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2024 European Private Capital Outlook

Our analysts' outlook for European PE and VC in 2024

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

2024 outlooks

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Introduction

As uncertainty has spread throughout financial markets in 2023, we have witnessed varied trends across asset classes and regions. Our 2024 European Private Capital Outlook offers insight into the developments that could shape private equity (PE) and venture capital (VC) in the next 12 months.

Looking back at 2023, European dealmaking has been slower, with larger declines in VC compared with PE. VC deal value is on course to fall significantly, whereas PE deal value is displaying resilience and is expected to finish marginally lower relative to 2022's figures. Although deal value figures are muted, it is worth stressing that unprecedented levels of activity took place in 2021 and 2022, and 2023 represents a correction—rather than a collapse—in private capital activity.

Substantial exits have been rare in 2023, with the initial public offering (IPO) of UK-based Arm the standout liquidity event of the year. VC-backed public listings have struggled to gain momentum, largely hindered by the modest share prices of public companies that were previously VC backed. The lack of appetite to risk a public listing in 2023 has coincided with stubborn macroeconomic challenges, including inflation and weak economic growth. However, green shoots are emerging. With interest rate hikes paused, there are signs that broader market sentiment may improve, and activity could pick up with the cost of debt flattening.

Capital raised by PE and VC funds demonstrated contrasting trends in 2023. In Q3, CVC Capital Partners Fund IX raised €26.0 billion from limited partners (LPs), a historic amount that made it the world's largest PE buyout fund. Major PE firms including KKR and Permira closed megafunds as well, providing further indication of their fundraising clout amid a testing environment for fund managers. In contrast, the aggregate capital raised by all Europe-based VC funds in 2023 is unlikely to surpass CVC Capital Partners' mega-fundraise. Capital flows have slowed, and VC fundraising is on pace to fall below the 2022 total at the year's conclusion.

With 2023 drawing to a close, we have selected our forward-looking outlooks for 2024. This note provides our views on European PE and VC for the year ahead and evaluates underlying themes as well as risks at play.

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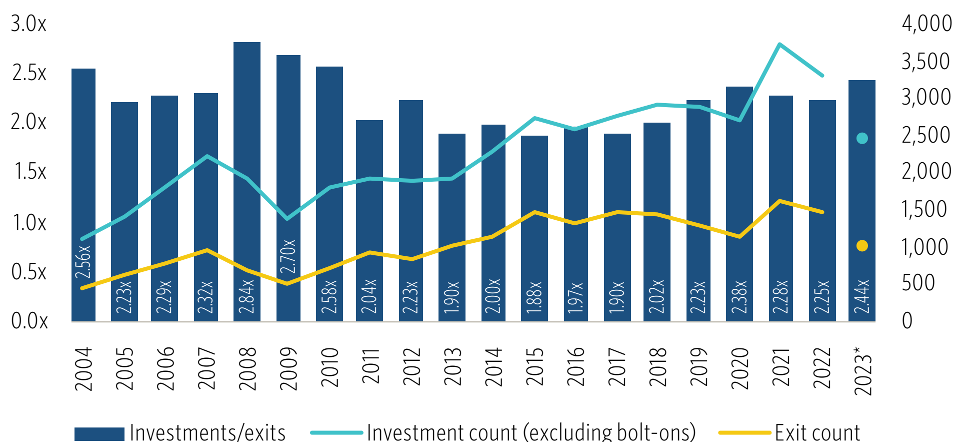
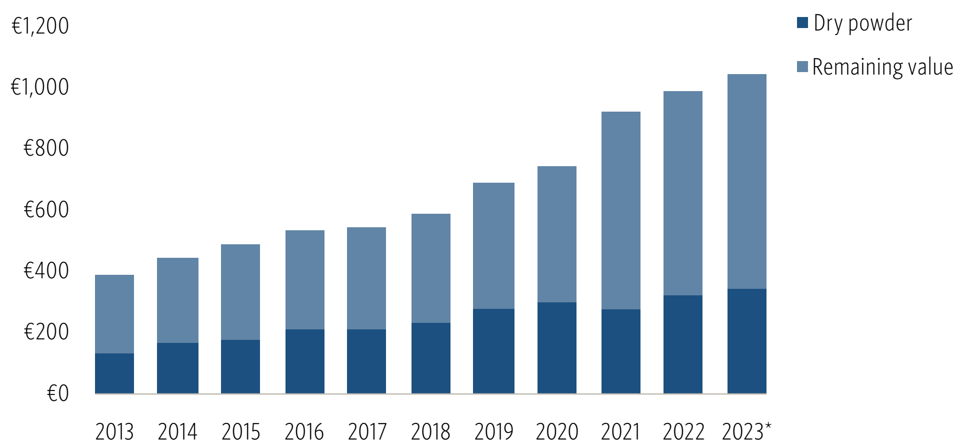
Outlook: The European PE investments/exits ratio will reach a 15-year high due to a muted exit market stemming from price dislocation.

