Methodology
In the second and third quarters of 2021, Mergermarket, on behalf of Dechert LLP, surveyed 100 senior-level executives within private equity (PE) firms based in North America (45%), EMEA (35%), and Asia-Pacific (20%). In order to qualify for inclusion, the firms all needed to have US$500m or more in assets under management and respondents could not be first-time fund managers. The survey included a combination of qualitative and quantitative questions, and all interviews were conducted over the telephone by appointment. Results were analyzed and collated by Mergermarket, and all responses are anonymized and presented in aggregate.
Introduction: Total eclipse

The global private equity (PE) industry is scorching hot. Pent-up demand for deals was unleashed in H2 2020 following a brief hiatus as the COVID-19 pandemic sent economies all over the world into lockdown. As we head towards 2022, there is little sign of this momentum letting up.

It doesn’t matter on what front the industry’s success is measured; the numbers speak for themselves. There were 4,605 buyouts globally in Q1-Q3 2021, already beating the annual record for global PE volume.

The rebound is also stark in value terms, with the industry on course to breeze past previous records. The US$1.17tn worth of deals recorded between January and September 2021 has already eclipsed every prior full-year total stretching back to 2015. In other words, annual PE deal value looks set to more than double year-on-year. The previous record of US$846.8bn, set in 2007 immediately before the financial crisis put an end to the credit boom of that period, is already shattered.

Recent activity has also seen the return of mega club deals. One such example in June saw PE giants Blackstone, The Carlyle Group and Hellman & Friedman join forces to acquire Medline.

Several factors are driving this robust activity. Historic levels of monetary and fiscal stimulus have been deployed to reflate economies and mitigate the disruptive impacts of the pandemic, sending public equity and private capital market prices soaring in the process.
Technology is also figuring largely in deal flow, inflating valuations. Whether pure tech assets or businesses in industries that are undergoing a secular digital transformation, technology as a theme is driving demand and pushing multiples higher in what is an already extremely high-price environment. Bargains are few and far between.

**Fundraising record-breakers**

Like dealmaking, fundraising has been similarly bountiful. In the first nine months of 2021, US$630bn was collected by private equity firms, according to Preqin.

Based on the current run rate, the industry could top previous records this year, surpassing US$1.2tn. Mega funds in particular are making their presence known. Blue-chip managers have been a major beneficiary of investor demand, in many cases raising their largest vehicles to date.

Take Hellman & Friedman Capital Partners X, which successfully closed on US$24.4bn in July, or Carlyle Fund XI, which, with a target of US$27bn, will become the largest PE fund ever raised if that figure is reached.

Absent yield in the forever-depressed rate environment and motivated by the denominator effect, investors in search of returns continue to place capital with PE fund managers. Investors understand the transformation that private businesses must go through to succeed going forward, and that PE’s active stewardship of assets is uniquely positioned to benefit from this pressure on companies to redevelop their business models and digital channels.

Strong investor demand, however, hardly guarantees that everything will be smooth sailing. Vaccine rollouts have delivered early results but are decelerating sharply. In some markets, including the U.S., infection rates have had a fourth wave and continue to threaten economic growth.

PE has adapted well to these new realities, conducting due diligence remotely and in many cases ramping up the number of potential target companies screened, as investment teams and committees have more time to focus on deal flow. As the industry navigates its most active period ever, perhaps the biggest challenge is how to compete effectively when putting its dry powder to work.

Amid the ongoing flight to quality, GPs will have to bid high and early to win auctions. The winners in this environment will create opportunities for themselves by drawing upon their existing relationships, from investment banks and legal advisors to corporate partners and sector networks, and even competing fund managers. Being heavily armed with capital is a major boon for the global PE industry. But you can have too much of a good thing. Looking forward to 2022, COVID-19-induced supply chain disruptions and emergent inflationary trends will also need to be considered. Cooler—and more creative—heads will prevail.
Key findings

35% of respondents this year flagged the amount of dry powder and ability to put capital to work as one of the biggest challenges facing the industry.

Almost half (45%) of respondents say they have increased their use of private credit financing in buyouts over the last three years, a noticeable jump from our previous annual PE report, when 35% of respondents reported the same.

To stay ahead of the curve, 80% of APAC firms are locking in a good deal early, while 74% of EMEA firms are creatively sourcing deals. 67% of North American firms are investing in structured equity transactions, including minority investments.

58% of North American respondents expect the number of carve-outs targeted by their firm to increase over the next 12-18 months, a similar result when compared to our survey last year.

29% of respondents single out climate change as the single most important ESG consideration taken into account when contemplating investing, with the second most selected consideration being sustainability (14%).

41% of North American respondents expect market conditions for PE exits over the coming 12 months to be very favorable, compared with just 29% of EMEA respondents and 10% of APAC respondents who say the same.

60% of North American respondents and 49% of EMEA respondents expect a significant increase in LP scrutiny of ESG issues and reporting in deals over the next three years. Just 20% of APAC respondents say the same.
Deal environment: Challenges, processes and auctions

Few GPs will complain about having access to too much money. But extrapolate that out to the PE industry writ large, and mountainous stores of dry powder pose a problem. It naturally leads to stronger competition and higher entry prices, which can make achieving promised returns more challenging if multiples don’t continue to rise during the hold period.

It’s a familiar story. The industry has battled with its own success for a number of years already and, like so many other trends, the pandemic has shifted things up a gear. Investor demand for PE is at an all-time high and money is pouring into fund managers’ coffers, increasing demand for deals. It follows that more than one-third (35%) of respondents this year flagged the amount of dry powder and ability to put capital to work as one of the biggest challenges facing the industry.

“If you’re in an auction right now, it’s extremely competitive. You almost have to preempt it in order to win,” says Markus Bolsinger, co-head of Dechert’s PE practice. “You have to pay at the very top end, and leaning on your existing relationships is becoming increasingly important.”

A third (33%) of respondents also point to challenging region-specific economic and political factors, including myriad macro risks at play in the current market. Uncertainty around the sustainability of current growth rates is likely to persist, especially as COVID-19 infection rates continue to wax and wane. Over the past nine months, inflation has also been a major concern for
While taxes alone do not tend to meaningfully affect appetite for deals, any rise could make M&A more expensive on a price-to-earnings basis.

In China, a recent crackdown on the tech and education sectors wiped billions of dollars of value off the Shanghai and Shenzhen stock exchanges. While this intervention may create buying opportunities, the measures have been profound, including a ban on profit-making and capital raising by private tutoring businesses. This has the potential to create a pullback in Chinese PE deal value in the near term as market sentiment cools.

The view from Europe

Europe presents its own obstacles. A broad aversion to foreign investment in sensitive sectors—a concern that has been heightened by the pandemic—is being felt in PE circles. For example, the UK’s stock market has been singled out as a prime source of attractively priced assets since Brexit and its impact on sterling.

However, politicians have voiced concerns over take-privates, namely that the
acquisition of supermarket chains Asda and Morrisons by private equity could threaten the country's food security at a time when supply chains are already under significant strain due to Brexit and the pandemic. The takeover of Ultra Electronics, which serves defense markets, by Advent International-backed Cobham has also been singled out by policymakers for potentially undermining the UK's national security.

Far from easing tensions, the pandemic has exacerbated protectionist sentiment while also increasing the impetus for governments to tax businesses to pay down historic levels of public debt. Private equity will almost certainly come up against these political forces in all regions.

**Material adverse change clause in effect**
Since the early stages of the pandemic, buyer termination clauses have become more prominent features of deal documentation. One form of these are material adverse change (MAC) clauses, mechanisms by which investors can contractually protect their downside, allocating among deal parties the risk of a MAC occurring between the execution of transaction documents and closing the deal. MAC definitions are often vaguely worded—sellers prefer them to be narrowly defined, rife with exclusions for market and industry-wide changes, while buyers hope they can be interpreted more broadly to give them greater protections.

While MAC clauses tend to feature in around 10-20% of all M&A deals (and much more heavily in North America than elsewhere), there are other similar tools at buyers' disposal that are gradually becoming more popular.

“Auto-termination rights, where buyers can terminate the deal if there is a failure under an antitrust or foreign investment regulatory scheme, are becoming more common,” says Christopher Field, co-head of Dechert's PE practice and London corporate group.

