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2022 European Private Capital Outlook: H1 Follow-Up

A midyear assessment of our PE and VC predictions

PitchBook is a Morningstar company providing the most comprehensive, most accurate, and hard-to-find data for professionals doing business in the private markets.

2022 predictions

These predictions were taken from our 2022 European Private Capital Outlook published on December 14, 2021. We have provided an H1 2022 update in this publication.

Dominick Mondesir
Senior Analyst, EMEA Private Capital

Prediction: At least 15 companies that have been through a SPAC merger will be taken private by sponsors in 2022.

Rationale: Hundreds of special purpose acquisition companies (SPACs) have produced disappointing returns for investors and are performing poorly in the liquid markets, which is breeding opportunities for sponsors through take-privates. The SPAK ETF illustrates the lacklustre performance of SPACs, having returned -14.3% as of October 31, 2021, while the S&P 500 and the Euro STOXX 50 indexes have each returned over 20.0% during the same period. A recent analysis shows 65% of SPAC deals completed at a valuation north of €887 million ($1.0 billion) are trading below €8.9 ($10.0) per share.[1] The aggressive hunt for yield from cash-rich investors fuelled the SPAC boom as gluttony has outpaced fear in the markets.

Many SPACs have merged with companies that are not ready for the public markets, most notably in the first wave in early 2021. For example, US-based electric vertical takeoff and landing (eVTOL) taxi startup Archer Aviation (NYSE: ACHR) merged with the Atlas Crest Investment SPAC in Q3 2021 at an EV of €2.4 billion ($2.7 billion), despite booking no revenue. Approximately one year after Archer Aviation closed a €5.3 million ($6.0 million) seed round, it now trades on the public markets at approximately 70.0% below its 52-week high, at less than €5.3 ($6.0) per share. Furthermore, US-based Metromile (NASDAQ: MILE) merged with the INSU Acquisition SPAC in Q1 2021 at a €1.0 billion valuation, while in Q4 2021 the company agreed to merge with Lemonade (NYSE: LMND) for less than half that initial €1.0 billion valuation. Sponsors will be closely monitoring take-privates of several SPACs as pricing is favourable, availability of debt financing is high, performance has been poor, and rising rates loom. For instance, Italy-based SICIT 2000 went through a reverse merger in 2019 with SprintItaly (MIL: SPRT), to then be taken private in Q3 2021 by Neuberger Berman for €380.5 million.

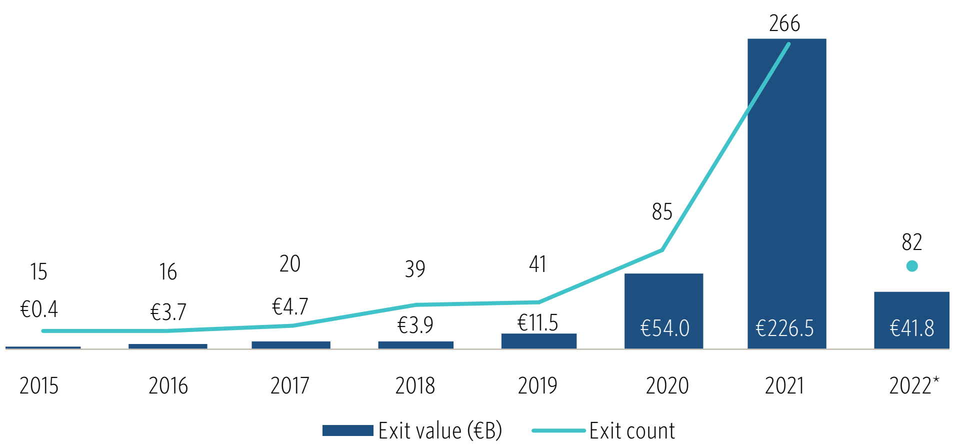
Caveat: First, a decent proportion of SPACs are merging with early-stage pre-revenue companies, which are likely too early in their lifecycle for a private equity (PE) sponsor. Second, regulators, including the Securities and Exchange Commission and the Financial Conduct Authority, have taken active steps to revamp SPAC rules, which aim to increase investor protections, improve alignment with key stakeholders in a SPAC, and enhance disclosures on targets. The knock-on effect could be better performance of SPACs, which may slow take-private activity, as SPAC prices move upwards. For example, the recent listing of Hambro Perks Acquisition Company (LON: HPA1) on the London Stock Exchange will test if the new rules help translate into better performance. Third, sponsors have outsized incentives through the SPAC "promote" to keep the SPAC listing frenzy alive. And finally, when REITs, business development companies, and high-yield debt products first arrived in the capital markets, they all had a quick acceleration in activity when first established; they then cooled and normalised before quality was found. We could be in the phase of normalisation or establishing quality in the SPAC market, which would dwindle the number of take-private opportunities.