PE investments/exits ratio



Source: PitchBook • Geography: Europe • *As of November 30, 2023

PE AUM (€B)



Source: PitchBook • Geography: Europe • *As of March 31, 2023

Rationale

As of November 30, 2023, the PE investments/exits ratio was at its highest since 2010, and we believe the current macroeconomic headwinds will persist into 2024, putting further pressure on exits relative to investments. This ratio tracks the number of PE investments, excluding bolt-ons, over the number of PE exits. Low interest rates leading up to the peak of the bull market towards the end of 2021 helped general partners (GPs) amass record amounts of dry powder. Pressured to put capital to work, GPs have been deploying this dry powder regardless of exits and fundraising. This has thus increased the numerator. On the other hand, the last 18 months were characterised by monetary tightening and a correction in valuations, which led to a pricing dislocation between buyers and sellers. Ultimately, we

saw exits dry up—most notably public listings, which were virtually muted. This decreased the denominator. Looking at 2024, we expect exits to remain subdued relative to dealmaking. From a macro standpoint, although inflation is coming down, it is still not at target, and recessions are still possible for some economies. The risk of recession will put pressure on exits to corporates whilst "higher rates for longer," which seems to be the consensus, will put pressure on exits to sponsors. Finally, we do not foresee a strong return to IPOs because sponsors are increasingly moving away from this exit option, preferring mergers & acquisitions instead, where they have more control over pricing. All of this will result in higher investment levels and lower exit count, in our opinion, pushing the investments/exits ratio to record heights.

Risks

Faster-than-expected interest rate cuts are the largest risk to our thesis. This could happen for two reasons. First, in a blue-sky scenario, inflation drops faster than anticipated, and central banks start cutting rates to boost investment and growth, which has stagnated in recent years. Second, in a worst-case scenario, major European economies fall into a recession, and central banks are forced to cut rates to encourage spending. This could happen for a number of reasons, including geopolitical conflicts, a hard landing from increasing rates too quickly, and changes in political policies. The former scenario would likely lead to higher valuation multiples, cheaper borrowing, higher leverage, and an increase in exits. This could decrease the ratio depending on the effect on investments. On the other hand, the latter scenario may lead to an increase in the risk premium demanded by investors, which would keep public listings muted.

