INSIGHTS

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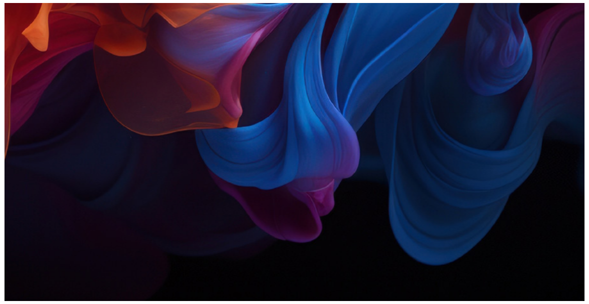
PRIVATE EQUITY WIRE



GLOBAL OUTLOOK 2024

FOREWORD

Value creation, thriving secondaries markets, a big push on infrastructure, private wealth spotlights, multi-strategy funds, the credit boom and a focus on liquidity are just some of the highlights we're expecting from private markets in 2024.

The industry is abuzz. Though economic uncertainty remains, the mists have cleared on many fronts – LP priorities, growth sectors including the resurgence of tech assets, and the staying power of an elevated interest environment among them. The rapid advancement of AI, and the somewhat more staggered progress towards sustainable investing, remain constant driving forces.

The Private Equity Wire Global Outlook Report 2024 features contributions from the leading names in private markets worldwide.

In section one, we read market overviews – the interplay of macroeconomic forces and the world of alternatives. Among the contributors, Blackstone's recently appointed Global Co-Chief Investment Officer, Lionel Assant, talks about resilience and growth in the European private markets landscape.

Section two zooms in on deal hotspots emerging under current market forces. Experts from BlackRock and Apollo give us the big picture, while Adams Street's Brian Dudley give us insight into growth equity opportunities.

Many have talked about the importance of value creation in the current private markets environment – learn from Permira, Riverside and Thoma Bravo experts in section three about the role of tech, operational efficiencies and ESG in building up asset value.

And finally, the energy transition continues to demand more financial backing, which aligns with a growing focus on impact investments and opportunities worldwide. Experts from Tikehau, Blue Earth and Stafford offer insight on this front in section four.

We would like to take this opportunity to thank all our contributors, and we look forward to bringing you the latest insight on private markets trends throughout the course of 2024.

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MARKET FLOWS

Leaders from Blackstone, Federated Hermes and others offer their take on macro shifts and their impact on private markets worldwide

> We prioritise investing in faster growing sectors of the economy, in businesses that can remain robust in an economy that may be slowing

LIONEL ASSANT
EUROPEAN HEAD OF PRIVATE EQUITY
BLACKSTONE

Blackstone takes a long-term view when investing and we believe Europe remains an attractive proposition. 2023 has undoubtedly been more subdued for deal making with rising rates, inflation and geopolitical instability creating headwinds. While it is reasonable to assume relatively low economic growth as we move into 2024, the fundamentals of our approach to investing remain the same and the green shoots in deal making provide an indication of activity picking up.

We prioritise investing in faster-growing sectors of the economy, in businesses that can remain robust in an economy that may be slowing. These sectors — digital consumer technology, software, energy transition and travel and leisure industries, to name a few — are supported by long-term tailwinds that can deliver returns for our investors. Our conviction in these sectors mid to long-term is strong despite inevitable short-term headwinds when the overall economy slows down.

Technology is increasingly shaping how we live and work. Our recent investment in Civica, a leading provider of mission critical software to the UK public sector, will help public services significantly reduce administration and focus on their constituents. In the energy transition, our investment in Enstall (previously Esdec), an international player in the rooftop solar space, will support the decarbonisation of the global economy. We also continue to back the UK staycation market. This year, we invested £170m into Haven Holidays, the UK's leading holiday park operator, to support facilities upgrades and create 500 new permanent jobs, in addition to acquiring two hotels in England and Scotland as we continue to grow our brand of UK adults only Warner Leisure Hotels. Civica, Enstall and Bourne Leisure are recent examples of European companies having grown significantly ahead of the GDP, while creating tangible value for our investors.

Another key facet of our investment approach in our private equity business is that we focus exclusively on control-orientated transactions with an emphasis on primary deals with significant buy-and-build potential. This is where we have deployed the vast majority of the $20bn in Europe over the past two decades. In these investments, we can drive real transformation through our portfolio operations team, which is even more critical to create value at times where the economy is sluggish, like it may well be in 2024. One such example is stow Group, a leader in racking solutions, where we supported the creation of a brand new robotics division. The growth of e-commerce has driven an acceleration in warehouse demand, and modern, scalable logistics automation systems are fundamental in taking warehouses to the next level of sophistication.

