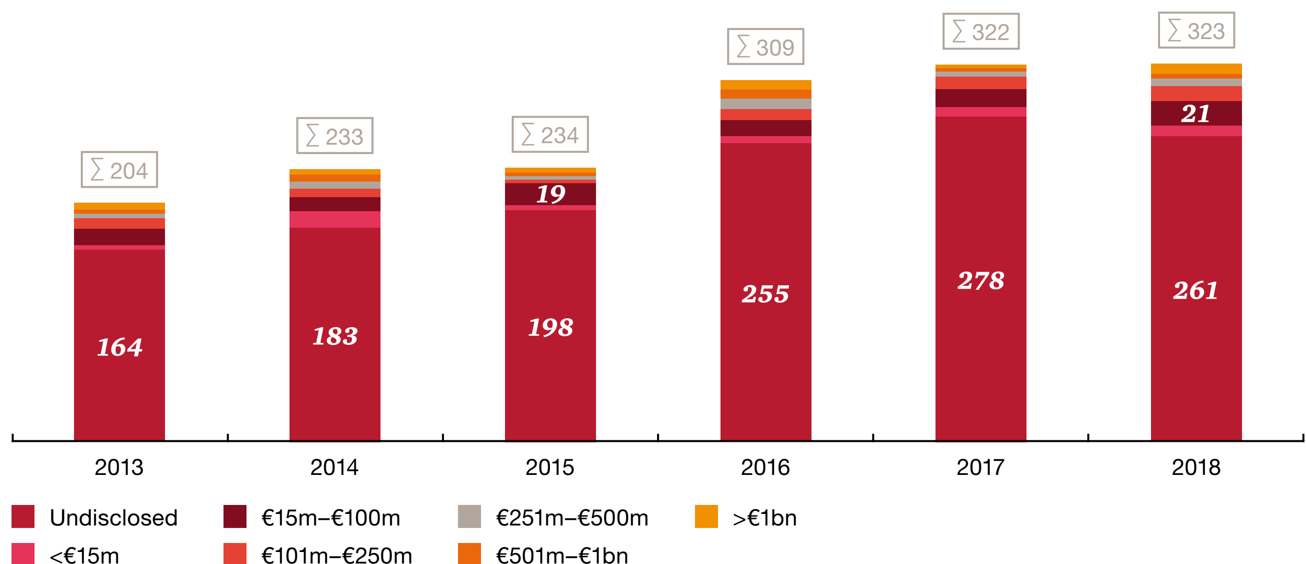
Fig. 8 DACH Buyout Trends, 2013–2018



Focusing on buyouts alone, €30.9bn was invested across 323 transactions. This is the second-highest sum of capital invested since the financial crisis, representing an annual gain of 56%, while volume of deals remained at the high prior year level.

There was little change in the composition of deal value splits in 2018, the biggest differentials being a higher number of deals with undisclosed values and a notable jump in €1bn-plus deals from three in 2017 to nine. These included the aforementioned Techem and Bayer deals, both of which were in the top ten buyouts in Europe, as well as three that made it into the top 20: Advent International's €2.8bn acquisition of Austrian industrial group INNIO; Morgan Stanley Infrastructure's €2.8bn takeover of VTG, a German rail logistics company; and EQT Partners buying Germany software business SUSE Linux for €2.2bn.

Fig. 9 DACH Buyouts, Split by Deal Size, 2013–2018



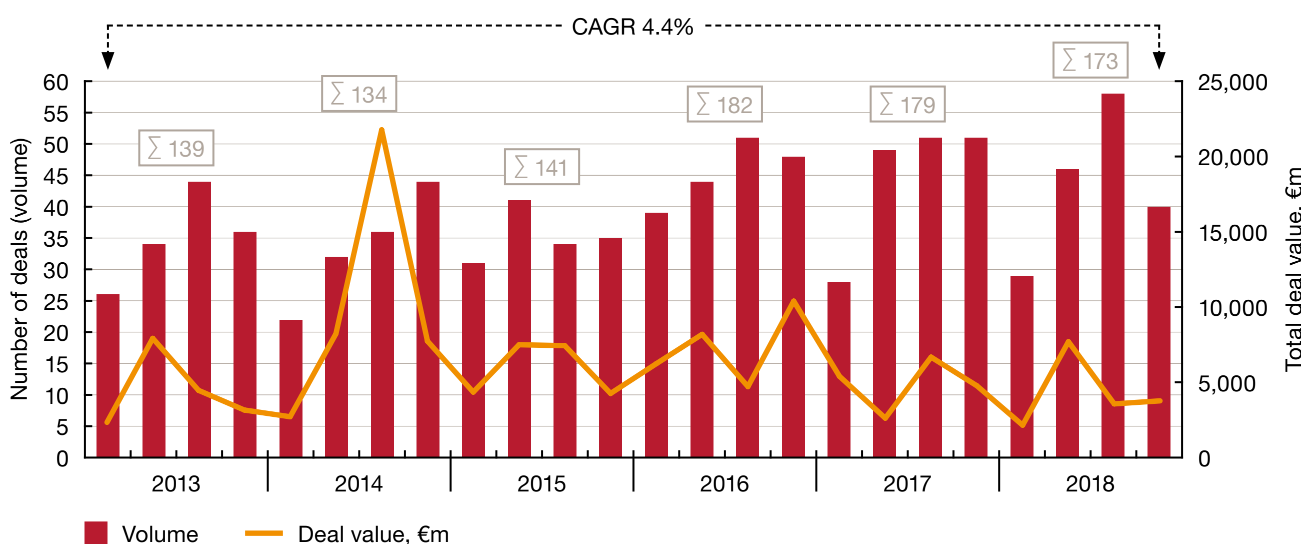
Exit figures

Exit activity was relatively robust volume-wise, with 173 company sales recorded. This is slightly lower than both 2017 and 2016 but well over the five-year trailing average of 138 deals. However, DACH exit value has posted its weakest year in recent memory. Just €17.1bn worth of divestments took place in the region, nearly half the €23.9bn average over the last five years and the lowest figure since at least 2013.

DACH claimed just one of the year's top 20 largest exits, Techem, a secondary buyout (and therefore also included in the top buyout league table). This transaction alone (€4.6bn) accounted for more about one-third of all exit value in 2018.

This is the natural consequence of the industry's fundraising cycle. As has been the case across Europe, German GPs have capitalised on the seller's market of recent years to dispose of assets at peak valuations, securing returns for their LPs and shifting their attention towards making new deals with newly minted funds.

Fig. 10 DACH Exit Trends, 2013–2018



Sector focus

The DACH PE market's three most popular sectors are industrials and chemicals, TMT and consumer, which accounted for the most deal volume in the period 2017 to 2018 and the preceding five years, and this is likely to remain the case for the foreseeable future. In the past two years, however, Pharma, Medical & Biotech has climbed from fifth to fourth place in the industry ranking, gaining 3ppts against the 2013–2016 period. With technology driving returns, we expect business services to increase its share in total deal making acitivity.

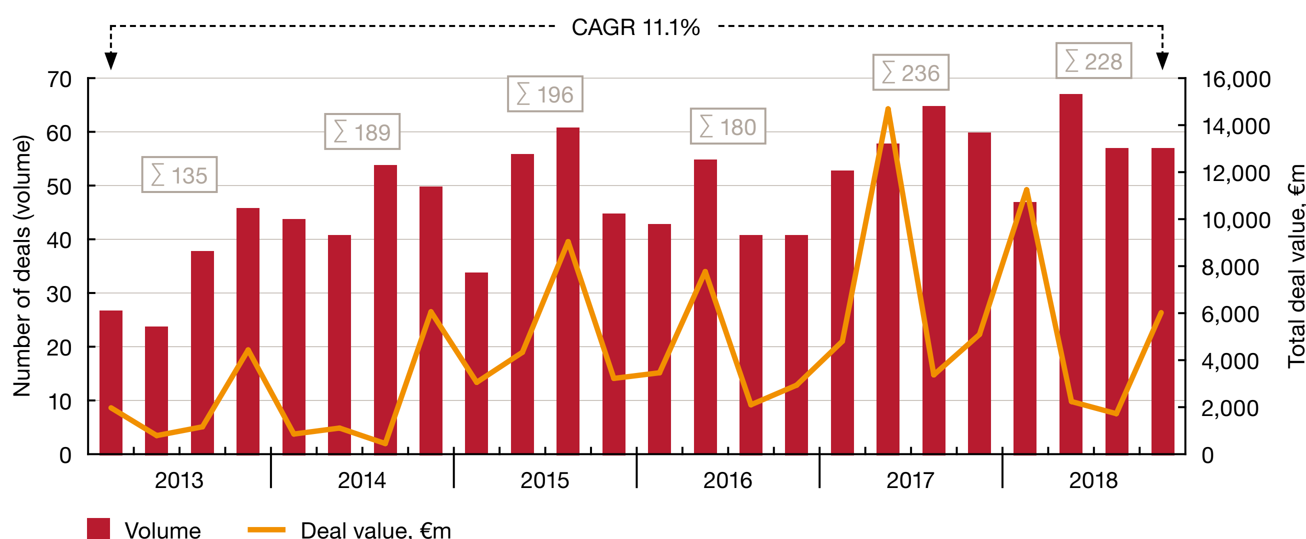
As is the case across Europe, industrials and chemicals sees the most capital invested; however, in the DACH region it is consumer and PMB that have historically been the number two and three sectors and claimed 11% of buyout value each between 2013 and 2016. That changed markedly in 2018, with consumer more than halving to just 5% of deal value and PMB more than doubling to 26%.

Deep dive: Benelux Spotlight

Benelux Spotlight

The Benelux's PE market had an active 2018 and, like DACH and Europe as a whole, this was driven by robust dealmaking in the face of subdued exit activity. In total, 228 transactions (buyouts and exits) were recorded, an annual dip of 3% but comfortably above the five-year average of 206 deals. On the value side, €21.3bn worth of deals were made, down 22.2% on 2017 but again well over the €16.8bn average of the preceding five years.

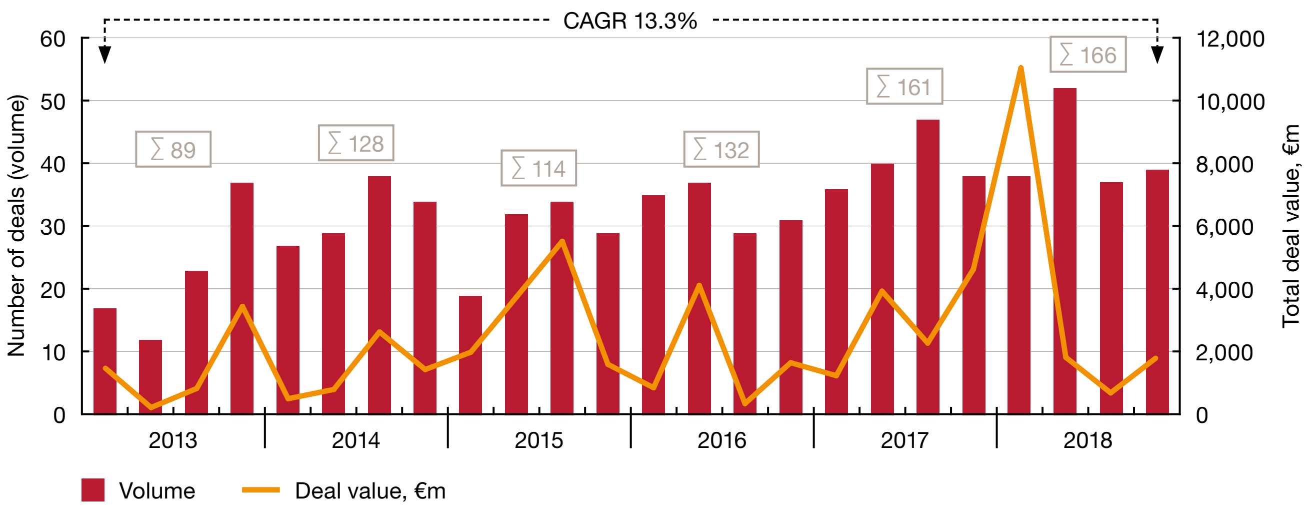
Fig. 11 Benelux Private Equity Trends, 2013–2018



Turning to buyout activity specifically, there were 166 deals in the Benelux worth a combined €15.3bn. This is a 3.1% rise in volume terms and on a value basis the market significantly outperformed, besting 2017 by 33% and coming close to doubling the €8.4bn five-year average.

While this is the highest sum of capital invested in the Benelux PE market since the global financial crisis, context is important. The previously mentioned €10.1bn acquisition of Dutch industrial group Nouryon was the largest buyout of the year in Europe, being more than 50% larger than the next biggest deal (Recordati), and has therefore heavily skewed the numbers.

Fig. 12 Benelux Buyout Trends, 2013–2018

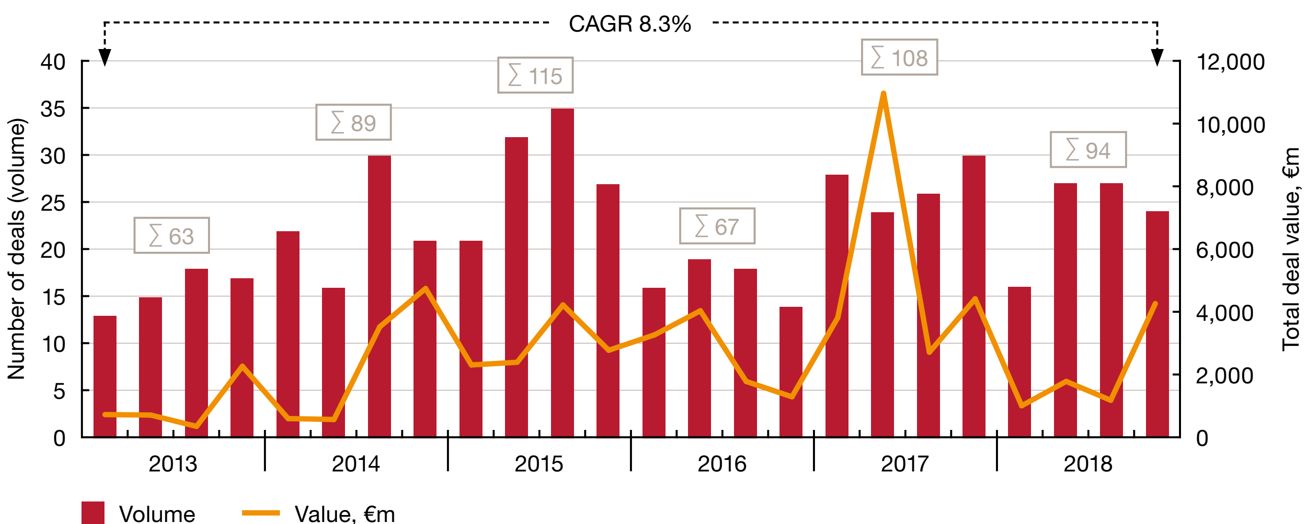


Exit figures

The Benelux exit market was relatively subdued in 2018. The 94 sales recorded was in line with the historical average of the preceding five years (94 deals), but the €8.2bn realised from assets was the lowest sum since 2013 and represented an annual fall of 62.7%. This was also a 28.1% decrease on the historical average.

In this way, the Benelux PE market followed a trend evident in the wider European market: GPs held firm in their new dealmaking activity but slowed down their divestments following recent years of abundance that have seen cash returned to LPs en masse.

Fig. 13 Benelux Exit Trends, 2013–2018



Sector focus

Looking at sector splits, there was a modest shift away from industrials and chemicals last year on a volume basis, although it remains the most popular Benelux sector, accounting for 21% of buyouts, down from 26% between 2013 and 2016. Consumer, previously the second most active industry, accounted for 14% of deals, therefore falling into fourth place. The most notable gainer was business services, which gained three percentage points to claim 19% of buyouts in the period 2017–2018, putting it in second place. TMT also gained three percentage points to 19%, maintaining its third place position.

With regard to value, it is unsurprising that industrials and chemicals accounted for 52% of buyouts in 2018 because of the huge Nouryon investment by Carlyle and GIC. However, there are some less expected results. TMT, previously the top sector and claiming 29% of value between 2013 and 2016, represented just 4% of euro invested in 2018. Similarly, financial services did not account for even 1% of Benelux buyout value in 2018 but was the number two industry between 2013 and 2016, claiming 18% of capital invested.

B Key Findings

A new record

1,566 buyouts worth €175bn were completed in Europe in 2018, a post-crisis high for both volume and value. The number of deals overachieved 2017's total by 11%; however, there was a 25.1% annual increase in capital invested, indicating a weighting towards larger buyouts.

Exit activity slips

In contrast, the exit market had a far quieter year. There were 945 company sales during the year worth a combined €139bn. This represents annual falls of 4.5% and 13.1% respectively, and the weakest exit activity on both a volume and value basis since 2014.

Covenant breaches down

Portfolio companies are tripping their banking covenants less frequently. Just over half (51%) of respondents saw 10% or more of their portfolio companies break one or more bank covenants in 2018, a notable fall from the 82% who said the same in last year's survey.

Rising co-operation

An overwhelming majority of respondents (92%) say they have been undertaking more co-operation with strategic investors, making this the most widely cited change to PE firms' business models in the last three years, ahead of using less leverage or financial engineering (87%) and having a greater focus on active portfolio management (82%).

What LPs want

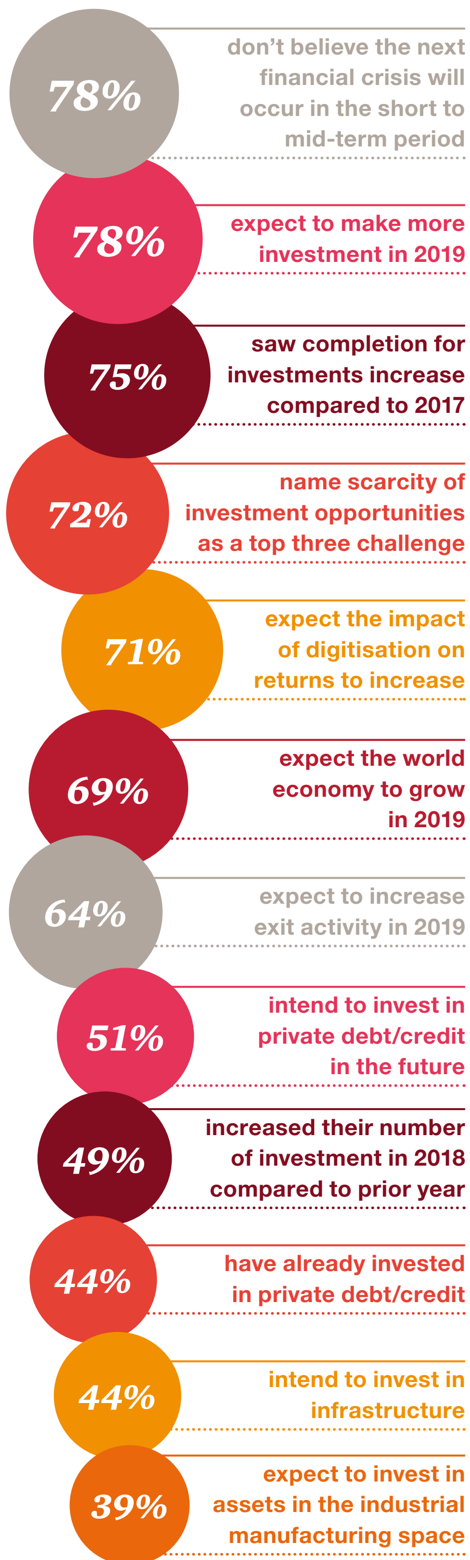
More than four in five (82%) of respondents point to increased frequency of individual co-investment as a top three change to what LPs expect from their fund managers, while pressure on management fee levels is cited by 80%. These are clear signs that LPs are seeking to reduce costs and improve returns performance.

Credit in vogue

We find that 44% of respondents have already invested in private debt/credit and that 51% intend to do so in future. This makes credit the most favoured asset diversification strategy among PE managers.

Digital returns

93% of respondents say they agree that digitising portfolio companies will expedite the realisation of the equity story, and thus decrease the holding period of the portfolio. Supporting this, 79% of respondents say that the level of digital transformation they implement will be important to future exits and the returns they achieve.



