Covid-19 and the world of private equity

Optimism in an uncertain environment

mazars

Introduction

February 2021

We are delighted to present the findings from our global survey of the institutional funding market, covering participants from the private equity and private debt landscape.

This survey was conducted in December 2020 and follows on our report released in June 2020, '<u>Covid-19 and the world of private equity</u>', which captured the sentiment from a pool of investors at the start of the pandemic. The aim of the survey is to understand the challenges and concerns funds are facing, gauge their level of optimism for the future and to understand their strategy for responding to the global crisis. We have compared the views presented in the first edition to current views in order to understand how this sentiment has changed as we navigate through this testing period.

We look forward to hearing your thoughts on the findings. Should you have any questions, please feel free to contact myself of any member of the Mazars Financial Advisory team – <u>additional contact details can be found at the back of this report</u>.

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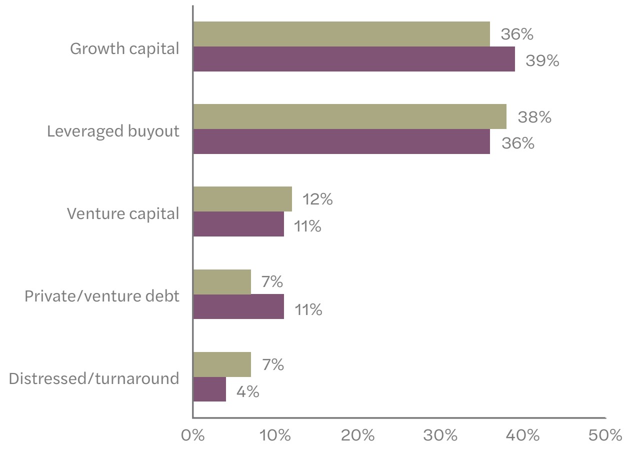
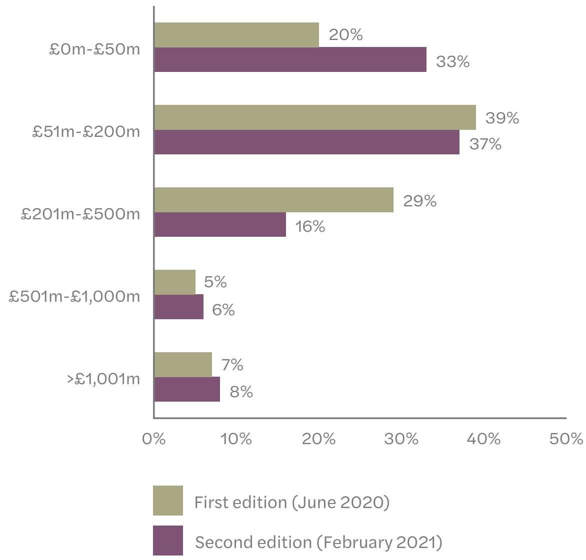
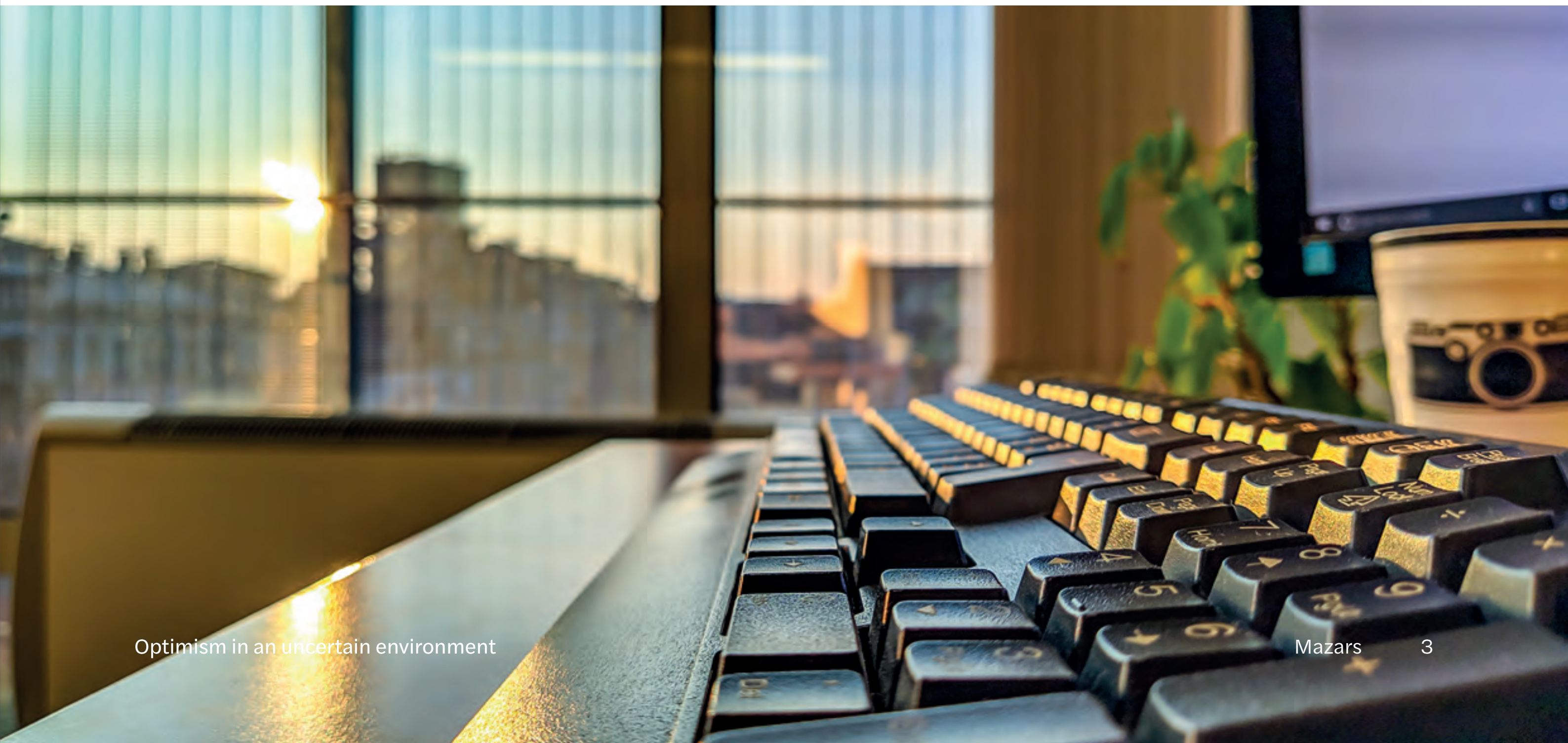
Survey respondents