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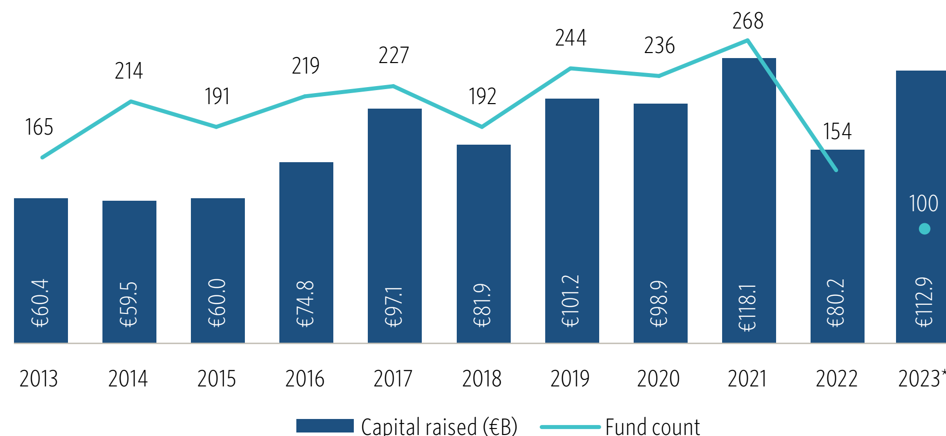
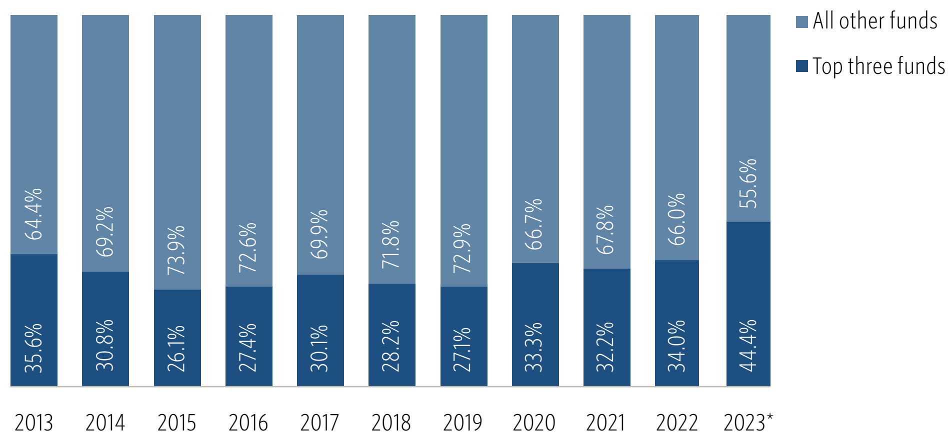
Outlook: PE fundraising concentration in the top three funds will hit a record percentage as fundraising drops from 2023 levels due to macro headwinds.

PE fundraising activity



Source: PitchBook • Geography: Europe • *As of November 30, 2023

Share of PE capital raised by the top three funds



Source: PitchBook • Geography: Europe • *As of November 30, 2023

Rationale

PE fundraising is on track for a record year in 2023 in terms of capital raised despite the fund count being the lowest in over a decade. This will be surprising to most given the macroeconomic headwinds the industry has faced and the consensus that fundraising has dried up in the latter part of 2023. The key lies in that the top three funds (all megafunds) closed in 2023 have contributed 44.4% of the capital raised YTD: CVC Capital Partners Fund IX at €26.0 billion, Permira Fund VIII at €16.7 billion, and KKR European Fund VI at €7.5 billion. Experienced PE managers with established track records and existing client relationships defied the glut in fundraising.

Looking at 2024, we believe fundraising will be lower than in 2023 and estimate the top three funds will total about €45 billion based on the current open funds aiming to close in 2024. If fundraising in 2024 drops below €100 billion, which would imply a 12% to 15% year-over-year (YoY) drop, then European fundraising will hit a record concentration in the top three funds.

We believe fundraising will fall in 2024 as less capital is distributed back to LPs due to the lack of exits. Higher interest rates have made borrowing more costly and have also contributed to the reduced capital available for fundraising.

Risks

In Europe, PE as an asset class has more than doubled in assets under management (AUM) in the past decade, going from less than €500 billion in 2014 to more than €1 trillion in 2023. We believe this trend will continue to grow in the long term as new institutional mandates with long investment horizons start allocating to private markets. These new inflows of capital have helped sustain fundraising in 2023 and may continue to do so in 2024 as well.

The other risk relates to the macroeconomic environment. If interest rate cuts do materialise faster than expected, this will help fuel further fundraising. Lower rates would allow for increased borrowing and thus more capital commitments, whilst at the same time, higher valuations would boost exits, which would free up further capital available for fundraising.