Nearly three-quarters (73%) of North American survey respondents have seen some degree of increase in the use of MACs and other termination clauses in the context of the pandemic. In other regions, the rise of buyer-friendly rights is less commonly reported. Around half of EMEA (54%) and APAC (50%) respondents report seeing an increase in these contract features recently. This differential should be expected. For example, in a typical PE sale in Europe the buyer does not have any walkaway rights, unlike in the U.S.

Over 70% of all respondents also say they have seen an increase in the negotiation or expansion of wording around what events constitute, or more precisely what do not constitute, a MAC, and more than 80% of all respondents have seen an increase in the use of representations & warranties (R&W) insurance.
and other seller cost benefits. R&W policies were already widely used pre-pandemic, as they have benefits for both sides of a transaction. For buyers, the insurance protects against inaccuracy in the representations and/or breaches of the warranties by the seller. For the sell-side, the availability of R&W insurance offers a means to push for public-style, walk-away transactions. Prior to these policies being adopted, sellers would be expected to withhold 10% or more of the purchase price in escrow to back-up any potential indemnification claims. Reducing or entirely eliminating this escrow improves liquidity and PE investors’ IRRs, and the impetus for putting these protections in place has never been greater.

Given the unpredictability of the economic restart and its sensitivity to the ebbs and flows of the ongoing pandemic, one should expect to see the increasing prevalence of R&W insurance and buyers continuing to pay close attention to MACs and other contractual termination rights.

**Horizon scanning**

When surveyed for our last annual report, a large share of respondents (42%) suggested a Biden victory and Democrat control of Congress would have a negative impact on the U.S. private equity market. Much of that resistance stems from the new administration’s hopes to update the U.S. tax code, not only by hiking the corporate tax rate but also the long-term capital gains tax rate. These changes have yet to come to fruition and therefore remain a concern.

When asked which upcoming developments will have the biggest effect on the deal environment over the coming 12-18 months, respondents most commonly point to higher corporate tax rates (30%).

“People do not know what is coming, but an increase in taxes is widely expected. Sellers have already been putting up everything that is ready for market. Even though a company may not be entirely ripe for exit, funds are making the analysis of whether selling now in the current tax environment makes sense versus what they expect the environment to potentially be next year,” says Bolsinger. “I think there will be another rush to close transactions prior to year-end.”

Tax is not only a consideration for U.S. investors. Public debt has skyrocketed globally as governments provided fiscal stimulus through the pandemic and increasing the

**HAVE YOU SEEN AN INCREASE IN THE NEGOTIATION AND/OR EXPANSION OF WORDING OF WHAT CONSTITUTES A MAC (MATERIAL ADVERSE CHANGE)? (YES ONLY)**

<table>
<thead>
<tr>
<th>Region</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asia-Pacific</td>
<td>70%</td>
</tr>
<tr>
<td>EMEA</td>
<td>77%</td>
</tr>
<tr>
<td>North America</td>
<td>71%</td>
</tr>
</tbody>
</table>

**HAVE YOU SEEN AN INCREASE IN THE USE OF WARRANTY AND INDEMNITY INSURANCE/REPRESENTATION AND WARRANTY INSURANCE AND OTHER SELLER COST BENEFIT (SUCH AS BUYER BEING LIABLE FOR VDD COSTS)? (YES ONLY)**

<table>
<thead>
<tr>
<th>Region</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asia-Pacific</td>
<td>85%</td>
</tr>
<tr>
<td>EMEA</td>
<td>83%</td>
</tr>
<tr>
<td>North America</td>
<td>80%</td>
</tr>
</tbody>
</table>
tax revenue will be one means of addressing this. What’s more, countries have long sought to stop profit shifting and there are signs this may finally be resolved.

In July, the Organization for Economic Co-operation and Development hosted talks centering on a global overhaul of cross-border taxation of multinationals, with 130 countries backing plans for new rules that would levy a global 15% rate based on where profits are made. The plans were finalized in October and will take effect in 2023. However, given its focus on the very largest companies in the world, PE managers are unlikely to bear the brunt of these changes.

**Economic issues**

Other developments expected to shape the PE dealmaking environment over the next 12-18 months include the potential for another recession, cited by 29% of respondents, while conversely 26% say that economic growth (or a lack thereof) will impact the deal market.

Growth prospects remain highly uncertain. While countries displayed a sharp rebound in H1 with the economic restart, there were signs of deceleration in the third quarter, with GDP having been supported in the short term by monetary and fiscal intervention. By distorting earnings projections and risk-reward calculations, historic central bank and government support for the economy can make dealmaking especially challenging.

“Government stimulus programs will affect the deal environment,” says one survey respondent who is the managing director of a U.S. PE firm. “The number of opportunities and risks will change. Dealmakers also need to think about inflation and how it would affect the demand for their company products and services.”

**IN YOUR ESTIMATION, WHICH CURRENT OR UPCOMING DEVELOPMENTS WILL HAVE THE BIGGEST EFFECT ON THE DEAL ENVIRONMENT OVER THE COMING 12-18 MONTHS? (RANK THE TOP TWO 1-2, WHERE 1 IS MOST IMPORTANT)**

<table>
<thead>
<tr>
<th>Development</th>
<th>Rank 1</th>
<th>Rank 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Higher corporate tax rates</td>
<td>16%</td>
<td>14%</td>
</tr>
<tr>
<td>Potential downturn/recession</td>
<td>18%</td>
<td>11%</td>
</tr>
<tr>
<td>Economic growth</td>
<td>19%</td>
<td>7%</td>
</tr>
<tr>
<td>Fear of inflation</td>
<td>4%</td>
<td>18%</td>
</tr>
<tr>
<td>ESG factors in business (e.g. climate change, diversity, governance issues)</td>
<td>6%</td>
<td>13%</td>
</tr>
<tr>
<td>China economic slowdown</td>
<td>8%</td>
<td>7%</td>
</tr>
<tr>
<td>After-effects of the COVID-19 crisis</td>
<td>7%</td>
<td>7%</td>
</tr>
<tr>
<td>US Government stimulus programs</td>
<td>8%</td>
<td>4%</td>
</tr>
<tr>
<td>After-effects of Brexit</td>
<td>5%</td>
<td>6%</td>
</tr>
<tr>
<td>Civil unrest</td>
<td>2%</td>
<td>7%</td>
</tr>
<tr>
<td>Chinese expansionism</td>
<td>3%</td>
<td>4%</td>
</tr>
<tr>
<td>U.S.-China trade conflict</td>
<td>4%</td>
<td>2%</td>
</tr>
</tbody>
</table>

**Rank 1**

**Rank 2**

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WHAT TRENDS DO YOU SEE GROWING AS AN AFTER-EFFECT OF THE COVID-19 CRISIS? (SELECT ALL THAT APPLY)

- More distressed deals: 60% (Asia-Pacific), 64% (EMEA), 71% (North America)
- Increase of add-on acquisitions for existing portfolios: 55% (Asia-Pacific), 66% (EMEA), 64% (North America)
- Increase of teaming up with strategics: 60% (Asia-Pacific), 63% (EMEA), 58% (North America)
- More seller reinvestment opportunities: 49% (Asia-Pacific), 60% (EMEA), 56% (North America)
- Less travel and more remote portions of the process: 45% (Asia-Pacific), 51% (EMEA), 58% (North America)
- Acceleration of fundraising: 49% (Asia-Pacific), 51% (EMEA), 65% (North America)
- More co-investment opportunities to limit exposure: 46% (Asia-Pacific), 50% (EMEA), 60% (North America)
- More club deals: 30% (Asia-Pacific), 37% (EMEA), 53% (North America)
- Greater emphasis on ESG: 43% (Asia-Pacific), 31% (EMEA), 43% (North America)
- Trading vintage, successful portfolio companies to successor funds (with the appropriate approvals): 40% (Asia-Pacific), 54% (EMEA), 29% (North America)
- Fund restructurings: 10% (Asia-Pacific), 17% (EMEA), 22% (North America)
APAC PE deals have made a roaring comeback, more than doubling in value in Q1-Q3 2021 compared with Q1-Q3 2020, with Q2 proving especially fruitful. There were US$199.6bn worth of buyouts in that period, 46% of which occurred in Q2. This invested capital was shared across 688 transactions, giving a mean deal size of just over US$290m.

This represents a recovery from a lull that pre-dates the pandemic. Deal value had already begun trending down in 2018, with fundraising also easing off. While dealmaking in the region was significantly impaired in Q1 2020, China's swift containment of COVID-19 meant activity was quick to return.

