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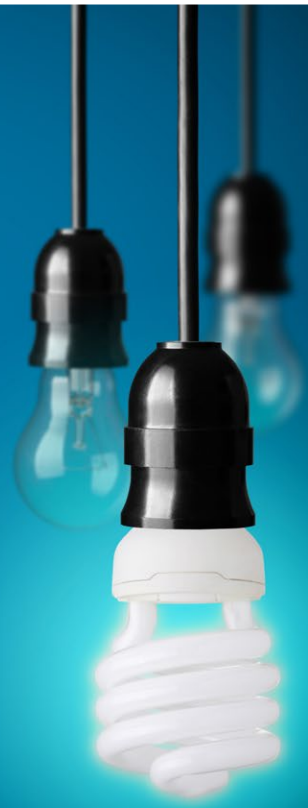
PRIVATE EQUITY SECTOR **ALERT**



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Trends in the private equity sector in 2021

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Trends in the private equity sector in 2021

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In late August 2020, we published an article entitled "*Emerging trends in the private equity industry in the post-pandemic environment*" in which we touched on mitigation strategies that the private equity fund industry used to adapt to the economic crisis created by the COVID-19 pandemic.

This article follows on from that 2020 article and touches on four trends that have developed in the private equity fund industry in the year that has followed. These trends have emerged against a backdrop of the development of COVID-19 vaccines and the roll-out of a vaccination programme in South Africa. In turn, this has led to a progressive easing of lockdown restrictions on businesses and the public despite successive waves of infections caused by COVID-19 variants. Gradually, South Africa, along with the rest of world, is entering a new "*normal*".

Private equity fundraising is increasing (slowly)

Fund managers who had slowed or paused their fundraising activities last year in response to the pandemic appear to be re-engaging with investors and some new funds have been successfully raised in the first half of 2021. In 2020, many fund managers were focused on preserving and restructuring their portfolio assets and most of their time was spent ensuring that their existing investment portfolios endured the difficult economic conditions. In addition, raising funds was particularly difficult given that many investors paused their capital supply because of the uncertain economic conditions.

In 2021, as economic conditions have slowly improved and investors have become more willing to invest capital in private equity as an asset class, many fund managers have been able to begin focusing on fundraising again.

This has been helped by easing travel restrictions across the globe, which has meant that fund managers and promoters can again travel to meet with investors as part of their fundraising roadshows.

Changing and growing investment opportunities

Fund managers are also finding new opportunities for investment so they have potential investment pipelines to interest investors. The difficult economic and social conditions created by the pandemic are continuing, though improving. As a consequence, we have seen interest in fundraising for impact funds, which have measurable social and environmental impact in parallel with financial returns. Impact funds and investing existed before the pandemic, but we have seen a definite increase in emphasis on impact investing in its wake.

Trends in the private equity sector in 2021*...continued*

Investors are increasingly focusing on investment in funds which have strong commitments to environmental, social and governance (ESG) (and reporting on compliance with ESG requirements).

The continuing need for energy in South Africa has also created interest in private equity fundraising for development of new power generation facilities (including by private energy off-takers). The renewed emphasis on development of renewable energy power generation by the South African Government has meant new interest in fundraising for investment into new renewable energy power plants and into existing renewable energy power plants in South Africa. This is illustrated by the fact that the fifth round of the Renewable Energy Independent Power Producer Procurement Programme is now in progress.

Increased focus on longer-term investments

Part of the reason that investors have been interested in investing in energy generation facilities is that such investments are generally held for a longer term and generate stable returns, making them less exposed to shorter-term economic shocks like the COVID-19 pandemic. The interest in investing in energy generation facilities is illustrative of increased emphasis on private equity investment into longer-term assets in the infrastructure sector as a whole. As a result, fund managers focusing on longer-term investments have been particularly interested in establishing permanent capital vehicles and private equity funds with longer lifespans.

These fund managers have been intent on private equity fund terms which include provision for longer fund lifespans from the outset (i.e. longer than the typical 8 to 10 years), and extending the fund lifespans at the discretion of fund managers, or with advisory committee consent.

These extended lifespan provisions in fund agreements make intrinsic sense for funds focusing on long-term investments, but also make sense where funds focus on shorter-term investments. When there is an event like the COVID-19 pandemic which affects the entire global market (or even one sector), depressing the values of assets and making realisation of those assets difficult, fund managers can trigger provisions to extend fund lifespans and hold those assets until economic conditions improve and assets can hopefully be realised at better value.

Prioritising environmental, social and governance

Investors are increasingly focusing on investment in funds which have strong commitments to environmental, social and governance (ESG) (and reporting on compliance with ESG requirements).

The increased emphasis on ESG in the private equity industry predated the COVID-19 pandemic. We have found that compliance with ESG requirements was particularly important to development finance institutions (DFIs) which commonly invest in private equity. However, the COVID-19 pandemic has deepened that emphasis.

Increasingly, both DFIs and other institutional investors are requiring that the private equity funds in which they invest adhere to their own ESG requirements and the best practices in the private equity market. In particular, investors are focused on making sure that fund managers report more comprehensively,

Trends in the private equity sector in 2021*...continued*

Many fund managers are intent on marketing themselves and their new funds as market leaders in compliance with the best ESG practices and so have been willing to increase their capacity to comply with the best ESG practices in the private equity market, where necessary.

and more often, on compliance with ESG requirements. Investors want to be able to hold fund managers accountable for their compliance with ESG requirements.

Fund managers have noticed this too. Many fund managers are intent on marketing themselves and their new funds as market leaders in compliance with the best ESG practices and so have been willing to increase their capacity to comply with the best ESG practices in the private equity market, where necessary.

A new *"normal"* world is emerging after the COVID-19 pandemic. Slowly, cautiously, restrictions are easing around the world and economic activity is increasing. In the private equity industry, this new *"normal"* has meant that investors and fund managers are increasing fundraising efforts again. However, those fundraising efforts have been focused on new and different investment opportunities like impact investment addressing the effects of the pandemic and longer-term investments shielding investors from the worst effects of events like the pandemic. The deeply negative social impact of the pandemic has focused attention on ESG issues, and investors and fund managers are also much more interested in making sure they comply with ESG best practices in the private equity industry.

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