Economic optimism

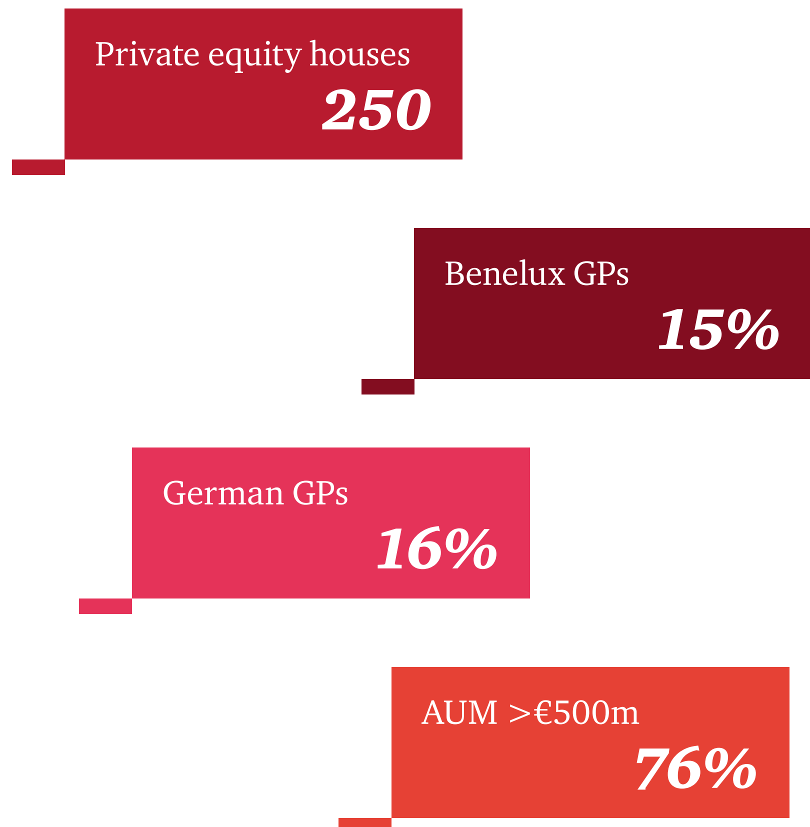
More than two-thirds (68%) of GPs say that they expect the world economy to grow in 2019, although 66% are only anticipating low growth. Furthermore, more than three-quarters (78%) of respondents do not believe the next financial crisis will occur within the next one to three years.

Brexit unappealing

45% of respondents say that Brexit makes the UK a less attractive destination for PE investments in 2019 and only 5% say the country will be more attractive this year as a result of its secession from the bloc. However, the remaining 50% majority say they don't believe Brexit will have any impact on the UK's attractiveness for buyouts.

Germany in favour

Nine in ten respondents believe Germany's PE market will become more attractive, followed by 85% who point to the Netherlands and 84% who say Switzerland will become more appealing. Notably, the UK is falling out of favour. In last year's survey 49% said they thought the country would become more attractive for PE investing over the proceeding five years. This has now fallen to just 29%.



C Methodology

In Q4 2018, Acuris Studios, the research and publications arm of Mergermarket, spoke to 250 PE principals on behalf of PwC. Job titles include partner and managing director. Sixteen percent of these funds are based in Germany and 15% in Benelux countries, with the remaining 69% based elsewhere in Europe. Responses were anonymised and aggregated. All PE firms of respondents had a minimum of €250m of assets under management.

Fig. 14 Respondent country

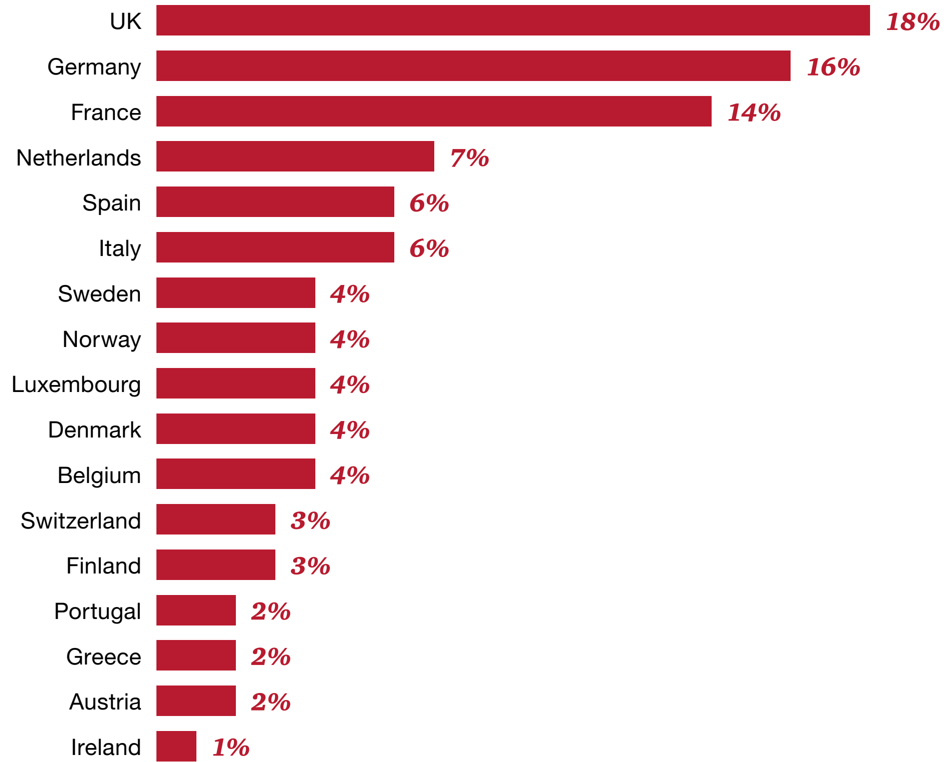
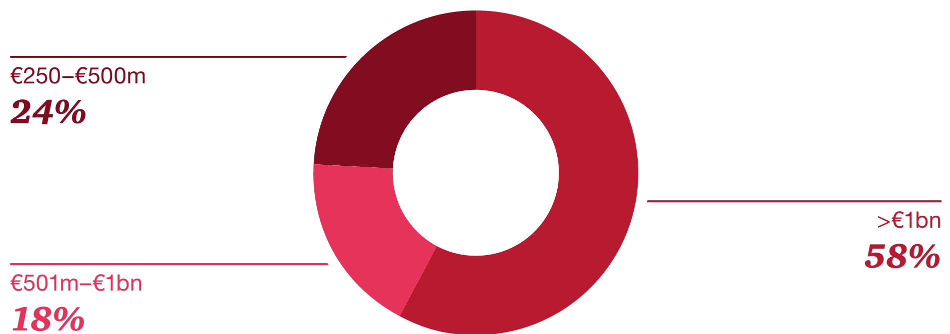
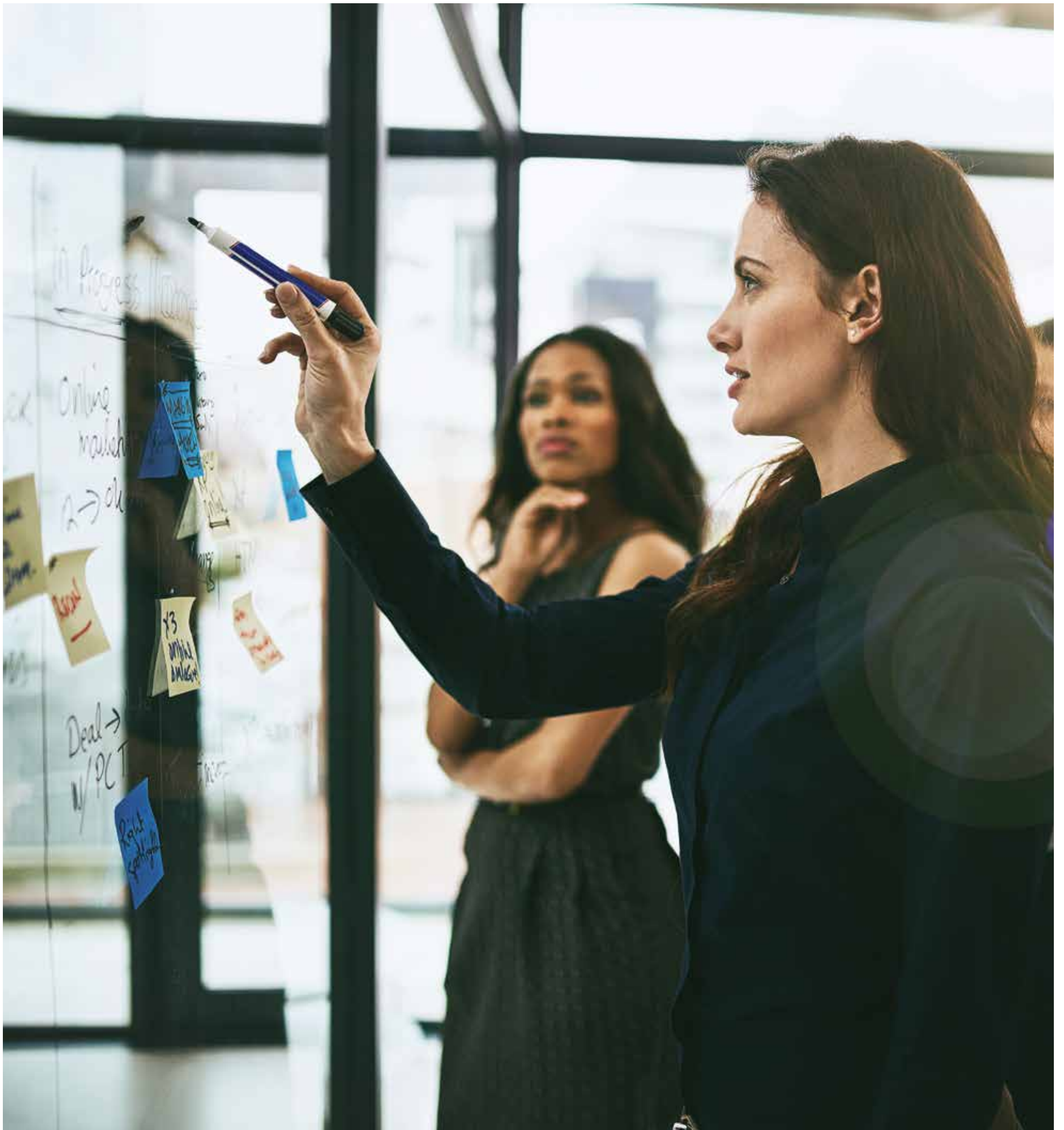


Fig. 15 Capital under management of resdpondents



D Detailed Findings



1 2018 in review

Large minority of PE respondents increased their number of new investments

The PE market set a new record in 2018, with deal volume topping 5,000 buyouts for the first time in history. A total of $456bn was invested across 5,106 deals globally, according to figures from Preqin. On a value basis, this is just short of the all-time high of $460bn put to work in 2015.

Ongoing optimism

This banner year is consistent with our survey findings. Nearly half (49%) of respondents say they increased the number of new investments they made in 2018, while 27% sustained the same level of deal activity as the previous year. Only 24% say the number of new investments decreased.

In keeping with this trend, 83% of respondents say the number of potential transactions they reviewed increased last year compared with the year before, including 44% who say the number increased significantly.

These findings reinforce the data in the market overview of this report, which shows that European dealmaking activity is firing on all cylinders.

Recent volatility in public markets notwithstanding, prices have remained stubbornly high in recent times and this remained the case in 2018. This explains why new deal activity is so high despite the challenging pricing environment. This dynamic is explained well by a partner of a fund with AUM €500–1bn: "Private equity firms have evolved now, they know how to deal with volatility and the issues such has call for lower fees and increasing costs. They are now focussing on technology, process innovation and other value add, which will steer their investments through the volatile conditions and get them higher returns. In the next 12 months PE firms and their investments in Europe will be focussed on value add primarily through technology."

While high earnings multiples may not seem compatible with high levels of dealmaking activity, the seller's market has meant that PE funds have been able to return cash to their investors, who continue to seek the asset class's outperformance and therefore re-invest with PE fund managers in a virtuous circle.

Fig. 16 Compared to 2017, has the number of new investments made by your organisation this year ...?

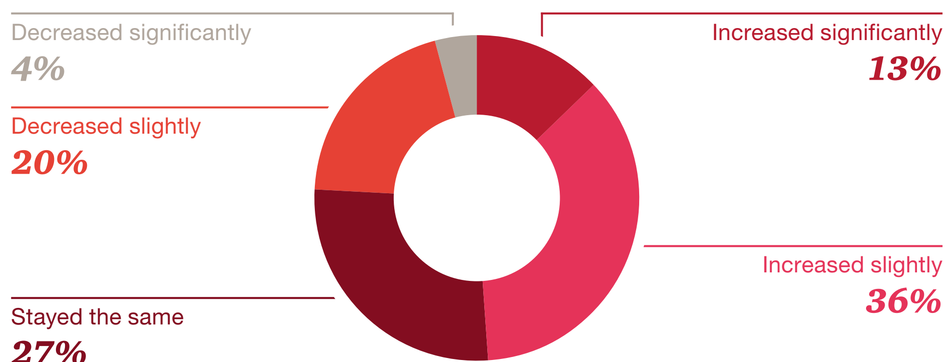
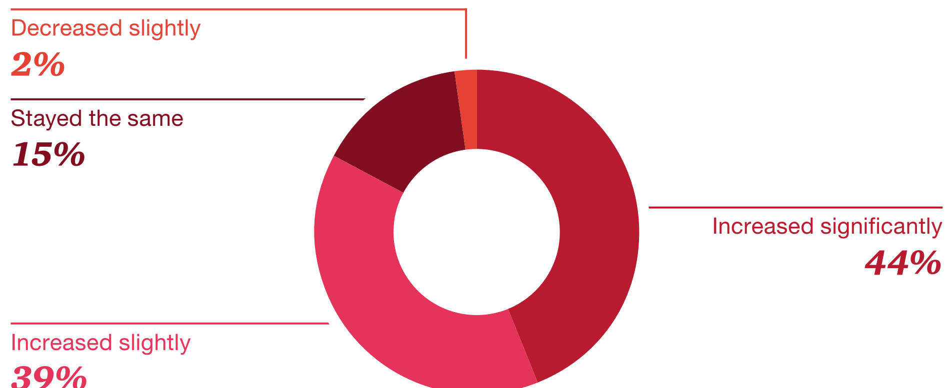


Fig. 17 Firstly, compared to 2017, has the number of potential transactions which you have reviewed in an average month this year ...? (Please select one response only.)

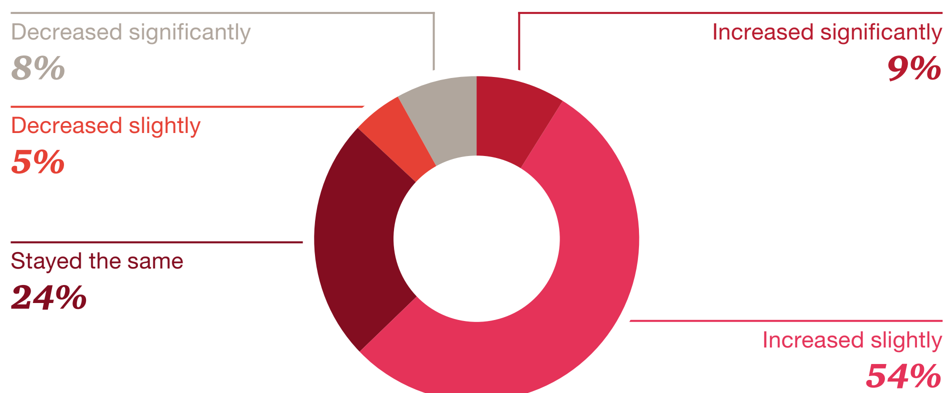


Majority increased the number of exits

The prevailing seller's market has been highly conducive to exits in recent years. GPs have been able to lock in returns across their portfolios and this finally resulted in an inevitable fall in exits in Europe last year, as fund managers have already made great efforts to realise gains for their investors. In 2018, however, exit volume fell by 4.5% and exit value dropped by 13.1%, resulting in the weakest exit market since 2014.

Despite the fall in exits, the majority of respondents in our survey continued to offload assets into what remains a highly competitive market marked by attractive prices for those funds with assets that are ready to be sold. However, over half only slightly increased their exits, 24% say divestment activity remained the same, while 13% decreased their exits. These figures could potentially reverse in 2019 as exit activity slows further.

Fig. 18 Compared to 2017, has the number of exits made by your organisation this year ...? (Please select one response only.)

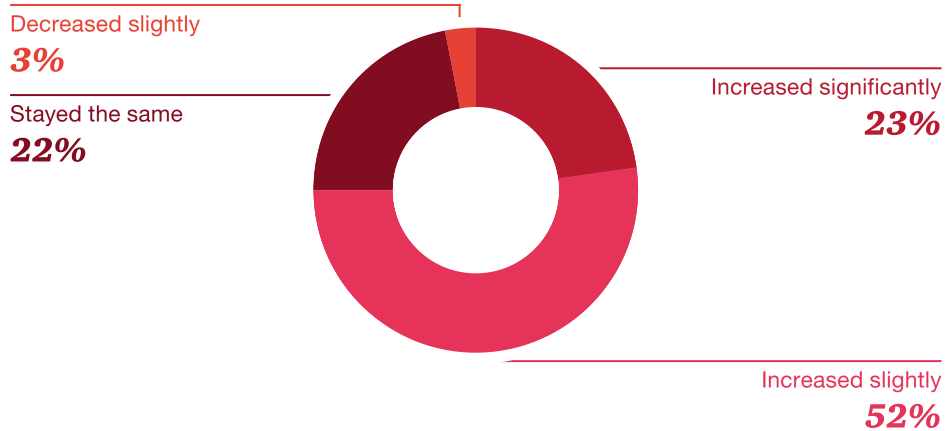


Competition is running high

There has never been more capital chasing deals in the private market. In 2017, global PE dry powder, i.e. uninvested capital committed to PE funds that has yet to be deployed, topped $1trn for the first time and this figure has since risen to $1.2trn. This means that competition for assets has never been higher, hence persistently full asset pricing.

Exactly three-quarters of respondents say that competition among PE firms increased in 2018 compared with 2017 and, for many, these competitive dynamics are a cause for concern. “Even though PE firms are sitting on record levels of dry powder, there is some hesitation in making new investments,” says the executive of a UK PE firm. “There will be very little earnings growth on offer, and competition will be intense for what is available.”

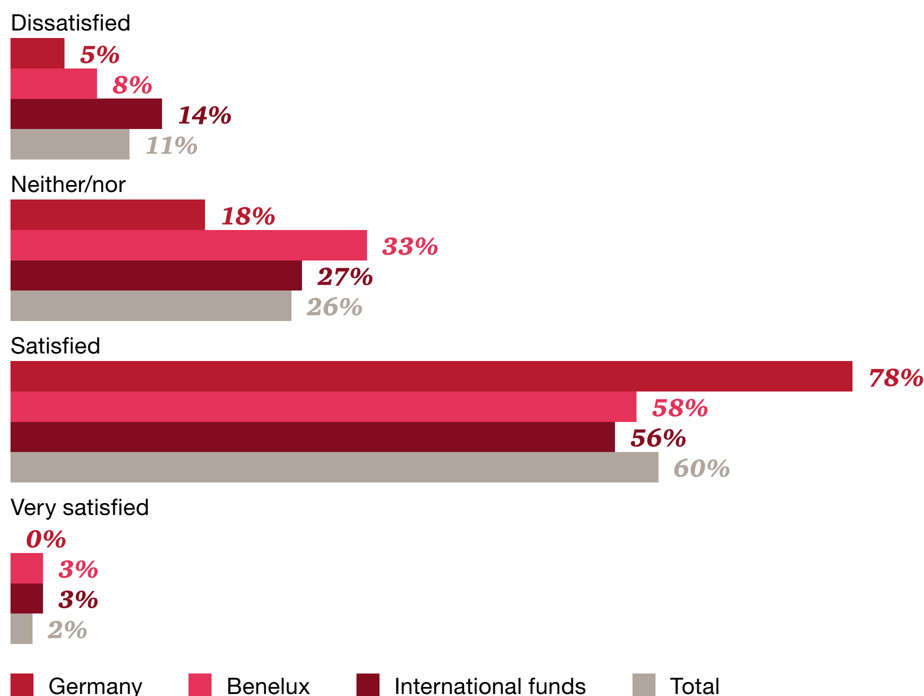
Fig. 19 Compared to 2017, would you say that competition for investments among private equity firms has ...?



Portfolio satisfaction high

A number of factors influence the development of PE firms’ portfolio companies, but these can broadly be segmented into organic growth, driven by demand within a given industry and the wider economy, and inorganic growth achieved through bolt-on acquisitions and market consolidation.

For the most part, firms are satisfied with the development of their portfolio companies, 62% of respondents reporting such optimism. This rises to 78% of respondents who are based in Germany and falls to 59% for international funds. Meanwhile, 61% of Benelux-based firms are satisfied in this regard.



Fewer broken covenants

Portfolio companies are tripping their banking covenants less frequently, indicating that either GPs are using leverage more prudently or earnings growth is sufficiently robust to meet interest and amortisation repayments, or both. Just over half (51%) of respondents saw 10% or more of their portfolio companies break one or more bank covenants in 2018, a notable fall from the 82% who said the same in last year's survey.

There is also a clear differentiation between markets, with 19% of international fund respondents reporting covenant breaks by one or more portfolio companies, 10% of respondents in Benelux saying the same and just 3% of Germany-based respondents reporting such breaches. This could be a symptom of the interest barrier rules that have now been in place in Germany for more than a decade. The German government limited the tax deductibility of interest expenses to 30% of EBITDA in 2008, brought in when the global credit boom came to a halt, to cap the tax incentives for debt financing.

Some see challenges on the horizon with regard to servicing portfolio company debt, not just in terms of breaching covenants but the impact of the cost of meeting debt obligations on future returns. "The biggest risk I see is the increasing of interest rates. This will push up financing costs and affect the overall value that can be created from PE investments," says the executive of a UK PE firm.

