Welcome to our recent analysis of mid-market transactions involving private equity investors. Here we take a look at the PE market including transaction volume, values and key trends. We consider the potential market outlook and explore how, despite a somewhat bumpy two quarters, competition for quality assets means appetite for investment remains strong.

Highlights include:

All UK PE Deal volumes and values fell by a third. While the number of PE deals in the UK market has been much lower, the amount of money available has remained unchanged. This meant competition was fierce for a smaller number of deals. Auctions were really well attended and so prices actually strengthened.

During Q1 2019, we saw deals start to abort because buyers and sellers decided that they couldn’t proceed until the outcome of Brexit was known. As the Brexit deadline approached, European buyers in particular got nervous and started to defer deals. With the recent time extension, some deals could remain side-lined for the next couple of quarters.

Investment appetite remains high in the Mid-Market. What we haven’t seen is a wholesale reduction in confidence. While PE firms are being more cautious, they are willing to bid hard for companies they see as high-value and resilient. Their choice has been either bid hard or don’t bid at all.

Competition continues to raise prices. Factors such as Brexit and US/China trade tensions are driving cautiousness among PE firms, however they continue to bid hard for companies that they see as high-value and resilient, leading to a strengthening of prices.

Bolt-on and minority investments on the rise. Given the amount of dry powder in the market and the general scarcity of deals; strategically, PE firms are expected to remain focused on bolt-on transactions for their existing portfolio companies, as well as continuing to pursue ‘buy and build’ investments. Bolt-on’s have accounted for approx. 50% of all mid-market PE deals over the last four years. Minority stake deals are also expected to gain more traction, already accounting for 20% of all mid-market PE deals this quarter.

Tech convergence across all sectors expected to drive TMT investment. Given the focus that all industries are placing on technology, it is expected that this sector will see substantial growth in PE investment over time. Indeed deal values of mid-market PE investment in TMT increased by 52% in Q1 versus Q4 2018.

We hope that our analysis will help you navigate the market opportunities and make the right strategic decisions in 2019.

Happy Reading,

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* This analysis defines mid-market deals as those with a deal value of between £10m and £300m
**PE investment in the UK gets off to a slow start in 2019**

Total PE investment in the UK declined substantially in Q1 2019, with a 34% drop in deal volume and values compared to Q1 2018, volumes fell 46% versus Q4 2018. While ongoing uncertainty related to Brexit likely played a significant role in the decreasing activity, other market variables also had a role, including a scarcity of high-quality deals which lead to a rise in assets prices as well as increasing concerns related to global trade policies.

**PE investment in mid-market rises, while deal volume drops to five year low**

Compared to other areas of PE investment, Mid-Market PE deals in the UK continued to attract attention from PE investors in the UK over the past few quarters. In Q1 2019, for example, PE funding to UK mid market companies rose substantially, despite a sharp decline in the number of deals to a five-year low of 93. The focus of PE on the mid-market was noticeably higher than on other market segments; mid market companies accounted for 82% of PE investment during Q1 2019, far above the average of 40% of investment seen since 2014.

**Quarterly UK Mid-Market PE Deals (value and volume)**

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**PE investors remain cautious, but willing to make big bets on resilient companies**

Given the amount of uncertainty in the UK market, PE investors in the UK remained relatively cautious with their investments over the past two quarters. Many enhanced their focus on due diligence, particularly related to companies perceived to have higher Brexit risks. This increasing focus on due diligence likely had an impact on both deal volume and transaction speed.

During Q1 2019, the UK market saw some PE deals start to abort as European buyers decided to pause proceedings until the outcome of Brexit was determined.

At the same time, there continued to be strong competition for and interest in companies deemed to have more resilient business models.

PE investors showed a willingness to bid high in order to win the best deals. This led to increased competition and higher prices for strategic growth targets, while others have been unable to attract funding despite the significant amount of dry powder in the PE market.
Investment declines across all key sectors to end 2018

The number of UK-based PE deals declined in both Q4 2018 and Q1 2019 in the UK across most key sectors, with the exception of Energy and Financial Services. Energy-related PE deals volume remained low but steady, while PE investment in Financial Services fell sharply in Q4 2018 before rising slightly in Q1 2019. The number of deals in the Consumer Goods & Retail space dropped considerably in both quarters, reflecting the sector’s vulnerability to Brexit risks – particularly among companies that export or have bricks and mortar locations.

Interestingly, mid-market focused PE investment volumes in each key sector dropped significantly between Q1 2018 and Q1 2019, whilst deal values were down, they were less impacted, down just 2% in Q1 2019 versus Q1 2018. Sectors seeing the highest deal values in Q1 2019 versus Q1 2018 were Financial services, Healthcare, TMT and Energy. The increasing investment values in tandem with declining deal volume suggests a smaller number of large deals in keeping with trends seen more broadly in the UK market.

UK Mid Market PE volume by sector

The Technology, Media, and Telecoms (TMT) sector saw increasing interest from PE firms in recent quarters, in part due to the convergence of all sectors with technology. Almost every sector has been experiencing a technology renaissance, with interest in areas like fintech, healthtech, autotech, and others growing very rapidly. The increasing focus on TMT companies was apparent in Q1 2019, with four of the UK’s top middle market deals focused on companies in the space.

The growing interest in using technology in order to refresh, scale, or expand products and services will likely continue to drive PE interest in the TMT sector in the UK regardless of market uncertainties.

Future Outlook

Looking to the months ahead; while volumes may continue to soften as vendors wait for economic and geo-political uncertainty to clear, private equity investors will still be keen to put their war chests to work for the right opportunities.

With the Brexit can kicked further down the road, there’s a likelihood that those who have retrenched into ‘wait and see’ mode, will remain in this holding pattern for the next six months at least, or perhaps even until the end of the year.

In the meantime however, private equity teams will remain hungry to invest in those quality businesses that have a compelling growth story, that are backed by strong management teams and which have the focus and confidence to overcome wider market uncertainty. And they will be prepared to pay significant multiplies in doing so.
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