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Private Equity

European private equity groups forced to keep assets longer

Some firms are struggling to exit investments made when the industry boomed while interest rates were low

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European private equity firms are being forced to hold assets for ever-longer periods of time, highlighting the problems the industry is having returning cash to investors.

Last year, companies sold by buyout groups in Europe were owned for an average of nearly six years, according to data provider Gain.pro, the longest period since at least 2010. Typically, private equity seeks to own assets for between three and five years. Hold periods hit their lowest in 2012 and 2020 when the average investment was owned for less than five years, the data shows.

The traditional buyout model has come under growing pressure over the past two years, with firms struggling to exit investments made when the industry boomed in a low interest rate environment.

Successive rate rises have increased the cost of borrowing to finance new deals, meaning that buyout groups have been less willing to buy assets from each other.

At the same time, the IPO market — another traditional exit route for private equity — has also been quiet, while businesses have had to contend with the pandemic, high inflation and increased geopolitical instability. This has left private equity firms globally sitting on a record 28,000 unsold companies.

"First of all Covid came and then everything that followed after. It wasn't a double whammy, it was a triple whammy," said Philip De Vusser, Gain.pro's COO, referring to high interest rates, inflation and supply chain shocks from Russia's invasion of Ukraine.

The slowdown in dealmaking coupled with more expensive financing means that firms are becoming more selective about which assets they buy, industry executives and advisers said.

This raises questions about how they will sell companies that are not growing as quickly and with lower profit margins, something they are under pressure to do in order to return capital to their investors.

"You have to show exits but if it is at a 0.5 money multiple, will you really do it?" De Vusser said. "You want to make a good exit if you are fundraising."

The average revenue growth rate for companies declined in relation to the length of time they were held by their private equity owners, the research shows.

Assets owned for more than seven years were growing on average at 6.5 per cent a year, less than half the rate of those owned for less than three years, the report said.

Examples of companies owned by private equity for more than five years that have failed to sell over the past year include pet food company Partner in Pet Food, commercial laundry company JLA and holiday resort group Center Parcs, according to people familiar with the details. This was partly because of valuation disagreements between buyers and sellers.

"Interest rates are a big driver of multiples," said Sid Jain, head of research at Gain.pro. "Investors are less willing to sell at the lower multiples, so even for the highest quality assets investors are unwilling to pay out."

As well as the difficulty exiting some businesses, the average hold length is also being pushed by groups seeking to keep their best assets for longer.

They can do this by tactics such as creating a "continuation" fund. This is a new fund that assets are transferred to and investors are given the chance to cash out.

Recent examples include European investment group Permira moving assets including wealth manager Evelyn Partners and data centre group Teraco into a new fund. Permira invested in the assets in 2014 and 2015 respectively, according to its website.

Riccardo Villa, head of strategic capital advisory at placement agent Rede Partners said that these "cross fund trades . . . [had] really increased over the past couple of years".

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