Fig. 21 Percentage of companies that broke one or more bank covenants, or otherwise needed to enter negotiations with their financing providers during the previous year

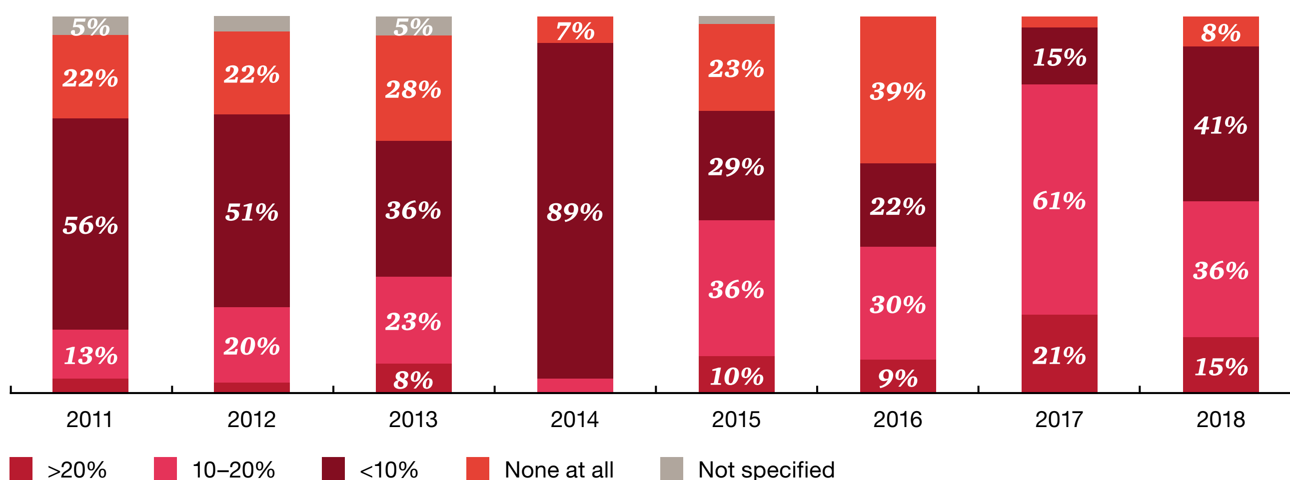
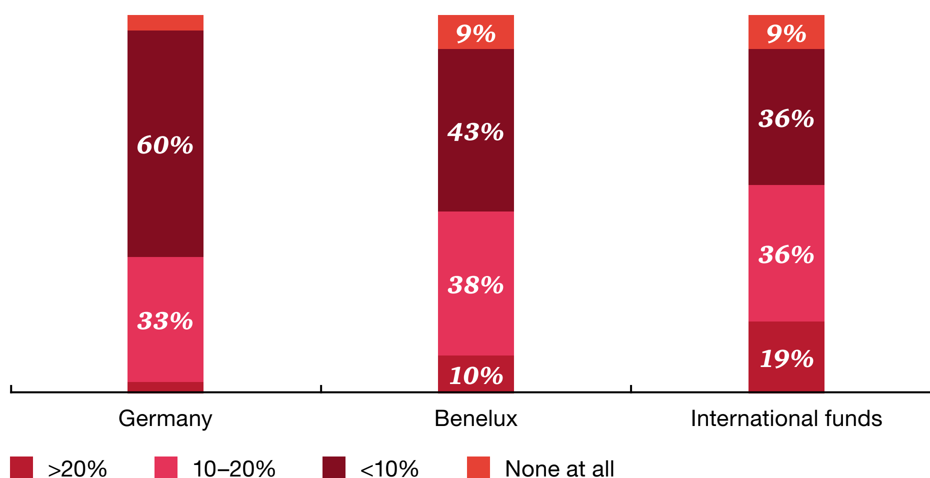


Fig. 22 Percentage of companies that broke one or more bank covenants, or otherwise needed to enter negotiations with their financing providers during the previous year by geography



Reasonable ratios

Across all territories, i.e. Germany, Benelux and international funds, GPs appear to be employing judicious levels of debt. More than four in five (81%) of firms say that the average debt-to-equity ratios employed in their deals in 2018 were 50% or below, with only 4% using more than 60% debt in their transactions.

This bodes well at a time when there are indications of a global economic deceleration, which has largely been associated with a slowdown in China. For instance, Germany's economy grew by 1.5% last year, its slowest rate since 2013 as performance weakened in the latter half of the year. Given the close trading ties with China, any slowdown in Asia's largest economy is contagious for Germany.

This suggests that earnings growth at portfolio companies in the country have come under pressure in recent months, therefore prudent levels of acquisition debt will give companies greater headroom and decrease the risk of breaking covenants and losing control of companies to lenders.

2 The year ahead

Global economic growth expected

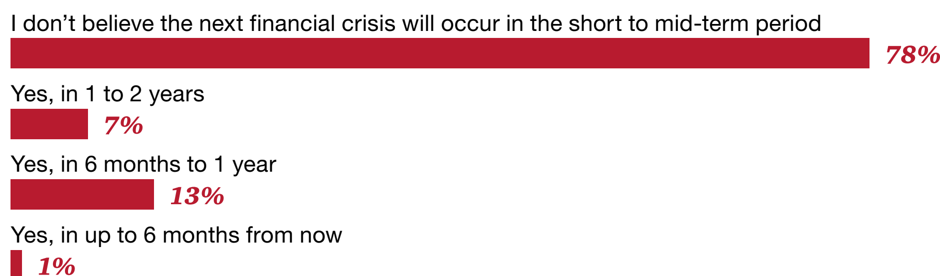
Volatility returned to stock markets in the final quarter of 2018, with a number of major indices ending the year at a loss. This has sparked concerns that equities might slip into persistent bear markets after years of rising valuations. Furthermore, since recessions are typically presaged by stock market falls months before, some are concerned that recent developments are an early warning sign of things to come in the global economy.

However, there are plenty of commentators who see recent volatility as no more than a market correction after stocks had reached record highs. This is supported by the fact that underlying earnings remain relatively robust and the global economy continues to grow, albeit at a slower pace in many countries.

This more optimistic viewpoint appears to be shared by the majority of private market participants. More than two-thirds (68%) say that they expect the world economy to grow in 2019, although 66% are only anticipating low growth. Furthermore, more than three-quarters (78%) of respondents do not believe the next financial crisis will occur within the next one to three years. A small minority of 14% believe the next such crisis will occur within a year.

An executive from Luxemburg sees an opportunity in volatility and comments: "Any disturbance in the market is an opportunity for PE investors. We are now in a market which slowly growing and at the same time remains volatile. This gives PE firms unique opportunity. PE investors will not shy away from these disturbances and will look for ways to capitalize on opportunity. PE firms will tailor their investment strategies to mitigate the risks that these disturbances can bring."

Fig. 23 Do you believe that the next financial crisis will occur in the short to mid-term period (i.e. 1–3 years) from now?



PE progress in 2019

Turning attention to the European PE market in particular, firms are broadly optimistic, especially those based in Germany. More than half (58%) of PE executives say they expect the market to improve in 2019 and this rises to 73% among German respondents.

Moreover, firms expect to act on this confidence in the market by both putting more money to work and realising more assets. This suggests too that fund managers see a return to rising stock markets in 2019, a trend that would support exit activity. More than three-quarters (78%) say they expect to make more investments in 2019 than they did in 2018, including 22% who expect a significant increase. This is closely followed by 64% who say they anticipate the number of exits their firm makes in 2019 to increase.

Fig. 24 How do you expect the European deal market for private equity to develop in 2019? Do you think it will …?

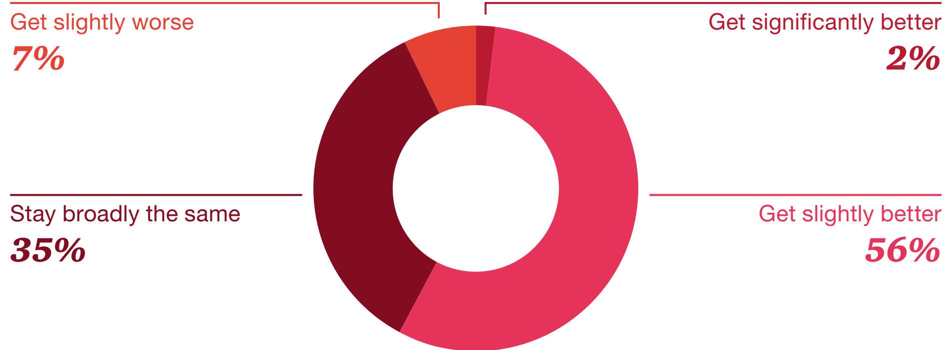


Fig. 25 How do you expect the European deal market for private equity to develop in 2019? Do you think it will …?

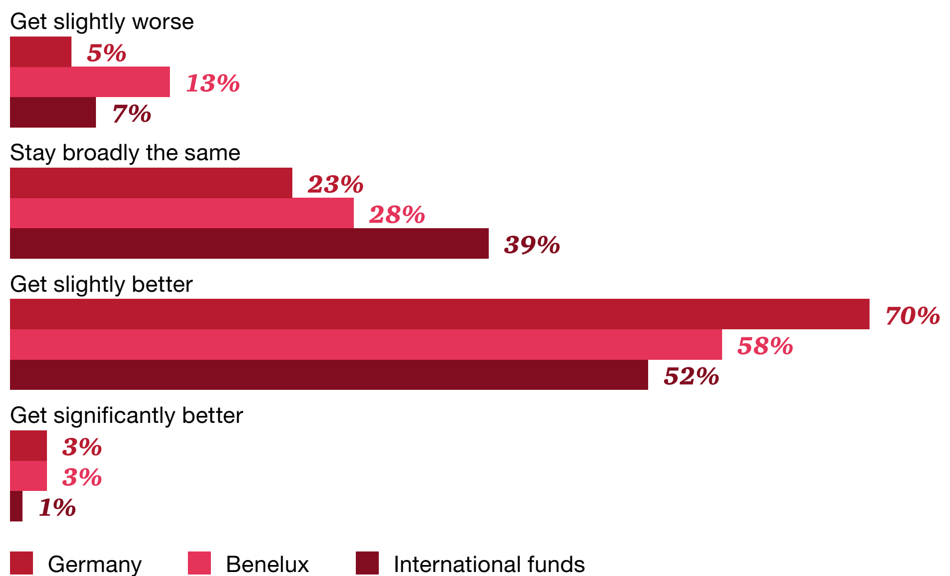


Fig. 26 Compared to 2018, do you expect the number of new investments made by your organisation in 2019 to ...?

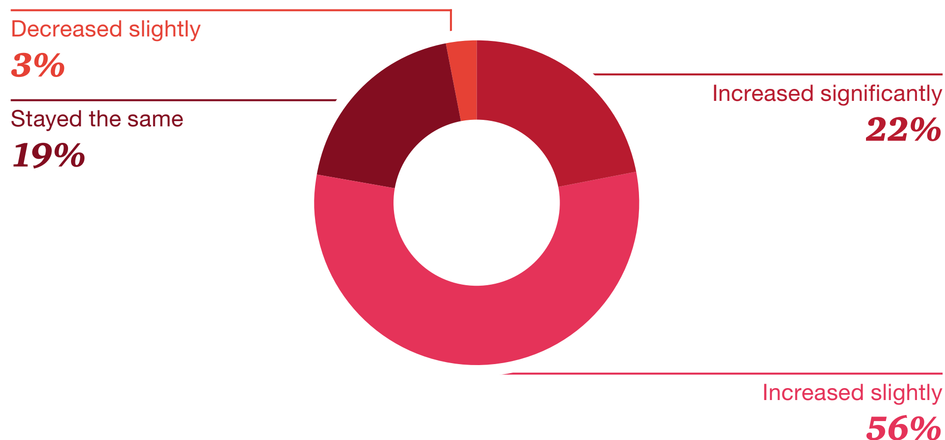
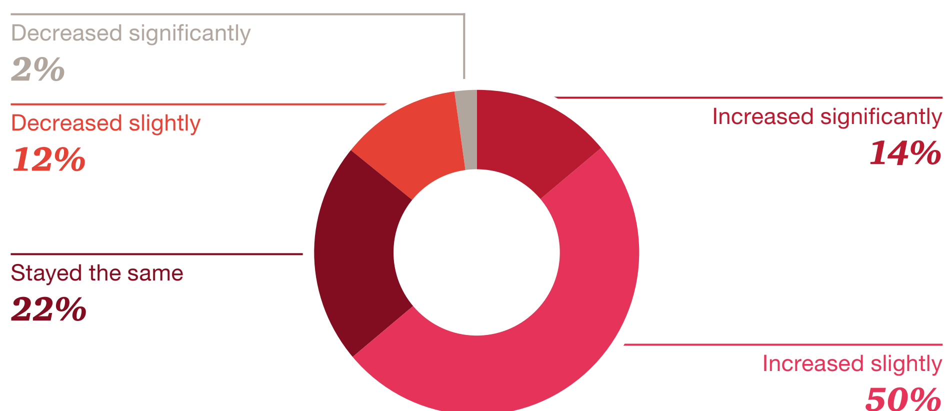


Fig. 27 Compared to 2018, do you expect the number of exits made by your organisation in 2019 to ...? (Please select one response only.)



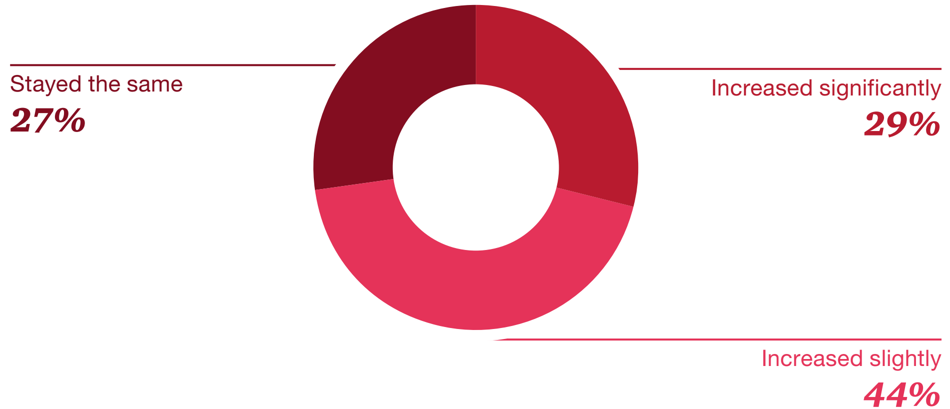
A competitive market

One of the most defining characteristics of the PE market's evolution has been the steady rise in competition. Originally a fringe asset class, PE has increasingly become a mainstay of investors' portfolios and the industry has matured to deliver ever-larger buyout funds, sector specialism and spin-outs from established firms.

Between 2000 and 2015 the number of active firms more than doubled from 1,453 to 3,530, according to Pitchbook data. Meanwhile, aforementioned dry powder is now sitting at $1.2trn, this stockpile leading to steadily increasing purchase multiples, making the job of PE funds in smartly and prudently investing their investors' capital all the more challenging.

This shows no sign of abating. Nearly three-quarters (72%) say they expect competition for investments among PE firms to increase in 2019, including 28% who say they expect it to increase significantly.

Fig. 28 Compared to 2018, do you expect competition for investments among private equity firms in 2019 to …? (Please select one response only.)

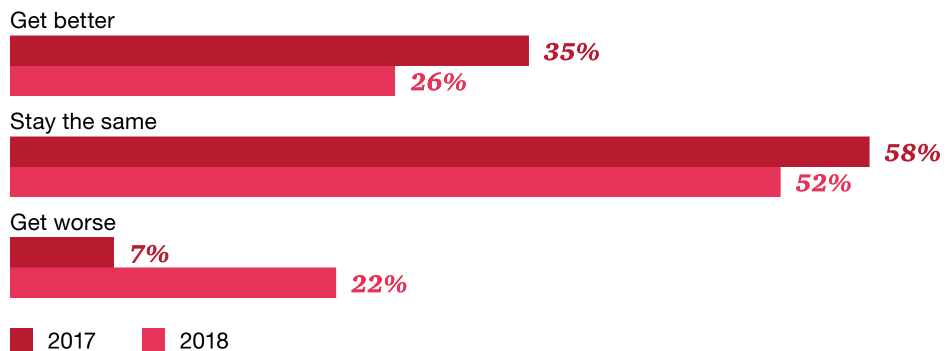


Taking credit

Sentiment around obtaining leverage for buyouts is broadly positive, but there does appear to be some anxiety, which might be expected given recent turbulence in capital markets. Just over half (52%) of respondents in this year's survey say they expect the availability of credit for leveraged buyouts to stay the same in 2019 as it was in 2018. However, there is a sharp increase in the number of respondents this year who think the availability of credit will worsen – 22% this year compared with 7% in last year's survey.

This coincides with the high-yield bond market temporarily closing to new issuance. In the US, Targa Resources issued the first junk bond of 2019 and the first such bond for six weeks, after market volatility caused issuers to sit on the sidelines. If confidence in the capital markets returns and sustains, PE sponsors should expect to be able to tap the bond market to finance their deals in 2019.

Fig. 29 Looking ahead to 2019, compared to 2018 do you expect the availability of credit for leveraged buyouts to …? (Please select one option only.)



Operational improvements are key to equity stories

Operational improvements are expected to remain the number one most important factor influencing the equity story of investments in 2019. However, the significance of such improvements has fallen from last year, with a greater emphasis now on financial engineering and digitisation.

Last year we found that 44% of respondents cited improving portfolio company operations as the key influence on equity stories, and that has since dropped to 28% who say the same. Meanwhile, only 9% last year saw financial engineering as the primary influence on equity stories versus nearly a quarter (22%) who now see this as the greatest influence for 2019.

Notably, digitisation is gaining prominence. In 2017, only 11% said that digitisation was the most important factor influencing equity stories and this has now risen to 18% who are now placing the greatest emphasis on this. An executive of a €1bn+ PE fund stresses the importance they see in the digitisation: "Digitisation is the key to progress in the current market. The market is now driven by technology and everything is going digital. We take the technology change and market transformation very seriously and always ensure we invest in companies which are at least on par with the latest trends and digitisation is certainly on the top of the list."

Meanwhile, 44% of respondents say operational improvements are the most important influence on return on investment, and a further 35% say this factor is the second most important influence on return on investment.

"There is a direct relationship between operational improvements and returns. Such improvements increase the company's ability to sustain growth and overcome increasing regulatory and market uncertainties. This has a positive impact on the business's valuation and the eventual return we make on exit," says the managing partner of a German PE firm.

Fig. 30 Looking forward to 2019 which of these factor, do you consider will be the most important influence on equity stories on acquisitions for your organisation?

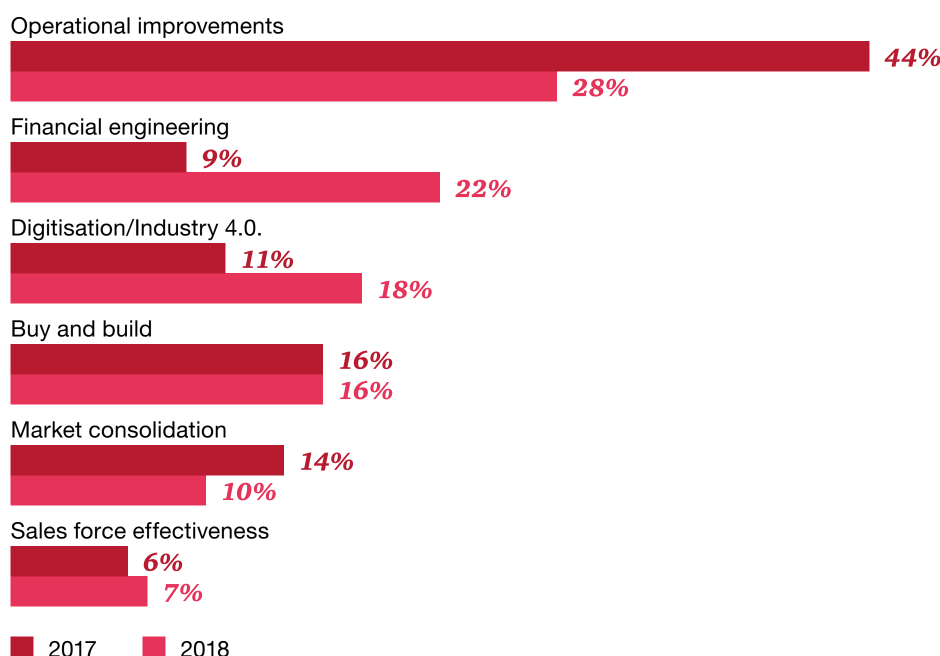
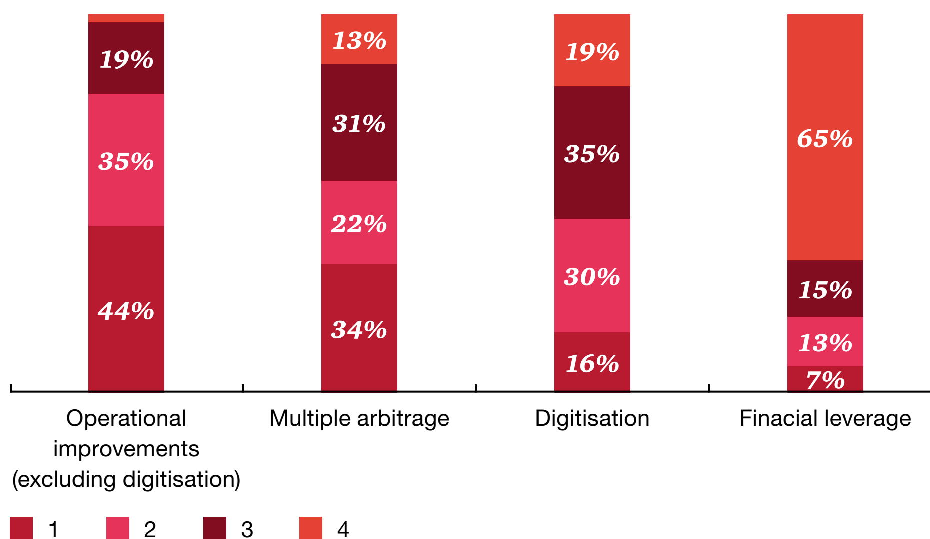


Fig. 31 Please rank the following in terms of importance, regarding their influence on your return on investment.