1: "The SPAC Machine Sputters Back to Life After Dramatic Meltdown," *Financial Times*, Ortenca Aliaj and Miles Kruppa, November 21, 2021.

H1 2022 update: This prediction is not on pace to come true.

Five companies that have publicly listed via a SPAC were taken private in H1 2022. At the current pace, the number of take-privates will fall short of our prediction. However, given the excess volatility in public markets and struggling performance of SPAC listings in recent months, take-private activity could tick upwards in H2 2022. Several companies are trading below historical highs achieved in recent years, and sponsors equipped with high levels of dry powder may feel 2022 is an opportune time to take companies private that are potentially undervalued in public markets.

SPAC exit activity



Source: PitchBook | Geography: Global
*As of June 30, 2022

Dominick Mondesir
Senior Analyst, EMEA Private Capital

Prediction: Global carveout deal value will hit a new high of €200 billion in 2022.

Rationale: Due to the pandemic, the PE supply-and-demand dynamic for corporate carveouts has never looked more conducive for a stellar year. At time of writing (November 2021), global carveout deal value stands at €171.6 billion, its second-highest figure on record, and we still have around six weeks of 2021 left.[2] Carveout trends from 2021 will extend into 2022, pushing the year to a new record for a few reasons.

First, pandemic-related stock underperformance, reducing stimulus, and the prospect of further lockdowns because of the potential of a more transmissible, deadly, and vaccine-resistant COVID-19 variant forming are driving corporates to intensely re-evaluate their core competencies and exit noncore assets to pay down debt accumulated during the COVID-19 crisis. Corporates will sell business units to more closely align the core of the organisation with changing consumer and employee behaviours, supply chains, and environmental, social, and governance matters—most notably in the climate and sustainability spaces—which should foster a growing supply of carveout targets. While not quite carveouts, conglomerates such as GE, Johnson & Johnson, and Toshiba split into two to three independent businesses as management, shareholders, and activist investors determined that the whole was worth less than the sum of its parts as they look to improve balance sheet strength. This activity will prompt similar behaviour from competitors, with some opting for outright divestitures to hungry sponsors.

Second, in this zero-rate environment, M&A provides the most viable path to outsized growth for corporates, and with this comes more intense government and regulatory scrutiny. The EU, UK, and US governments all enhanced their abilities to review mergers in 2021, thereby increasing the potential for forced divestitures. This is where sponsors will be willing buyers. For instance, in Q3 2021, manufacturer of optical lenses Essilor (PAR: EL) acquired Netherlands-based eyewear retailer Grand Vision Optics (AMS: GVNV) for €7.6 billion ($8.5 billion), with EU regulators mandating the combined entity divest more than 300 stores to close the deal.

Third, sponsors are under fierce pressure from LPs to quickly deploy their record dry powder and drive higher risk-adjusted returns. The inherent complex and less-trodden path of carveouts could prove a fertile hunting ground for sponsors to deploy capital and augment IRRs. For example, a recent survey by Dechert LLP shows that 58% of North American managers expect the number of carveouts targeted by their firms to increase in 2022.[3]

Caveat: Carveouts can be complex, cumbersome, and time-consuming deals to execute. With speed and scale critical in the new dawn of PE, not all GPs will have the resources or expertise to play in this arena. For example, only 40% of

2: Note: As of June 30, 2022, PE carveout deal value hit a new high of €222.6 billion in 2021.
3: "2022 Global Private Equity Outlook," Dechert and Mergermarket, November 9, 2021.