Despite the undeniable challenges we have seen through 2023, we have also seen remarkable resilience across Europe. Challenges around cost and availability of capital remain and interest rates are expected to remain higher for an extended period, which will create attractive entry points for new deals and interesting opportunities for Blackstone in 2024. We look forward to the new year with optimism.

BROOKS HARRINGTON

PARTNER - HEAD OF NORTH AMERICA, PRIVATE EQUITY

FEDERATED HERMES

After a 40 year absence from developed economies, inflation returned with a vengeance and continued into 2023, forcing governments and central banks to raise base rates, trim spending and remove capital from the global economy. As an asset class that came to maturity during the low interest rate and inflation period, private equity benefited from rising valuations, readily available credit for debt packages, the funding of cash-intensive business models and a consumer that was willing and able to spend. The next ten years will be driven by different tailwinds.

In the year ahead, the unlevered or low-levered parts of private equity are likely to have an easier ride while rates stay high and financing conditions tight. This typically includes lower mid-market, growth buyout and transformational plays.

While public markets continue to be difficult to predict with any degree of certainty, there is plenty of dry powder still out there in the private markets for deal flow activity. However, pressure on valuations for all but the top tier assets will likely keep the temperature from rising too fast. The upside scenario would be a rate cut beyond expectations and/or dovish posture from the central banks which could raise multiples and revive the exit market.

2023 saw a tougher fundraising environment and the industry caught its breath after what was an environment of extremely rapid-fire fund raises during the ‘great exit’ years of Covid. In 2024, some LPs will be ready to restock but the denominator effect is likely to continue, which in turns links into cross-asset class market performance.

Given the macro economic and turbulent geopolitical backdrop, consistency of performance through cycles will be in sharp focus for allocators. The past three to four years have seen a global pandemic, wars, a stock market roller coaster and the sharpest rise in bond yields globally in four decades. In light of these obstacles, funds that can show consistency of performance during these tough times are likely to be the best positioned.

The constriction of available capital within the private equity space will continue to reward investors who have dry powder—coupled with the experience and track record of investing through cycles—and have global reach that provides an abundance of potential investment opportunities.

In 2024 and beyond, investment returns for private equity will rely more heavily on organic revenue growth and cash flow generation in their portfolio. Successful investments will be driven by business models that are not only exciting and providing real economic value in the short-term but will also remain compelling and valuable in five or ten years’ time. We’ve observed in our portfolio that companies which are squarely on theme in structural megatrends like tech-led innovation, healthcare and net zero-led transformation of big industries are likely to continue to see strong demand independent of the cycle.

Industries such as blockchain and AI will provide further potential opportunity for investors that are able and willing to participate but must also be able to separate the hype from reality from an investment perspective.

As with any economic environment, there will always be prudent investments available for private equity, but with new tailwinds taking shape, flexible global investment frameworks will be required to seize the opportunities created by market conditions.

GREG MOERSCHEL
MANAGING PARTNER
BPOC

BPOC is a 27-year-old healthcare-focused PE firm focused on the US middle market. The firm invests across four verticals: providers, outsourced services, manufacturing and distribution, and pharmacy. We adhere to three principles when evaluating an investment: controlling costs, broadening access, and improving quality.

The last decade has produced consistently strong returns in US healthcare largely due to an abundance of inexpensive leverage, emerging business models predicated on consolidation and a relatively quiet regulatory and reimbursement environment. As interest rates rose from 2022-23, the cost of leverage has affected portfolio company cash flows. While leverage is available, the quantum is less, which in turn has affected new platform investment activity and exits. Today, the market is highly bifurcated, with most assets trapped in a valuation standoff between buyer and seller expectations. Still, some of the highest quality assets are trading, albeit at slightly lower multiples compared to 2021 and 2022.

Recent news from the Fed Reserve, which foresees interest rates cuts in mid-2024, may provide a catalyst to more transaction activity. We suspect, however, that the motivation of the Fed to formally set this expectation is a function of both a view that the economy is weakening and a subtle political influence as the elections approach. It was just a few weeks ago that the Fed was guiding us toward “higher for longer”, despite the bond market pricing an inverted yield curve. In any case, lots of speculation and contradictions exist. We conclude that if interest rates do in fact fall in the next six to nine months, deal volume will pick up if for no other reason than the bid-ask spreads between buyers and sellers will narrow. However, this may be happening against a backdrop of slower macro economic growth.

Specific to US healthcare, we expect more dispersion in results in this next cycle. Why? From 2019 to 2022, dozens if not hundreds of consolidations (mostly in the provider segments) were initiated at very high valuations by both healthcare specialists and multi-sector funds. Today, many of these companies are starved for acquisition capital, overlevered and without obvious exit options. The result will likely be longer hold periods and lower returns for firms that have bet heavily on consolidation strategies. The specialty physician practice management sector is the most obvious. Further, we anticipate reimbursement pressure in 2025, the first year of a new President and Congress, and with profound budget issues on the horizon.