On a scale of 1 to 4, where 1 = most important and 4 = least important

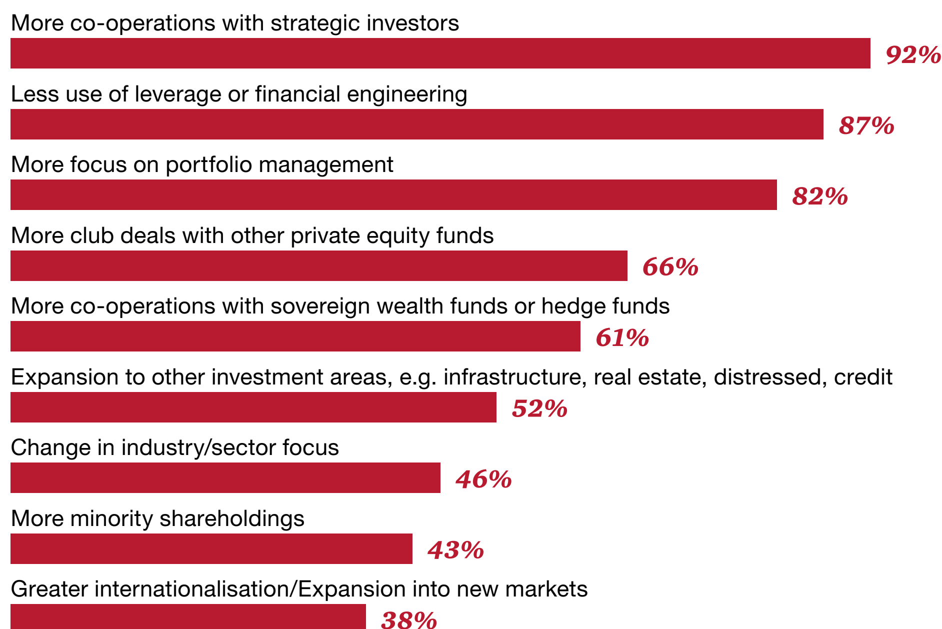


Increasing strategic investor co-operation

In recent years, PE funds have had to change tack in order to meet the demands of investors and give themselves a competitive edge. In the industry's early years it used to be that funds could rely on financial engineering as a primary means for achieving returns. As firm numbers have proliferated, increasing competition for deals, business models and strategies have become more sophisticated.

One of the most striking developments has been the collaboration with strategic investors. This broadly comes in two forms – giving LPs direct access to deals as co-investors, thereby increasing a PE fund's firepower and ability to complete larger deals; and bringing in relevant corporates as co-investors on buyouts, again increasing financial firepower but also bringing valuable industry knowledge to the table and a potential investor to exit to in future.

It should be expected then that an overwhelming majority of respondents (92%) say they have been undertaking more co-operation with strategic investors, making this the most widely cited change to PE firms' business models in the last three years. Further, 87% say they are using less leverage or financial engineering, and 82% say they have more focus on active portfolio management.



Limited partners, higher expectations

Limited partners have come to expect more from their PE managers. While the very best-performing GPs have greater bargaining power with regard to management fees and carried interest structures, the broad trend is that investors have pushed back in the years following the global financial crisis. A particular point of contention has been that GPs were able to reap considerable income on their 2% management fees on committed, not invested, capital even if funds underperformed.

In our survey we find that nearly three-quarters (71%) say LPs' expectations have increased over the past three years and 35% say these expectations have increased significantly.

Turning to what is expected, 82% point to increased frequency of individual co-investment as a top three change, while pressure on management fee levels is cited by 80%. These two are very closely related. LPs have come to seek greater levels of co-investment as a means to improve investment performance by reducing management fees.

One GP based in Luxembourg explains that there is a herd effect at work and that, as co-investment rights become the norm, there is no use fighting the tide: "Limited partners want to co-invest with us and in almost every investment we plan to make. It is not that they do not believe in us, but it is a trend they are following. Every limited partner feels that if they co-invest and manage these investments, they will be able to reduce their management fees and achieve better returns. It has become a trend and we cannot do anything against it."

While a 2-and-20 model is typical of PE funds; whereby investors pay an annual 2% fee on their committed capital plus share 20% of the profits on investments above an agreed threshold or hurdle rate; with co-investments a 1-and-10 model is more common. In this way, pushing back on management fees and increasing co-investment are both ways of boosting performance by reducing costs.

The partner of a UK PE firm explains how this trend poses its own challenges, namely conflicts over how best to manage investments: "Now limited partners want to co-invest with us and even recommend target companies. This is a new challenge that we need to deal with. Co-investments affect our independence. There are significant differences in the way we look at investments and the way limited partners look at investments, and that can cause a lot of issues when trying to develop a portfolio company."

Meanwhile, 77% of respondents say that increased disclosure requirements are one of the top three changes to LP expectations in recent years, and 29% say this is the top change, ranking it above all others. Again, this presents its own challenges for GPs, with one PE partner in Italy saying: "Everything cannot be disclosed to the limited partners and we want our investors to respect that fact. But limited partners now have started asking to disclose everything related to investments, which does not sit comfortably with us."

Tellingly, only 18% of GPs say that increased expectations on ESG topics is a top three change in LPs' expectations, and just 5% say this is the top change. This illustrates that, while environmental and social matters have rightly risen on investors' agendas in recent years, ethical investments are more of a nice-to-have and, ultimately, it is financial returns that matter most.

Fig. 33 Have expectations and requirements of your Limited Partners (LPs) changed during the prior three years?

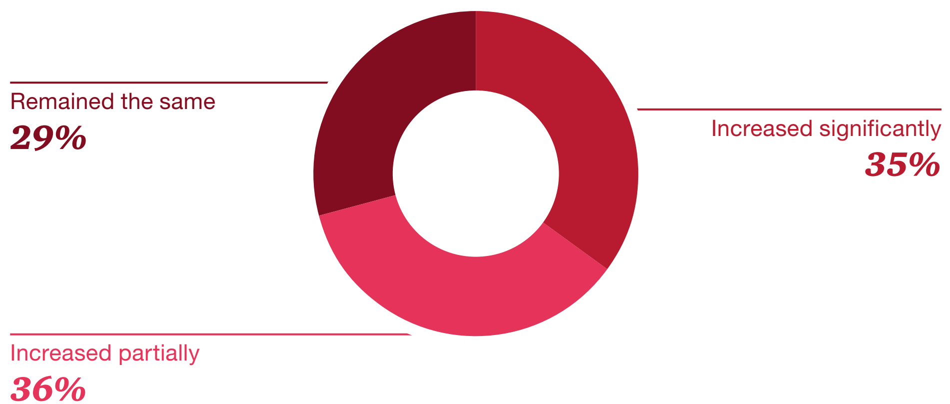
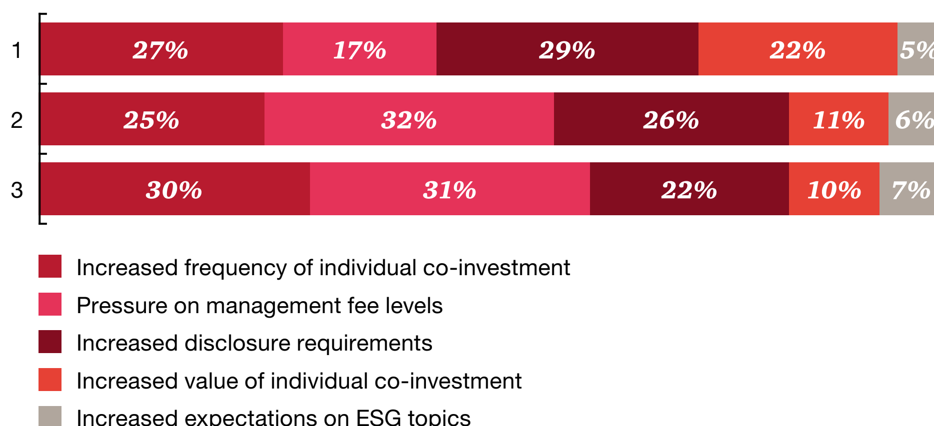


Fig. 34 Which of the following best describe the changes in expectations and requirements from your Limited Partners …? (Please rank top three, where 1 = biggest change.)



When asked about significant contributors to their next fund, 90% of respondents say funds of funds will invest and this rises to 95% among Benelux respondents. This is followed by insurance companies (80%) and family offices (73%).

Meanwhile, 42% expect banks to invest in their forthcoming funds. This lower anticipated turnout compared with other investor types is to be expected given post-crisis regulatory changes, namely Basel III in Europe and the Volcker Rule, part of the Dodd Frank Act, in the US. Both pieces of regulation have placed greater restrictions on the ability of banks to invest in the asset class, in a bid to reduce risk in the financial system.

Sovereign wealth funds are cited by fewer firms (34%) than any other investor type, despite the fact that the entry of these pools of national capital reserves have been one of the most prominent new entrants to the asset class in recent years. However, this is explained by the fact that sovereign wealth funds have vast sums of money to invest, therefore have tended to seek so-called managed accounts, co-investments and direct deals, thereby circumventing GPs' LP funds altogether. Only a minority of mega funds have the capacity to absorb the size of tickets that sovereign funds are looking to invest.

Fig. 35 Thinking about the next fund you will raise, which of the following investment partners, if any, will you expect to significantly contribute to your Limited Partner (LP) structure? (Select all that apply.)

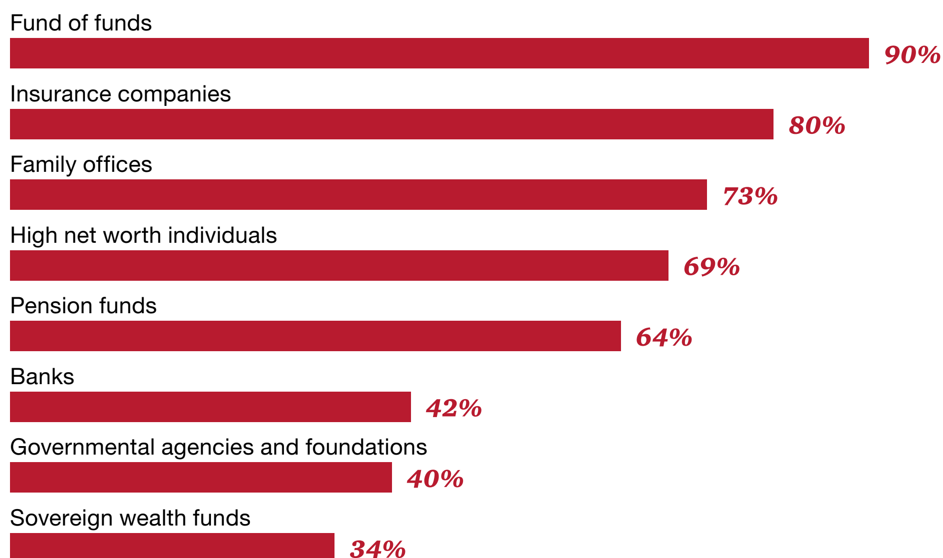
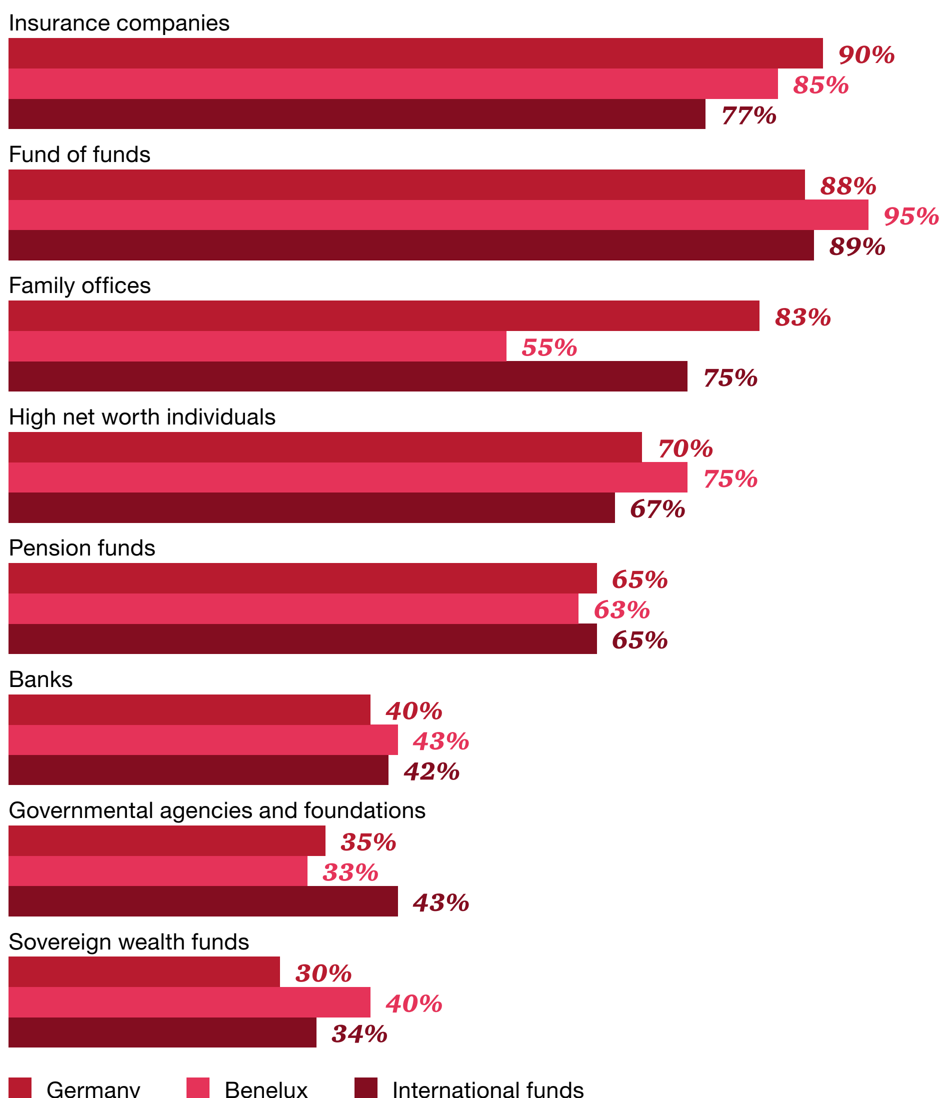


Fig. 36 Thinking about the next fund you will raise, which of the following investment partners, if any, will you expect to significantly contribute to your Limited Partner (LP) structure? (Select all that apply.)



Industrials, consumer and tech are top three

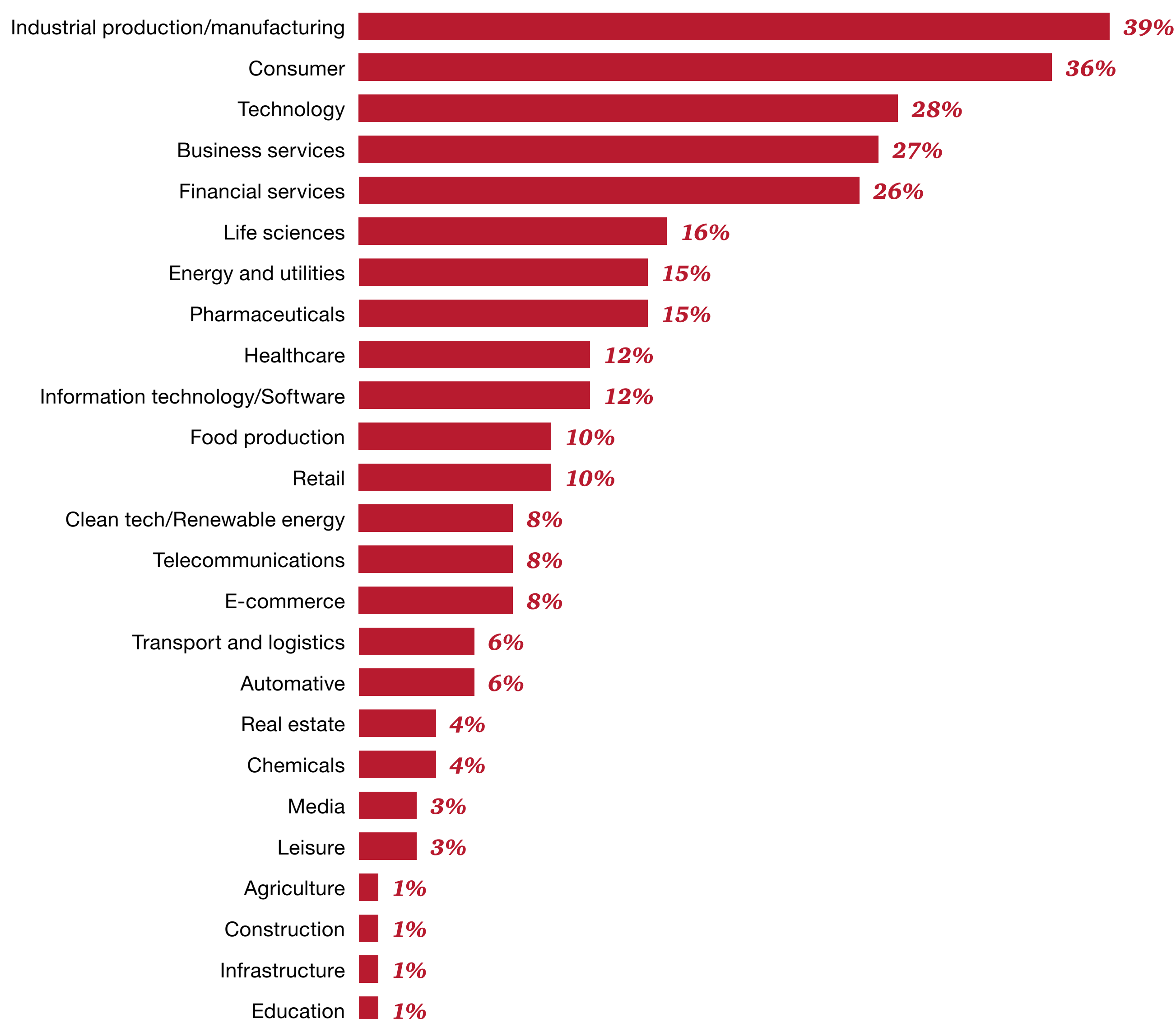
When asked about the top three sectors for investment over the next two to three years, the top choice is industrial production/manufacturing, with 39% pointing to this area. This reflects our findings from last year's report in which industrial production/ manufacturing was the joint top choice in last year's survey alongside technology. The second choice this year, cited by 36% of PE firms, is the consumer sector.

A French GP explains the differing rationales for investing in consumer versus the industrial production/manufacturing space: "In sectors like consumer the opportunity is growth-oriented. Consumer spending has increased and there is always a need for product expansion and diversification. We can play an important role in helping the company expand its product or geographic presence and diversify in new areas. In sectors like industrial and real estate the opportunity is to make the most of low valuations and buy attractive assets, then help them reduce costs and make operational improvements."

Last year's top choice of technology is now the third most popular, with 28% of respondents anticipating tech investments. This annual fall in interest coincides with significant market correction that was largely led by large falls in the stock prices of big tech firms like Facebook and Amazon. Technology is widely believed to have become an overheated sector, both in public markets but also PE and venture capital, the latter of which has seen numerous tech unicorns (private companies with $1bn-plus valuations) emerge, as VC funds have ploughed billions into the space. It follows, therefore, that PE investors have cooled somewhat on the sector.

At the same time, as one German GP says, it is rare that technology does not touch most sectors in some form, even if companies are predominantly classed as belonging to a non-tech industry. "Our investment activity will focus on capturing the digital wave. Sectors like technology, healthcare and business services are now rapidly adopting digital technologies and the potential that companies in these sectors present is tremendous."

Fig. 37 In your opinion, which of the following industries is your organisation most likely to invest in over the next 2 to 3 years? (Please name a maximum of 3 industries.)



Asset diversification

The addition of new strategies to PE firms' product offerings is becoming increasingly common. For many years already the industry's largest operators including the Blackstone Group, the Carlyle Group and KKR have expanded into asset types such as credit funds, distressed debt, infrastructure and sector-specific vehicles. But smaller, single-fund firms are increasingly adding more strings to their bows by diversifying their asset expertise to cater to investors' needs and increase their fee income.