Similar to the last survey carried out, the majority of the participants were leveraged buyout and growth capital funds, making up a combined 75% of total respondents. Survey participants were primarily based across Europe, with the remaining respondents from Asia and the Americas.

Investors surveyed had a fund size of up to £500m. The most common fund size was £51m-£200m, with the second most common being £0m-£50m. These two fund sizes account for around 70% of respondents.







The first signs of optimism

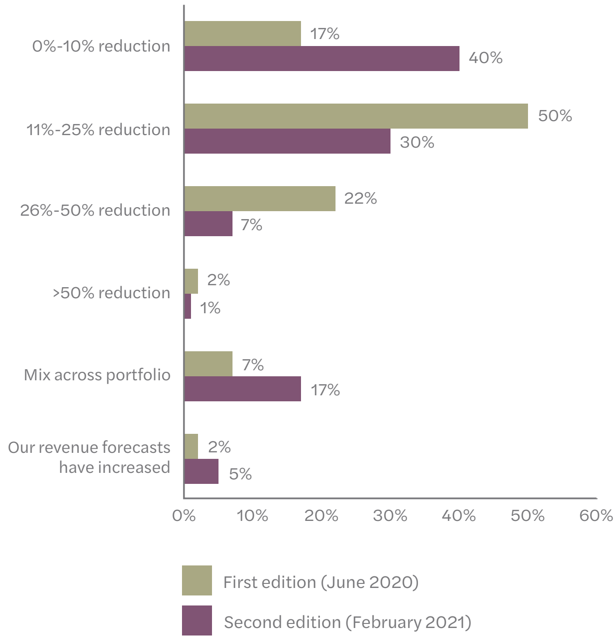
How impacted have the revenue forecasts of your portfolio companies been for the next 12 months?