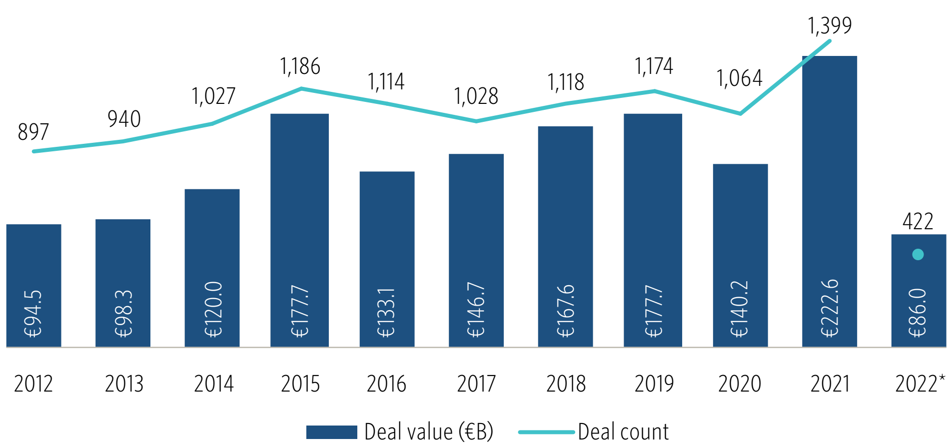
Europe, Middle East, and Africa managers and Asia-Pacific managers expect to increase carveout activity in 2022, according to a recent survey.[4] Despite the prospect of a more hawkish fiscal-monetary policy, interest rates are still expected to be historically low, which could dissuade some companies from selling business units, as debt is still cheap and liquidity is plentiful.

H1 2022 update: This prediction is not on pace to come true.

In H1 2022, PE carveout deal value reached €86.0 billion, pacing slightly below our predicted figure. Nevertheless, evolving market dynamics and the shifting macroeconomic backdrop could affect carveout deal activity. Companies may be forced to offload assets to raise capital as margins thin in the recessionary environment expected in H2 2022. Sponsors and companies may press ahead with deals to fuel inorganic growth efforts as organic growth becomes harder for cyclical businesses facing reduced demand.

In contrast, dealmakers may feel that widespread uncertainty, high inflation, and rising interest rates are creating myriad challenges when trying to accurately value a company in the current climate. Thus, activity could cool in sectors such as information technology in coming quarters until valuations pick up.

PE carveout deal activity



Source: PitchBook | Geography: Global
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4: "2022 Global Private Equity Outlook," Dechert and Mergermarket, November 9, 2021.

Nalin Patel
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Prediction: European VC deal value will hit a record €175 billion in 2022.

Rationale: We anticipate venture capital (VC) deal value in Europe will continue an aggressive upward trajectory and hit €175 billion in 2022 as investors and startups double down on dealmaking efforts. The COVID-19 pandemic has accelerated capital flows into tech-based VC-backed companies, and we feel that further investment will be conducted to seek out heightened long-term returns amid high inflation, low interest rates, and an uncertain period for wider global financial markets.

Capital has found its way into venture as tech businesses have thrived during COVID-19 restrictions. Rising numbers of online users have driven up recurring revenues of companies looking to close outsized rounds at swelling valuations. We expect dealmaking in Europe to increase as nontraditional and international investors target fast-growing European assets looking to scale globally. The European VC ecosystem has matured significantly in the past three years as round sizes and valuations have spiked. Europe now possesses a wide variety of unicorns in different sectors and geographies, and these companies will likely drive deal value figures to new heights with enormous late-stage rounds.

Caveat: The threat of a bubble bursting always remains in the financial industry. Volatility has been a key theme across wider financial markets in 2021, and with a mooted tightening of monetary stimulus amid inflationary pressure, capital availability could decline. Many VC analysts felt the COVID-19 pandemic would be a market-correcting black swan event; however, broadly speaking, it has been the opposite. Overall, the VC ecosystem is in great shape, with VC funds flush with capital from recent exits, healthy quantities of new startups that received first-time rounds, and strong growth rates for existing portfolio companies. But the threat of an industry-defining scandal or revelations about an opaque private market valuation persist. As witnessed with WeWork (NYSE: WE) in 2019, news stories can go viral and quickly dampen appetite within the VC ecosystem.