This is also true among our survey cohort. We find that 44% of respondents have already invested in private debt/credit and that 51% intend to do so in the future. Similarly, 39% have already invested in infrastructure and 44% have plans to going forward.

A Swedish GP explains that the defensive nature of infrastructure in particular is what makes it so appealing: "We now prefer long-term investments so that we do not have to worry about short-term risks like recent macroeconomic uncertainties. Infrastructure investments are long term and the growing demand and focus of successive governments on infrastructure spend gives us confidence in this strategy. Infrastructure spending is a necessity and even if spending is cut short in the short term, over the long term infrastructure spending will always increase."

Fig. 38 Has your firm invested in any of the following asset classes? (Select all that apply.)

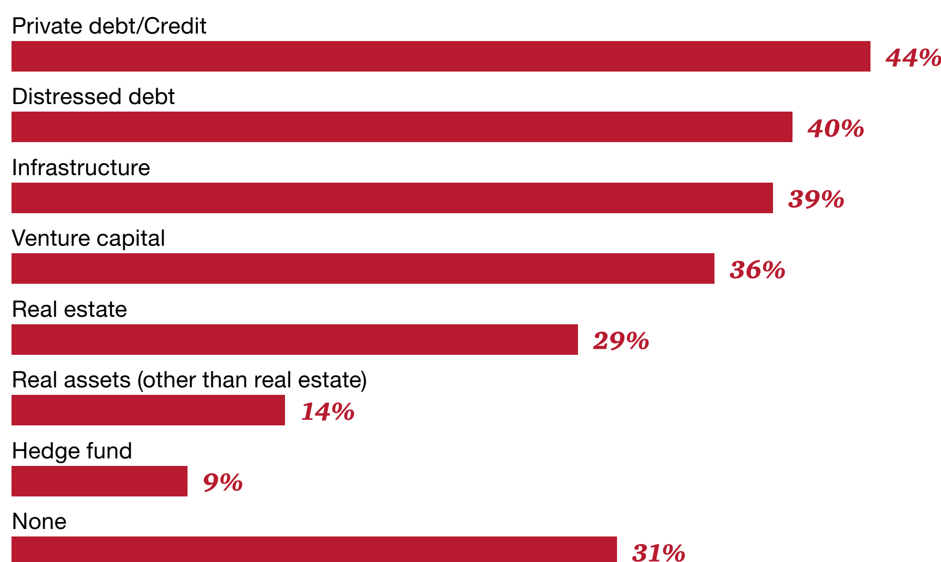
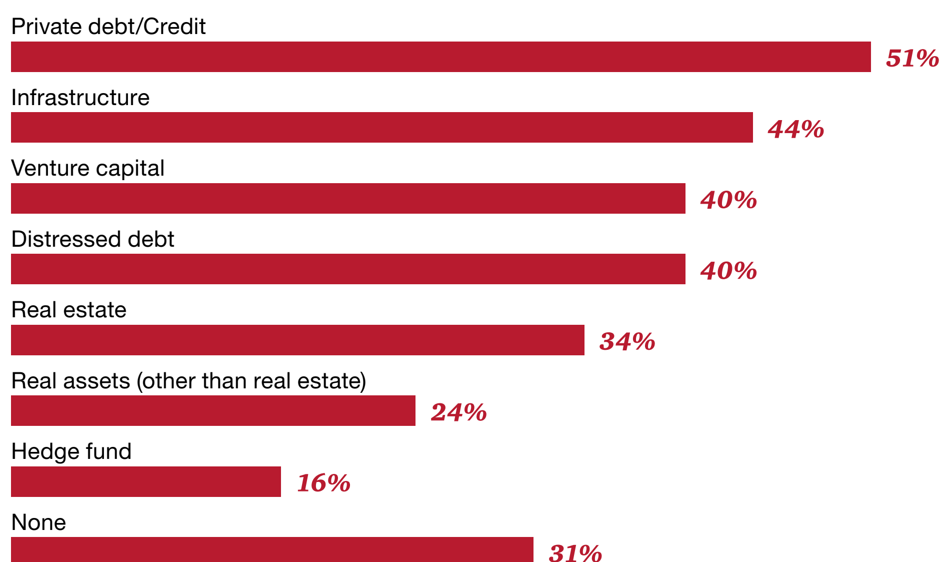


Fig. 39 Does your firm currently plan to invest in any of the following asset classes? (Select all that apply.)



The battle for assets

Europe's PE market is not without its long-term challenges. Nearly three-quarters (72%) of respondents point to a scarcity of investment opportunities over the next five years as one of the top three issues that GPs must contend with.

While there is unlikely to be a shortage of companies to acquire, the real question is whether there will be enough investable companies, at fair valuations, to absorb the record level of dry powder that exists in the system. Indeed, well over half (57%) of those surveyed say that increasing competition between funds will be a top three challenge, again illustrating concerns about the supply of quality assets being sufficiently adequate to meet demand.

This theme closely relates to another of our noteworthy survey findings. When asked whether they expect the number of PE houses in Europe to increase over the coming three years, a full 76% said they anticipate an increase, with 26% expecting a significant rise.

While there is naturally some degree of attrition among lower-quartile managers, the overarching trend in what is now a mature asset class is that firms have well-established, institutional brands and spin-out teams continue to emerge from these. Given the rising demand among investors for exposure to PE, it is logical that the number of PE firms in the market available to manage that capital should rise. Indeed, as already mentioned, the number of firms more than doubled to 3,520 in the 15 years up to 2015.

Fig. 40 Again looking ahead, what are the key issues which the private equity industry in Europe will face in the next 5 years? (Please rank top three, where 1 = most important issue.)

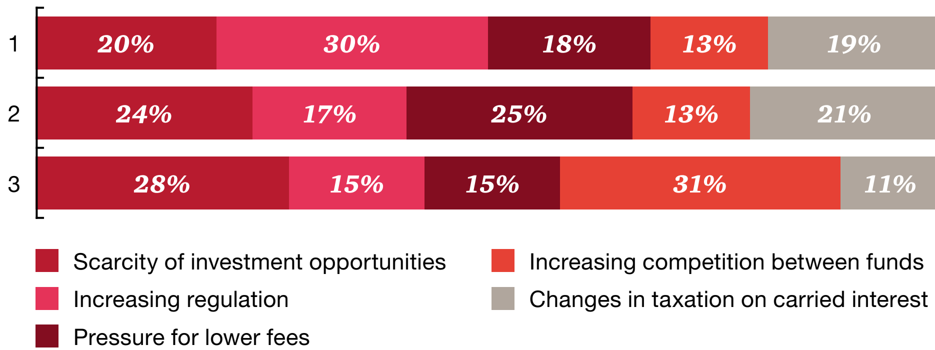
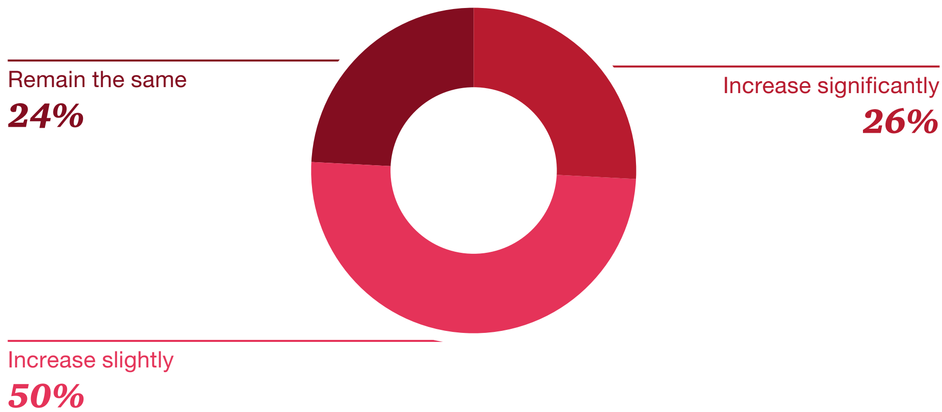


Fig. 41 Looking forward to the next three years do you expect the number of Private Equity (PE) houses in Europe to …? (Please select one option only.)



3 Focus on value creation

Operational cost reductions and operational improvements regarded as most important to value creation

PE has a number of value creation strategies in its toolkit, from passive techniques such as multiple arbitrage and financial engineering to more hands-on approaches, namely upgrading the operations of investee companies. It is the latter that truly distinguishes the industry's best performers from lower-quartile firms, as it is not possible to deliver true alpha with leverage and rising valuations.

Encouragingly, we see that these proactive strategies are having a more meaningful influence on returns. More than four in five (83%) of the surveyed PE executives say the impact of operational improvements has increased over the past three years in respect of return on investment. Looking ahead, this trend is expected to continue, with as much as 91% of the survey cohort anticipating an increase in the positive impact of improved portfolio company operations on returns at exit.

Not only can optimising operations result in higher cash multiples and IRRs, it is a means for fortifying businesses facing economic headwinds. As one executive of a Swiss PE firm says: "We take a flexible approach to operational improvements, analysing and determining what a particular company needs to be able to grow. Technological improvements, change in process, dedicated leadership and so on strengthens companies and allows them to weather volatile markets. These improvements lead to greater efficiency, higher output and increased levels of customer service, which help to make a company a reputed brand."

Of course, operational improvements is a broad term and such improvements come in various guises. When asked what specific levers are most important to value creation within the equity story, operational cost reduction came out on top, followed by digitisation in second place. However, as the results in graph 44 show, the approximately even weighting for various approaches indicates that GPs commonly draw widely upon the various value creation levers they have at their disposal.

Fig. 42 During the past three years has the impact of operational improvements (excluding digitisation), multiple arbitrage, financial leverage and digitisation on your return on investment increased, decreased or stayed the same?

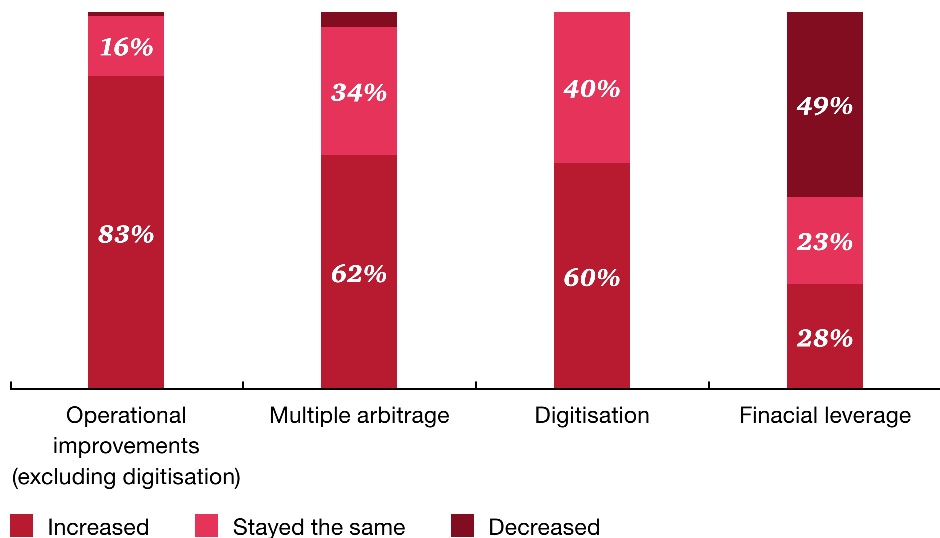


Fig. 43 Looking forward, do you expect the impact of operational improvements (excluding digitisation), multiple arbitrage, financial leverage and digitisation on your return on investment to increase, decrease or stay the same?

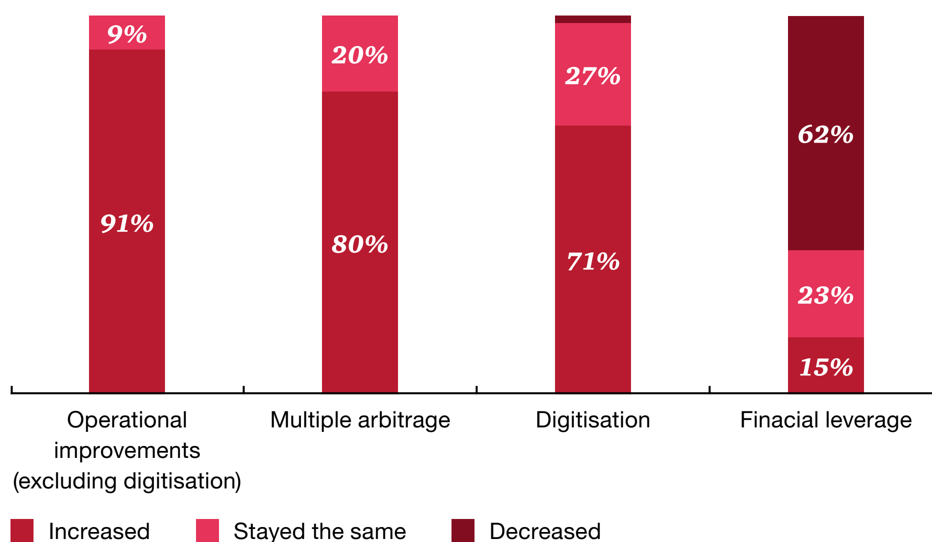
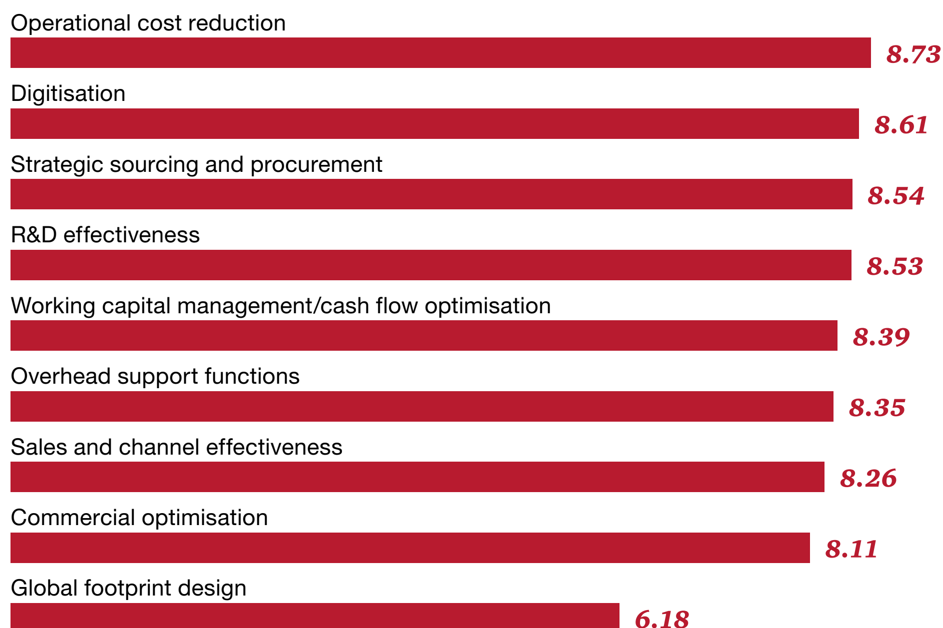


Fig. 44 Which levers are most important to value creation within the equity/investment story?

On a scale of 1 to 10 where 1 = least important and 10 = most important.



The drive to digitise

The opportunity to improve a portfolio company through digitising its operations represents huge potential for PE funds. This is especially significant in an environment in which secondary buyouts, in which a company is sold from one PE firm to another, have become the norm. For instance, according to Pitchbook data, in 2010 such fund-to-fund transactions represented 36% of all PE-backed exits and this now stands at 48%.

It is generally understood that as a company passes through multiple PE owners, each successive owner must work harder to eke out operational improvements as the easy wins have already been made. Digitisation offers the potential to make further improvements to a business whose operations have already been significantly rationalised.

It should therefore not be surprising that a large majority (78%) say that digitisation/industry 4.0 has changed the way they look at new investments and they model it into their equity story at entry. Further, 93% of respondents say they agree that digitising portfolio companies will expedite the realisation of the equity story and thus decrease the holding period of the portfolio. Supporting this, 79% of respondents say that the level of digital transformation they implement will be important to future exits and the returns they achieve.

Says a Swedish GP: "Digitisation is the key to progress in the current market. Everything is driven by technology and everything is going digital. Digitisation will be a core part of what we do and we always ensure we invest in companies that are at least on par with the latest digital trends."

Fig. 45 Has digitisation/industry 4.0. changed the way you look at new investments and do you model it into your equity story already at entry?

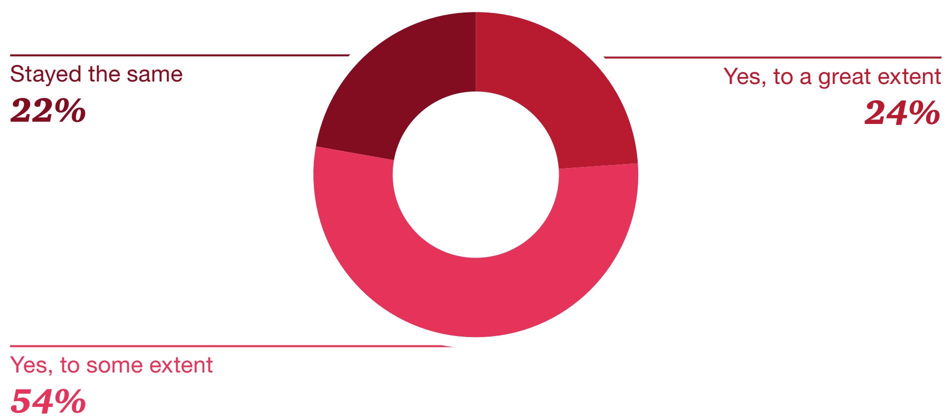


Fig. 46 Do you believe that digitising portfolio companies will speed up the realisation of the equity story and thus decrease the holding period of the portfolio?

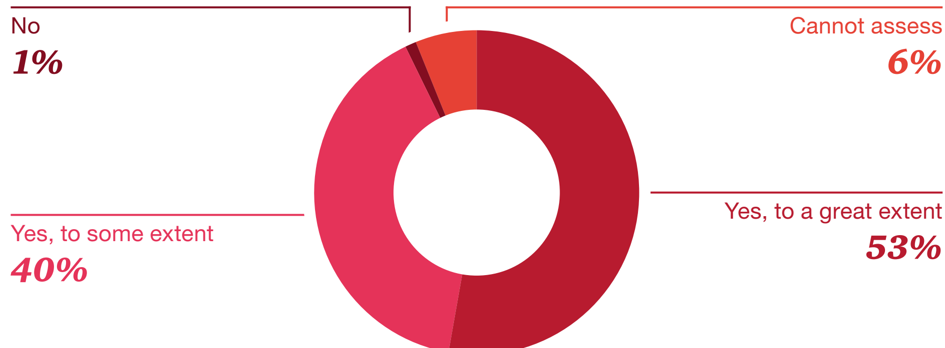
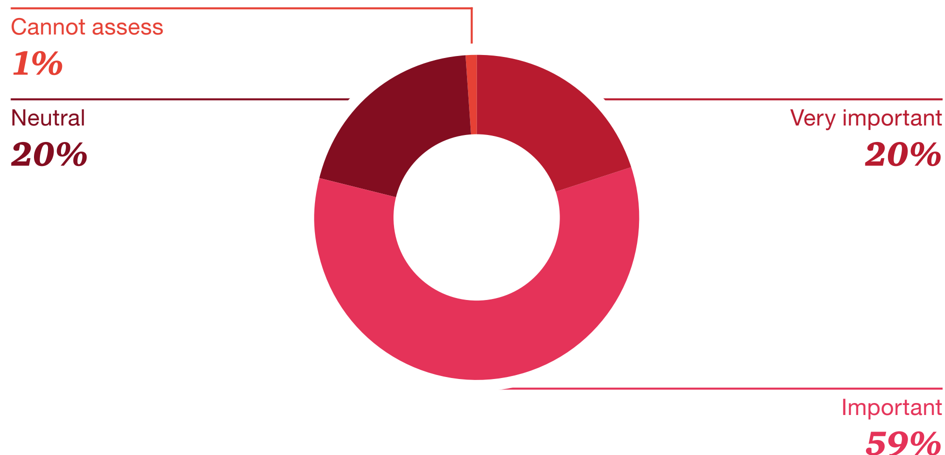


Fig. 47 To what extent do you believe that the level of digital transformation is important to the future exits from your current portfolio companies and the subsequent return to be achieved?



Almost all respondents (97%) have made investments in digitally transforming their own firm or portfolio company business models in the past year. The prime focus of their attention has been on data analytics, cited by 97% of firms, with nearly three-quarters (73%) transforming their businesses with Internet of Things applications and more than half (59%) investing in artificial intelligence.

