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M&A OUTLOOK 2025

PRIVATE EQUITY LEADERS SEE OPPORTUNITIES DESPITE MARKET HEADWINDS

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In October 2024, BZ hosted an exclusive roundtable in London, bringing together private equity leaders and senior advisors to explore the evolving M&A landscape heading into 2025.

Despite a contraction in deal volumes in H1 2024, total deal values have risen. With the implications of the UK autumn budget and continued macroeconomic uncertainty top of mind, the roundtable offered valuable insights into how market participants are adjusting their strategies and identifying emerging opportunities.

This report distils key insights from the roundtable discussion and outlines strategic considerations for market participants. It highlights essential themes such as deal activity and market sentiment, evolving trends, potential implications of the Chancellor's Autumn Budget Statement, and an outlook for 2025.

Thanks to our expert panel for your contribution:

Tom Callaghan, Endless LLP (TC), **Henry Gregson**, Acorn Capital Management (HG), **David Jolly**, Weight Partners Capital (DJ), **Calum MacEwen**, Cap10 Partners (CM), **Alastair Mills**, HIG Capital (AM), **Randal Pringle**, Rothschild & Co (RP), **Valentina Vitali**, Limerston Capital (VV), **Alistair Wood**, Deutsche Numis (AW)

Left to right:
Alastair Mills, Henry Gregson, Duncan Maybury, Alistair Wood, Cem Yaslak, Tom Callaghan, Valentina VitalI, Alex Hall, Calum MacEwen, Randal Pringle, Rob Wakeford

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1. EXECUTIVE SUMMARY

PRIVATE EQUITY NAVIGATES MARKET DYNAMICS

Financial Environment

- Deal values were reported to have risen 5% in H1 2024 despite volumes falling by 25%
- Financial sponsor deals were said to be down 34% with corporate deals down 18%
- UK inflation has dropped to 1.7%, with roundtable participants anticipating interest rate cuts in early 2025
- The UK mid-cap market shows promise after 40 months of continuous equity outflows
- Private credit funds have gained market share from capital markets, with one participant signalling that spreads were being compressed by approximately 150 basis points
- Continuation funds have emerged as crucial alternatives to traditional exits, with a major player said to have raised $16 billion for this market
- Debt pricing has improved significantly over the past 12-13 months, with all-in rates highlighted at <9%

Strategic Market Shifts

- Increased focus on operational value creation over financial engineering
- Greater emphasis on sector selectivity, with healthcare showing resilience while consumer sectors face headwinds
- Private equity firms building specialist teams in pricing, data, and supply chain management
- Growing attention to legislative changes, particularly around labour protection and government funding arrangements
- Movement from the post-COVID bull market of Q2 2021-mid 2022 to a more normalised market environment
- Impact of structurally higher UK tax rates on investment returns

2. DEAL ACTIVITY AND MARKET SENTIMENT

Current Market Dynamics

The roundtable discussion revealed a complex and evolving deal landscape in 2024, where deal values are rising despite a decrease in volumes, indicating a flight to quality.

Cem Yaslak, Regional Director – London, BZ (CY): "In H1 2024, the value of M&A deals rose by 5% compared to the same period in 2023 though transaction volumes fell by 25%. Interestingly, financial sponsors saw a 34% decline in the first half of 2024 compared with the previous year, while corporates experienced an 18% decrease. Meanwhile, around 15,000 portfolio companies are held globally by PE sponsors for four years or longer, which presumably have to be exited at some point."

Diverse Perspectives on 2025

As participants contemplated the year ahead, they expressed a mix of cautious optimism and practical concerns regarding market recovery. Several noted that current conditions might necessitate action, regardless of the overall economic sentiment.

TC: *"It can't get much slower than it has been. The market can't be supressed for too long as private equity funds have to make exits to raise new funds, given LPs are currently very focused on capital return."*

VV: *"Much depends on what happens in the budget at the end of the month. While the outlook doesn't look particularly rosy, it is still uncertain."*

DJ: *"Whichever way the budget lands, at least there will be more clarity. This should spur increased activity, though the impact on valuations remains uncertain."*

Economic Context and Market Behaviour

Participants explored broader economic considerations, with participants debating whether the focus on macroeconomic conditions was helping or hindering deal activity.