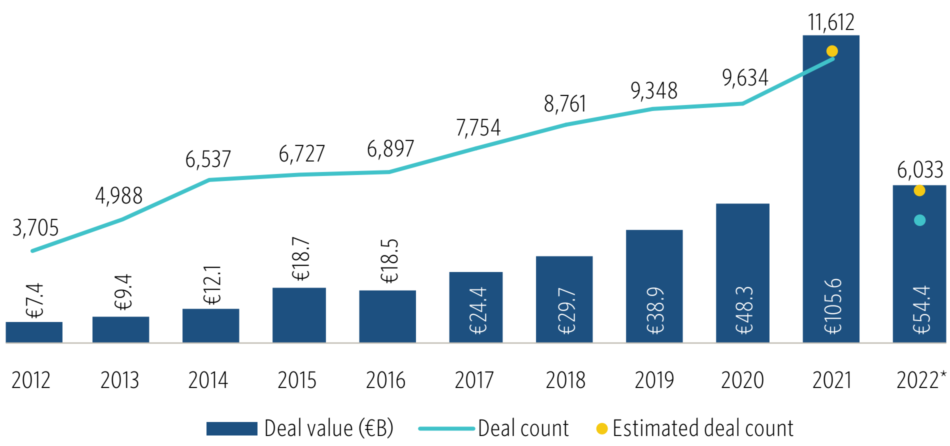
Despite the threat of new variants, new lockdowns, and varied vaccination rates in European countries, we are hopefully past the worst of the pandemic. Numerous pandemic-driven success stories have emerged in areas such as online event tools and remote working solutions. However, the sustainability of rapid growth for fast-growing businesses remains an ever-present question facing VC-backed companies. For example, previously VC-backed US-based home fitness provider Peloton (NASDAQ: PTON) saw losses worsen and its share price tumble in recent months. Declines in pandemic-induced usage could affect startups' ability to demonstrate long-term revenue growth, close rounds, and increase overall deal value figures.

H1 2022 update: This prediction is not on pace to come true.

Deal value has kept pace with 2021. However, an aggressive increase to €175 billion in 2022 is highly unlikely. As records tumbled in 2021, few would have expected wider financial markets to shift as considerably as they have in 2022. Economic growth forecasts have been slashed, inflation has soared, and rising interest rates have altered policies affecting investment decisions. Tech public equities struggled in recent months, as forecasts priced in weaker outlooks for economies and companies. Recessions now seem inevitable in major economies across the globe.

VC deal value remained resilient, at €54.4 billion in H1 2022, but the record set in 2021 will be difficult to surpass given the current macroeconomic backdrop in Europe. Reports of valuation haircuts, down rounds, and layoffs will likely further dampen investment appetite as growth becomes harder amid a recessionary environment.

VC deal activity



Source: PitchBook | Geography: Europe
*As of June 30, 2022

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Prediction: Nordic VC activity will reach a new record deal value of €20 billion, with over 1,000 deals occurring.

Rationale: The Nordic VC ecosystem has developed impressively during the past five years, with deal value jumping to €11.3 billion in 2021 through mid-November. We expect this momentum to carry through into 2022. There are several huge late-stage companies across the region that could drive up deal value figures with fresh funding rounds. Companies in Sweden include battery developer Northvolt, healthtech app creator Kry, and buy-now, pay-later provider Klarna. Further companies include database-as-a-service specialist Aiven in Finland, business spending platform Pleo in Denmark, and data management company Cognite in Norway. Sweden is no longer the only major deal value generator in the Nordic region, and we expect multibillion-euro companies will close multimillion-euro rounds across various sectors and countries in the coming year.

We anticipate increased dealmaking in the region could help the Nordic ecosystem become one of the highest deal value producers in Europe in 2022, perhaps surpassing the France & Benelux region as the third largest in Europe. The Nordic VC scene is now well-known by much of the global venture ecosystem, and we expect capital flows from US, European, Asian, and domestic VC funds, along with participation from nontraditional investors, to grow as late-stage Nordic companies seek outsized financing. With deal value figures predicted to rise across Europe, the region will likely compete on a more level playing field with the more established venture ecosystems in the UK & Ireland, France & Benelux, and Germany, Austria, and Switzerland (DACH) regions for substantial VC rounds. Investors are casting a wider net to seek out less expensive investments by tapping into new regional pockets, and the Nordic region is well-positioned to capitalise on increased capital flows entering VC. It already has an established ecosystem with experienced networks, skilled talent, and cutting-edge startups.