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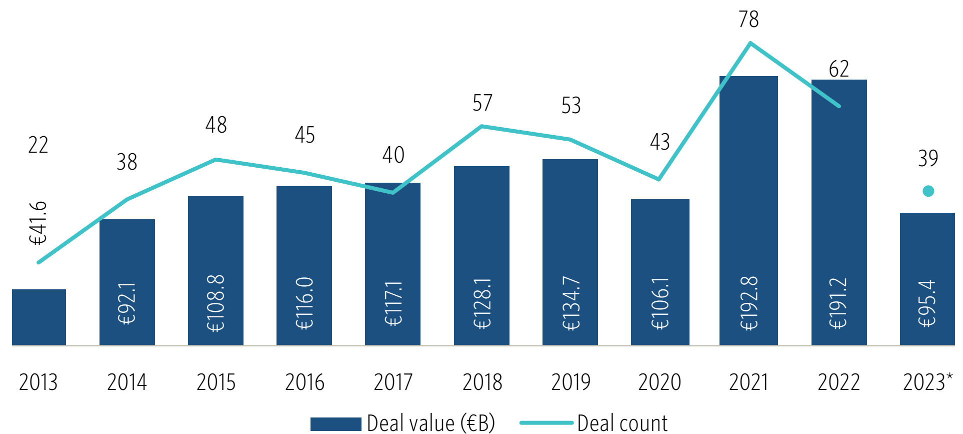
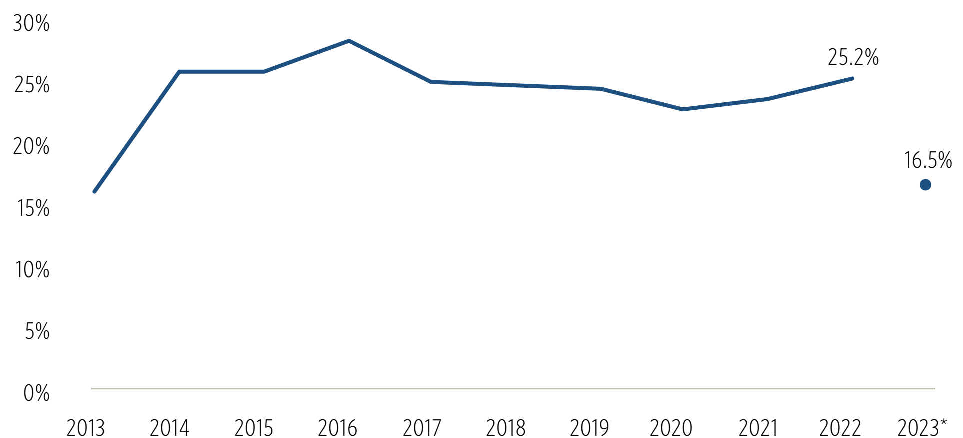
Outlook: Megadeals will constitute less than 20% of overall PE deal value as uncertainty around the cost of debt persists.

PE megadeal activity



Source: PitchBook • Geography: Europe • *As of November 30, 2023

Megadeal value as a share of all PE deal value



Source: PitchBook • Geography: Europe • *As of November 30, 2023

Rationale

Megadeals (deals of €1 billion or more) contributed 24.2% on average to annual deal value from 2013 to 2022. In 2023 YTD, the proportion was 16.5%, and we expect the figure to remain below 20% in 2024. Megadeal value could pick up from 2023 levels, but we believe it will stay below historical proportions of overall deal value given the testing interest rate environment.

Large leveraged buyouts could fall out of favour because they are reliant on significant portions of borrowed debt. Higher interest rates mean the cost of debt to fund deals has risen, and we could see fewer substantial deals taking place due to the spiralling costs involved. Although the impact may be felt on all PE deals using

debt instruments, we expect greater declines at the top end of the PE landscape, where bigger loans require costlier interest repayments, in absolute terms. Although interest costs rise proportionally to deal sizes, PE firms may spread their capital across smaller deals to diversify and mitigate downside risk from one large outlay. Smaller, mid-size deals such as bolt-ons could become popular, and growth could be identified in middle-market transactions as corporations focus on right-sizing rather than relying on the concept of “bigger is better.” Lower valuations tied to revenue multiples could also force deal sizes lower, leading to fewer deals crossing the megadeal threshold in 2024.