HG: *"Private equity should stop fixating on the economic environment and focus on their core mission: sourcing, executing, managing, and exiting deals, irrespective of market conditions. The economic outlook is broadly positive, with early signs of interest rate cuts on both sides of the Atlantic. The UK's inflation drop to 1.7% suggests another rate cut by the end of Q1 2025, which could stimulate deal activity through cheaper debt availability."*

AM: *"The market's current hesitancy is puzzling compared to the post-COVID recovery. While the initial deal focus was on sectors showing clear benefits, activity broadened significantly across all sectors except consumer. The UK's position has strengthened relative to other major European economies, presenting attractive opportunities, assuming the autumn budget avoids major disruption."*

Post-Pandemic Market Analysis

The conversation shifted to examining how market fundamentals have evolved since the pandemic, with particular attention to capital flows and structural opportunities.

CM: *"Market dynamics are fundamentally driven by liquidity and capital availability. The UK mid-cap market remains structurally underfunded after 40 months of continuous equity outflows, creating clear opportunities. As a new fund without legacy positions, we're in an advantageous position as pure buyers in this market."*

Exit Market Conditions

Participants noted observations about the improving environment for exits, particularly when compared to the challenges faced in the previous year.

AM: *"Our experience on the sell-side has markedly improved in 2024 compared to 2023. While last year's market conditions made exits challenging across our portfolio, we've successfully completed three exits this year, with each process following a more normalised pattern and attracting sufficient buyer depth. These were quality assets that demonstrated consistent trading performance, without facing any significant impediments to completion."*

Valuation Challenges

The discussion focused on the interplay between interest rates, multiples, and return expectations, revealing how market participants are adapting their strategies.

TC: *"The fundamental issue is you can't change what you pay for a business. The debt markets a few years ago supported much higher multiples than they do now. Until interest rates decrease, this will continue to impact the multiples buyers are willing to pay."*

CM: *"The mainstream private equity strategy over the past 15 years has been primarily growth-focused. As PE's share of institutional investors' portfolios has grown, so has the available liquidity in mid-market, upper mid-market, and large-cap PE. This increased demand has driven up multiples. Historically, investors paid premium prices for quality businesses because they could count on achieving similar or higher multiples at exit. This was largely driven by central bank monetary policy and the superior returns PE could offer compared to public markets. However, these macro dynamics are no longer present where we stand today.*

This may represent a structural shift back towards an operational value creation model in PE. In the current macro environment, private capital allocators need to focus on operational improvements, business repositioning, and creating fundamental value – rather than relying on capital supply dynamics. The key question remains: "what happens to those firms who've relied on the 'buy high-quality assets and hope for multiple expansion' strategy for the past 15 years?" They may lack the operational skill sets needed in this new environment."

RP: *"We have a significant pipeline of expected launches. We initially anticipated a number of these to happen this year, but they're being pushed back."*

AM: *"What are the main factors causing these delays? Is it driven by your advice, or are the clients themselves saying they're not ready?"*

RP: *"Interestingly, there's rarely a single reason. It's typically a range of factors: slightly weaker trading, the valuation expectations we discussed, and varying levels of pressure from sponsors to exit. The pipeline continues to grow because of those delays, albeit we are starting to see some movement."*

3. MARKET EVOLUTION

As private equity firms navigate challenging market conditions, innovation in exit strategies has become increasingly critical. The emergence of continuation funds and evolution of debt markets are creating new opportunities for portfolio management.

AM: *"There's this dynamic around continuation funds which is relatively new. It's a release valve for private equity firms who are nervous about putting assets into the market. There's huge amounts of money raised, and while it focuses purely on the private equity market, it provides an option for those nervous about market valuations. One advisory firm has raised something like $16 billion to focus on this market, so it's not small change."*

Debt Market Evolution

The lending landscape has undergone significant changes, prompting a detailed examination of how both private credit funds and traditional lenders are adjusting their approaches.