Caveat: The Nordic ecosystem may generate significant liquidity via outsized exits rather than deal value in 2022, given the maturity of highly valued companies in the region. For example, Klarna's valuation reached €37.4 billion in 2021, and it could decide to exit, which may trigger other late-stage VC-backed companies to follow suit. Extensive capital options have drastically extended funding runways within European VC; however, with strong investor appetite for tech public listings in 2021, Klarna could exit and deliver long-awaited outsized returns to investors.

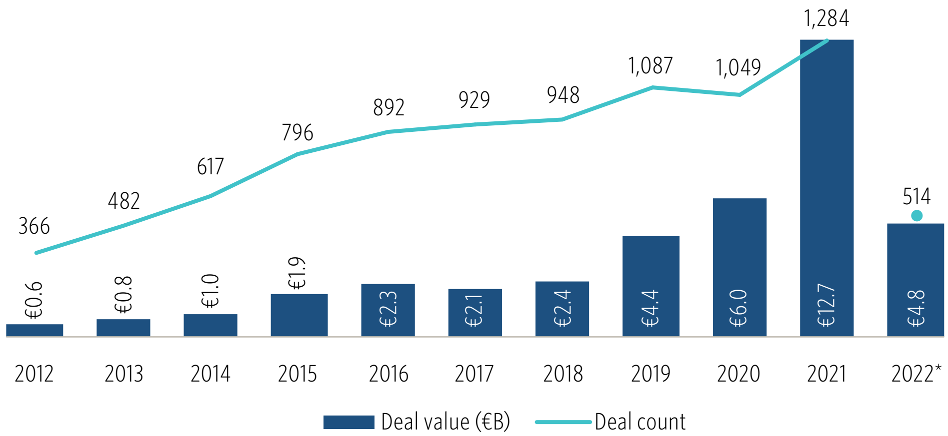
Investors may target less developed and expensive regions in Europe, such as Central & Eastern Europe or Southern Europe, and deal value may not increase at the rate it did during 2021. LPs and GPs could attempt to find better value for money investments, which proved difficult to do in 2021. The pandemic increased capital within venture, and the hottest regions may face a flattening of investment curves if they price out investors or fail to produce a healthy new pipeline of startups.

H1 2022 update: This prediction is not on pace to come true.

As dealmaking has flattened across Europe in H1 2022, the Nordic ecosystem is also pacing to record lower deal value and count figures from 2021. Despite uncertainty, deal value could still record the second-largest figure on record at the conclusion of 2022. Several highly valued companies remain in the Nordic ecosystem and will continue to drive dealmaking in coming quarters. It is highly unlikely, however, that new records will be set in 2022 with markets tightening.

Klarna, one of the most valuable VC companies in the Nordic region and Europe, took a valuation haircut to €6.4 billion for its recent funding from a €37.4 billion post-money valuation in 2021. Valuation haircuts and down rounds for flagship VC-backed companies are notable and can have knock-on effects for companies and investors conducting deals. Companies that have experienced rapid growth and commanded a premium may find it harder to justify a lofty valuation in a recessionary environment wherein valuations are being recalibrated. Layoffs have also been reported at startups across the globe, including Nordic-based Klarna, Voi, and Kry, illustrating that cost-cutting measures may be required to extend funding runways. These factors could make dealmaking harder as investors cherry pick which portfolio companies to support as demand for capital increases.

Nordic VC deal activity



Source: PitchBook | Geography: Nordics
*As of June 30, 2022

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Prediction: VC-backed public listings will decline in value and count from 2021 highs.