At BPOC, our most recent funds have been weighted significantly toward outsourced services, namely staffing and services to payers and providers. The staffing assets have clearly outperformed and should continue to do so as the US has a long-term secular shortage of healthcare providers. In addition, we have successfully and consciously constructed our portfolios with diversity of business models and value drivers. Specifically, we underwrite organic growth most importantly and tend to rely less on acquisitions. In 2024-25 we are focused on, among other sectors: manufacturing, riding the very real re-shoring tailwinds; technology-enabled cost containment solutions and services; consulting services; and niche provider businesses with a focus on special populations. The theme is decidedly around cost containment.

KEISUKE YAMASHITA

CHIEF INVESTMENT OFFICER, MANAGING DIRECTOR, HEAD OF VENTURE CAPITAL & PRIVATE EQUITY INVESTMENT

MCP ASSET MANAGEMENT

As global investors continue to diversify their portfolios, Japan's venture and growth capital landscape is emerging as an attractive, relatively untapped area of opportunity. The country's venture capital ecosystem, while growing, is still maturing compared to its counterparts in the US and China. While the total startup funding amount in Japan only is about $6bn, this represents a tenfold increase since 2013. This maturation highlights that Japanese startups, especially those in deep tech sectors like robotics, are ripe for growth and global expansion. These sectors are where Japan holds a competitive edge, yet they often require substantial investment to compete globally, creating a unique niche for discerning investors.

There's a notable gap in the middle-market segment, particularly for growth capital. Many Japanese startups that have completed the proof-of-concept stage are undervalued compared to their Western counterparts. This presents an opportunity for investors to enter at an attractive price point. Additionally, the Japanese government's commitment to bolstering the venture capital environment, especially in supporting foreign investment in promising companies and accelerating deep tech innovation, is emphasised by their recent initiative, announced last year, which aims to grow investment into Japanese startups to some JPY10tn ($66bn) by 2027. This initiative is a clear signal of the country's intent to foster a vibrant entrepreneurial ecosystem.

Japan's venture capital potential extends beyond Tokyo. Regions such as Fukuoka, strategically positioned near major Asian markets, highlight opportunities in Japan's heartland. Success stories of giants like Toyota and Nintendo, which originated from regions outside Tokyo, affirm their vast potential. Furthermore, Japan's venture capital appeal extends to positive social and environmental impacts. With a focus on addressing issues related to the country's aging population and energy transition, there are opportunities for impact investing that align with global trends towards sustainable and socially responsible business practices.

The Japanese market is also witnessing the infusion of talent from investment banking and private equity into the venture space, bringing global expertise in scaling businesses. It adds a layer of credibility and viability to these ventures, making them more attractive to foreign investors.

Investor interest in Japan is increasingly coming from diverse sources, including family offices and smaller allocators with existing ties to the country. However, appeal of Japan's venture ecosystem is becoming more apparent, as US and European institutional investors are increasingly seeking opportunities in sectors where Japan has a strong foothold.

The distribution to paid-in capital (DPI) ratio is a critical factor for investors. In Japan, this ratio is competitive with markets like the US or China, indicating a healthy market capable of offering robust returns. As the ecosystem matures, it is poised to attract larger institutional investors. The challenge of aligning ticket sizes with startup needs is being addressed, making the ecosystem increasingly accessible to foreign capital.

In conclusion, Japan's venture capital landscape in 2024 offers an opportunity for investors looking to diversify and capitalise on emerging trends in the global economy. With government backing, a focus on sectors where Japan excels and a maturing ecosystem conducive to growth and innovation, the Japanese market represents a promising avenue for global investors.

DEAL HOTSPOTS

BlackRock, Apollo and Adams Street identify market segments likely to house the most deal activity through 2024

LYNN BARANSKI

MANAGING DIRECTOR, GLOBAL CO-HEAD OF PRIVATE EQUITY PARTNERS

BLACKROCK EQUITY PRIVATE MARKETS

2023 has seen rising interest rates, prolonged inflationary pressure, as well as broad economic and geopolitical uncertainty, all leading to slower deal activity. Nonetheless, private equity has historically outperformed global public equity markets across market cycles, including during times of significant market volatility, and we remain optimistic for 2024.

In the developing environment, private equity managers will continue to do what they do best – emphasising long-term value growth over short-term performance. Specifically, managers will continue targeting businesses facing long-term market tailwinds amid positive secular shifts, benefiting from an asymmetry of information inherent to the due diligence process in private equity and injecting capital efficiently to expedite value creation.