RP: *"From a debt perspective, there's definitely appetite to support deals and good levels of competition from lenders. We've seen significant improvements in pricing and terms over the past 12-18 months, though it's primarily focused on high-quality assets."*

CM: *"Private credit funds took significant market share from capital markets due to committed capital availability and ability to execute larger, more flexible deals. They raised significant funds during that exceptional deployment period. They're now under deployment pressure across the board which has compressed pricing."*

Market Reset and Value Recognition

Participants explored the necessary conditions for market normalisation, acknowledging that some difficult decisions may need to be made to move forward.

DM: *"No-one really wants to recognise a loss. To bridge the valuation gap, there needs to be a push to kick-start this process. You've gone through an extended period of flipping assets relatively easily over a shorter period. This is a phase where you need to work harder, probably need to hold assets for longer, and a reset may be necessary to start recognising some of these losses. This could mark the beginning of a 'new normal' moving forward."*

Sector-Specific Considerations

The roundtable examined how different sectors are performing in the current environment, with particular focus on consumer-facing businesses and healthcare.

DJ: *"We focus on consumer and healthcare sectors, but there's been a shift in appetite. Consumer has fallen out of favour – not just from rising rates, but from online competition, COVID, and squeezed cost of living."*

AM: *"From my perspective, there's more product available for consumer assets now, albeit from a low base. This is especially true in travel, which was non-existent six months ago. There are also experiential businesses, which despite being somewhat 'me too', performed well before summer, although results were mixed."*

DJ: *"I agree, especially regarding travel and consumer financial services, which have stayed resilient. Generic high street pubs or hotel chains are still challenging."*

CM: *"Many sectors are still feeling COVID's aftershocks, particularly in global supply chains where ripple effects are creating too much uncertainty for investors. Certain industrial and medical supply chains are still de-stocking, affecting fundamentally good businesses. Near-term revenue volatility remains high, making investment challenging. However, some sectors have stabilised and become more predictable. It's about being able to estimate near-term developments with reasonable probability."*

Facility Terms and Lending Appetite

The discussion turned to practical considerations about debt facilities, with participants seeking clarity on current market terms and lender preferences.

TC: *"How are maturities looking currently, and what's the lending appetite for the next term?"*

RP: *"The tenor of new facilities hasn't changed materially - you're typically looking at 6 to 7 years unless specifically requesting shorter terms. Direct lenders show a strong appetite to follow their portfolio investments, which often yields more competitive terms. Banks show similar tendencies but are more restricted in the terms they can offer. For lenders, it makes more sense to follow assets with proven track records within their portfolios rather than take new risks in the current market. Overall, the outlook is quite positive."*

4. UK BUDGET AND TAX OUTLOOK

As the government grapples with a potential £40 billion fiscal adjustment, private equity leaders face significant policy uncertainty. The anticipated shift in the tax burden toward UK businesses is already influencing deal timing and investment strategies. Amid widespread market pressures and unique challenges, roundtable participants discussed their perspectives.

CY: *"There's been a lot of crystal ball gazing in terms of what might happen in the Autumn statement. The FT last night indicated that the Chancellor needs to raise as much as £40 billion through a combination of tax and spending cuts, and it increasingly sounds like most of that tax burden is going to fall on businesses. How are you, if in any way, preparing for this event? Has it impacted your business and your plans going forward?"*

Operational Impacts and Labour Costs

Participants shared insights into how potential policy changes could affect their portfolio companies, particularly those with significant workforce considerations.

VV: *"Decisions made in the Autumn statement may impact the deals pipeline, as well as impact portfolio exits. We are hard at work to ensure our companies maintain strong performance in the current market."*

Labour Regulations and Healthcare Sector Impact

Changes in labour regulations and healthcare policy could potentially create specific challenges for businesses.