Investors have become more bullish. For example, as of 25 June, Asia-focused PE funds had raised US$80.5bn, according to the latest available Preqin data at time of publishing. That figure is up 59% from a year prior and the highest level in two years. This brought dry powder in the region to a record US$384.9bn.

Even previously overlooked markets are becoming more popular. PE in Japan, the world's third-largest economy after the U.S. and China, is significantly underrepresented.

The industry there claims 8% of the M&A market versus 15% in the U.S., according to Bain & Co. Preqin data shows that a record 80 PE and venture capital funds focused on Japan closed in 2020, raising US$10bn between them. Carlyle alone raised US$2.3bn to invest in the country.

Corporate governance reforms and rising shareholder activism are spurring a wave of business restructuring announcements and boardroom reshuffles in the market, piquing PE funds’ interest in take-privates and corporate divestitures. The highest-profile of such deals has so far failed to materialize, after CVC Capital Partners abandoned a US$20bn acquisition of Toshiba in April. But carve-outs to PE are being closed, evidenced by Blackstone’s US$2.3bn buyout of multinational Takeda Consumer Healthcare, the over-the-counter arm of multinational Takeda.

Healthcare and consumer deals remain in high demand, but it is technology, media & telecoms (TMT) that is outshining other sectors. Funds are queuing up to acquire companies that have performed well through the pandemic, and tech is an obvious bright spot, claiming 43% of all APAC deal value in Q1-Q3 2021.
Technology also has the potential to figure highly in APAC exit activity. Special purpose acquisition companies (SPACs) are in their infancy in the region relative to the U.S., which saw a recent explosion in cash-shell IPOs. Encouraged by investor demand and fueled by a desire to encourage more high-profile tech listings in its stock exchange, the Singapore stock exchange has recently introduced a SPAC listing framework and the Hong Kong stock exchange is following closely in pursuit of the same.

“SPAC mergers are a very viable exit option because listings have always been very difficult for companies in the region. Those who are unable to achieve secondary exits or who can’t do listings are seriously considering de-SPACs as an alternative,” says Siew Kam Boon, a partner in Dechert’s Singapore practice.

However, one of the challenges facing exits in APAC in the eyes of respondents is the adjustment of pro-forma financials to account for the impact of the pandemic. Understanding the fundamental financials of a business is paramount for buyers and can be complicated by large earnings swings, while heavy competition for deals can...
make it more difficult to determine accurately the fair value of assets.

“Because we’re still in something of a growth stage compared with more mature markets, there is lots of competition including from strategics and tech titans,” says Boon. “Buyers are not valuing businesses necessarily based solely on historicals and are placing a different premium on growth and other strategic reasons. This makes pricing deals less predictable.”

“SPAC mergers are a viable exit option because listings have always been relatively rare for companies in the region.”

Siew Kam Boon, Dechert LLP
The global PE industry is certainly not short of cash commitments. There has never been a better time to raise funds, especially for large, established firms with strong brands. But record reserves in a market where asset prices are inflated by historic levels of stimulus present their own difficulties. Namely, GPs must work extra hard on their investment theses and avoid paying over the odds for middling assets.

LPs understand that while PE on average delivers exemplary financial returns, fund managers have their work cut out for them. This is of particular concern for EMEA respondents, 34% of whom say that convincing investors their capital will be put to work in a timely manner is the biggest fundraising challenge their firm is facing. In APAC this falls to 25% and to 16% in North America, where investors are seemingly unconcerned about their PE managers’ ability to deploy their capital.

“It has taken time to convince investors that their capital will be put to work fast. We have been prepared with the potential target list and the valuation summary, but convincing investors has been most stressful,” says one respondent, the managing director of a Dutch PE firm.

This is echoed by the managing director of a French firm, who said: “We have to demonstrate to investors that we can apply their capital in an apt manner. There are many challenges to source the right targets in the current environment, so the situation has become tricky.”

Size matters
The biggest fundraising challenge for North American fund managers is competing against larger GPs, cited by 22% of respondents in the region. It is no secret that while PE is seeing record sums of capital pour into funds, assets under management are not growing equally across the spectrum.

This trend was already playing out prior to 2020, but the pandemic has exacerbated it. Travel restrictions benefited established managers as capital went to those firms with a bounty of strong, existing LP relationships. Conversely, first-time funds accounted for only 16% of closes in 2020, according to Preqin, the lowest level in a century. What’s more, the 50 biggest PE firms raised 50% of all capital in the industry. “There is tough
competition in markets and the larger GPs are providing favorable terms for investors in order to attract more business. This has been a challenge to compete for LP capital,” says the managing director of a U.S. PE firm.

**Creative sparks**
Based on the current environment, most respondents from all regions say that to stay ahead of the curve, their firm is creatively sourcing deals (60-74%), locking in a good deal early (63-80%), allocating a separate, dedicated pool of capital for opportunistic deals (60-70%), and/or investing in structured equity transactions, including minority investments (51-75%).

All of these tactics fall under the broader umbrella of creativity and flexibility, maximizing the volume of investable opportunities. This is important in a highly competitive market flooded with capital, not only from traditional fund sources but also SPACs, which are in direct competition with PE funds for private assets.

“Thinking creatively and using diversity of approach is paramount. Getting to know the company early and then leveraging that is becoming more and more important,” says Field. “That could mean doing a growth investment with

### WHAT IS THE BIGGEST GLOBAL FUNDRAISING CHALLENGE YOUR FIRM HAS FACED? (SELECT THE MOST IMPORTANT)

<table>
<thead>
<tr>
<th>Challenge</th>
<th>North America</th>
<th>EMEA</th>
<th>Asia-Pacific</th>
</tr>
</thead>
<tbody>
<tr>
<td>Convincing investors their capital will be put to work quickly</td>
<td>34%</td>
<td>25%</td>
<td>16%</td>
</tr>
<tr>
<td>Large LPs concentrating their investment relationships to a smaller number of funds</td>
<td>20%</td>
<td>14%</td>
<td>16%</td>
</tr>
<tr>
<td>Competing against other funds for LP capital, especially the largest GPs</td>
<td>22%</td>
<td>15%</td>
<td>11%</td>
</tr>
<tr>
<td>Meeting fundraising deadlines</td>
<td>20%</td>
<td>15%</td>
<td>3%</td>
</tr>
<tr>
<td>LP skepticism surrounding valuations and health of pre-pandemic investments</td>
<td>20%</td>
<td>13%</td>
<td>9%</td>
</tr>
<tr>
<td>Securing smaller commitments (under US$100m) from large institutional investors</td>
<td>14%</td>
<td>7%</td>
<td>7%</td>
</tr>
<tr>
<td>LP’s inability to conduct sufficient due diligence because of the pandemic</td>
<td>9%</td>
<td>8%</td>
<td>5%</td>
</tr>
<tr>
<td>Handling the fundraising roadshow remotely</td>
<td>7%</td>
<td>6%</td>
<td>7%</td>
</tr>
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</table>

### DOES YOUR CURRENT FUND (OR ANOTHER INVESTMENT VERTICAL SPONSORED BY YOUR FIRM) PROVIDE FOR MINORITY CO-INVEST DEALS?

<table>
<thead>
<tr>
<th>Region</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asia-Pacific</td>
<td>45%</td>
<td>55%</td>
</tr>
<tr>
<td>EMEA</td>
<td>57%</td>
<td>43%</td>
</tr>
<tr>
<td>North America</td>
<td>76%</td>
<td>24%</td>
</tr>
</tbody>
</table>
a view to ultimately becoming a controlling investor, or taking a minority investment in a large family-owned business.”

More than three-quarters of North American respondents say their current fund provides the ability to hold minority co-investments. A slimmer majority of EMEA respondents say the same (57%), while less than half of APAC respondents say their current fund provides for such deals. Meanwhile, 84% of respondents from all regions say their current fund invests in growth capital deals, with 62% saying their interest in growth investments has increased over the past 12-24 months. This speaks to the benefits of diversification in the industry and, aligned with this, 61% say their interest in broadening their investment strategy has also risen over the same period.

“This is an increasingly prevalent theme. Certain firms have created specific fund vehicles for growth equity investments. This is very much on the radar,” says Boon. “It gives firms more options and choice, and if you’re a large cap PE fund you can back an earlier stage company and gain early access and potentially higher returns. Importantly, it could also be a helpful platform for a buy-and-build play.”