Rationale: We expect public listings to cool as nontraditional investors and VC funds flush with capital from recent exits reinvest into new batches of startups. At the time of writing (November 2021), public listing exit value is on pace to outstrip deal value for the first time since 2018. In 2019, public listing exit value (which includes IPOs, direct listings, and reverse mergers with SPACs) dropped 80.9% after 2018 was skewed by Spotify's (NYSE: SPOT) direct public offering (DPO). Public listings ballooned in 2021, delivering excess levels of liquidity back to LPs amid insatiable appetite from investors targeting tech company debuts. LPs may now want to deploy capital into rounds rather than exit additional investments. Moreover, risky, lengthy, and costly public listings could be put on hold as mature companies seek out late-stage capital—which has been widely available—rather than an exit in 2022.

We believe the COVID-19 pandemic and subsequent uncertainty dried up investment opportunities and growth prospects of troubled sectors, including tourism, transportation, and energy. Consequently, heightened growth rates of emerging online businesses and swelling market capitalisations of Big Tech companies have piqued the interest in new tech-based listings. However, growth could now slow for online businesses with lofty valuation multiples as governments look to avoid lengthy lockdowns that shut down certain sectors, such as tourism and hospitality. Founders and VC investors have been keen to accelerate towards an exit in 2021 to exploit favourable market conditions, but these dynamics may shift as economies reopen and travel resumes despite the ongoing threat from new COVID-19 variants.

Caveat: Plenty of VC-backed companies ripe for an exit remain in the European ecosystem heading into 2022. Robust levels of liquidity in recent months will not hamper exit desire from founders and VCs looking to cash out. Numerous companies that have demonstrated strong growth during the pandemic have experienced stickiness with their products or services, which could lead to long-term disruption and steady exit flows. Favourable exit conditions for VC-backed tech listings may persist in public markets and drive up listings, especially if nations re-enter lockdowns, inoculation rates flatten, or variants spread quickly.

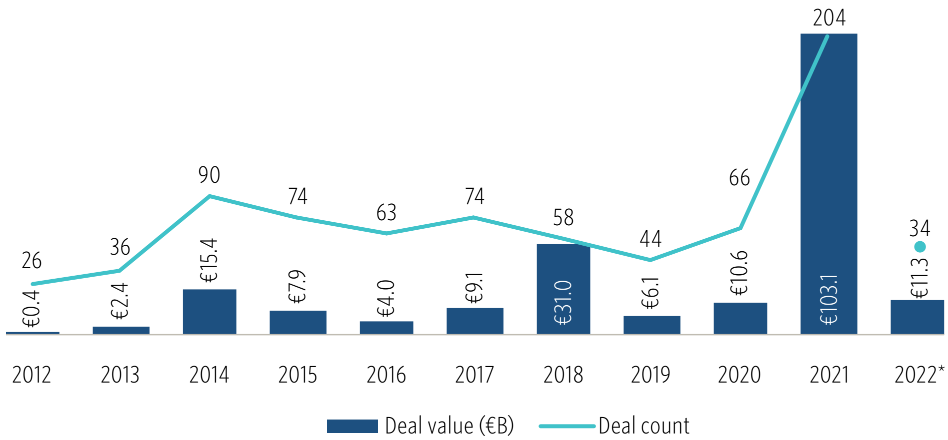
European exchanges are competing fiercely among themselves and the US for the most sought-after tech listings. Reforms to listing requirements and loosening of rules could entice further companies to exit. Popular exit options now include DPOs and reverse mergers via SPACs, alongside traditional IPOs, which could entice further listings in the near term.

H1 2022 update: This prediction is on pace to come true.

The record public listing activity in 2021 has proven to be an outlier year. Exits markets regressed to pre-2021 levels in H1 2022, as the macroeconomic backdrop shifted considerably. Increased focus on tech companies carrying high valuations drove exit value in 2021. Fast-forward to 2022, and established public tech stock prices have fallen as weakened growth estimates have dampened appetite. Companies that publicly listed in the past 18 months have struggled, too, with many trading below their exit valuation. As a result, exiting the VC ecosystem in the current climate has become far less appealing for investors, founders, and board members.

Despite the gloomy outlook, exit activity is comparable to pre-2021 levels. Therefore, stakeholders could view the near-term uncertainty as an opportunity to get organised for an exit event when markets rebound. Volatility is an ever-present element within financial markets, and the appeal from take-privates or alternative exit routes via acquisitions or buyouts could rise in upcoming months.

VC-backed public listing exit activity



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