Further decline in revenues expected, but lower than that experienced in the prior year (2020)

The majority of respondents expect revenue from their portfolio companies to fall over the next 12 months, which is consistent with the sentiment at the start of the pandemic.

30% of respondents expect a fall in revenue of 11%-25%, compared to 50% in our first survey. In addition, 40% of respondents noted that they expect a decline in revenue of 0%-10%, compared to 17% in the first survey. This implies that the overall sentiment has improved with more participants expecting a lower decline than in the prior year. However, the real question from this is whether this means a lower drop in revenue is expected overall, or whether the percentage decrease is simply lower due to a decline in revenue having already materialised in the prior year.

Unsurprisingly, the survey highlights that levels of optimism are largely sector-dependent. For example, a number of respondents commented that they expect their travel and hospitality assets to continue to be adversely impacted in the short to medium term.



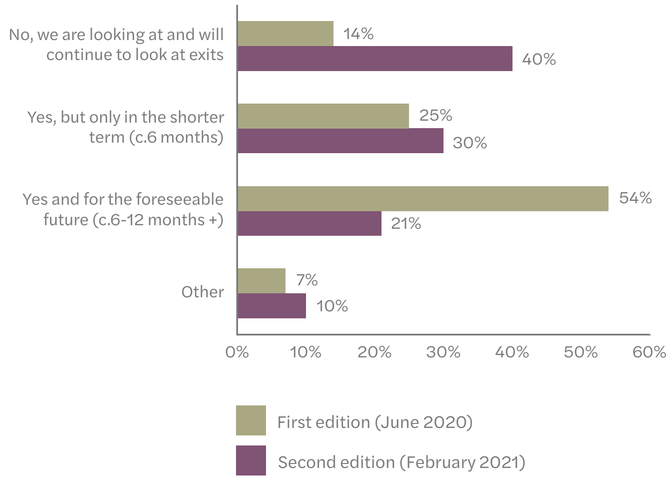
"Our SAAS companies will see increases in revenue, however other companies will bear a reduction"
– respondent from a growth capital fund

Do you think Covid-19 will result in your fund pausing exit strategies from maturing portfolio companies?

Fewer delays on exits expected as funds look forward for the next 6-12 months

In May, 79% of respondents noted that exit timing for their portfolio companies would be delayed. This was unsurprising given that, at the time, 90% of funds were anticipating a fall in portfolio company revenues.

In comparison, 51% of survey respondents now expect to delay their exit strategies, indicating that there has been some increased level of optimism over the second half of 2020, potentially reflecting some of the reduced restrictions towards the end of 2020 and the anticipation of a vaccine rollout in Q1 2021.



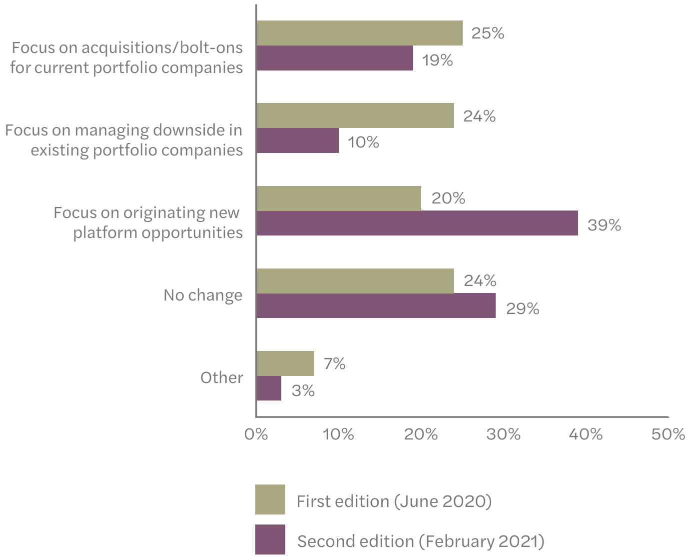
The first signs of optimism

Which of the following best describes the strategy of your fund for the next 12 months?

