Building an investment case for Europe

IPEM 2022

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Over the last nine months there has been a backdrop of macro turbulence triggering: inflation to reach a 40-year high; an energy crisis; supply chain issues; and a labor shortage. Most recently, we have witnessed Europe and the US' almost instant market reaction to the outlining of the UK's 'mini-budget', with sterling dropping to an all-time low and British bond prices collapsing. These factors, amongst others, are adding pressure to global markets and as such, not only impacting company profit margins but also, making it difficult to raise capital.

> To discuss investment in Europe in the current economic climate, Alantra joined key operators in the private market space at IPEM 2022, in Cannes.

Below we explore the main talking points from the conference.

There still remains the largest amount of dry powder ever seen in the European market, and the fundamentals that create a solid European industrial ecosystem are still in place. However, with strong economic headwinds, it is a **difficult time for European corporates and investors.** Over the coming quarters, investment cycles will likely be longer, and funding may be delayed.

We are seeing banks increasingly cautious in their approach to lending – with high inflation rates adding hesitancy to their lending potential. There has also been a correction in public markets that has added difficulties for companies looking to raise capital and has further increased concerns around financing. With this backdrop, private capital - either through equity or debt - poses an alternative solution and will become increasingly important for many business operators over the coming quarters in order to continue deal processes.

€2.2tn

total Assets Under Management (AUM)of private capital based in Europe[1]

Private equity is forecast to remain by far the largest asset class in 2026- making up **43%** of private capital in Europe[2]

Infrastructure and private debt are set to experience the strongest growth in overall AUM between 2021 and 2026. Their respective CAGRs are **24%** and **19%**[2]

Therefore, despite M&A deal volumes experiencing a 32% drop year-to-date, for those businesses still looking to transact in sectors that have proven durability **alternate deal structures could be the answer.**[3] Private equity may limit the percentage they take in businesses, and in some cases, create joint ventures with other private equity firms to share cost and de-risk deals. In times of uncertainty, minority deals create much needed liquidity for business operators while allowing the company to continue generating the cashflow required to sustain growth. This also **allows for a larger partnership between investors and founders/ CEOs** and a sharing of expertise to aid businesses through the changing market landscape.

1 As of December 2021, Future of Alternatives 2027 report Preqin Pro, October 2022
2 Future of Alternatives 2027 report Preqin Pro, October 2022
3 Refinitiv – 'Deal Making 2022- A Q3 Deep Dive', September 2022

So, where are the opportunities for value creation for corporates and investors?

As businesses enter the coming quarters with overarching market uncertainty, there is **the potential for many to sleepwalk into the current crisis** - with labor and supply chain disruption, increasing energy costs, and soaring inflation slowly increasing the bottom line. The two key areas that businesses can look to incorporate in order to **mitigate this risk - by tempering rising costs or to increase revenue generation** - are **digital transformation and energy efficiency.**

The digitalisation trend has been long talked about as a way to increase production, reduce costs, and streamline internal processes. However, digitalisation also offers new opportunities for value creation for businesses hoping to weather the current economic storm. Digitalisation has graduated beyond simply creating smoother business operations and now allows companies to:

- Increase unit production through improved manufacturing speeds
- Uncover new patterns to drive new products and services through AI and machine learning
- Enhance visibility and tracking of products throughout the supply chain to reduce delivery delays and meet demand
- Automate front and back-office processes to reduce human capital reliance
- Respond to problems quickly to mitigate business impact
- Reduce risk created by external factors, such as cyber attacks