Fig. 48 **Have you made investments in digitally transforming your own firm or portfolio company business models in the past year?**

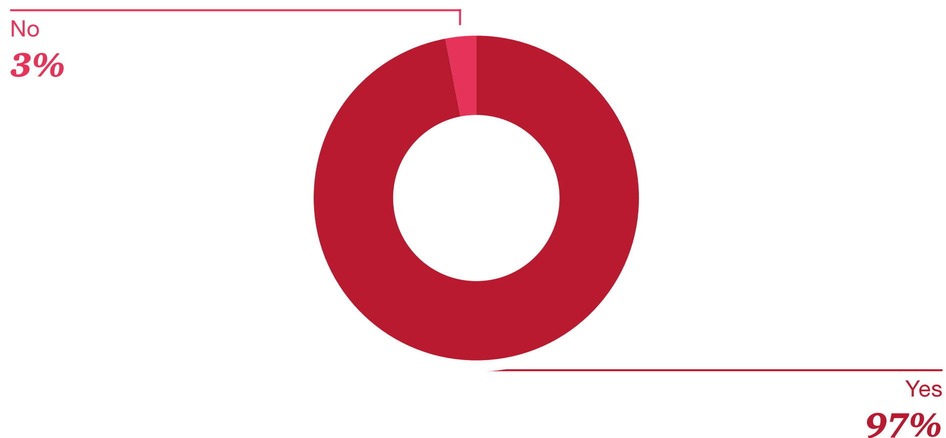
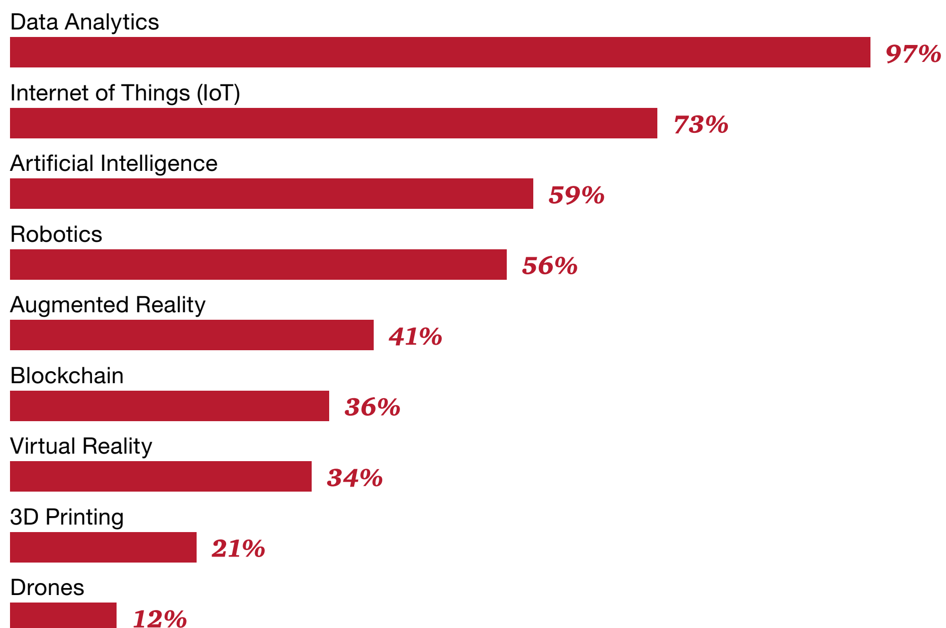


Fig. 49 **Which of the following areas will you be investing in? (Select the most important.)**

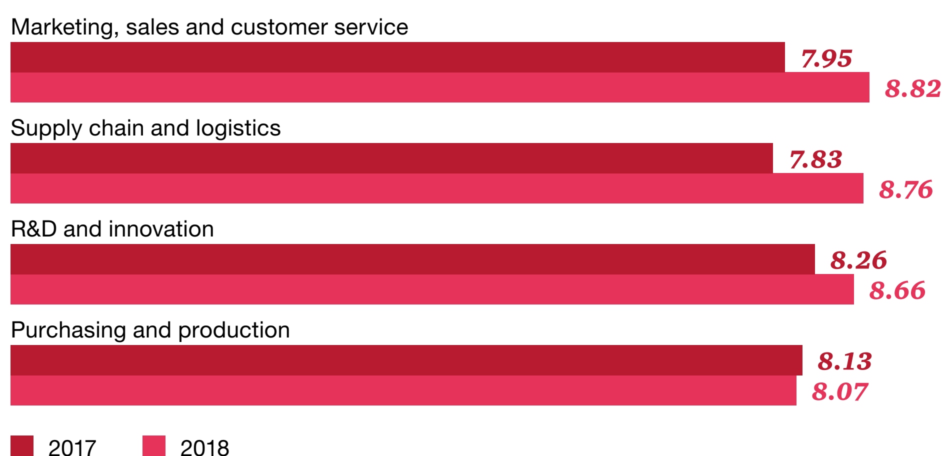


Customers drive digital

Understanding how best to apply these technologies will be crucial in delivering outsized returns in the coming years. From our survey we see that PE firms believe digitisation will touch various parts of the business, although the marketing, sales and customer service function is top, with a mean score of 8.82. The second-highest scoring business function is supply chain and logistics, with 8.76, and in third place is R&D and innovation, with a score of 8.66. This represents a reversal from last year's report, in which R&D and innovation was the corporate department which received the highest score and marketing, sales and customer support was in third place.

Fig. 50 Which part of the company business model do you think is impacted the most from digital transformation?

On a scale of 1 to 10 where 1 = impacted least and 10 = impacted most.



Data with destiny

It is not only portfolio companies that can benefit from digitisation, but PE firms themselves. The PE market has grown over the years to become highly competitive, with an estimated 3,000 firms active in Europe alone. This means that harnessing anything that can give firms a competitive edge will be highly sought after.

Encouragingly, respondents' sentiment regarding investing in digitising internal operations is overwhelmingly optimistic. Three-quarters say they will be investing in digitisation over the next year, and 93% of this majority are planning on investing in data analytics specifically, demonstrating the value of data at both the portfolio and fund manager levels.

Analytics can be applied to various facets of PE funds' day-to-day work and this is reflected in the survey responses. Nine in ten respondents say they have already used data analytics for identifying potential target companies, 87% for valuation purposes and 80% for due diligence work. Looking ahead, a full 98% say they will use data analytics for valuation purposes and 81% say they will use this technology in future for predicting portfolio company performance, up from 51% who have used it for this purpose in the past year.

Fig. 51 Will you be investing in digitisation over the next year?

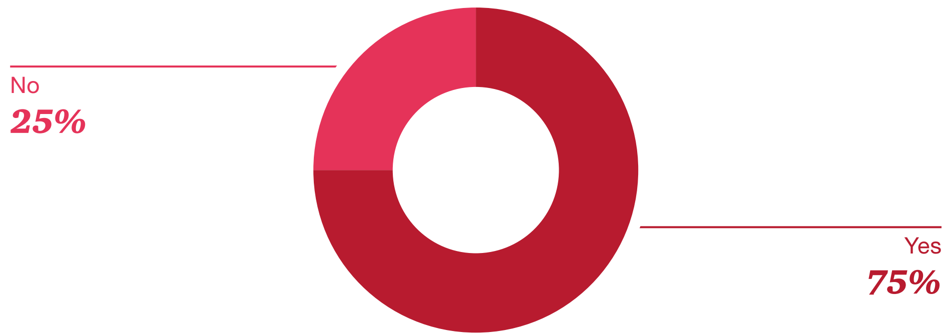


Fig. 52 Which of the following areas will you be investing in? (Select the most important.)

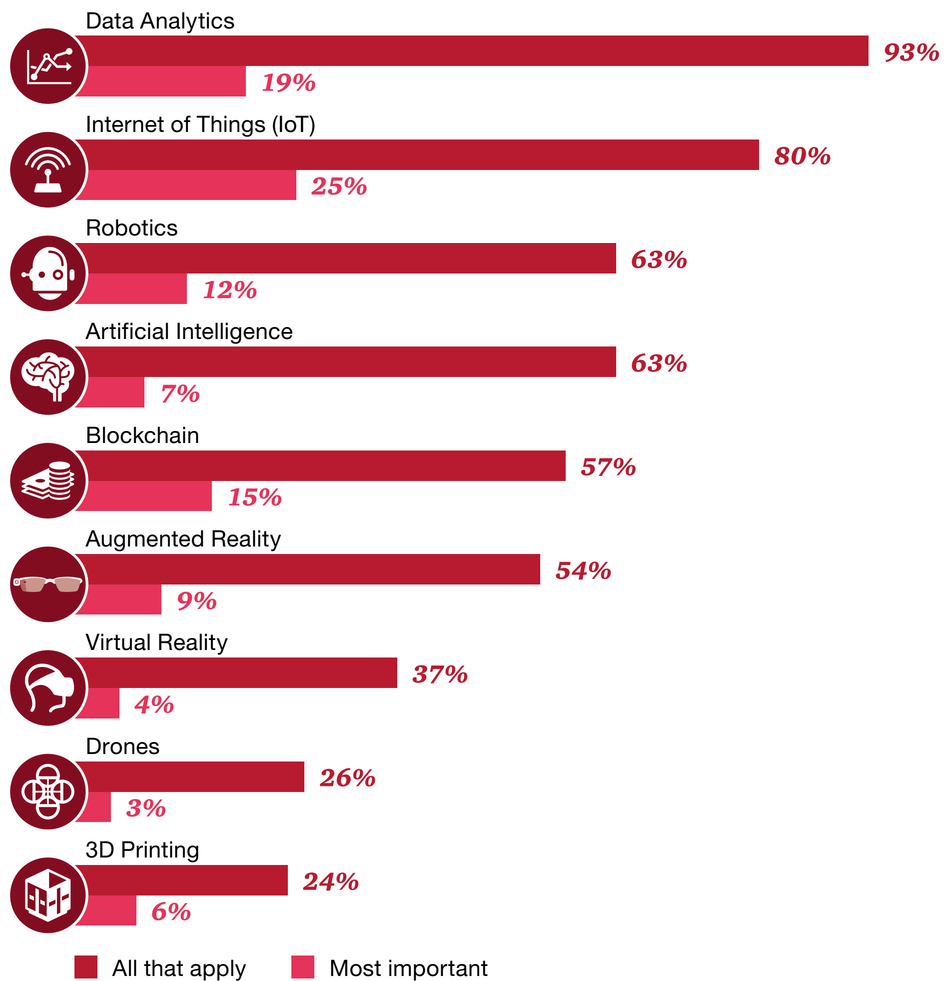


Fig. 53 In which of the following areas of the investment cycle has your organisation used data analytics in 2018? (Please select all that apply.)

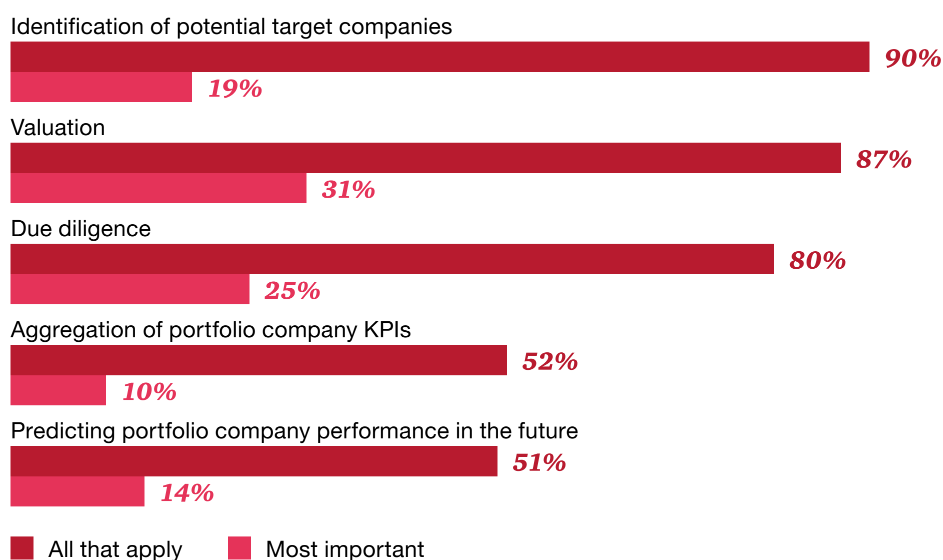
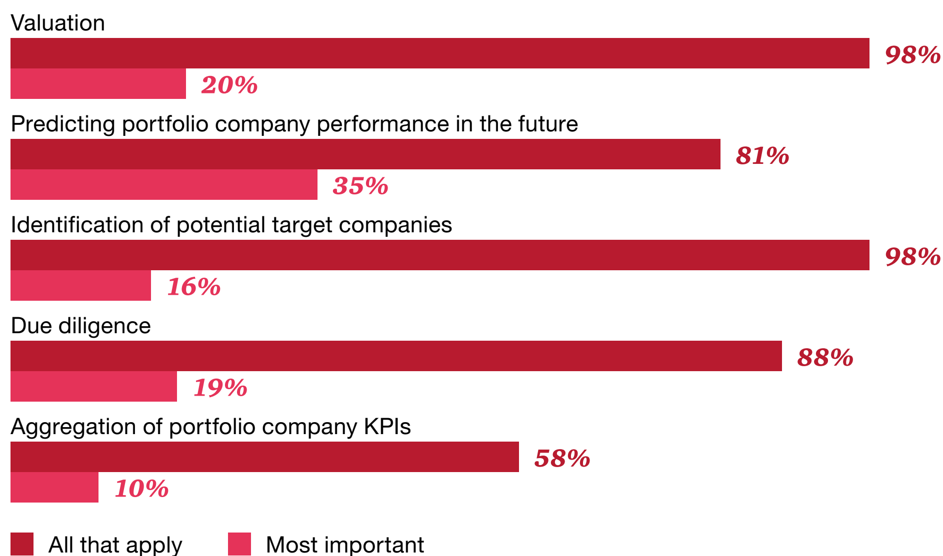


Fig. 54 In which of the following areas of the investment cycle do you anticipate your organisation will use data analytics in 2019? (Please select the most important.)



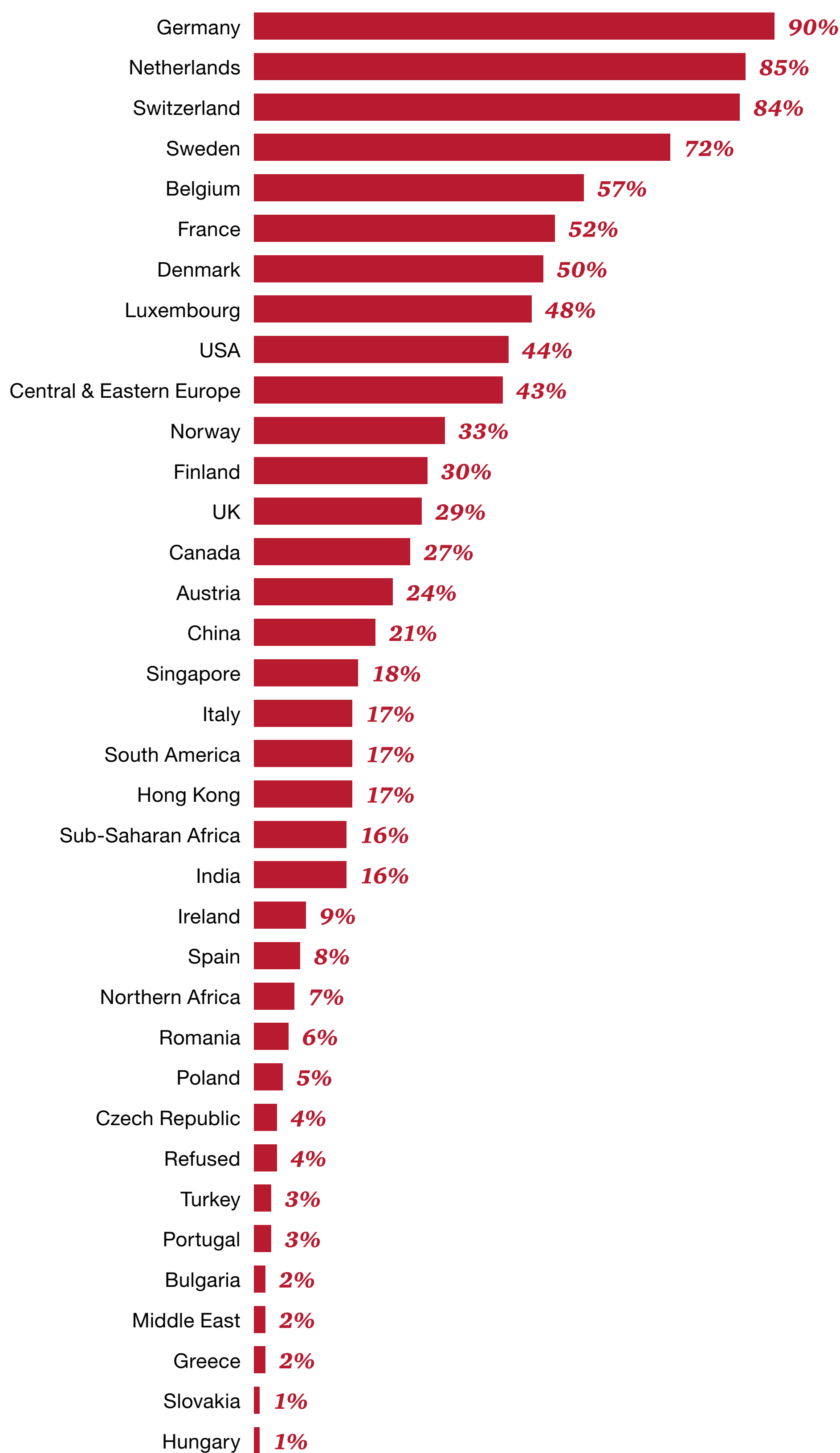
4 Global hotspots

PE firms are optimistic about Germany, the Netherlands and Switzerland

The one country that is most widely expected to become more attractive for PE investing over the next five years is Germany. There has been some frustration that the opportunity to unlock value from investing in the Mittelstand, the approximately 3.7m small and medium-sized family-owned businesses that are the backbone of the country's economy, never fully materialised as expected. Nonetheless, Germany is home to some of the most sophisticated manufacturers in the world and represents significant potential. We find that 90% of respondents believe Germany will become more attractive, followed by 85% who point to the Netherlands and 84% who say Switzerland, another DACH country, will become more appealing.

Notably, the UK is falling out of favour. In last year's survey, 49% said they thought the country would become more attractive for PE investing over the proceeding five years. This has now fallen to just 29%. It would seem that the political situation in the UK is impairing investor sentiment over the medium to long-term prospects of the country's PE market, which remains the largest in Europe both in absolute terms and as a percentage of GDP.

Fig. 55 In your opinion, which countries or regions will become more attractive for private equity investments over the next five years?



The impact of Brexit

Britain is due to withdraw from the EU on 29 March, although at the time of writing the terms under which the country will leave are unclear. Even if the UK and EU agree on a separation deal before the deadline date, the move is unprecedented and has the potential to negatively impact investor confidence and drag on economic performance, at least in the short term.

This poses numerous considerations for PE. Country-focused funds that invest exclusively in the UK may find fundraising challenging as international LPs adopt a wait-and-see approach, and then there is the impact on portfolio companies to consider. The potential introduction of trade tariffs will be onerous for investee companies and may require previously unnecessary licences and authorisations, with highly regulated businesses, such as pharmaceuticals firms, and companies that rely heavily on imports and exports, such as manufacturing and consumer goods firms, likely to be most exposed.

It is unsurprising, then, that 45% of respondents say that Brexit makes the UK a less attractive destination for PE investments in 2019 and only 5% say the country will be more attractive this year as a result of its secession from the bloc. However, UK GPs can take some comfort in the fact that the remaining 50% majority say they do not believe Brexit will have any impact on the UK's attractiveness for buyouts.

Similarly, as much as 59% of the cohort say that Brexit will have no effect on the attractiveness of EU countries as destinations for PE dealmaking, although a significant minority of 25% believe that it will make the EU more attractive than the UK.

In summary, investors see Brexit as either a disbenefit for UK PE or as an immaterial development for the industry, with only a very small minority viewing it as beneficial for the UK's buyout scene.

Fig. 56 What is the impact of Brexit on the attractiveness of the UK for private equity investments in 2019?

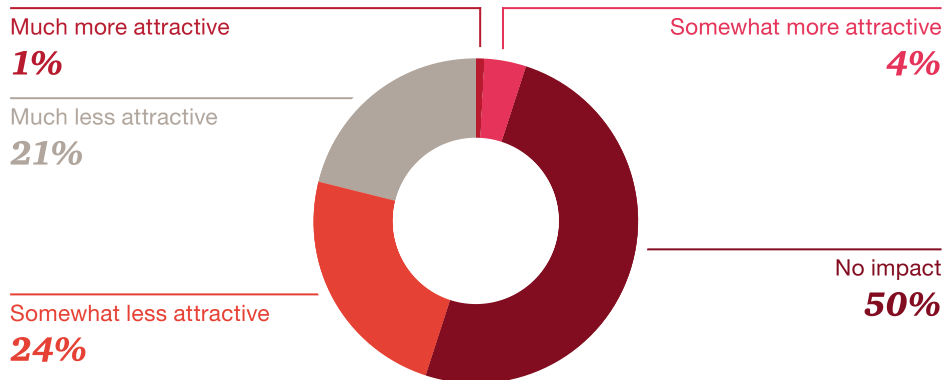


Fig. 57 What is the impact of Brexit on the attractiveness of the UK for private equity investments in 2019?