More focus on new opportunities, both platforms and bolt-ons, with many continuing as normal

There was a broad split of opinion regarding investor focus in the first edition. At the time, 24% of respondents reported to be focusing on managing downside as a priority, compared to 10% at the end of the year. Similarly, 24% had reported that there would be no change in their strategy, compared to 29% currently. The significant shift away from downside protection and portfolio management further illustrates the growing positive sentiment in the market.

This shift in sentiment may well be as a result of lack of deployment in 2019/20, where a number of funds will have expected to invest more but were held back by challenging economic and political backdrops, namely due to Covid-19 and Brexit.



What level of deal flow and activity are you seeing in the current environment?

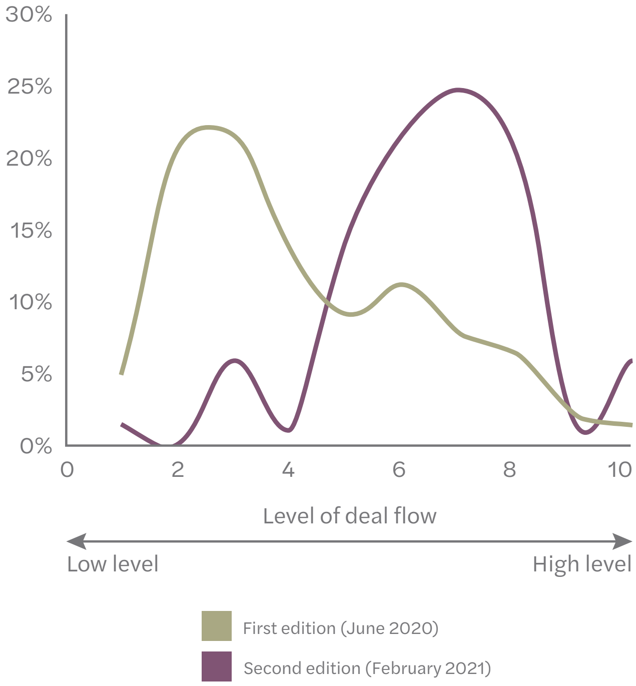
Deal flow seems to have improved, with participants seeing an increase in the number of transactions

Unsurprisingly, there was a significant decline in M&A activity in March 2020, with the majority of respondents seeing a reduced amount of deal flow during the first lockdown.

Despite the uncertain environment, the majority of investors continued to be open to new opportunities. This approach may have supported the considerable increase in deal flow since the last edition. 65% of transactions in 2020 were completed during the second half of the year, compared to 48% in 2019 (by deal value). In addition, transaction values in Europe increased by 5.6% in 2020 when compared to the previous year.*

Looking at the current environment more broadly, this could be driven by a number of factors, including the availability of funds in the market, increased appetite from vendors to de-risk their capital in light of the impact of the pandemic, and other factors specific to certain countries, such as the potential capital tax changes in the UK that could come into force over the next 12 months.

*Source: Mergermarket Global & Regional M&A Report 2020



Private equity are continuing to look at new investments

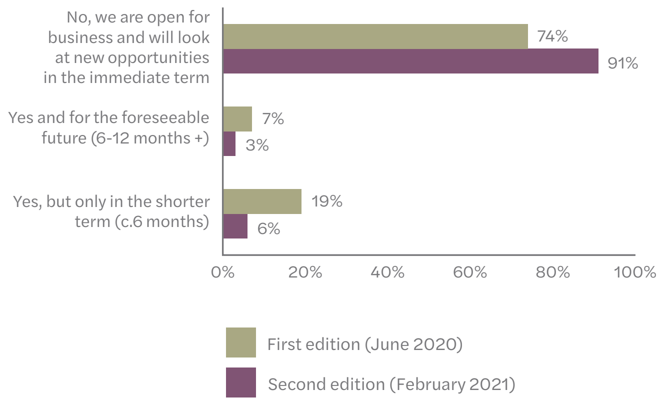
Do you think Covid-19 will cause your fund to cease looking at new investments for a period of time?