**OVER THE LAST 12-24 MONTHS, HOW HAS THE LEVEL OF INTEREST IN THE FOLLOWING CHANGED?**

<table>
<thead>
<tr>
<th>Category</th>
<th>Increased</th>
<th>Stayed about the same</th>
<th>Decreased</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partnerships with strategic buyers</td>
<td>74%</td>
<td>16%</td>
<td>10%</td>
</tr>
<tr>
<td>Growth equity investments</td>
<td>62%</td>
<td>25%</td>
<td>13%</td>
</tr>
<tr>
<td>Diversification of investment strategy</td>
<td>61%</td>
<td>28%</td>
<td>11%</td>
</tr>
<tr>
<td>Larger/differentiated potential pool of targets</td>
<td>47%</td>
<td>28%</td>
<td>25%</td>
</tr>
<tr>
<td>LP desire for greater control over the direction of portfolio company</td>
<td>47%</td>
<td>28%</td>
<td>25%</td>
</tr>
<tr>
<td>Targeting of minority stake investments</td>
<td>45%</td>
<td>32%</td>
<td>23%</td>
</tr>
<tr>
<td>Co-investment and joint ventures on the part of your LPs</td>
<td>45%</td>
<td>30%</td>
<td>25%</td>
</tr>
<tr>
<td>Opportunity for lower-risk investments/diversification of risk</td>
<td>44%</td>
<td>33%</td>
<td>23%</td>
</tr>
</tbody>
</table>
In a similarly creative vein, almost three-quarters (74%) of all respondents say their level of interest in partnerships with strategic buyers increased over the past 12-24 months. “That has become very successful,” says Field. “These partnerships have a de-risking effect for both sides. The investors get deep industry knowledge. And for the strategics, even if they do M&A that’s not their main business, they’re able to team up with someone who does that every day.”

**One direction**

Another reason that firms are having to show greater creativity, flexibility and indeed patience comes from LPs’ desire for greater involvement. Nearly half (47%) of respondents note that LPs are expressing a desire for greater control over the direction of portfolio companies. This is an emerging topic but part of a broader theme.

It is standard practice for PE firms to have LP advisory committees, though these are typically formed for the purpose of advising the GP on fund issues, such as material changes to the governing documents of the fund or to vote on the triggering of key-man clauses. Historically, GPs have been given free rein to deploy capital and apply their expertise to drive value.

However, several related trends have strengthened over recent years. One is that investors are demanding greater transparency from their managers, particularly regarding fee structures and portfolio company performance.

In tandem, LPs have pushed further into direct investing. This is in the form of co-investments sourced by their GPs and invested outside of the fund, but also institutions building benches of in-house dealmaking talent. This more independent and involved approach chimes with the observation among respondents that LPs are speaking up more and insisting on having more of a say over how investments could be managed for greater performance and returns.

**IN THE CURRENT ENVIRONMENT, WHAT STRATEGIES DOES YOUR FIRM EMPLOY TO ENSURE IT STAYS AHEAD OF THE CURVE? (SELECT ALL THAT APPLY)**

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Asia-Pacific</th>
<th>EMEA</th>
<th>North America</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creatively sourcing deals (e.g. incubators, executives training camps, teams on the ground in fertile start-up regions)</td>
<td>70%</td>
<td>60%</td>
<td>60%</td>
</tr>
<tr>
<td>Locking in a good deal early and negotiating rights to double down</td>
<td>80%</td>
<td>63%</td>
<td>64%</td>
</tr>
<tr>
<td>Separate, dedicated pool of capital for opportunistic deals</td>
<td>70%</td>
<td>63%</td>
<td>60%</td>
</tr>
<tr>
<td>Investing in structured equity transactions, including minority investments</td>
<td>75%</td>
<td>51%</td>
<td>67%</td>
</tr>
<tr>
<td>Leveraging network to source proprietary deals</td>
<td>54%</td>
<td>58%</td>
<td></td>
</tr>
<tr>
<td>Differentiated investment thesis instead of a strategy/sector agnostic approach</td>
<td>25%</td>
<td>46%</td>
<td>47%</td>
</tr>
<tr>
<td>Utilizing earn-outs</td>
<td>20%</td>
<td>24%</td>
<td>34%</td>
</tr>
</tbody>
</table>
**Private credit**

After being initially sideswiped in early 2020, private credit markets made a quick and assured comeback. As public and private markets bounced back, direct lending funds were again eager to deploy into opportunities following the pandemic-induced temporary pause in supply and have benefited from a robust and growing deal pipeline. There is no shortage either of PE buyouts on offer or of credit funds looking to back them.

The long-term outlook is positive. Private credit is the third-largest private capital asset class after PE and real estate. Experts say that current private credit assets under management stand at US$1 trillion and Preqin estimates that will grow to US$1.46tn by 2025.

As much as 45% of respondents in our research say they have increased their use of private credit financing in buyouts over the past three years. This represents a noteworthy increase from our last annual report, when 35% of respondents said they had increased their use of private credit, and most (53%) said their use of this type of debt had not changed over the preceding three years.

For this year’s survey, over half (54%) of EMEA respondents now use private credit as the preferred choice over traditional bank financing in their buyouts, with other regions also showing a positive bias towards this funding type.

It’s easy to see why. When negotiating private credit, buyout targets and their new PE owners are typically able to customize borrowing terms to a far higher degree. This can result in extra turns of leverage, more accommodative and tailored borrowing covenants and greater flexibility overall. And since direct lending does not rely on loan syndication, there are deal execution benefits to be had.

One of private credit’s greatest strengths is its dependability. By comparison, liquid credit markets tend to be far more sensitive to the vagaries of market technicals, especially during disruptive periods. Private credit tends to be far less affected by volatility, as loans are held for the long term in lock-up funds that are not traded.

More than a quarter (26%) of respondents consider the greater predictability of private credit to be its primary advantage over using traditional bank financing. This was a clear benefit to our research participants, such as the partner of a U.S. firm who observed: “The traditional banking sources have become very strict amid the current uncertain conditions. Private credit funds are more open to new opportunities.”

Partner, U.S. PE firm
when it comes to lending amid the current uncertain conditions. Private credit funds, on the other hand, are more open to new opportunities."

This was echoed by the managing director of a French firm who said: “The greatest advantage is the flexibility of financial terms. The private credit markets have grown significantly since the financial crisis and their flexibility is the main reason for this growth.”

In close second with 24% of respondents’ votes is the easier process involved in situations where the portfolio company is not performing to plan. GPs believe debt funds are more straightforward to work with in these worst-case scenarios compared with negotiating with a bank or investors who acquired loans on the secondary market.

There is no shortage of demand for private credit on the part of PE funds, and this is likely to be matched by supply. Lenders can achieve yields that far exceed those on investment-grade loans, especially when more junior debt is blended into a unitranche product and with more favorable and customizable borrowing terms. With interest rates back at rock bottom to stimulate growth and PE dealmaking booming, the case for private capital managers to expand their credit offerings has never been stronger. For private credit, the only way is up.
In Q1-Q3 2021, North America logged 1,958 PE deals with US$560.9bn invested, representing a 252% year-on-year gain in dollar terms over the three quarters. Two sectors that outperformed were, unsurprisingly, TMT and pharma, medical & biotech. The pandemic accelerated digital consumer habits and increased business dependency on fiber networks and infrastructure, while also creating unprecedented demand for medicines and healthcare services.

Investors have sought to back assets that serve these needs and which are positioned for long-term success post-pandemic. TMT took the crown by a considerable distance, claiming US$214.2bn worth of deal value through Q3, while pharma, medical & biotech followed with US$87.9bn. Combined, these two sectors accounted for half of all transaction volume up to Q3.

The industry is scaling up further in the region known as the birthplace of the PE mega deal and mega fund. This can be seen both in the fundraising market and the types of deals being struck, which are beginning to show similarities to the boom years prior to the GFC.

The growing popularity of mega funds was already a theme over the past decade, with investors scaling back their manager relationships to streamline their PE programs. “For the big LPs, they cannot have 200, 300 relationships for the large pools of money they manage, so that capital goes to the large pockets. And those tend to be the mega funds, a lot of which are managed in the multi-strategy asset management houses,” says Bolsinger.

Furthermore, capital is still pouring in. Despite the slowdown in dealmaking last year, global PE and venture capital dry powder hit a record level of nearly US$2tn in 2020. The historic monetary and fiscal stimulus that has been deployed in response to the pandemic has caused stock markets to reach all-time highs. The denominator effect, which prompts LPs to raise their absolute PE allocations to maintain their relative capital allocations across asset classes, is causing capital to be channeled into the industry. Consequently, some truly staggering funds are being raised by marquee names.