Looking ahead to 2024, persistently high interest rates will impact company valuations and debt levels. Amid this shift from lower to higher rates, the market can be divided into deals concluded pre- and post-2022. Pre-2022 deals, executed in a low-rate setting, now face increased SOFR rates, redirecting cash flow from business reinvestment to interest and debt repayment. In the current high-rate environment, new deals will be financed with lower absolute debt levels, necessitating either reduced asset prices or increased equity contributions compared to pre-2022 transactions.

In the coming year, we expect most value creation to come from top-line growth and margin improvement led by hands-on engagement by shareholders and alignment with management.

We expect high-quality sectors such as healthcare, technology, industrials and selective financial services to remain an investment focus. We also expect investment opportunities to arise behind 'near-shoring' trends impacting supply chains, as well as selectively in defence and space opportunities given geopolitical tensions and fragmentation, and transition energy opportunities.

We are currently seeing very high-quality deal transacting where there is a significant M&A component to value creation, which can be done at much lower multiples to bring the blended purchase price multiple down. This strategy provides lower cost M&A tuck-ins, and the ability to drive top-line growth while often finding synergies.

In addition to buy and build strategies, as large companies navigate economic uncertainty and evaluate strategic needs, we expect an increase in corporate carve-out activity. These deals are opportunities to acquire non-core divisions, that have likely been under invested with weaker management teams. We engage when we see proven business models with untapped value creation potential where we can bring in best-in-class management with properly aligned incentives.

Similarly, companies under strain due to rising interest rates may represent attractive distressed and troubled asset opportunities.

We expect private equity investors to continue to capitalise on depressed public equity valuations for long-term growth by executing take-private transactions.

Venture capital and growth companies, often without debt, thrive on innovation, disrupting traditional industries, or creating efficiencies. As companies stay private for longer, high-growth exposure can increasingly be found in private markets. In 2024 and 2025, we expect to see consolidation in the growth space and to find compelling opportunities at more attractive prices.

We remain optimistic that private equity will continue to outperform public markets as we take on the challenging market environment in the coming year.

MATT NORD
CO-HEAD OF EQUITY
APOLLO

DAVID SAMBUR
CO-HEAD OF EQUITY
APOLLO

The dominant stories for private equity in 2024 will continue to be the elevated cost of capital, the looming maturity wall and the need to return capital to LPs. It has been almost two years since interest rates began to rise, and many in the industry are still adjusting to this new normal. As we move through 2024, we expect to see more deal activity overall, and especially from firms that demonstrate an ability to adapt. Firms that maintained price discipline and avoided over paying for assets throughout the high-growth, low-rate environment following the financial crisis have seen greater success weathering this more volatile, higher-rate environment, and we expect that they will continue to find investment opportunities in 2024.

In terms of capital deployment opportunities, we see significant value stranded in the public markets for investors who know where to look. Public index averages can be quite misleading. For example, while the S&P 500 as a whole is up approximately 15-20% for the year, just seven stocks have driven almost all the gains. If you look below the surface, you get a much different picture. Many public companies are trading below their 10-year averages, especially medium-sized companies that are more typical private equity buyout candidates. Corporates are increasingly open to exiting the public markets in this environment, so we expect that public-to-private transactions will continue in the year ahead.

We also expect sponsor-to-sponsor transaction volume to be robust as monetisations accelerate in 2024 and beyond. As rates increased over the past two years, some private equity firms adjusted capital structures to try to extend their runway and hold out for better returns. But this can only continue for so long. Over time, firms will increasingly look to exit investments, especially if the equity markets continue to improve. Sponsors holding on to attractive assets may look to return capital to their investors without fully monetising their investments. These firms might increasingly consider hybrid solutions or structured transactions that enable them to partially monetise while keeping a stake in their investment. This dynamic will create opportunities for industry players who are able to act as solutions providers to other private equity firms.

Above all, creativity will be at a premium in 2024 when it comes to structuring and sourcing transactions. Firms that have weathered cycles in the past and demonstrated an ability to maintain discipline and find innovative solutions should be well-positioned to continue to transact and create value in the year ahead.

> *Past returns of growth equity managers can give investors a false sense of security*

BRIAN DUDLEY
PARTNER, GROWTH EQUITY
ADAMS STREET PARTNERS

At Adams Street, we've been in the fortunate position to observe the intricacies of the growth stage ecosystem over several market cycles, when there have been great as well as less attractive times to invest. In our view, which period we are in tends to be largely determined by two (mostly) independent factors.