An overriding response of 'open for business'

In the last survey, there was a strong consensus of 'business as usual', with 74% responding that they were very much 'open for business' in the immediate term and would continue to look for opportunities to invest in new businesses and scale platforms with bolt on acquisitions.

The general optimism demonstrated in the last edition clearly translated into increased M&A activity in the second half of 2020, with respondents reporting a significant increase in deal flow, as outlined earlier in this report.

91% of surveyed participants are currently looking for opportunities in the immediate term, indicating increased levels of confidence when compared to the last survey.

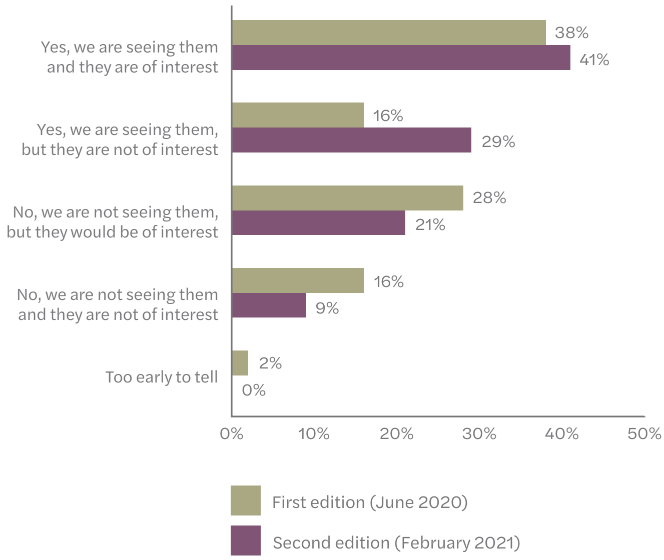


Have you come across distressed or accelerated opportunities due to Covid-19? If so, are these types of opportunities of interest?

More distressed opportunities are arising as the pandemic has continued and government support has started to be withdrawn

A prevailing change from earlier in 2020 is the volume of distressed opportunities coming to market, with 70% of respondents seeing these types of mandates (whether of interest or not). It is likely that this will increase further as government support continues to reduce, with initiatives (such as government backed loans) expected to end soon in some countries.

It is interesting to note that 62% of respondents would be interested in pursuing distressed opportunities, especially given that the majority of respondents are either leveraged buyout or growth funds. This implies there may be some change in investment thesis either from the fund or their portfolio companies to deploy further capital in 2021.



The private equity community has become accustomed to working in this 'new normal'

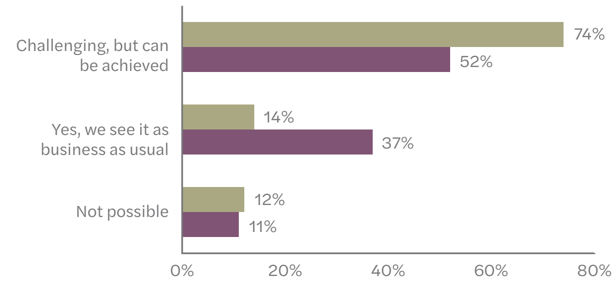
Do you believe it will be possible to complete deals while working from home?

Deals are certainly possible, but the execution is more challenging

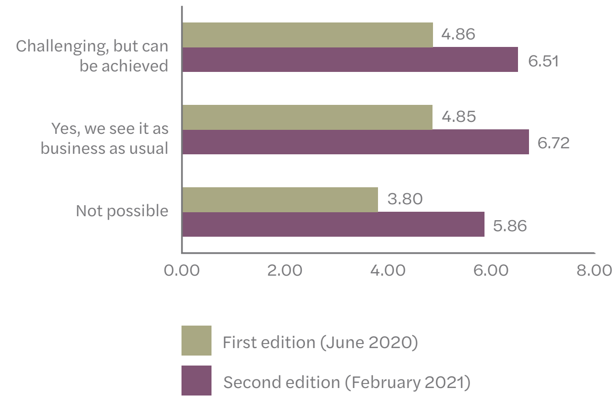
In line with the responses from our initial survey, 89% of investors believe it is possible to complete deals remotely. Some investors even commented that adapting to managing a process remotely has been relatively straightforward. The real challenge has been seen on new transactions where meeting and building a rapport with the management team of a business is often an extremely important initial phase. As we are now going through an extended period of lockdown across Europe, it will be interesting to see if this improves as we all adapt to a longer period of remote working.