In July, Hellman & Friedman closed its 10th fund at US$24.4bn, making it not only the largest raised so far this year but one of the largest in industry history. But it is unlikely to hold that distinction for long – Carlyle Group is raising a US$27bn fund of its own. These are no anomalies either. In January, Silver Lake Partners closed its sixth flagship fund on US$20bn.

“Yesterday’s bulge bracket deal is today’s middle market,” says Christopher Field.

It is not only funds that are supersizing. Our research shows that 53% of North American GPs anticipate the increasing...
prevalence of club deals in the pandemic’s wake, well above expectations of the same in EMEA (37%) and APAC (30%).

This is already coming to bear. Although the financial terms were not publicly disclosed, U.S. medical supply company Medline was acquired by a consortium comprising Blackstone, Carlyle and Hellman & Friedman. Dechert is advising GIC as a participant in such a transaction. While considerably larger than any other buyout, smaller club deals have made an appearance. One example includes the combination in June of transportation services provider WorldWide Express and logistics specialists GlobalTranz Enterprises, both leading non-asset providers of technology-driven third-party logistics solutions. The deal is being sponsored by a consortium led by CVC Capital Partners, which Dechert advised, with other consortium members including GlobalTranz’s current lead investors, Providence Equity Partners and PSG.

These club deals are a callback to 2005-08, when some of the largest deals were struck. This strategy allows several firms to pool their capital to acquire larger companies than would be possible alone, simultaneously spreading the risk among parties. With so much capital at PE giants’ disposal, expect more of this to come.
In the world of M&A and capital markets, the buzz around SPACs was hard to ignore in the last quarter of 2020 and the opening months of 2021. SPACs are nothing new, of course, but they took off in a major way recently for several reasons.

First, markets are awash with liquidity. Second, these speculative cash shells skew heavily towards technology assets as deal targets and the pandemic has only made the investment case for tech that much stronger. Third, SPAC IPOs are less onerous and costly than traditional ones. These conditions aligned for a bona fide SPAC explosion in Q1, breaking all records before a clampdown by the Securities & Exchange Commission (SEC) and a series of class-action lawsuits raised some difficult questions, leading to a dramatic slowdown for SPAC IPOs in Q2 and Q3. The first quarter saw 298 SPACs raise nearly US$88bn, more than the 248 SPAC IPOs that raised around US$83bn in all of 2020, according to SPAC advisory firm ICR.

PE’s relationship with SPACs is complicated. On the one hand, they represent a direct competitor for private assets, but by the same token an additional source of liquidity for exits. PE fund managers can also use SPACs as vehicles for their own deals, fast-tracking private assets to stock markets. SPACs also often require private investment in public equity (PIPE) deals to top up their capital if the value of their chosen target exceeds the cash holdings they raised and/or to fill gaps as a result of shareholder redemption requests, which is an opportunity for PE to get involved in these deals at a later stage. Indeed, 57% of respondents say they are either very likely (18%) or somewhat likely (39%) to make a PIPE investment, either via a SPAC or otherwise.

Two-thirds of respondents to our survey say their
HOW LIKELY IS YOUR FIRM TO CONSIDER THE FOLLOWING DEAL TYPES AT PRESENT?

- Partnerships with strategic buyers: 41% Very likely, 46% Somewhat likely, 11% Unclear, 2% Not very likely
- Trading vintage, successful portfolio companies to successor funds: 33% Very likely, 37% Somewhat likely, 20% Unclear, 9% Not very likely
- Club deals: 32% Very likely, 36% Somewhat likely, 14% Unclear, 18% Not very likely
- Vertical integration with a portfolio company: 30% Very likely, 41% Somewhat likely, 14% Unclear, 12% Not very likely
- Investment in structured equity/salvation capital structures: 28% Very likely, 49% Somewhat likely, 12% Unclear, 10% Not very likely
- Reinvestment opportunities: 27% Very likely, 31% Somewhat likely, 12% Unclear, 29% Not very likely
- Carve-out of orphan/non-core divisions from corporate sellers: 25% Very likely, 37% Somewhat likely, 22% Unclear, 16% Not very likely
- Combining a portfolio company with another firm’s portfolio company: 19% Very likely, 17% Somewhat likely, 34% Unclear, 29% Not very likely
- Private investment in public equity (PIPE): 18% Very likely, 39% Somewhat likely, 30% Unclear, 12% Not very likely
- Take privates: 18% Very likely, 33% Somewhat likely, 31% Unclear, 17% Not very likely
- Distressed deals: 14% Very likely, 47% Somewhat likely, 21% Unclear, 17% Not very likely

Legend:
- Very likely – this deal type is appealing in the current environment
- Somewhat likely – we’re open to the idea
- Depends entirely on the particular deal
- Not very likely – this deal type doesn’t work for our model or is unappealing
- Unclear at present
organization is either currently employing a SPAC (41%) or have considered it and are likely to use one (25%). What’s more, well over half (59%) say the fewer hurdles involved with SPACs is one of their main advantages as a vehicle for raising capital or listing a private company going public. Furthermore, 55% point to SPACs’ advantage of having more favorable costs compared to traditional IPOs.

The reason for these benefits is that, as pure cash shells, SPACs are not operating companies when pursuing an IPO. The lack of financial statements means there are fewer material SEC obligations to meet, and the auditing process is shortened. This can expedite a listing by anywhere from two to four months, helped also by the fact they don’t require IPO roadshows to raise investor interest.

However, they are not without their shortcomings. SPACs’ popularity has attracted regulatory scrutiny in the U.S. In April, the SEC warned that the common classification of SPAC warrants as equity instruments rather than liabilities in their accounts is misleading. This put the brakes on issuance activity. By July the regulator clarified what is required for warrants to be classed as equity, meaning sponsors have had to re-evaluate their accounting. In addition, SPACs have become a target for class-action litigation. As a result, following a record first quarter, the SPAC market came to a screeching halt with issuance dropping substantially in the second and third quarters as regulatory pressure and litigation mounted.

“SPACs are highly cyclical, and the tail end of what we are currently in is SPAC 3.0. The money raised generally needs to be deployed within 24 months and the SPAC...
WHAT DO YOU VIEW AS THE MAIN DISADVANTAGES OF USING A SPECIAL PURPOSE ACQUISITION COMPANY (SPAC) AS A VEHICLE FOR RAISING CAPITAL OR FOR A PRIVATE COMPANY OR BUSINESS/DIVISION GOING PUBLIC? (SELECT TOP THREE AND RANK 1-2-3, WITH 1 BEING THE GREATEST DISADVANTAGE)

<table>
<thead>
<tr>
<th>Advantage</th>
<th>Rank 1</th>
<th>Rank 2</th>
<th>Rank 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Presence of “hot money” investors and arbitrage funds that “park” their cash and do not intend to become long-term shareholders</td>
<td>15%</td>
<td>15%</td>
<td>24%</td>
</tr>
<tr>
<td>Post-merger trading can be subdued if too many pre-acquisition stockholders redeem their stock at closing</td>
<td>20%</td>
<td>14%</td>
<td>9%</td>
</tr>
<tr>
<td>Dilution of original shareholder value</td>
<td>19%</td>
<td>19%</td>
<td>5%</td>
</tr>
<tr>
<td>Lackluster investment record</td>
<td>9%</td>
<td>11%</td>
<td>22%</td>
</tr>
<tr>
<td>Availability of PIPEs to fill the equity gap</td>
<td>14%</td>
<td>18%</td>
<td>8%</td>
</tr>
<tr>
<td>Stockholders can reject proposed acquisitions</td>
<td>6%</td>
<td>16%</td>
<td>8%</td>
</tr>
<tr>
<td>Use of projections can mean stock price is unstable, adding risk to secondary sales</td>
<td>10%</td>
<td>4%</td>
<td>11%</td>
</tr>
<tr>
<td>Poor historical reputation/ Past instances of fraudulent schemes</td>
<td>7%</td>
<td>3%</td>
<td>13%</td>
</tr>
</tbody>
</table>

sponsors are now looking to put it to work, at the same time battling the SEC scrutiny and whatever they have to do in terms of their financial disclosures,” says Bolsinger. “The wave of lawsuits has started, mostly for deals that have already been completed, both of which will be somewhat of a chilling factor.”