Risks

Interest rate hikes have levelled in recent months as inflation has come down. Therefore, the cost of capital could fall in 2024, leading to larger deals closing. A number of substantial PE funds closed in 2023, and they will be looking to deploy capital, which could underpin funding for large deals in 2024. Less frequent but larger deals give GPs fewer relationships to manage. In theory, this should offer GPs greater time to focus on their best assets and improve their growth prospects. With a lack of megadeals in 2023, PE firms with dry powder may be looking to deploy capital at the earliest opportunity. Given the macroeconomic picture, cut price valuations could act as catalysts for dealmaking, with multibillion-euro valuations cooling in recent months. As a result, megadeals that have been put on hold could be revived as a clearer picture of interest rate regimes is established in 2024.

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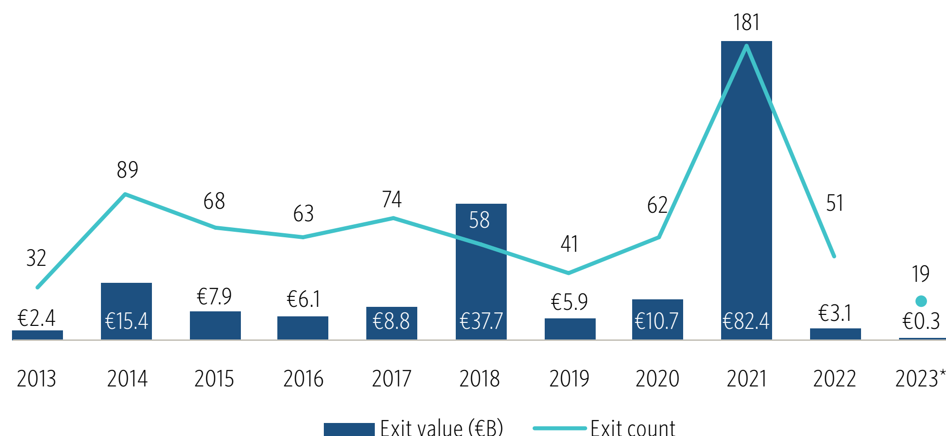
Outlook: There will be no meaningful recovery in the value and volume of VC-backed IPOs in 2024 as macroeconomic factors weigh on public markets.

VC IPO activity



Source: PitchBook • Geography: Europe • *As of November 30, 2023

Rationale

"Higher for longer" has emerged as the theme to frame the second half of 2023 and is set to be carried through 2024. Such sentiments have echoed throughout Europe, with the Bank of England stating there is no scope to cut rates soon and the European Central Bank intending to keep rates high "as long as necessary." High interest rates do not bode well for long-duration, growth (tech) stocks, proven by recent IPOs. Recent listings of Arm, Ionos, and Oddity Tech have all returned -5.4%, -20.9%, and -26.6% YTD, respectively, as of November 30. The market environment, therefore, still does not appear conducive to IPOs, and stakeholders remain cautious as fewer listings have been done at much lower valuations this year. As of the end of November, VC-backed IPO exit value sat at 9.9% of 2022 levels, and the IPO count is less than of 2022 levels. Trends are stronger for PE; nevertheless, IPO counts and quarterly trends through the year are weak. We therefore see little cause for change next year and do not expect IPO exit value or count to significantly grow from 2022 or 2023 levels.

As funding runways become more stretched, specifically for more mature areas of the market, companies will have to find other means to extend cash runways or raise new financing. These may include cost-cutting; acquisitions/consolidation; follow-on rounds from existing investors; or new sources of financing, such as venture debt. We have heard anecdotes of this throughout 2023; most recently, publicly listed player Spotify cut 17% of its workforce.[1] There were also further layoffs at industry bellwethers such as Meta.[2] As listings continue to lose share of exit value, we believe venture-growth players will lean on the aforementioned ways to raise financing.

1: "Spotify Cuts 1,500 Jobs, CEO Ek Says Streamer Must Be Leaner," Bloomberg, Lucas Shaw and Ashley Carman, December 4, 2023.
2: "Exclusive: Meta to Lay Off Employees in Metaverse Silicon Unit on Wednesday," Reuters, Katie Paul, October 3, 2023.