The first is the state of technological innovation, which provides the basis for managers to make compelling investments. While it is difficult to predict the 'what' or 'when' of each innovation cycle – be it smartphones, the Internet, cloud computing or generative AI – technological innovation is an immutable force that compounds over time, which can provide larger and ever more significant value creation, and capture, for companies and their managers over subsequent decades.

The second factor is the balance, or ratio, between the supply of capital provided by growth managers, and the demand for capital by growth companies.

In late 2020, supply of growth capital outweighed demand, which is why we saw the size of capital rounds balloon and valuations skyrocket. That imbalance has now reversed so that today – and, in our opinion, likely for the foreseeable future – demand for growth capital far outweighs supply.
We think there are three key reasons for this recent reversal:

1. In late 2022 and early 2023, the valuation reset encouraged many growth companies to delay fundraising. Many of those companies now need to raise capital because their cash balances have dwindled.

2. Over the past handful of years, an active and vibrant early-stage VC ecosystem funded a significant pipeline of promising and highly innovative companies. As these companies mature and grow, many will graduate into the growth stage and require capital to continue their trajectory.

3. For numerous reasons, many non-traditional growth equity participants have left the market. In 2022, their share of deal volume fell (Pitchbook), in our opinion a trend that is likely to continue in 2023 and beyond, reducing the pool of available capital to growth stage companies.

This supply/demand dynamic is so important because it significantly influences investment returns. Owing to the current state of technological innovation and the current supply/demand dynamic, we believe we could be at the onset of one of the best investing environments in almost a decade.

However, past returns of growth equity managers can give investors a false sense of security. Robust economic conditions over the past decade allowed many managers to experience unrealized mark ups (as well as lower loss rates) in their portfolios. But the economic climate has changed, which is likely to put pressure on many managers' portfolios.

In our view, robust innovation trends coupled with a favourable ratio of capital demanded to capital supplied are likely set to create one of the best growth stage investing environments in recent memory.

Such investment periods don't come around often, making it critical for managers to take advantage of the opportunity. To do so, we believe growth equity managers must possess three key characteristics: a differentiated approach to originating and winning deals; a proven approach to underwriting; and an experienced team that can execute against the opportunity set. Conducting diligence on a growth manager's existing portfolio is also essential to expose the absence of one or more of these critical traits.

VALUE CREATION

The best routes to value creation, as laid out by leaders from Thoma Bravo, AssetMetrix, Riverside and Permira

HUDSON SMITH

PARTNER
THOMA BRAVO

There's an old adage in dealmaking that companies are bought, not sold. With interest rates, and therefore the cost of capital, expected to remain high in 2024, I predict that even in another year of muted dealmaking volumes, only the best companies will be bought. In the new year, I think we'll see strategics continue to be acquirers of exceptionally well-run businesses and PE portfolio companies serve as active buyers, taking advantage of strategic opportunities, particularly in the middle and lower-middle markets.

As software-focused investors, we look to invest in the best companies in what we think is one the best, most innovative and resilient sectors regardless of the macro environment. Enterprise software continues to be incredibly durable in the face of economic headwinds due to how mission-critical it is to customers. During times of economic uncertainty, we have seen, and (I predict that) we will continue to see, an increase in companies adopting software solutions to automate aspects of their business in an effort to reduce costs and improve profitability.

As AI went mainstream this past year, people began to see just how powerful a tool it can be for increasing productivity. While AI is new to many, it's something that software companies have been using for years to better serve their clients. In addition to continuing to adopt AI, I expect software companies will continue to look to strategic M&A to enhance product offerings and for this to be a bright spot of activity within the overall dealmaking ecosystem. I also expect to see strategic buyers outside of pure play software seek to purchase software companies to take advantage of these trends and accelerate their digital transformations.

In a high interest rate environment, I expect to continue to see buyers prioritise acquisitions of companies with best-in-class operations, underscoring the value a sponsor can add by focusing on operations. Being a GP that can create value by improving operations rather than through financial engineering has outsized importance in this environment. While different in many ways, we are seeing parallels to the financial crisis of 2008-2009 when firms that focused their efforts on transforming companies to be best-in-class across metrics through operational discipline saw positive outcomes as economic conditions improved.

Despite my general prediction that 2024 will be another year of uncertainty, I am bullish on the value creation opportunities that result from operational excellence and hope to find new deals where this can be applied. I remain confident in the software sector and have witnessed its demonstrated ability to thrive in even the most challenging economic environments.

DR. DIMITRIS MATALLIOTAKIS

CEO, CHIEF PRODUCT & TECHNOLOGY OFFICER

ASSETMETRIX

Will AI disrupt the private capital industry in 2024? Not in terms of adoption. Still, 2024 will reaffirm the accelerating digitalisation of the private capital markets that is reflected in the ever-increasing technology investments by GPs, LPs, and all asset servicers. This trend has not been substantially affected by the slow down in deal making and fundraising activities in 2023 and we expect it to pick up pace in 2024.