Our research participants are keenly aware of the downsides. They most commonly emphasize the presence of “hot money” investors and arbitrage funds that park their cash and do not intend to become long-term shareholders as one of their concerns (54% overall). However, the number one concern (20% of first-choice votes) pertains to the fall in share price that a de-SPAC can trigger, as stockholders sell their shares once the deal closes. Three Stanford and NYU academics found last year that while SPACs with high-quality sponsors perform better than others, investors that hold shares at the time of a SPAC’s merger see post-merger prices drop on average by a third or more. That’s a significant downside risk and may be too much for many to accept.

“There are definitely headwinds and a lot of hot money from sources of capital that are not really long-term investors. You don’t know how many of them will be around, so you need to raise PIPEs.” says Bolsinger. “So, SPACs will continue to be around but the pace of new issuances is unlikely to match the pace in the last quarter of 2020 or the first quarter of this year.”
Buy and build
The pandemic has caused seismic economic and market shifts that have drastically altered the prospects of many businesses. Companies that were sure-fire bets in 2019 may no longer be so solid long term, while other business models that had yet to gain traction may now be flourishing.

While buy-and-build strategies have been an important page in PE’s playbook for as long as the industry has existed, the current climate gives added impetus for this approach. Looking at their existing portfolios, GPs have to evaluate and pivot their companies towards strategies that can sustainably succeed post-pandemic. In this context, add-ons offer a way to repurpose existing assets and put them on course for success by expanding into new geographies or adjacent product and service lines, and accelerating digitalization.

Naturally, building out an asset presents its own challenges. Ongoing restrictions on movement during the pandemic mean fund managers must think carefully about integration and reach.

“For teams to accelerate growth, they will be thinking about add-on opportunities,” says one respondent who is the founding partner of a Japanese PE firm. “Selecting targets in the proper location and with close proximity to the portfolio companies will be important.”

Regarding the biggest challenges facing their firm when making add-on acquisitions for a platform company, almost half (49%) of respondents say gaining buy-in from management teams at the acquired companies is the top issue. A further 46% of respondents consider one of the top buy-and-build hurdles to be formulating a strategy to achieve synergies and growth for the enlarged company. Without strategic alignment, a shared vision and all parties pulling in the same direction, value will not be fully realized.

When asked which two buy-and-build approaches their firm adopts most often, respondents are relatively split, but most commonly point to the strategy of building a dominant player in an emerging sector (53%). This speaks to the emphasis that financial sponsors are placing on growth. Despite the many setbacks and hardships caused by the pandemic, PE has a knack for creating value during periods of dislocation. By identifying developing sectoral dynamics, GPs can spot emergent themes and capitalize on the first-mover advantage, scaling up platform companies that are well-positioned to excel post-pandemic via multiple add-ons.

“For teams to accelerate growth, they will be thinking about add-on opportunities. Selecting targets in the proper location and with close proximity to the portfolio companies will be important.”
Partner, Japanese PE firm
WHAT ARE THE BIGGEST CHALLENGES YOUR FIRM FACES WHEN MAKING ADD-ON ACQUISITIONS FOR A PLATFORM COMPANY? (SELECT TOP TWO AND RANK THEM 1-2, WHERE 1 IS MOST IMPORTANT)

1. Integrating the add-on acquisitions effectively
   - Rank 1: 36%
   - Rank 2: 13%

2. Upgrading existing management team to deal with larger and more complex footprint
   - Rank 1: 26%
   - Rank 2: 8%

3. Identifying a sufficient number of suitable add-on targets during the hold period
   - Rank 1: 19%
   - Rank 2: 15%

4. Generating and/or raising enough capital (including debt) at the platform company to make add-on purchases
   - Rank 1: 20%
   - Rank 2: 6%

5. Formulating a strategy to achieve synergies and growth for the enlarged company
   - Rank 1: 14%
   - Rank 2: 32%

6. Gaining buy-in from management teams at the acquired companies
   - Rank 1: 13%
   - Rank 2: 36%

7. Identifying a sufficient number of suitable add-on targets during the hold period
   - Rank 1: 19%
   - Rank 2: 15%

8. Generating and/or raising enough capital (including debt) at the platform company to make add-on purchases
   - Rank 1: 20%
   - Rank 2: 6%

9. Formulating a strategy to achieve synergies and growth for the enlarged company
   - Rank 1: 14%
   - Rank 2: 32%

10. Gaining buy-in from management teams at the acquired companies
    - Rank 1: 13%
    - Rank 2: 36%

WHICH BUY-AND-BUILD STRATEGIES DO YOU CURRENTLY USE MOST OFTEN? (SELECT TOP TWO AND RANK THEM 1-2, WHERE 1 IS MOST COMMON)

1. Building a dominant player in an emerging sector
   - Rank 1: 24%
   - Rank 2: 29%

2. Acquiring synergistic/complementary products
   - Rank 1: 24%
   - Rank 2: 21%

3. Building up a platform company around a core technology
   - Rank 1: 16%
   - Rank 2: 23%

4. Regional consolidation (i.e. acquiring similar businesses located in one specific region)
   - Rank 1: 21%
   - Rank 2: 17%

5. Regional diversification (i.e. combining similar businesses located in different regions)
   - Rank 1: 15%
   - Rank 2: 10%
Carve-outs

The stars are aligned for a standout year for carve-outs. On the buy-side, PE has mountains of dry powder. On the sell-side, corporates are under pressure to realign their portfolios to focus on core growth business lines and raise cash to pay down debt. It’s a match made in heaven.

In North America, 58% of GPs expect the number of carve-outs targeted by their firm to increase over the next 12-18 months. That’s not to mention the 29% who anticipate their carve-out activity remaining steady following a year of increased corporate divestment volumes. After the market pause in Q2 2020, these deals spiked to highs not seen in at least four years. To this point, 2020 saw US$348bn in carve-outs and Q1-Q3 of 2021 has already seen US$378.3bn.

APAC and EMEA respondents are slightly less bullish than their North American counterparts. Among APAC PE fund managers, 40% expect their participation in carve-outs to increase, while the remaining 60% foresee similar levels of activity. Meanwhile, 40% of EMEA PE shops see an increase and 31% expect such deals to be flat.

Across all regions, respondents say the most important drivers of carve-out activity are corporates selling business units to pay down debt (29%), followed by divestitures required by merger control or foreign investment regulatory authorities (27%). Both are strong themes in the current climate.

Global bond issuance surged by nearly a quarter to US$5.35tn last year amid a borrowing binge that helped companies survive the COVID-19 crisis. Corporates have been refinancing this debt and raising cash to pay it down, with business sell-offs an obvious means of raising capital.

Simultaneously, antitrust oversight, already high prior to the pandemic, has ratcheted up. According to President Biden’s recent Executive Order on Competition, the administration is increasing the scope of its antitrust enforcement and what it considers to be unlawful mergers. Not only is Big Tech in the crosshairs, agriculture, healthcare, transportation, and banking and consumer finance markets are also being reviewed, as are labor practices.

In China, while its Anti-Monopoly Law has been in place since 2008, the State Administration for Market Regulation has been adding staff and other resources as it augments efforts to crack down on anti-competitive behavior. In April, the competition watchdog hit e-commerce giant Alibaba with a record US$2.75bn fine after a probe found the company had abused its dominant market position for several years. As corporates come under greater scrutiny, financial penalties are liable to follow. Corporate sell-offs are one option to raise cash to meet these fines.

The stars are aligned for a standout year for carve-outs. On the buy-side, PE has mountains of dry powder. On the sell-side, corporates are under pressure to realign their portfolios to raise cash to pay down debt.
Over the next 12-18 months, what do you expect to happen to the number of carve-outs targeted by your firm?

North America
- Increase: 58%
- Stay about the same: 29%
- Decrease: 13%

EMEA
- Increase: 40%
- Stay about the same: 31%
- Decrease: 29%

Asia-Pacific
- Increase: 40%
- Stay about the same: 60%

In your opinion, what is the most important current driver of carve-out activity?