Risks

The weak dynamics in listings activity do not mean the pipeline is thin. On the contrary, we think the backlog of companies, specifically venture-growth players, remains healthy and growing. Prominent players that have reportedly been considering listing include Huel and CVC Capital Partners, with the likes of Shein closer to pulling the listings trigger. Therefore, when public market conditions are more primed for listings activity, we believe the recovery in such will be robust. Calling the timing of this is difficult, and whilst we are inclined to believe substantial listings activity will not occur in 2024, we could be wrong. If interest rate cuts start to take effect later next year, we could see valuations for tech companies become more favourable, as well as the number of companies choosing to list. More companies listing could cause more confidence in the market for others to do so, also supporting listing volumes.

The value-over-volume question, however, remains interesting. Whilst listing count may improve in the market, these listings will likely take place at lower valuations than what would have occurred in previous years. The industry has undergone a large correction in portfolio company valuations. And whilst base rates could start to be cut, in turn reducing discount rates, they are unlikely to settle to where they had been in previous years, meaning, YoY, discount rates would remain higher. However, we also acknowledge that structurally, most startups in the ecosystem have also had to pivot towards achieving profitability in the last year, or at least carving a pathway to it. Potential profitability may be more supportive of valuations upon IPO where investors are willing to pay a higher multiple for profitable companies.

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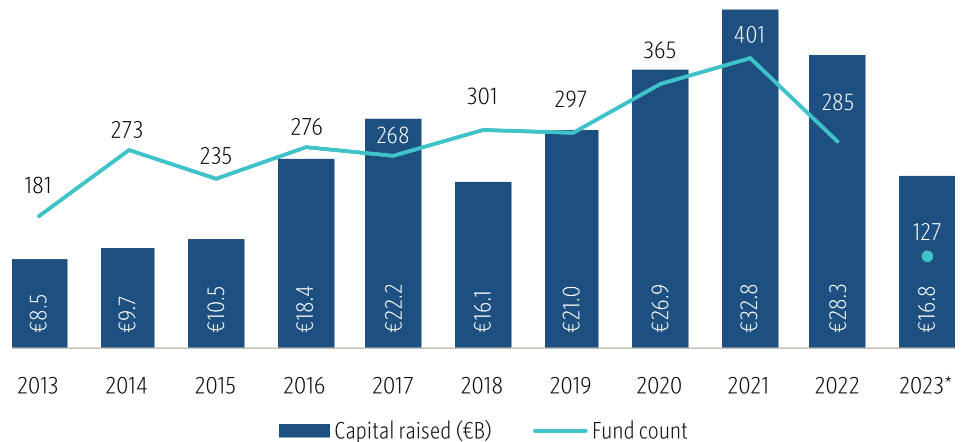
Outlook: VC fundraising levels will at least match 2023 totals as recovery from trough levels begins, supported by larger vehicles.

VC fundraising activity



Source: PitchBook • Geography: Europe • *As of November 30, 2023

Rationale

Despite weak returns in venture strategies given the trough valuations seen this year, LPs may also be wanting to optimise returns by investing at the dip. On a longer time horizon of 15 years, venture has emerged as a top returning strategy despite weak one-year horizon internal rates of return (IRRs), as noted in our latest Europe PitchBook Benchmarks report. The denominator effect appears to be less of a consideration for LPs when thinking about allocations to private markets. Liquidity and exit markets, however, still appear to be weak. But outside of listings, strategies such as acquisitions have taken share, and exit markets as a whole could improve next year, supporting LP liquidity and returns. Within the strategy, the top 10 closes so far this year have amounted to €6.6 billion, or 39.2% of capital raised. As it relates to current fundraising dynamics, we note the current top 10 open funds since 2020 total €9.1 billion, higher than the top 10 total closes in 2022.[3] Furthermore, if we extend the analysis to the top 20 open funds, the total potential capital raised amounts to €12.8 billion, already close to 2023 totals over just 20 funds as opposed to the 100+ that normally compose our yearly fundraising totals. These reflect the top tier of fund sizes, and there will clearly be more closes next year. Totals, therefore, could exceed depressed levels seen in 2023 and could also be boosted by a higher number of smaller fund closes through 2024.

3: This number reflects the target fund size or capital raised so far and therefore will be subject to change as more information is disclosed and more capital is raised until the funds close.