So, if AI is not expected to be the top priority in terms of actual technology adoption this year, what will the focus topics be? Two core challenges set the agenda for technology projects in 2024 and beyond: available, consistent, actionable data and digital workflows across organisational borders.

Effectively addressing the first challenge has triggered a shift in technology spend from point solutions, which have created data silos along the industry's value chain, to single-source-of-truth projects. The latter not only integrate multiple data sources into consistent, actionable data sets, but also for the open-platforms paradigm that can leverage the power of interconnected data flows to deliver actual value from data. These projects are demanding but will transform the industry in the mid-term. They will drive standardisation of interfaces and data exchange formats, will make impactful automation – already expected to be radically enhanced by AI – more feasible, and they will positively affect performance by analytics-driven strategies and execution.

The challenge of deploying adequate digital workflows across organisational borders goes beyond an integrated data layer to include human collaboration. Investing in platforms that can support intuitive, industry- and activity-specific digital workflows and automation to improve on inefficient and opaque operations, error-prone actions and time-consuming reconciliations is a priority in 2024. Well-established and new technological capabilities including machine learning are at the core of such projects, and their scope includes all interactions between GPs, LPs, asset servicers, and other third parties. Of particular focus this year are digital investor journeys and day-to-day fund operations.

The core drivers behind technology adoption have remained relatively stable over the past years and will do so in the foreseeable future as well: operational scalability, of particular importance in a year expected to bring the industry back on track for accelerated growth; regulation and the demand for higher transparency by institutional investors; technology as an instrument for competitive advantages in performance, quality of service and new market opportunities; and, last but not least, cost efficiency and the need to close the accumulated innovation and digitalisation gaps when compared to other industries.

Beyond 2024, the recent and further advances in AI will strongly impact technological agendas and innovation roadmaps. The easy utilisation of large volumes of unstructured data by leveraging the capabilities of large language models is expected to become common practice in the coming years. So will co-pilot functionalities and, very likely, insights by more effectively crunching numeric data.

In the coming years we anticipate the emergence of an ecosystem of interconnected open platforms that will facilitate and accelerate value generation in a truly digital manner. The need for such an industry-specific ecosystem will most likely trigger the consolidation of today's and tomorrow's diverse initiatives and technologies to a small number of dominant regional and global platforms.

KARSTEN LANGER
MANAGING PARTNER, EUROPE
RIVERSIDE

How does private equity generate financial performance in a low-growth environment? Given the latest GDP growth forecast for the EU in 2024 sits at less than 1%, this is a question many private equity firms may have spent the winter break pondering.

With today's now-pricier debt, and the fact that exits of any sort are more difficult to achieve, generating genuine organic growth has never been more important.

We believe the lower mid-market is the ideal space to deliver the performance that investors expect and need. The beauty of this segment is that you can always find pockets of growth, even when the overall economy appears to be sluggish or even flirting with recession, as seems to be the case at the moment.

The key lies in target selection and operating support. For us, target selection has this year meant finding companies that either benefit from a macro trend or market shift, or disrupt an existing way of doing things with a new and better solution, and we have this year found those in diverse sectors such as food, software, data and analytics and healthcare.

Providing robust operating support can allow a PE investor in the lower mid-market to help portfolio companies grow during times of economic turbulence more easily than larger companies – assuming it has the right team and tools in place.

Small companies tend to have more to gain from private equity ownership, as they typically are less developed from a management and governance perspective. Private equity firms bring strategic guidance to help companies refine their strategies, identify growth opportunities and navigate challenges, as well as management support and operational expertise to optimise day-to-day operations.

Prior to institutional ownership, smaller companies also may find it harder to take advantage of strategic growth opportunities such as international expansion, M&A, product and service development, digitisation, and sales force automation, all of which require capital and expertise to achieve. Private equity specialises in providing this type of support, helping businesses to capture and consolidate market share, enter new geographic markets and diversify sales offerings.

Deals in this market space are rarely highly leveraged, therefore in market conditions like we are seeing today — where debt is more expensive and less easy to secure — new investment activity does not grind to a halt and companies are less likely to suffer from debt overload than those at the larger end of the market.

From our vantage point of having invested in and supported hundreds of lower mid-market companies across the world, we are confident that, while the year ahead might not be the most positive we have ever experienced, the lower mid-market is the only place we would want to be investing capital, and growing businesses, at the current time.