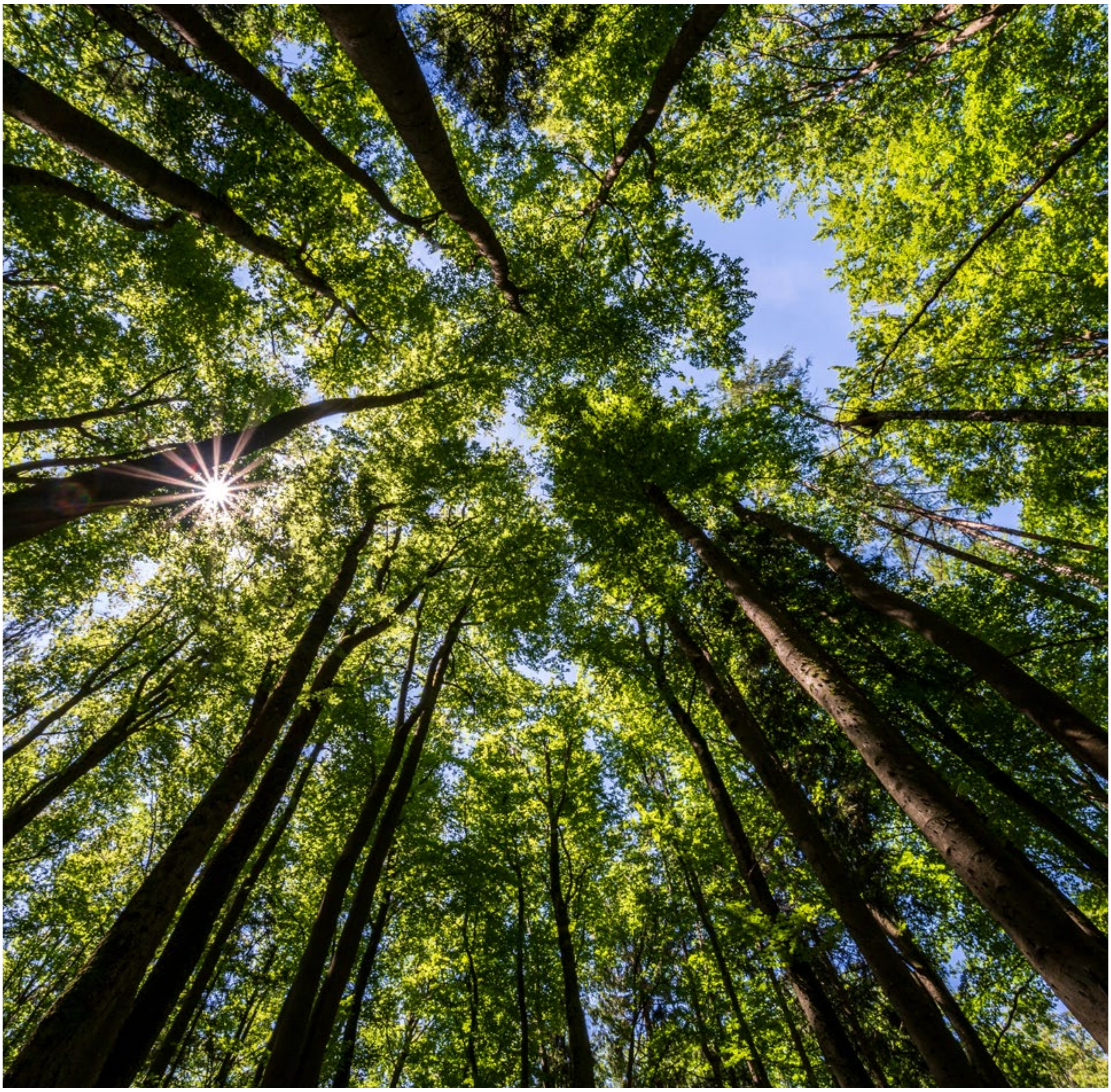
There are similar opportunities for businesses and investors in the need for reliable and low-cost energy.

Ultimately, digitalisation now offers the opportunity to reduce business costs while increasing revenue generation.

In order to deliver these opportunities quickly, business operators should **look to M&A to adopt technology** that would otherwise take years to grow at an excessive expense internally. Smaller technology businesses that offer solutions to companies looking to increase production, reduce costs, and protect business interests are readily available in the current market, and **early adopters gain competitive advantage** by ensuring smoother sailing during times of market turbulence.

There are **similar opportunities for businesses and investors in the need for reliable and low-cost energy.** Like digitisation, this is not a new trend however, with a forced shift in energy supplies, **Europe now sits in a unique global position.** For the first time, there is continent-wide government interest and funding to move away from traditional energy options and as energy costs soar, **companies too are forced to review their current energy supply.**

For company leaders, acquiring energy alternatives would aid in reducing spiralling energy costs and protect production lines against energy shortages. For example, in the industrial industry where businesses are energy intensive, **acquiring production lines of smaller companies who utilise more efficient energy structures in their supply chains** would not only increase production and build robust supply chains in the near-to-long-term but also **enhance processes and increase productivity and innovation.** In addition, this creates a competitor advantage as many companies look to offset rising running costs by increasing prices of their products and services.



As in most crises, some of the trends that were already prominent have been accelerated by market uncertainty and business needs. For investors, there is opportunity in increasingly sought-after technologies and alternative energy options, and with large capital to deploy, we expect increased interest in these areas in the coming years.

By adding innovation to traditional business models and implementing energy efficient options, companies not only reduce business exposure to current market uncertainty but also **generate new revenue options** at a time when many will be forecasting lower profit margins.

For investors, once they understand the impact on their portfolios and have a clear vision for the coming quarters, there could be new opportunities for investment in Europe. With capital ready to deploy, mitigating market uncertainty with alternate funding options, **investment into technology and energy innovation, and de-risking deals with consolidated or minority investments will allow activity to continue even in a stilted market.**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