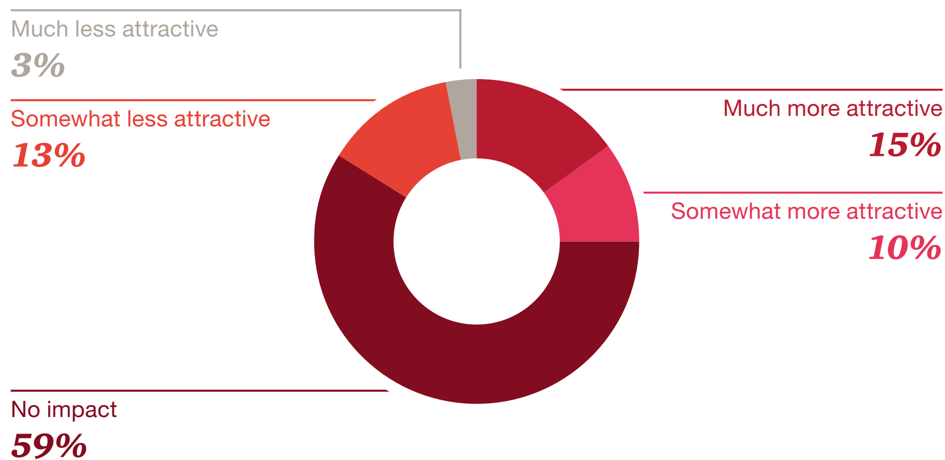
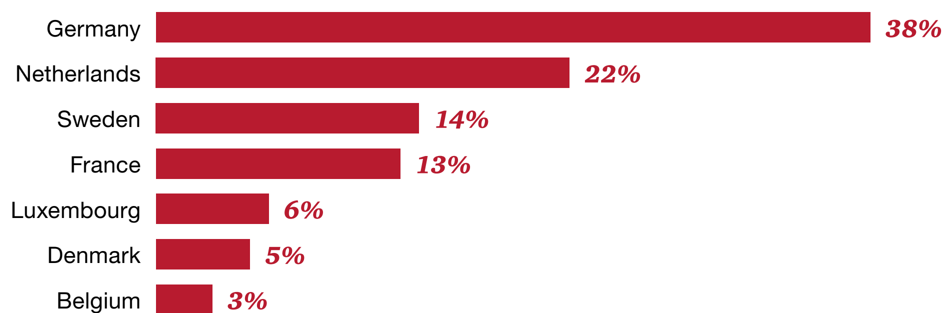


Fig. 58 Please specify which EU country you think is most attractive for private equity investments (Select one.)



5 Focus on Germany

Well over one-third (38%) of those surveyed believe that Germany is the most attractive EU country for PE investments, putting it ahead of any other member state. Second to Germany is the Netherlands, with 22% of the vote. When asked how Germany compares to other countries for making PE investments, 93% of survey respondents say it is good, including 48% who say it is very good. This broadly reflects sentiment in prior years. In our 2018 report the Netherlands came out on top, followed by Germany.

The country has some of the most appealing fundamentals not only in Europe but the world. It is the largest economy in the EU and fourth-largest globally after the US, China and Japan. Notably, it excels in engineering and advanced manufacturing, putting its goods in high demand. Indeed, Germany is the third biggest exporter behind China and the US respectively, with the shipment of goods to other countries representing 41% of national output. It also has strong trade ties with China, meaning that it benefits from the Asian powerhouse's high growth rates.

The downside to this interdependency, however, is that if China sneezes, Germany catches a cold. For example, a deceleration in Germany's economy in the final months of 2018 is attributed to ongoing trade tensions between the US and China and the effect this is having on the Chinese economy, with Brexit likely to also be a factor.

However, Germany stands out in Europe as a prime destination for PE dealmaking, especially over the long term: a full 100% of respondents that have existing investments in Germany intend to continue making deals there over the next five years and 81% indicate that they will increase their asset allocation, a clear sign of PE funds' commitment to Europe's economic engine.

Of the 49% of the cohort who do not currently hold any German companies in their portfolios, 22% say that this will change in due course. Judging by this sentiment it is therefore highly feasible that there will be an increase in buyout activity in Germany over the coming years.

Fig. 59 In an international comparison with other countries, how would you assess the attractiveness of Germany as a location for private equity investment? (Please select one option only.)

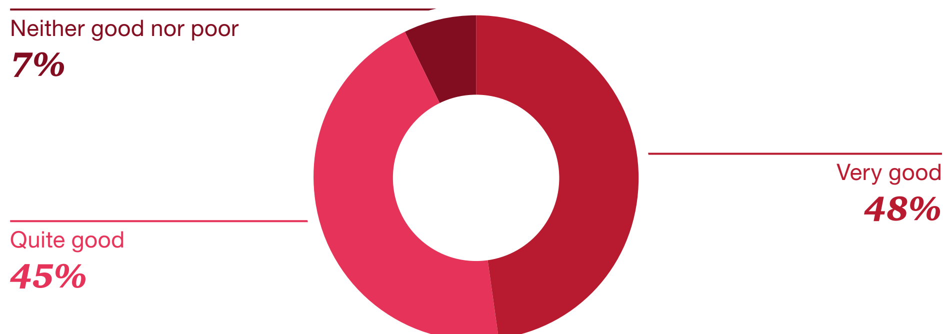


Fig. 60 **Does your firm currently have any investments such as portfolio companies in Germany? (Please select one option only.)**

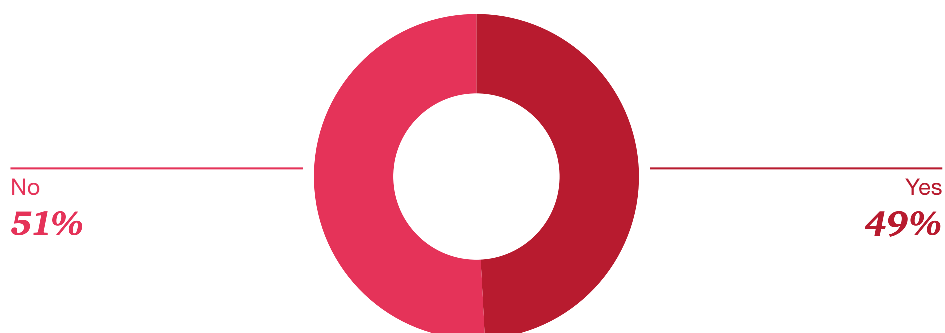
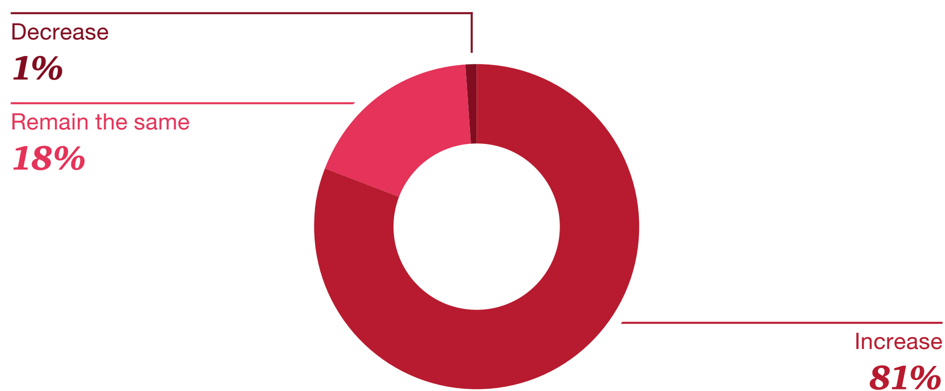


Fig. 61 **Do you think that the assets that you allocate to Germany over the next five years will … (Please select one option only.)**



Appendix

Fig. 62 What was the average debt to equity ratio used by your organisation on new investments made in 2018?

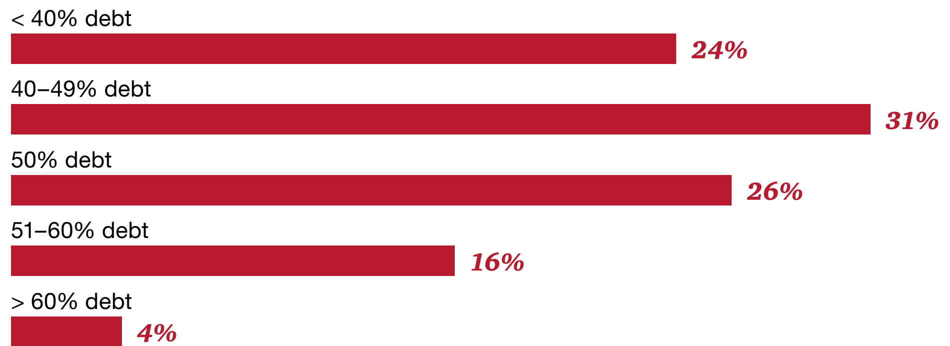


Fig. 63 How do you expect the world economic situation to develop in 2019?

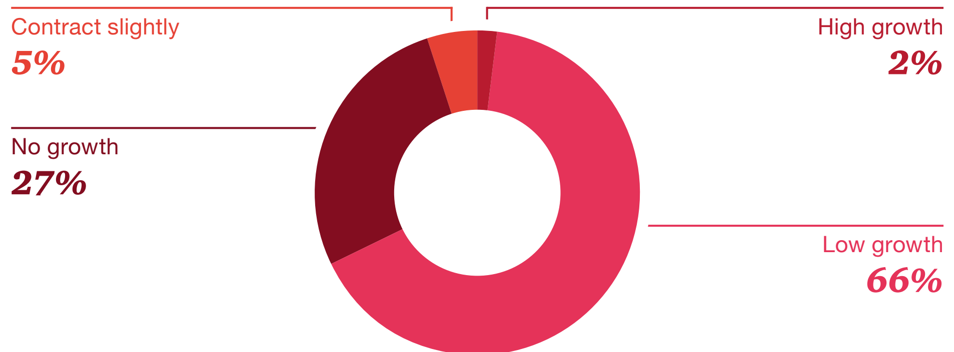
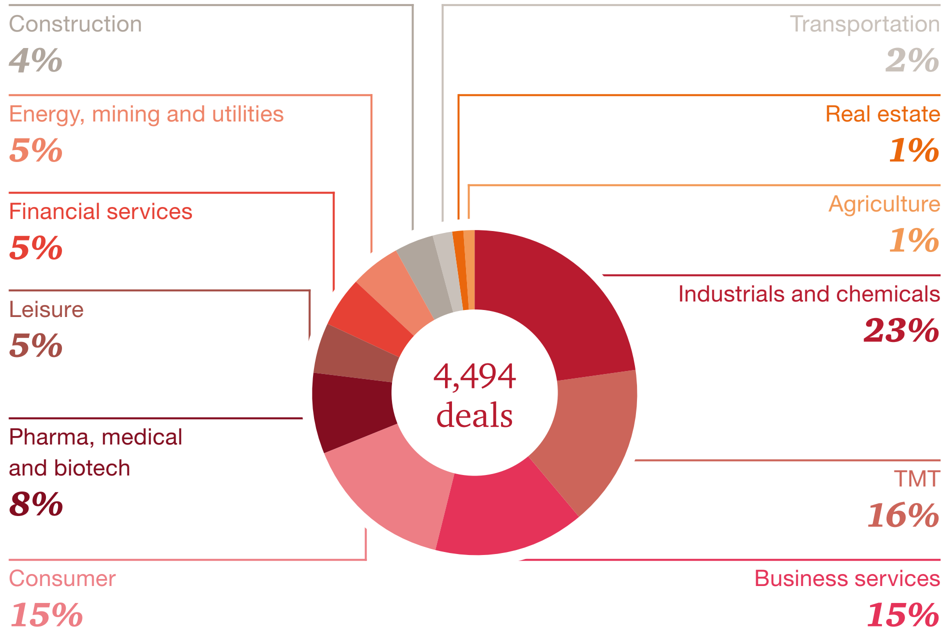


Fig. 64 European Buyout volume, split by industry

2013–2016



2017–2018

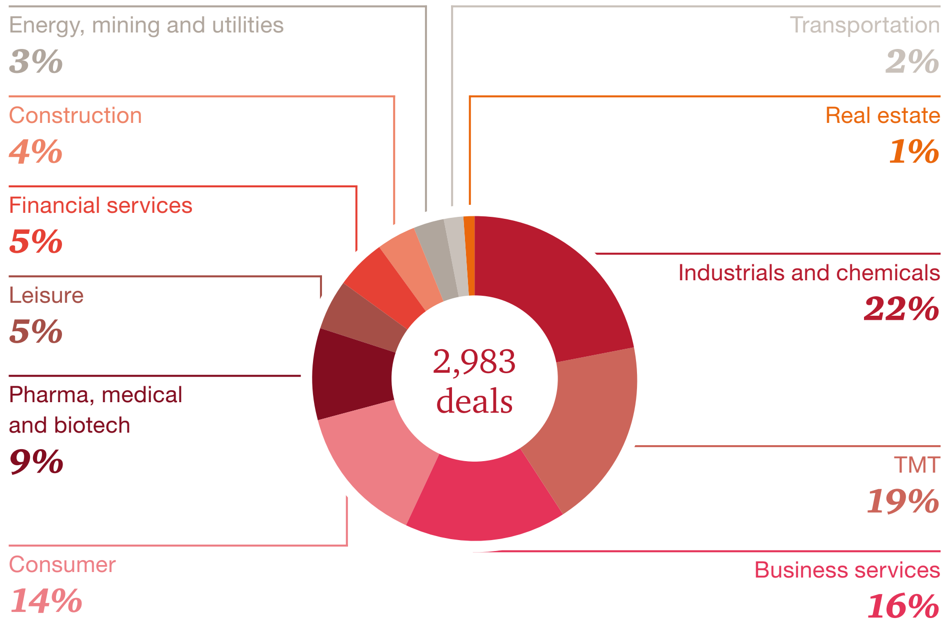
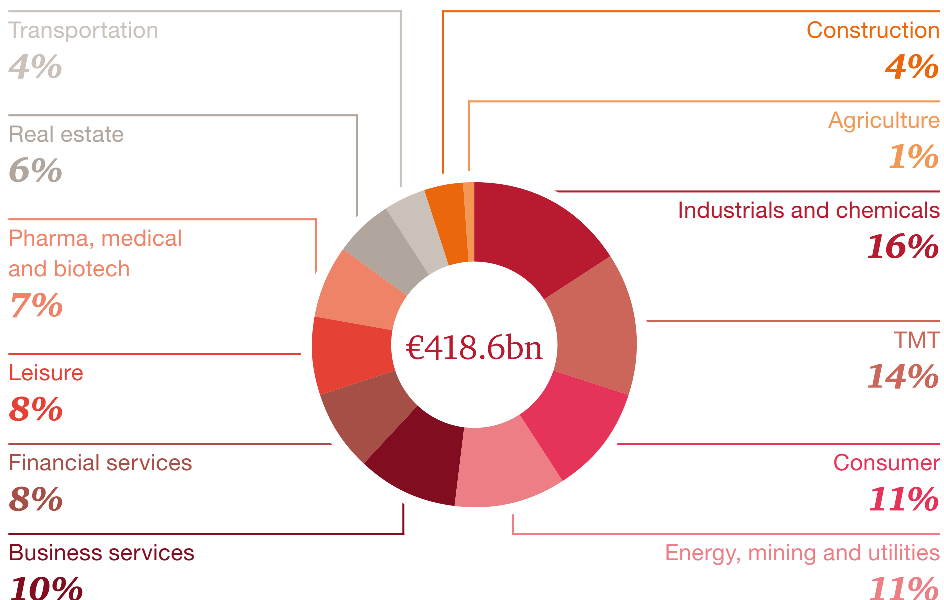


Fig. 65 European Buyout value, split by industry

2013–2016



2017–2018

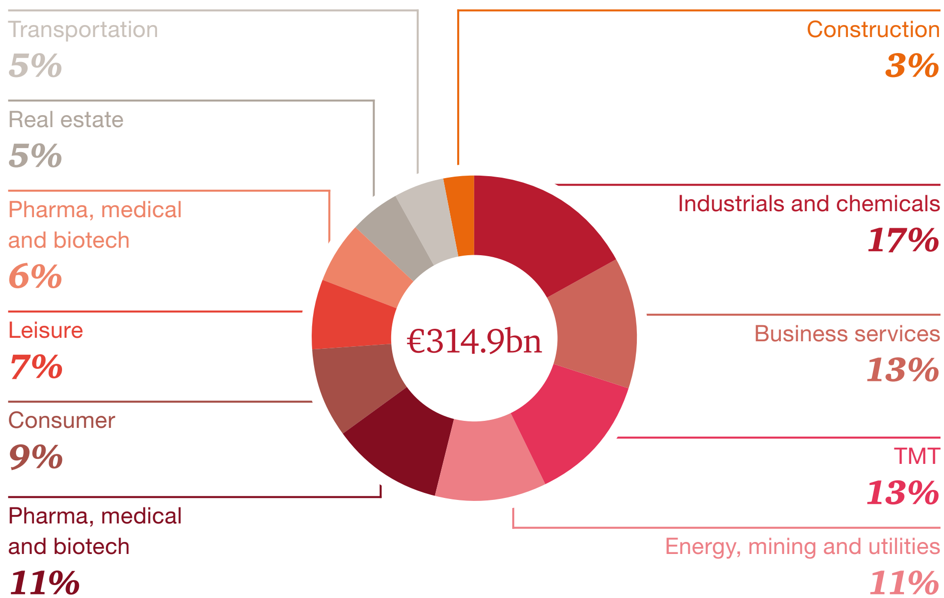
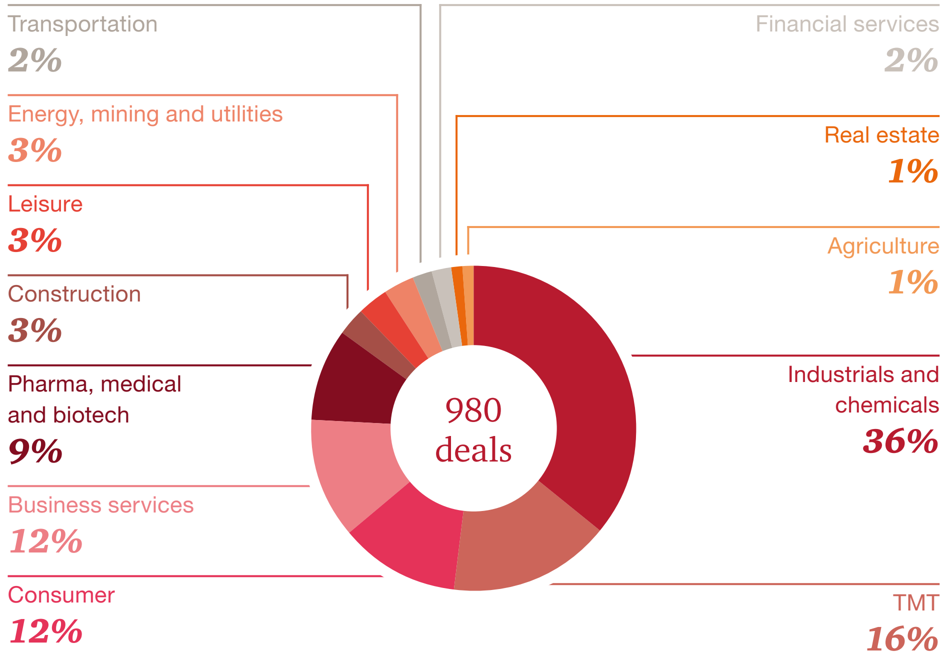


Fig. 66 DACH Buyout volume, split by industry

2013–2016



2017–2018

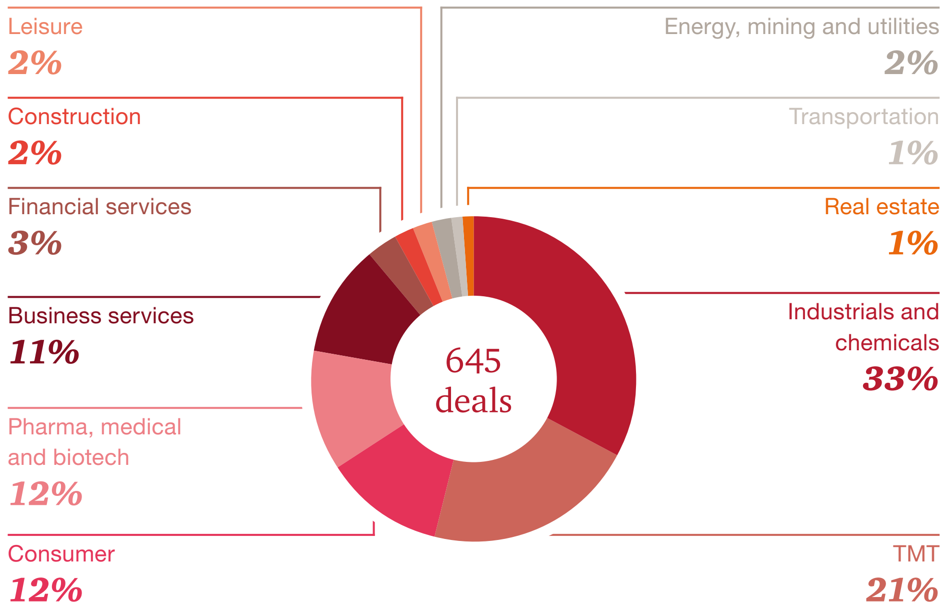
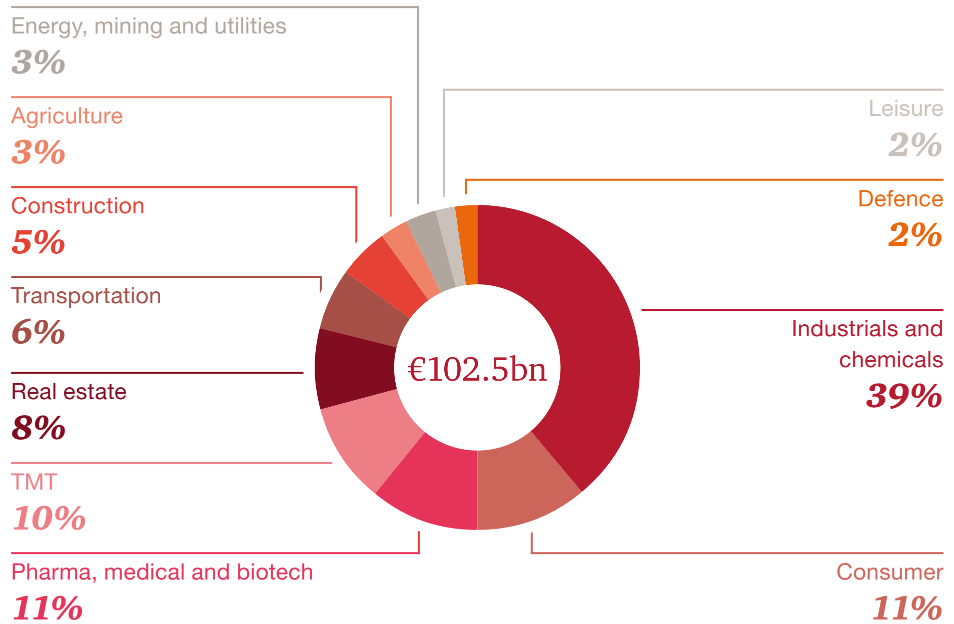