> *The role of technology in ESG implementation and measurement will continue to grow*

ADINAH SHACKLETON
HEAD OF ESG
PERMIRA

The interest rate landscape and pressure on the financial engineering model for returns mean that value creation is very much in the spotlight for 2024. Certain levers will likely have more appeal than others. Savings-driven operational improvements, for instance, enhanced in part by advances in technology, are in strong favour. As a whole, building future readiness at portfolio companies will be seen as significant value addition. Integral to these efforts is progress along environmental, social and governance (ESG) metrics.

Permira's Head of ESG, Adinah Shackleton, says: "Private equity firms will increasingly look to value carbon. Over the past year, we've focused on developing an approach to this for the existing portfolio and for selected new investments. Next year, we'll continue to develop this to better understand carbon-related liabilities and risks, but also value creation opportunities in the portfolio. For example, this year we worked with a healthcare company to identify potential cost savings of EUR6.5m per annum at one site by looking at their operations through an energy and decarbonisation lens."

Indeed, wider digital advancement will benefit ESG as a value creation lever, too. "The role of technology in ESG implementation and measurement will continue to grow. Tech-enabling ESG can provide numerous benefits for private equity and portfolio companies. Whether for data collection and reporting, climate scenario analysis, carbon foot printing tools or reputational risk monitoring, utilising these tools is increasingly important to ensure any ESG strategy is efficient and effective."

Collecting and reporting on data is also crucial from a compliance standpoint. In Europe, steadily evolving requirements under SFDR have put pressure on companies for reporting and disclosures, for regulators and LPs alike. According to Shackleton, this growing complexity also presents an opportunity to create more touchpoints with portfolio companies.

"Companies are dealing with an increasingly complex regulatory environment on ESG, with a significant step up in requirements for private equity, particularly in the EU but also in other markets. As a result, engagement with portfolio companies on strategy, alongside value protection and creation initiatives, will become even more critical to meeting these heightened expectations."

IMPACT AND ENERGY TRANSITION

How private markets firms can contribute to the energy transition in 2024, as outlined by, Blue Earth, Tikehau and Stafford

"Regulatory tailwinds, escalating public debate, and the heightened awareness for environmental and social challenges encourage a growing number of asset managers to administer their capital in a more responsible and sustainable manner"

KAYODE AKINOLA
HEAD OF PRIVATE EQUITY
BLUE EARTH

2023 was dominated by ongoing economic uncertainty. Lingering inflation, rising interest rates and high volatility contributed to a negative market sentiment. This challenging macroeconomic environment induced hesitance among investors to increase their impact allocation, requiring impact asset managers to be especially diligent with their deployment decisions. Despite this tough landscape, Blue Earth Capital saw strong fundraising and investment across our strategies – surpassing $1bn in AUM targeted at combining measurable impact with market-rate returns.

Interest in impact investing remains high. Regulatory tailwinds, escalating public debate, and the heightened awareness for environmental and social challenges encourage a growing number of asset managers to administer their capital in a more responsible and sustainable manner, while also seeking market-rate returns. To give an example, nearly 30% of investors in a recent Arthur D Little survey expect to increase their impact allocation in the coming 12 months, while a mere 2% plan to deploy less into such assets.

That's why we look positively towards 2024. As officials at some central banks contemplate first rate cuts, a rebound in public market valuations might ease the impact of the denominator effect, affording institutional investors increased opportunities to elevate their private market exposure. With ongoing diversification within the investor base, a growing number of institutional investors recognise the potential and significance of specialised impact investing. Family offices are also increasingly shifting toward impact assets, driven by an objective to combine financial returns with measurable impact. We see this particularly across Europe, with growing interest in Asia and North America.

It's becoming increasingly clear that impact can be combined with attractive financial returns, and a higher number of exits widely expected in 2024 should solidify this picture, supporting impact managers' broader fundraising activities. We see strong investor interest in customised investment solutions focused on environmental and social impact across developed and emerging economies. This is true for private equity and private credit, as well as primaries, secondaries, and co-investments. In line with broader private markets, we observe that secondary transactions are gaining relevance as a way to provide liquidity to primary investors. Blue Earth is currently augmenting its secondary investment activity to deepen market impact, specifically within historically limited frontier and emerging market impact secondaries.

We also see increasing investor appetite for tailored investment solutions offering diversified geographic exposure across key impact themes such as decarbonisation and the overall energy transition – particularly for private equity with a focus on North America and Europe.

With these tailwinds in mind, we believe that 2024 will be an important year for impact investing and are confident that the industry will take yet another important step towards more sustainable and responsible investing practices. At Blue Earth Capital, we continue to focus our efforts and global platform on addressing some of the most pressing environmental and social challenges whilst aiming for attractive financial returns.

