UK Private Equity After COVID-19: Same Old, Same Old?

Skadden

06 / 28 / 21

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Steven Hannah
Partner / London
44.20.7519.7090
steven.hannah@skadden.com

Chetan Sheth
Counsel / London
44.20.7519.7063
chetan.sheth@skadden.com

One Manhattan West
New York, NY 10001
212.735.3000

40 Bank Street, Canary Wharf
London, E14 5DS, UK.3000
44.20.7519.7000

U.K. private equity activity slowed abruptly at the pandemic's onset, then rebounded sharply during the second half of 2020. Today, this recovery shows little sign of slowing. As we look toward life after lockdown, will U.K. private equity return to business as usual, or has COVID-19 left a lasting mark on the industry?

More Investment Options

Pre-pandemic, PE firms were already establishing long-term funds and pivoting toward employing other forms of long-term capital (such as capital on the balance sheets of acquired insurers) to diversify their approaches to investment life cycles and reduce fundraising burdens. These trends appear to have intensified as PE firms sought to withstand the pandemic's periods of market volatility and may continue to supplement financial sponsors' use of fund-to-fund transfers to retain high-quality and potentially slower-to-mature assets for longer periods. Given financial sponsors' recent focus on targeting publicly listed assets, PE firms' ability to position themselves as longer-term investors may also help secure shareholder approvals for transactions.

Additionally, financial sponsors have in some cases been taking a longer-term approach to investments by acquiring control of assets more gradually. Rather than employing a more traditional buyout, a financial sponsor may initially acquire a minority interest (in some cases, in partnership with an established corporation) and then increase its ownership over time.

The resurgence of special purpose acquisition companies (SPACs) in 2020 and early 2021 presented PE firms with additional opportunities to raise capital and exit their investments; however, these deal-hungry and capital-ready vehicles also increased competition for potential acquisitions. While U.S. SPAC transactions appear to have slowed in recent weeks, European exchanges and listing authorities have shown increasing interest in such deals, particularly in the U.K. and the Netherlands, to avoid being left behind.

Sectoral Focus

Unsurprisingly, some sectors have rebounded more quickly than others, with tech, health care, financial services and industrials receiving the greatest investor interest. This divide may have been driven by the increase in remote work and inevitable focus on health care resulting from the pandemic. However, the multiple lockdowns in many countries and "false dawns" may have also played a part: Investors are looking more closely at the resilience of businesses and their ability to withstand the turbulence that may result from another wave of infections. In addition, investors are increasingly aware of asset digitalization's potential influence on exit valuations. This focus will likely continue, with specialized (or even sub-specialized) buyout funds with sectoral focuses increasingly gaining prominence. However, as investors gain confidence in the permanence of economic reopening and in the high level of pent-up consumer demand, opportunities in more distressed sectors, such as brick-and-mortar retail, travel and leisure, may also attract interest.

Speed and Due Diligence

Increased caution at the pandemic's onset led many private equity houses to spend greater time and resources on due diligence. Coupled with efforts to adapt to the remote working environment, this lengthened the timetables for pending transactions. In the current market, there is increasing evidence of the converse — transactions for the most highly sought-after assets, particularly in the sectors noted above, are being done at a faster pace than before the pandemic, with lighter-touch due diligence, as investors chase assets. Practice may follow the state of the market — for example, if the continued economic recovery is not as quick as currently predicted and buyers become more cautious, we may see a shift back to a more risk-averse approach.

Focus on Environmental, Social and Governance Considerations, Including Diversity

The pandemic intensified the focus on ESG considerations, with wider societal changes influencing PE firms' increasingly proactive approach. Public demand from limited partners, along with consumer — and employee — preferences for "ESG positive" companies, is expected to drive this further, with the ESG umbrella seen as covering a growing range of aspects, including the operations of financial sponsors themselves, from lockdown's blurred boundaries between work and home to employee mental health. Predicting how these factors will impact long-term working practices in the PE industry is difficult, but they appear to be impacting recruitment discussions. Similarly, the Black Lives Matter and similar movements have sharpened the focus on improving diversity, both within the PE industry and the businesses it influences.

Remote Working

Most, if not all, PE houses previously favored in-person meetings, particularly for fundraising and key management sessions. As legal restrictions on travel and in-person work recede, the timing and terms of returning to the office remain uncertain — will vaccinations or negative tests be mandatory? Which of the changes to working practices that resulted from COVID-19 will continue? The number of in-person meetings may initially rise above pre-pandemic levels as people try to make up for lost time, but uncertainty also exists around the future of business travel and the extent to which the City of London will remain the primary locus of work. A substantial portion of the professional services supporting the PE industry appear to be adopting permanent hybrid arrangements, but financial sponsors' positions are less clear.

Conclusion

As the PE industry, fueled by ever-increasing amounts of "dry powder," continues its dealmaking run and optimism grows that the pandemic will soon be behind us, there will inevitably be some uncertainty over the shape that a post-pandemic, post-Brexit U.K. PE industry will take. But COVID-19 has nevertheless brought — or, in some cases, simply accelerated — changes that we expect to feed into the new status quo.