Fig. 67 DACH Buyout value, split by industry

2013–2016



2017–2018

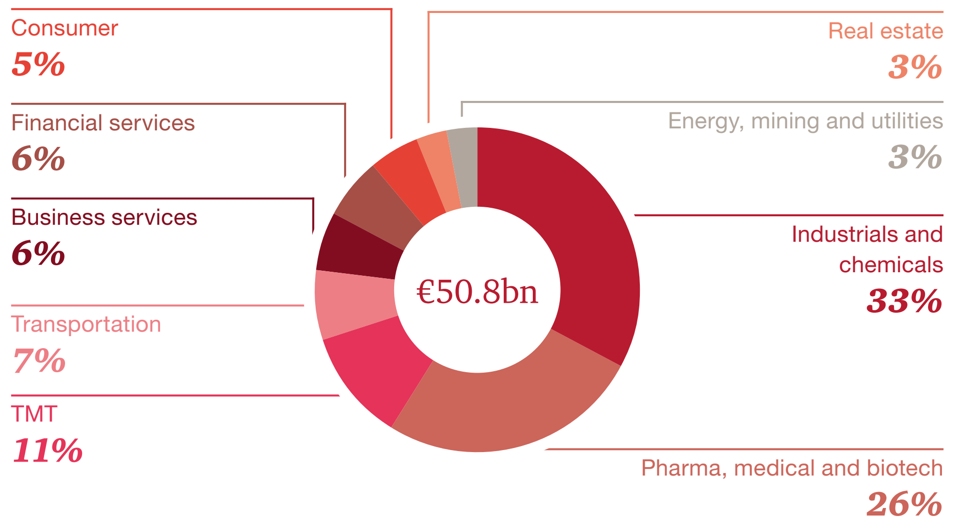


Fig. 68 Benelux Buyouts, Split by Deal Size, 2013–2018

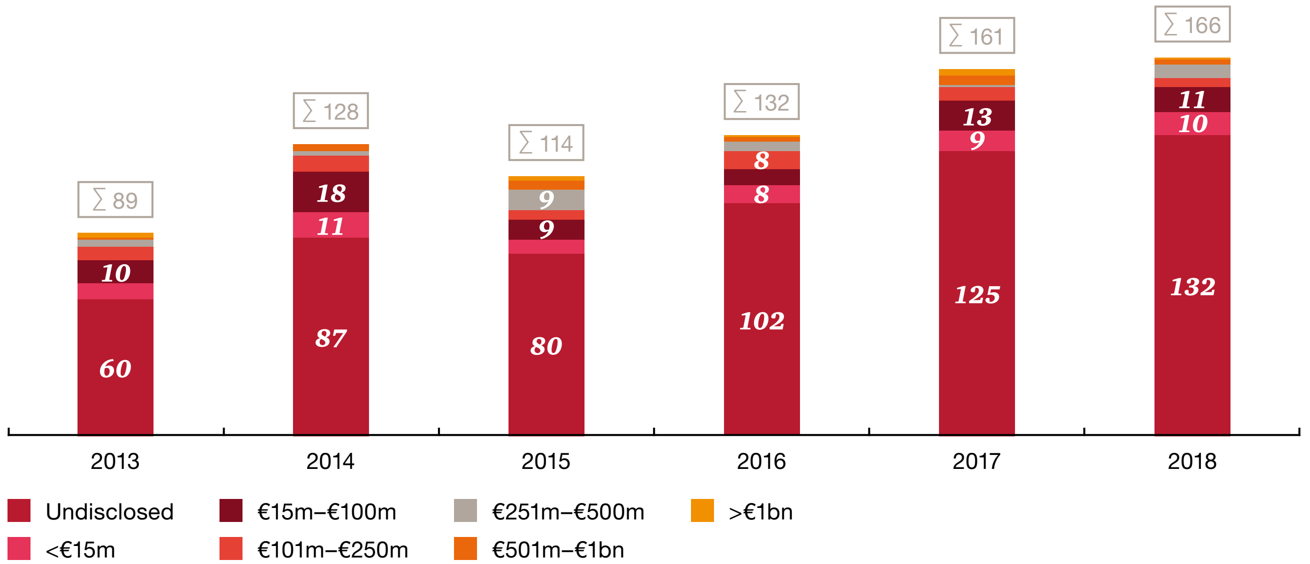
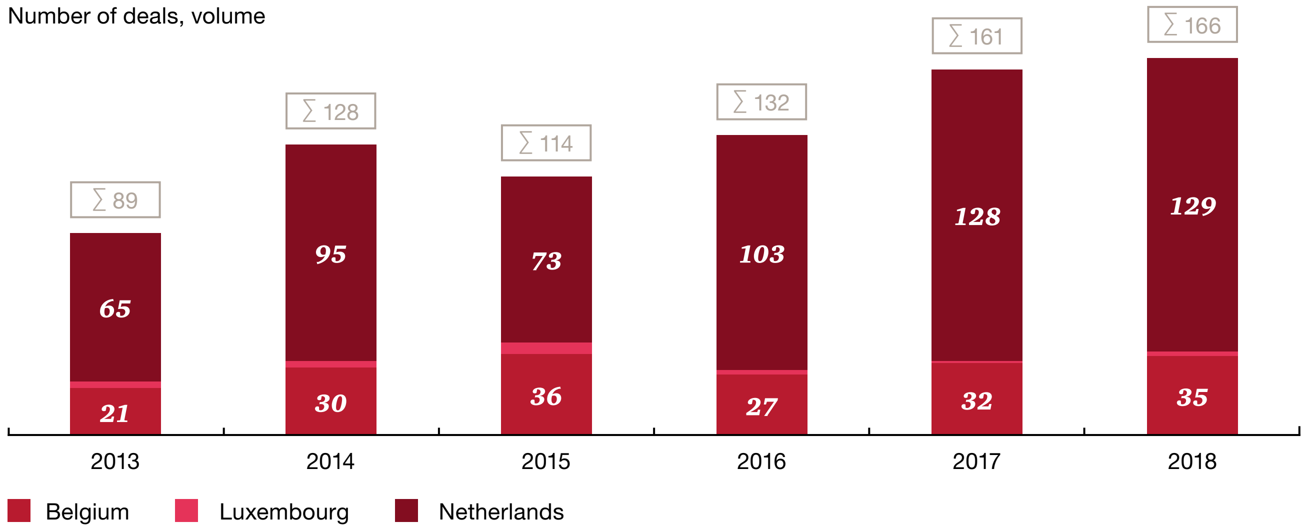


Fig. 69 Benelux Buyout, 2013–2018

Number of deals, volume



Total deal value, €m

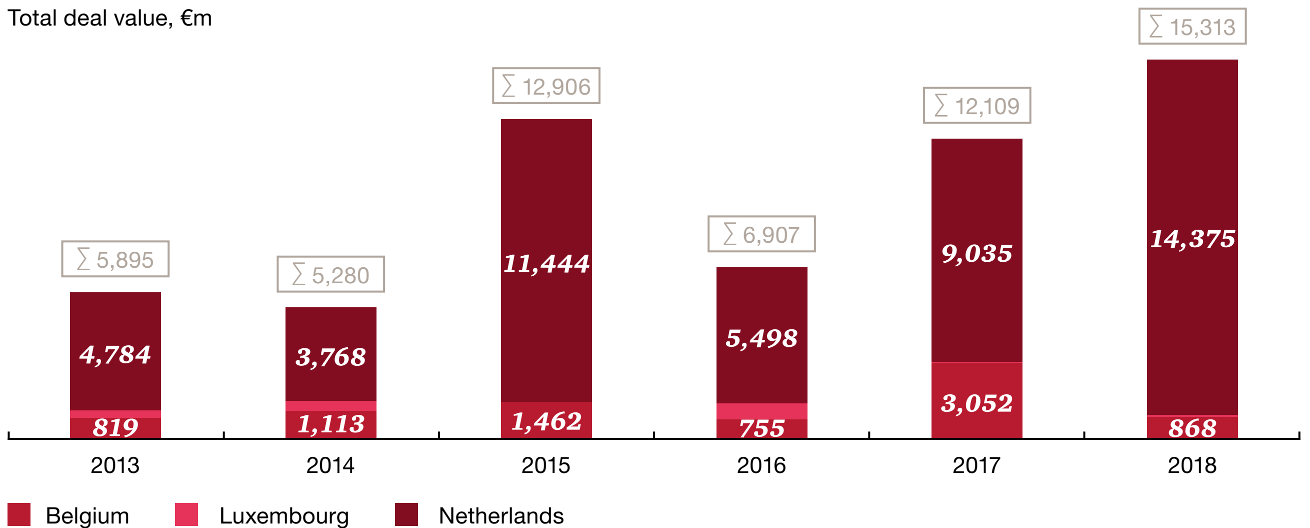
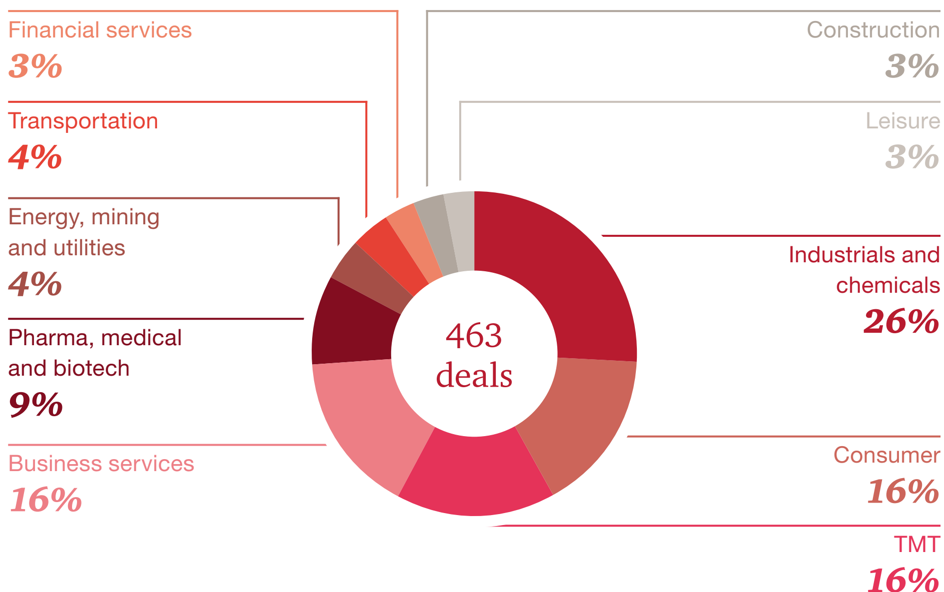


Fig. 70 Benelux Buyout volume, split by industry

2013–2016



2017–2018

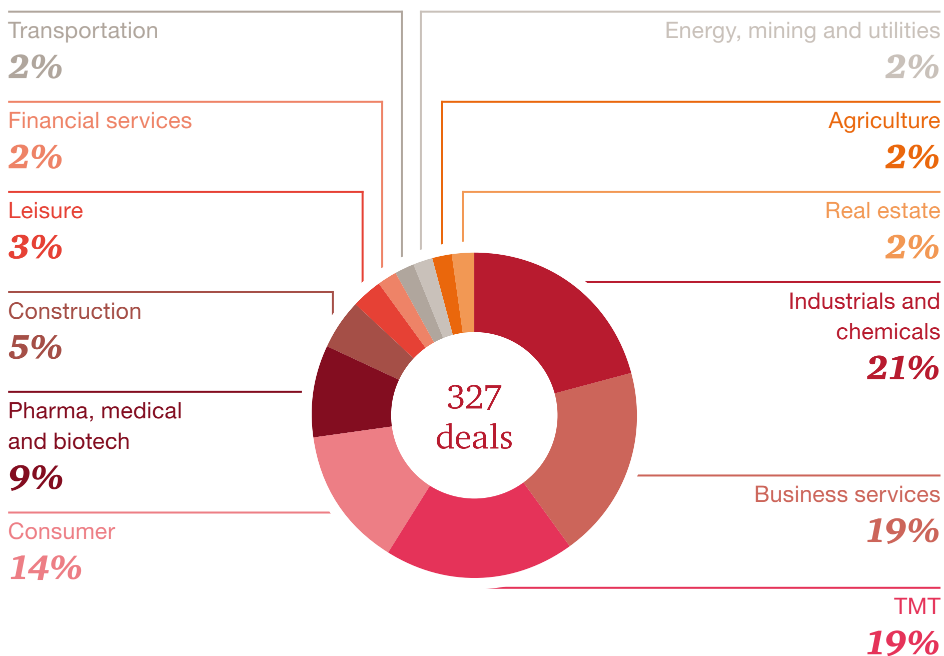
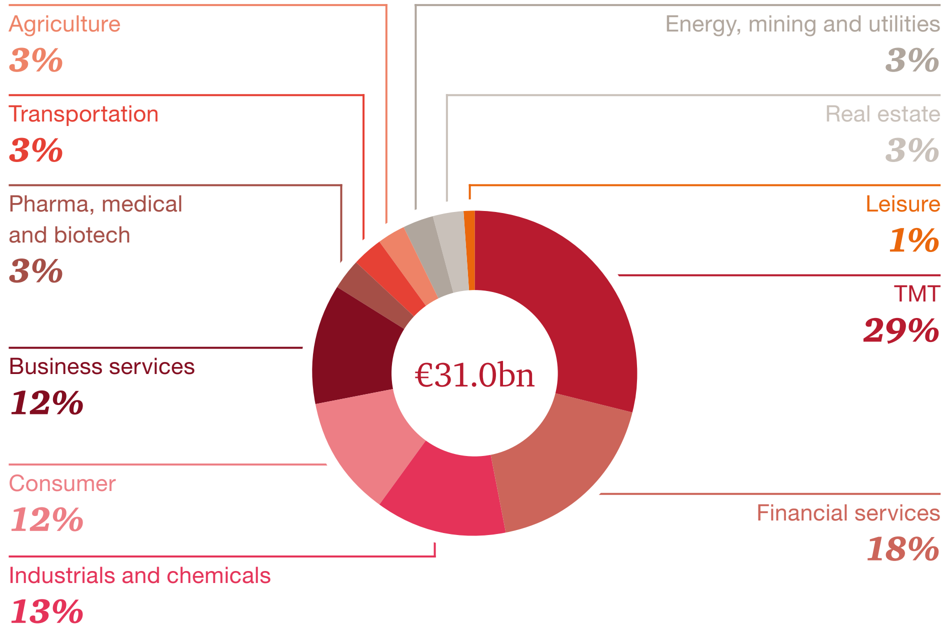


Fig. 71 Benelux Buyout value, split by industry

2013–2016



2017–2018

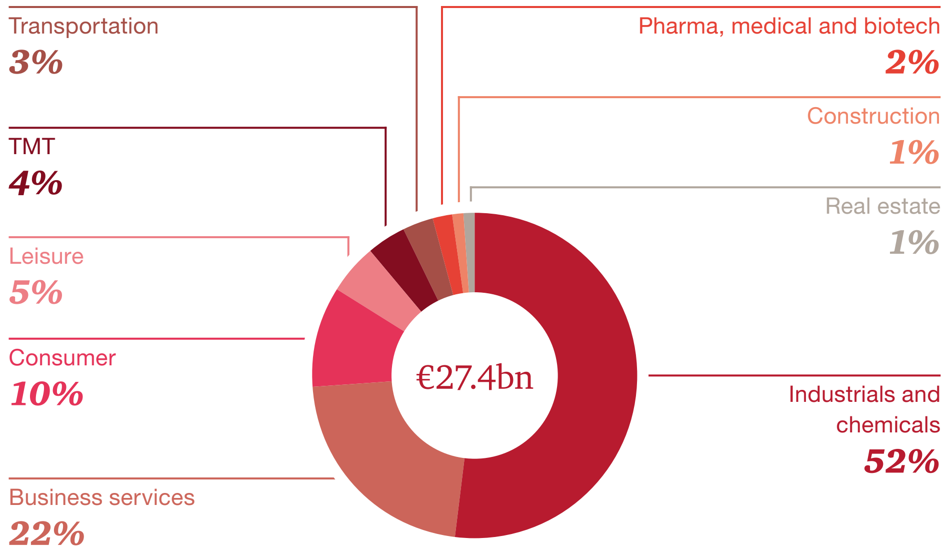
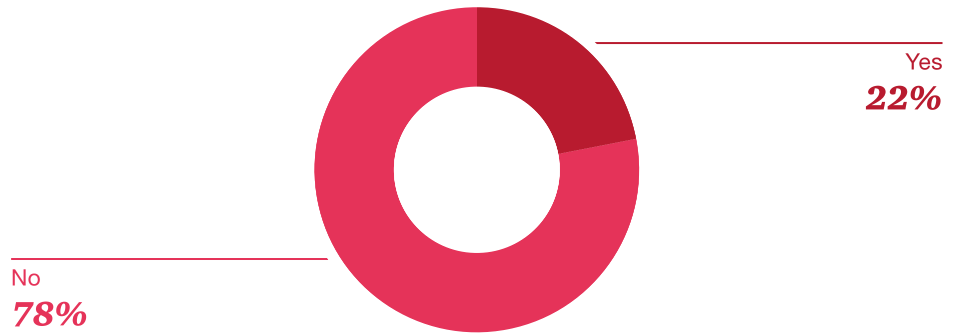


Fig. 72 Do you plan to make any investments in Germany over the next five years? (Please select one option only.)



List of Abbreviations

AUM	Assets under Management
Benelux	Belgium, Netherland and Luxembourg
bn	billion
CAGR	Compound annual growth rate
CEE	Central & Eastern Europe
CEO	Chief Executive Officer
DACH	Germany, Austria and Switzerland
EBITDA	Earnings before Interest, Depreciation and Amortisation
ESG	environmental, social and corporate governance
EU	European Union
GDP	gross domestic product
GP	General Partner
IMF	International Monetary Fund
IPO	initial public offering
LBO	leveraged buy-out
LP	Limited Partner
m	million
M&A	Mergers and Acquisitions
MD	managing director
PE	private equity
Q2	Second Quarter of the Year
Q3	Third Quarter of the Year
Q4	Fourth Quarter of the Year
R&D	Research and Development
SEE	South Eastern Europe
SME	small and medium-sized enterprises
TMT	Technology, Media and Telecommunications
UK	United Kingdom of Great Britain, Wales and Northern Ireland
US	United States of America

Contacts

Steve Roberts
Private Equity Leader
Tel: +49 69 9585-1950
steven.m.roberts@pwc.com

Ralf Ulrich Braunagel
Private Equity Tax Leader
Tel: +49 69 9585-6376
ralf.ulrich.braunagel@pwc.com

Elena Naydenova
Head of Private Equity Business Development
Tel: +49 69 9585-6731
elena.naydenova@pwc.com

Thomas Tilgner
Private Equity Audit Leader
Tel: +49 69 9585-1398
thomas.tilgner@pwc.com

Klaus Bernhard
Private Equity Assurance Leader
Tel: +49 711 25034-5240
klaus.bernhard@pwc.com

About us

Our clients face diverse challenges, strive to put new ideas into practice and seek expert advice. They turn to us for comprehensive support and practical solutions that deliver maximum value. Whether for a global player, a family business or a public institution, we leverage all of our assets: experience, industry knowledge, high standards of quality, commitment to innovation and the resources of our expert network in 158 countries. Building a trusting and cooperative relationship with our clients is particularly important to us – the better we know and understand our clients' needs, the more effectively we can support them.

PwC. More than 11,000 dedicated people at 21 locations. €2.2 billion in turnover. The leading auditing and consulting firm in Germany.