Risks

A tougher fundraising environment within private markets has been well documented throughout the year, with absolute levels of capital raised trending lower, close times lengthening, and more experienced firms gaining share over emerging ones. Within private strategies, we have seen venture fundraising lag other asset classes, sitting at 59.3% of 2022 levels through November this year. Part of the disparity to other strategies has been a function of fund-size closes; for example, PE has been significantly supported by the presence of megafunds in the asset class. Otherwise, venture has been one of the lower-returning strategies on a one-year horizon IRR, being the poorest performer in 2022. Whilst longer-term returns are more promising, near-term underperformance of the strategy means that LP allocations to the asset class may remain thin in 2023, especially where other areas of private markets appear to be more appealing. Also, given that valuations have continued to decline throughout the year and with low visibility on macro factors—mainly interest rates—LPs could remain cautious towards putting fresh money on the table. Of course, there will be several funds that are not captured in our data due to lags in disclosure; however, of the open fund totals we noted above, these vehicles are not guaranteed to close, which means this larger tier of fund sizes may not impact 2024 totals.

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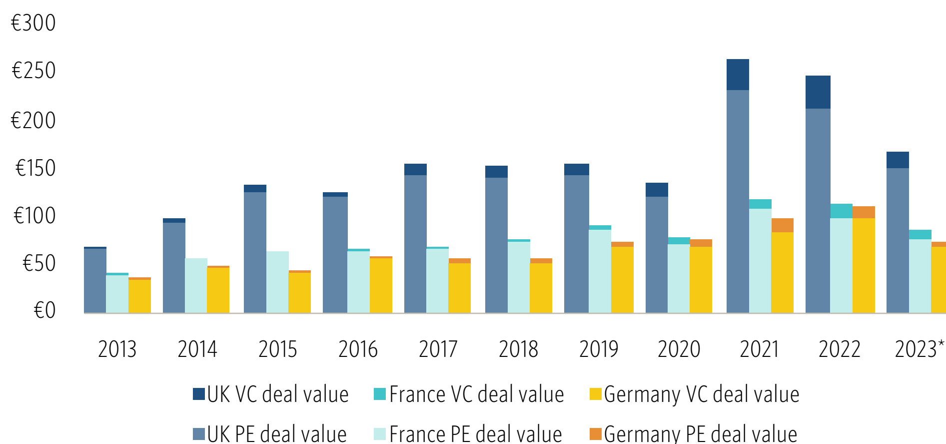
Outlook: The UK will remain the European leader for private capital, but France and Germany could close the gap amid a challenging geopolitical landscape.

PE and VC deal value by country



Source: PitchBook • Geography: UK, France, Germany • *As of November 30, 2023

Rationale

During 2021 and 2022, UK private capital (PE and VC) deal value was greater than France and Germany's private capital deal value combined, and it is on pace for a similar outcome in 2023. In 2024, we anticipate the UK will lead private capital deal value in Europe, but we believe it will not be greater than France and Germany's combined total. Despite the resilience displayed in recent years, we foresee France and Germany closing the gap to the UK in 2024. We believe the evolving geopolitical environment in the UK and developing opportunities in other nations could shift capital deployment in 2024.

The political landscape in the UK has been extensively covered in recent quarters, and with a UK general election due in 2024, investors and operators could pause major decision-making until a clearer legislative landscape is established. For example, a new government could implement long-term changes to taxation on carried interest, regulation of fund structures, and incentives or subsidies for certain industries. European nations including France and Germany are looking to bolster their private capital activity, with the former focusing policies on developing a strong tech ecosystem. Furthermore, investors may target less-saturated nations that possess fewer competitors to drive up asset prices in traditional private capital hubs, including the UK and US.

Risks

The UK could maintain its lead in terms of deal value in 2024, as strong figures over the past decade indicate the UK has not lost ground amid previous crises. The dominance displayed by the UK in recent years has been impressive considering the complexities created by the Brexit referendum and the COVID-19 pandemic. Both events triggered subsequent instability in the UK political system, as evidenced by the high turnover of prime ministers over the past seven years. However, external tribulations have had little impact on private market appetite in the UK. UK private capital deal value has been strong relative to its European peers, with issues such as inflation affecting all nations in recent quarters. With a possible rebound in late 2024 when inflation could be closer to target levels, other nations may struggle to close the gap with the UK if dealmaking picks up in the largest PE and VC market in Europe.

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