DJ: *"Our businesses often employ large pools of staff, so the new legislation around labour protections will impact our businesses significantly. If we get rid of zero-hours contracts, that will be particularly challenging for retail, leisure and healthcare. We're seeing healthcare businesses rushing to lock in any government funding arrangements contractually before the budget, in case those get thrown up in the air. We could see a shift in bias away from private sector providers back towards public providers, at least until it becomes clear that doesn't work - which is what happened last time."*

Political Climate and Market Sentiment

These challenges are occurring against a backdrop that has often been described as 'VUCA' in nature; an environment that is Volatile, Uncertain, Complex and Ambiguous.

TC: *"We were at an event the other day where an ex-political advisor was saying that the current government has done a poor job of talking the UK economy down without doing anything about it. It appears that it has really hurt consumer confidence. Looking at consumer sentiment surveys, there is negative sentiment across the board. The government has a lot to do to inject that confidence and momentum back into the UK economy."*

Market Timing and Deal Flow

The immediate response to these pressures is evident in current deal activity.

AM: *"We have seen a number of transactions this year where the certainty of the current tax environment became an increasingly important deal driver as the process advanced. It was not the primary catalyst behind the launch in most instances but the ability to sign and close before the end of October, locking in current tax rates, has been a more significant feature as the year has progressed."*

TC: *"It has been a helpful deadline, hasn't it? Artificially, it has driven activity that might have otherwise drifted to Christmas or next year."*

Cross-Border Tax Implications

Beyond immediate deal pressures, structural changes in taxation are reshaping investment calculations.

CM: *"We now have a structurally higher corporation tax rate in the UK, which creates a significant reduction in the levered-free cash flow yield that you can make on a target absent a reduction in price. Fundamentally, you're getting less cash flow from all your investments than you were two years ago. And if you look at your levered-free cash flow yield, you've got to price your equity accordingly - that's how we look at the world. That has to have a mechanical impact on the price at the top line. I don't think people have necessarily factored that in. You have significant variance across different European economies as well. In Ireland, there's very little corporation tax rate - obviously, that's likely to change. Where there are noted differences in valuation multiples by geography, the tax environment typically has a large part to play."*

Government Policy and Investment Environment

The uncertain business environment in the UK and looming US election, are creating concerns about future business conditions and investment returns.

HG: *"In Europe, I think we're all waiting to see what the result of the US election will be. In the UK, despite the rhetoric from the government, I think it's going to be a less friendly business environment, unless we see something unexpected in the budget on the 30th. I come back to the point that a private equity fund ought to be able to find, transact, and exit deals in more or less any environment. What I do not see is any of the benefits of the government's alleged business-friendly policies. I only see increased taxation on business and individuals. Why would you take a risk when your capital gains tax rate might be 40% or 45%?"*

Growth and Valuations in a Higher Tax Environment

Participants discussed the practical implications of increased taxation on business operations and investment decisions.

HG: *"It simply affects valuations. If a company faces higher taxes, cash flow is lower, so valuation drops. Take my engineering business – two years ago, we were heavily investing in capital equipment because of tax write-offs. It made sense to invest in expensive, automated machinery. That's all gone now, so we've reduced investment."*

Stressed Opportunities

The conversation turned to examining current market stress points and how different players are responding to challenging situations.

AM: *"To some extent, yes. With less cash flow and tighter margins, we're seeing some stress. Our sister fund backed Interpath, formerly KPMG's restructuring business, in mid-2021. There was an artificial lull in the insolvency space for about 18 months - you couldn't even put businesses into administration. Now we're back to normal market levels, though I expect it to increase. It's a contrast to my more optimistic outlook for conventional M&A."*

RP: *"There have been some cases in the news, especially with assets still stressed from COVID. Where there's been no improvement and no clear exit path, lenders' hands are being forced. But most are still wary of damaging sponsor relationships."*

5. OUTLOOK 2025: THE ROAD AHEAD

Despite prevailing market headwinds, the evolving landscape offers strategic opportunities for agile investors. The roundtable discussions revealed a transitioning market, with successful firms shifting focus from multiple arbitrage to operational value creation. New financing structures and continuation funds are providing added flexibility for deal-making.