PIERRE ABADIE

CO-HEAD OF THE GROUP'S PRIVATE EQUITY DECARBONISATION STRATEGY

TIKEHAU

As we set our sights on 2024, the impact of COP28 in the UAE resonates globally, paralleling the significance of the Paris Agreement. This pivotal summit marked a shift from abstract intentions to actionable strategies, signalling a seismic change in approach.

The unanimous support for a global pledge on renewable energy and energy efficiency by 175+ countries signifies a historic turning point. It's not just about the colossal numbers – tripling renewable capacity, doubling energy efficiency, with an annual investment of $4tn—it's about embracing feasible and achievable targets.

Committing to raising renewable capacity from 3,400GW to an audacious 11,000GW by 2030 is undeniably ambitious. Yet, this formidable goal is within reach, demanding an urgent acceleration – doubling, if not tripling, our current efforts. It's an ambitious but realistic target that underscores the pressing urgency of the present moment.

At Tikehau Capital, we believe that value lies in taking action today rather than waiting for groundbreaking innovations. Over the last 5 years, we've invested significantly – €1.2bn – into 14 companies dedicated to decarbonisation. Beyond financial metrics, this investment employs over 30,000 'green collars' across 100 countries, steering efforts toward electrification, renewable energy and fortifying energy efficiency.

The time of the unicorns has passed; instead, we see value in supporting entrepreneurs in quickly scaling their activities to become what we call 'Green Elephants'. These are companies that exceed €1bn in value by developing a decarbonisation business that doesn't rely on groundbreaking innovations. Our focus is on taking practical, low-tech solutions that truly make an impact, enabling the democratisation of these solutions at scale. This involves creating partnerships across the entire value chain, collaborating with like-minded organisations and people to decarbonise our economy at scale, today. The misconception that impact sacrifices returns is fading. The symbiosis of climate change solutions with suitable assets is yielding market returns – a testament to the marriage of profitability and sustainability.

The revelation by the International Energy Agency that 80% of the necessary transformation to halve our carbon footprint already exists is pivotal. It's about scaling up existing solutions – an urgent plea for conventional finance to amplify these endeavours.

The significant shift in investment trends toward decarbonisation signifies an evolving landscape. Already investing €1.8 in decarbonisation per euro in fossil fuels, this figure is projected to rise from €5 to €10 by 2030 – a significant shift in investment priorities. It is now a global investment market of $1.8tn that is growing 11% per year.

NIELS BARDELMEIJER
PARTNER
STAFFORD PRIVATE EQUITY

JESSE DE KLERK
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The 2023 IPCC report, released in March last year, clearly signalled the challenge for the years ahead. It made for grim reading and issued a 'final warning' on climate stating that without drastic action we will likely exceed global warming targets. The report was a renewed reminder of the vulnerabilities we face in the wake of the climate crisis. We are pushing the boundaries of the resources available on our planet, and without a rapid acceleration of climate action within the investment community, we will struggle to meet the world's needs.

At Stafford, we see the pivotal role that alternative investments can play in supporting the transition to a decarbonised economy and how investors can find value in adding or expanding these opportunities in their portfolios. Adaptation to this new world and strict risk management is key for mitigating these challenges. The IPCC report was a striking reminder that we should all be well underway on our journey to manage and mitigate this.

In order to achieve net zero goals, massive amounts of capital investments are required annually to fund climate solutions. In addition, a successful transition to a net zero economy requires business transformation across industries and on a global scale. We are convinced that private equity is uniquely positioned to finance and support the required innovation and scale-up of new climate solutions and effectuate change through its controlling position and longer time horizon.

As a member of the Net Zero Asset Managers initiative, Stafford is focused on providing solutions to investors that not only are able to deliver attractive financial returns but also support in achieving specific climate-related targets. Specifically within private equity, we develop tailor-made portfolios that support our clients in achieving their specific portfolio decarbonisation targets through investing in a combination of climate solutions, net zero-aligned companies, and low-carbon businesses. Besides the potential to realise a target return, a prerequisite for investment is the willingness to set meaningful and measurable emission reduction targets (or in the case of climate solutions, targets for saved or avoided emissions). During our ownership, we then track progress and engage in case needed, and report the results back to our client.

While this is relatively unexplored territory and there are clear regional differences when it comes to how net zero is addressed in the private equity market, we anticipate substantial changes in reporting and disclosures over the next few years. Investors are increasingly asking for GHG emissions metrics associated with their investments, which allows them to determine the overall emissions profile of their portfolios – and to track progress in decarbonising those portfolios. When we first started to integrate and report on ESG 20 years ago, many people saw this as a theme, and it required a lot of hard work to convince people that this was the only right thing to do. Now, ESG integration has become mainstream and even recognised as a source of potential value. We expect a similar development when it comes to net zero, only a lot faster.

PRIVATE EQUITY WIRE

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