- Corporates selling business units to pay down debt: 29%
- Divestitures required by merger control or foreign investment regulatory authorities: 27%
- PE firms carving out units of portfolio companies: 18%
- Corporates shoring up liquidity: 15%
- Corporates rationalizing non-core business units: 11%
There were 1,839 PE deals made in Q1-Q3 in EMEA, totaling US$391.2bn in value. Like other parts of the world, this represents the busiest Q1-Q3 period in at least five years as dealmaking has snapped back. Europe in particular has been slightly behind both the U.S. and China in its vaccine rollout but has now begun to build critical mass with its inoculated population, enabling a more confident economic reopening. As in other regions, TMT has been the dominant deal sector, claiming US$84bn of activity. However, a number of cyclical industries have been primary targets for funds. For instance, industrials & chemicals has seen US$67.6bn worth of acquisitions, just ahead of pharma, medical & biotech at US$53.7bn. What’s more, energy, mining & utilities and construction saw US$35.1bn and US$34.6bn invested, respectively.

While it’s difficult to draw conclusive reasons for this tilt towards economically sensitive sectors, it is worth pointing out that technology represents a smaller level of GDP value added in Europe than in the U.S. Europe also took more restrictive measures than the U.S. and was more affected by the pandemic than China, which until a flare up in July 2021 appeared to have stopped the virus in its tracks. As a result, Europe’s economy has been more severely hamstrung. In 2020, GDP declined by 6.8% across the European Union compared with a 3.5% downturn in the U.S. economy, with China growing by around 2.3%. This suggests, all else being equal, that there are more opportunities in Europe to buy into companies buffered by the crisis.

Consistent with this, more EMEA respondents point to distressed deal flow as being one of the expected impacts of the COVID-19 crisis. As much as 71% of GPs from the region say they anticipate more distressed deals, well ahead of any other region. For now at least, that does not appear to havematerialized in any meaningful way. The European Union’s stimulus has buttressed businesses and kept defaults to a minimum. Many expect that once monetary and fiscal support is withdrawn, companies will fall into distress, providing an opportunity for PE. When, or if, this will come to pass is another matter. Another survey finding that sets the region apart concerns the rising phenomenon of GPs selling assets to “continuation funds,” which are also managed by themselves. More than half (54%) of EMEA respondents say they expect one of the after-effects of the crisis to be trading successful portfolio companies to successor funds, which typically happens through a GP-led secondary transaction.

These transactions, while requiring the careful management of investors’ interests, offer significant advantages to investors as well as the GP. They allow GPs to retain management, through
a continuation fund, of high-quality assets, rather than sell them only to have to find a new company in which to invest. They also buy GPs more time if their funds have reached the end of their lifecycles but have not yet exited all of their portfolio companies. Investors benefit from having an option to exit for cash out of the existing fund, which is financed by the secondary buyer, or to rollover and reinvest their pro rata share of the assets via the continuation fund and thus retain investment exposure to the assets. Through the continuation fund, investors are typically exposed for an additional 3-5 years to the performance of the assets, which is bolstered by fresh capital being made available by them to fund follow-on investments in some or all of those assets. The GP will typically invest a substantial amount of its own capital in the continuation fund in order to ensure alignment of interests between it and its investors. As a result, investors can achieve superior returns compared to the assets being sold to third parties and GPs can earn greater amounts of carried interest.

EQT Partners and BC Partners are just two major names in Europe that have sold assets to their own continuation funds. With the pandemic disrupting exit timelines, and with Europe’s economies especially affected by the pandemic, one might expect the region to see more of this activity. Regardless of regional dynamics, this will become increasingly common practice across the industry. It is noted that the amount of dry powder held by secondary funds was, as of the start of 2021, at an all-time high and the number of participants in this segment of the private equity and private credit industry, both on the GP side as well as secondary investors, continues to increase. In the last two years, a number of sovereign wealth funds and pension funds have appeared as secondary buyers, and GPs with no previous experience of carrying out a GP-led secondary have embraced this form of transaction as a legitimate and, in many cases, the optimal tool to deliver liquidity to those investors who want liquidity as well as offering continued investment exposure to those who prefer to remain invested.

“GP-led secondaries have been a major feature of the European and U.S. markets over the last 18 months since COVID-19. They have become very commonplace. It’s yet another example of PE coming up with creative solutions to the challenges it has faced and, in the process, increasing the volume of capital it is able to attract to invest in these sorts of deals,” says Field.
The abundant PE buyout market is being matched by exits. Stock markets lifted by stimulus are allowing GPs to mark up their valuations and line assets up for IPO, a trend that kicked into gear midway through last year. In Q1-Q3 2021 there was US$666.8bn worth of exits, a level not seen since records began. North American respondents are the most positive regarding market conditions for PE exits over the coming 12 months, with 41% expecting them to be very favorable, compared with 29% of EMEA respondents and 10% of APAC respondents who say the same. In China in particular, exit sentiment may have dimmed since the government sought to rein in the rising power of its Big Tech sector. Alibaba’s recent record US$2.75bn fine as part of an antitrust probe could set a precedent for others. Ride-hailing app DiDi had its shares suspended in July just two days after its U.S. IPO for allegedly violating data security protocols. Chinese authorities have also threatened to curb the “disorderly expansion of capital” at the expense of public interests.

In short, Beijing is reining in its flourishing tech sector which has understandably chilled its stock market and is unlikely to support exit activity in the country, especially large technology IPOs. Nevertheless, at least 60% of respondents from all regions expect market conditions for exits over the coming year to be at least somewhat favorable. The sheer volume of investable capital in the economy means that quality assets are sure to find a home. “The recent sentiment in Beijing has created panic selling from those who do not
have the risk appetite, and this has created opportunities—and will continue to create opportunities—for buyers of quality assets at attractive valuations,” says Boon.

While respondents are less upbeat on Europe’s exit market, there are tailwinds that may be overlooked here. A number of investment banks including JP Morgan and Goldman Sachs are bullish on the region’s stock markets in 2021. This is because Europe was slow out of the blocks with its pandemic response, meaning its rebound is lagging the recovery in the U.S., where stocks are more widely seen as overpriced. This means more upside potential. With this momentum, PE funds cannot only float private assets but mark up their funds’ net asset values. All of this is conducive to strong exit activity.

**Overcoming hurdles**

However, the crisis period has naturally thrown up exit challenges. One issue has been the earnings noise caused by the pandemic. Certain businesses such as software, tech, biopharma and healthcare have seen their profits soar, compelling GPs to seek realizations. But buyers have rightly questioned the sustainability of those gains. If and when the pandemic recedes, will these high-flying companies fall down to earth? This can make forecasting problematic and create a bid-ask spread sufficiently wide that vendors and buyers are unable to meet in the middle. We find that half of APAC respondents say that pro-forma financials adjusting for the impact of COVID-19 is one of the biggest challenges they expect to face when exiting investments over the coming 12 months. This is less of a concern in other regions, with only 31% of EMEA and 24% of North American respondents flagging it up. Instead, EMEA (43%) and North American (49%) respondents most commonly point to securing a buyer willing to pay the desired valuation as one of the biggest challenges. Government and central bank policy has lifted markets back into all-time territory. For PE—which is simultaneously a seller and buyer of companies—this is both a gift and a curse.
Environmental, social and governance (ESG) issues have soared up the corporate agenda in a relatively short period. Until recently little more than a talking point, major institutional investors such as BlackRock, State Street and Vanguard Group have laid down the gauntlet to businesses to start taking action on climate issues. Consequently, PE will have to follow the tide as portfolio company customers and employees and LPs demand more sustainable and socially responsible corporate behavior.

Europe moves ahead
Europe has grasped the nettle on this front. In March this year, the EU introduced its new Sustainable Finance Disclosure Regulation, which requires private equity firms, pension funds, hedge funds and other asset managers to meet certain disclosure requirements for their investments related to climate, diversity and governance. It is not only European PE firms that must comply but also any managers that actively market their funds in the EU.

The U.S., too, is taking steps to improve ESG disclosures. While no new rules have been introduced yet, the Securities and Exchange Commission recently announced that it would step up efforts to enforce ESG disclosure missteps under its existing framework, including by harnessing data analytics to identify infractions.

With the writing on the wall, PE investors around the world are understandably

**How do you expect LP scrutiny of ESG issues / ESG reporting to change in deals over the next three years?**

<table>
<thead>
<tr>
<th>Region</th>
<th>Significant increase</th>
<th>Moderate increase</th>
<th>No change</th>
<th>Moderate decrease</th>
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<td>20%</td>
<td>45%</td>
<td>30%</td>
<td>5%</td>
</tr>
<tr>
<td>EMEA</td>
<td>49%</td>
<td>31%</td>
<td>17%</td>
<td>3%</td>
</tr>
<tr>
<td>North America</td>
<td>60%</td>
<td>36%</td>
<td>3%</td>
<td>2%</td>
</tr>
</tbody>
</table>
paying greater attention to these issues. Our research shows that the vast majority of respondents from all regions expect LP scrutiny of ESG issues and reporting to increase over the next three years. As many as 96% of North American respondents told us this, followed by 80% of EMEA respondents and 65% of APAC participants.