Generally, there is an inference that investors have adapted well to the new normal, with 52% of respondents believing it would be more challenging to complete deals remotely compared to 74% in the last survey.

Interestingly, there is some correlation between investor sentiment on successfully completing deals and the level of deal flow they are seeing. Those who answered that it is "not possible" to complete deals are typically seeing a materially lower deal flow, with an average deal flow score of 5.86 (1 being low and 10 being high).



Ability to complete deals vs. outlook for the next 12 months

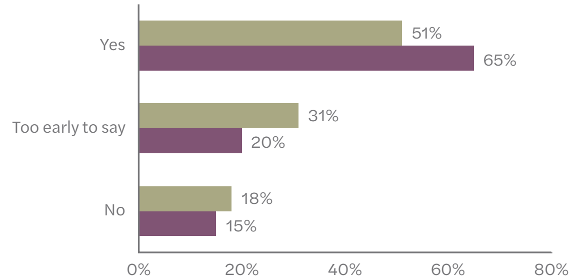


Do you feel your government has responded well to the current situation?

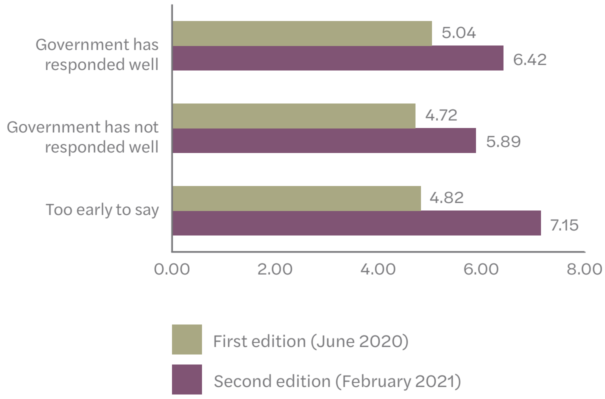
There is a general consensus that governments have responded well with some still unsure of the link between this and increased deal flow

In general, the majority (65%) of investors believe that their government has responded well to the pandemic (vs 51% previously). However, a significant proportion (20%) consider it too early to tell (vs 31% in previously). The percentage of participants stating they felt their government had not responded well fell from 20% to 15%; again pointing to more positivity as the pandemic has progressed.

Those who consider their government to have responded well have a marginally more positive outlook for the next 12 months, with an average score of 6.42 (1 being low and 10 being high), versus an average score of 5.89 for those who consider their respective government to have not responded well, which potentially indicates the lack of correlation between increased deal flow and government performance.



Government response vs. outlook for the next 12 months



Returning to business as usual

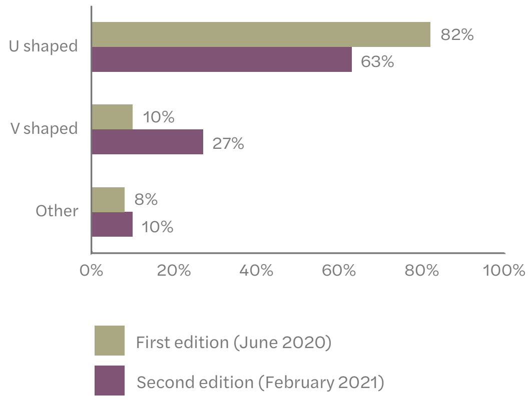
Do you anticipate we will have a V-shaped or U-shaped recovery post Covid-19?