Several key trends shaping the M&A and private equity landscape as we head into 2025 were highlighted. While deal volumes remain subdued, participants expressed cautious optimism about improving market conditions, particularly in the UK. This optimism is tempered by a pragmatic approach, as firms strengthen their operational capabilities.

The rise of continuation funds and evolution of private credit markets are creating new opportunities, though fiscal uncertainty and potential tax changes remain key concerns. The UK Autumn Statement, in particular, could significantly impact investment strategies and deal structures. Despite these challenges, there was broad agreement that experienced investors can find ways to create value across market cycles, with several participants noting an increase in pipeline activity.

While 2025 may not replicate the exceptional conditions of recent bull markets, roundtable participants expressed measured optimism about the opportunities on the horizon. The market's evolution toward operational value creation, aligned with a robust asset-based lending sector, supports a dynamic and sustainable private equity landscape. This close alignment creates a strong platform for those ready to adapt in a changing environment.

Positive Market Indicators

Key factors supporting improved conditions through 2025:

- Expected interest rate cuts in early 2025, with UK inflation already dropping to 1.7%
- Substantial pipeline of deals postponed from 2024 coming to market
- Growing appetite from debt providers, with improved pricing and terms
- Increasing acceptance of continuation funds as viable exit alternatives
- Opportunities in UK mid-market after 40 months of continuous equity outflows
- Emerging opportunities in sectors showing post-COVID recovery

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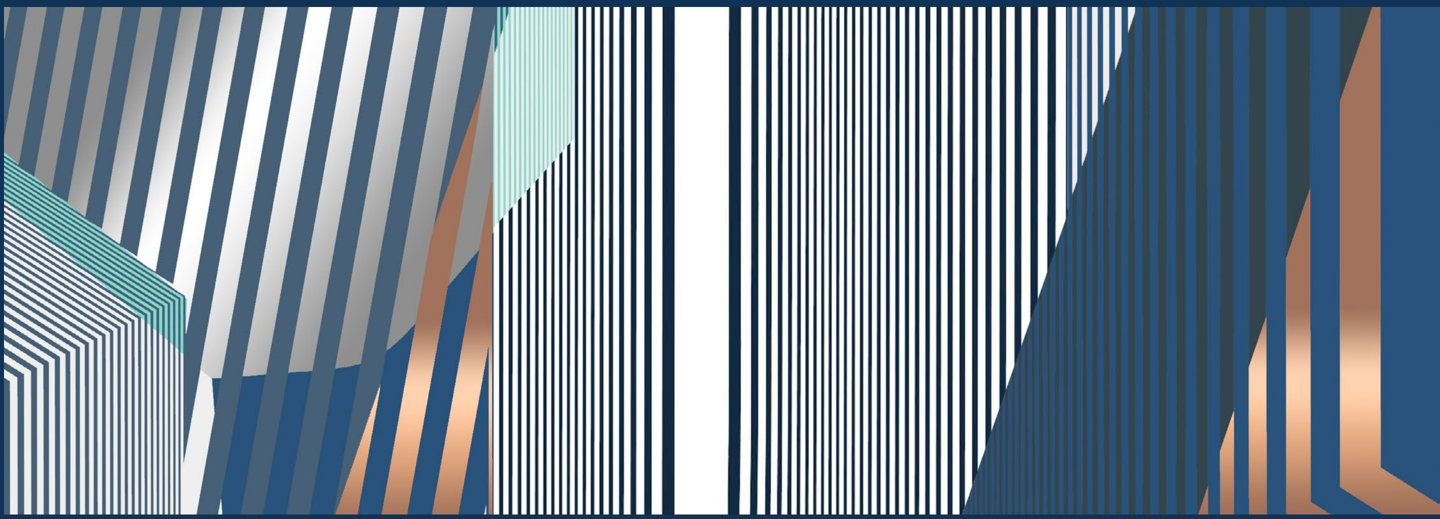

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