“Funds are very concerned about this and often try to find an ESG angle to their investments now,” says Boon. “There are a lot of advocates and activists out there, so funds are worried about the negative PR that it will generate if it’s known that they’ve invested in companies that could be perceived as harming the environment or failing to take action on ESG issues.”

The ESG spectrum
It is not only climate, diversity and other worker issues that are drawing fund managers’ attention. Also in vogue is the controversy over data privacy, ownership and sovereignty. This coincides with an explosion of personal data, a steady stream of cybersecurity breaches, and the growing belief that businesses are monetizing data without consent or with limited understanding among consumers. Any exploitation of personal data for commercial gain without permission is considered to be in contravention not only of laws such as Europe’s GDPR but basic corporate social responsibility, placing the issue under the “S” of ESG.

This topic is currently on PE investors’ minds. More than two-thirds (69%) of respondents cite privacy and data security as among their many ESG concerns. This is followed by employee welfare and development (60%) and climate change (56%).

However, when asked to single out their top ESG concern, the environment takes center stage. Nearly a third (29%) of respondents have climate change as their most important ESG consideration, with the closely related issue of sustainability in second place.
Boon observed that this is unsurprising given the “E” in ESG is the focus of most regulatory initiatives, is more quantifiable than the “S” and “G,” and is used as an investment benchmark.

PE firms are beginning to capitalize on the tectonic shift towards climate and sustainability. In July, TPG Capital announced the US$5.4bn first close of its TPG Rise Climate, the climate investing fund of the firm’s global impact investing platform, TPG Rise. It is the largest ever PE fund exclusively dedicated to backing entrepreneurs and businesses building climate solutions, and it won’t be the last. Just over three-quarters (76%) of North America respondents and over half (54%) of EMEA respondents say their firm is considering raising an ESG-focused fund in the next 12-18 months, compared with just 25% of APAC respondents who say the same.

Boon notes that this is because a climate-friendly investment strategy is becoming increasingly important to successful fundraising from U.S. and Europe-based LPs, which themselves are facing pressure to integrate ESG into their investment

### IS YOUR ORGANIZATION CONSIDERING RAISING AN ESG-FOCUSED FUND IN THE NEXT 12-18 MONTHS?

<table>
<thead>
<tr>
<th>Region</th>
<th>Yes</th>
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<td>30%</td>
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<td>EMEA</td>
<td>54%</td>
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</tr>
<tr>
<td>North America</td>
<td>76%</td>
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### HOW DO YOU EXPECT ESG IMPORTANCE IN YOUR INVESTMENT PROCESS TO CHANGE OVER THE NEXT THREE YEARS?

<table>
<thead>
<tr>
<th>Stage</th>
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<th>Moderate increase</th>
<th>No change</th>
<th>Moderate decrease</th>
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</thead>
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<td>Pre-investment</td>
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<td>31%</td>
<td>10%</td>
</tr>
<tr>
<td>At the time of investment</td>
<td>44%</td>
<td>32%</td>
<td>19%</td>
<td>5%</td>
</tr>
<tr>
<td>During investment</td>
<td>46%</td>
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<td>30%</td>
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</tr>
<tr>
<td>At the time of exit</td>
<td>28%</td>
<td>44%</td>
<td>25%</td>
<td>3%</td>
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</tbody>
</table>
process. APAC-based LPs are not yet under the same pressure on the ESG front and absolute returns remain the primary driver.

“One of the traditional attractions for the APAC region used to be its low-cost manufacturing base and less stringent environmental regulations. With the increased focus on ESG and sustainability (including modern slavery laws), private equity firms might consider targets less weighted by these and other ESG issues. Instead, because of APAC’s vast potential for globally significant climate and ecological impact, we expect to see much more private equity investment in renewable energy, high-quality natural capital, and corporations that use technology to reduce carbon emissions in the region,” says Boon.

Again, a greater proportion of North American and EMEA fund managers anticipate taking matters into their own hands during their investments compared with their APAC counterparts. A full 80% of North American respondents and 66% of their EMEA peers expect to audit and take any necessary action in relation to their portfolio companies due to perceived intransigence on ESG matters.

“ICorporating new ESG standards is an essential process,” says a respondent who is the managing director of a U.S. PE firm. “Dedicated teams are being developed by asset managers to assess their ESG credibility and make effective changes to improve standards.”

In some cases, this may require overriding management by exercising voting rights. This is in contrast to just 25% of APAC respondents who say the same. The lower activism in APAC typically relates to lack of LP pressure, insufficient ESG expertise, non-monitoring of ESG data and matters, and lack of management rights over the business, particularly in minority positions which is more commonplace in APAC.

“LPs of Asian funds comprise more private capital than MDIs or SWFs and therefore the level of scrutiny is different. To our knowledge, there have been no Asian funds which have linked carry to ESG goals,” says Boon. “Having said that, while APAC is significantly trailing behind North America and EMEA, there is a clear shift towards ensuring ESG compliance.”

DO YOU EXPECT TO AUDIT AND/OR TAKE ANY ACTION (E.G. VOTING AGAINST MANAGEMENT) IN RELATION TO YOUR PORTFOLIO COMPANIES DUE TO INSUFFICIENT ACTION IN ESG MATTERS (E.G. INTEGRATING CLIMATE RISK INTO THEIR BUSINESS MODELS OR DISCLOSURES)?

<table>
<thead>
<tr>
<th>Region</th>
<th>Yes</th>
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</thead>
<tbody>
<tr>
<td>Asia-Pacific</td>
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<tr>
<td>EMEA</td>
<td>66%</td>
<td>34%</td>
</tr>
<tr>
<td>North America</td>
<td>80%</td>
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</table>
Conclusion

The private equity industry has much room for optimism. Following the most disruptive year in recent memory, deals are being cut at a rate not seen for years and capital is being raised from investors with relative ease. Mega deals are back and mega funds are taking center stage. However, there are clear signs that capital is concentrating in the hands of the few, with a market of haves and have-nots developing through 2020/21. How this plays out over 2022 could continue to reshape the industry. At the time of writing there are also a number of headwinds building which managers may need to navigate, including the disruption of supply chains from the COVID-19 pandemic and questions around the permanence of emergent inflationary trends.

These issues and the increasing concentration of capital mean that new managers will have to work harder than ever to secure capital; they will need to develop and articulate clearly defined and competitive investment strategies. And once funds have been raised, putting them to work will not be straightforward given the volumes of capital chasing limited quality assets.

Take action on ESG
There is no obligation for firms to adopt ESG disclosures unless they are actively marketing funds across the EU. However, that should not stop them from doing so. Investors are placing an increasing emphasis on the environment, sustainability and diversity and this may also be a way to drive financial value through the life of a portfolio company holding period. All else being equal, a business that is leading on ESG is likely to be more successful, see more customer growth and will ultimately be more saleable when it comes time to exit.

Exit now
Only a minority of GPs in all regions expect exit conditions to become unfavorable over the next 12 months. Fund managers may be tempted to hang on to assets for longer to compound their returns. However, with equity prices hitting all-time highs, GPs should be taking advantage of the sellers' market to divest of any companies that are ripe for sale.
Sell to SPACs
The majority of PE fund managers are evaluating SPACs and how they could be employed in their quest to find and list upcoming deals. While the SPAC explosion that defined U.S. capital markets in Q4 of 2020 and Q1 of 2021 has subsided, there is still a huge volume of blank check money looking for deals and these vehicles can afford to pay high for assets. For the right company, with technology being a firm sector favorite, these could be an ideal exit opportunity.

Join the club
Typically the preserve of the mega fund fraternity, club deals offer an opportunity for more modestly sized fund managers to acquire assets that would ordinarily be out of their scope. Partnering with other PE firms can help all parties leverage the knowledge and expertise of all involved. And pooling capital in this way can help to give GPs more flexibility and options in what is a fiercely competitive deal market.
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Alissa Rozen
Head of Sales, Acuris Studios
Tel: +1 212 500 1394
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