Investors are increasingly expecting a V-shaped recovery

Whilst the majority (63%) of respondents were still anticipating a U-shaped recovery at the end of the year, the proportion of respondents expecting a V-shaped recovery has increased significantly from 10% to 27%. This increase in optimism is likely to be as a result of the successful vaccine trials and expected roll-out of the vaccines from Q1 2021, in addition to the extension of government measures to support businesses in the intervening period.

Other potential recovery types noted by respondents were L-shaped and W-shaped. However, the most common "other" response was a K-shaped* recovery. These comments are in line with those received in the last survey, where respondents suggested that there will be a divergence between sectors, with some such as travel and hospitality facing a deep recession, where more robust sectors will see continued growth.

*A K-shaped recovery occurs when, following a recession, different parts of the economy recover at different rates, times or magnitudes.



What is your outlook for the next 12 months?

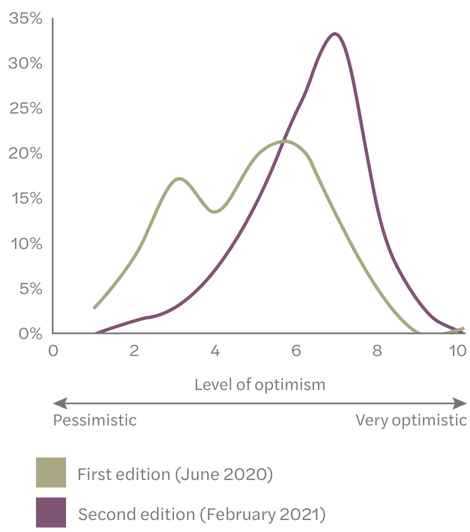
Increased levels of optimism in comparison to earlier in 2020

A key theme throughout this survey has been an increased level of optimism amongst the private equity community. The adjacent graph supports this thesis, with only 4% of respondents reporting a level of optimism of 3 or below, compared to 29% previously.

Similarly, 15% of respondents reported a level of optimism in excess of 8, compared to just 5% in June.

There has been a clear increase in the general level of optimism, with the majority of investors having a 'cautiously positive' outlook for the next 12 months. This is demonstrated by 70% of respondents falling within the 6-8 range, compared to 37% in June.

These responses indicate that whilst there are signs of some continued cautiousness within the private equity market, the majority of investors still have a positive outlook on the next 12 months.



Concluding comments

The confirmation of optimism in an uncertain environment

Although private equity investors continue to face a challenging environment, this survey has confirmed and reinforced a sense of optimism across the private equity community. After the shock of the first lockdown period, investors have again exhibited their resilience and capability to adapt to the uncertain environment.

Investors demonstrated that they were able to quickly adapt to the change in working conditions brought on by the pandemic. Whilst M&A activity was impacted in the short term in early 2020, the relatively smooth transition to remote working, in addition to a generally more positive market outlook, enabled deal flow to pick up considerably towards the end of the year.

The position of the majority of investors surveyed has not changed – private equity firms continue to be actively seeking new opportunities in the immediate term. A significant factor to this will likely be a combination of availability of capital, as private equity funds are behind their deployment timetables, and a potentially more settled political environment.

The main challenge will be whether and how quickly the global economy, supported by boosted confidence from the roll-out of the vaccines, will be able to recover to a pre-pandemic level of activity. For businesses in particularly affected sectors, the timing of any withdrawal of their respective government's support will be crucial to their survival.

We are here to help

As an international and fully integrated firm, Mazars is here to help you and your firm throughout this period of uncertainty. We have over 1,000 financial advisory experts in over 40 countries who have vast experience in advising private equity funds and their portfolio companies throughout the deal lifecycle.

If we can help in any way during this crisis, please do not hesitate to reach out to one of the contacts listed on the next page.

We plan to follow up on this survey to monitor progress. If you have any suggestions on topics or would like to be involved in our future communications, we would love to hear from you.

We are well equipped to carry out transactions while working remotely throughout the pandemic period, having advised on numerous private equity transactions around the world since the start of the crisis.

For more information on these transactions, please visit mazars.com/PEcreds.

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*where permitted under applicable country laws

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