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Private Equity Newsletter

SG Analytics' premier private equity monthly newsletter and your window to the latest trends, deals, and strategies reshaping the industry. Each edition of Axia will bring you an exclusive feature article and topical news developments with our experts dissecting critical topics, offering insights and commentary that go beyond the headlines.

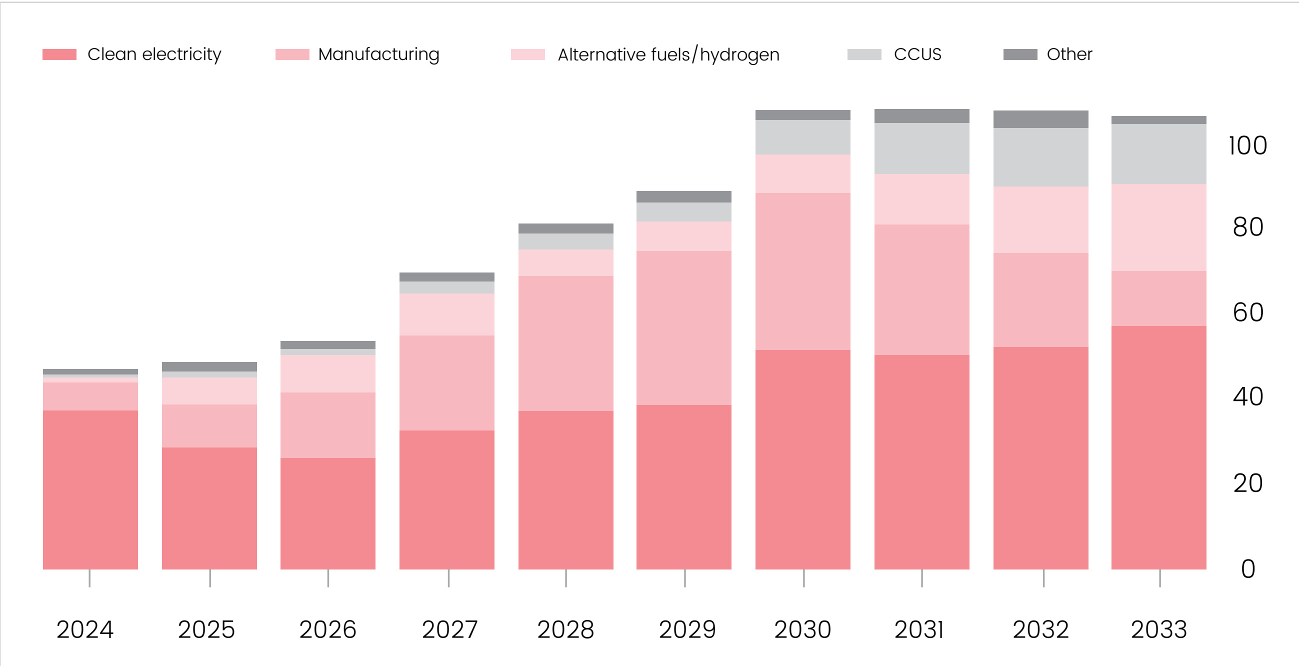
Navigating the Carbon Credits Boom: PE Firms at the Forefront

PE firms are emerging as pivotal players among the burgeoning carbon credits market. Regulatory support, corporate sustainability pledges, and increasing environmental awareness are driving demand. Moreover, the recognized benefits of PE participation, addressing needs on both the demand and supply sides, further fuel this growth.

A joint study conducted by BCG and Shell projects substantial growth in the voluntary carbon credits market, surging from $2 billion in 2021 to $10–40 billion by 2030. Additionally, the report highlights a significant expansion in the compliance carbon credit market, which soared to approximately $850 billion in 2021, marking a 2.5-fold increase from the previous year. Rising regulatory pressures, corporate sustainability initiatives, and greater environmental awareness among consumers largely fuel this growth.

Regulatory support, corporate sustainability pledges, and increasing environmental awareness are driving demand.

Figure 1: IRA Tax Credit Market Volume by Year ($B)



Source: Financial Times

Regulatory tailwinds have been a primary factor driving the market. The Biden administration has prioritized reducing the US's emissions, channeling billions of dollars in loans and grants to clean energy projects. The 2022 Inflation Reduction Act focused on utilizing tax credits to encourage new investments in clean energy infrastructure. This legislation empowered energy project developers with limited tax obligations to sell the credits they generated to third-party investors seeking to offset larger tax burdens. Moreover, the act expanded the scope of eligible clean-energy projects to encompass standalone battery systems, hydrogen plants, and qualified nuclear electricity plants.

Further, to enhance transparency in the carbon credit market, the SEC implemented new regulations designed to standardize climate-related disclosures by publicly traded companies in March 2024. These rules require companies to disclose scope 1 and 2 greenhouse gas emissions, aiming to provide investors detailed insights into the climate and energy transition risks that the company faced. The SEC is phasing the new rules gradually, with the first deadline scheduled for the fiscal year 2025. The regulation is expected to have a knock-on effect of creating a rise in demand for high-quality carbon credits from firms obligated to make these disclosures.

Several PE firms have ventured into this market recognizing the potential in the burgeoning demand for high-quality credits. The demand for PE stems from both the demand and supply sides of the market.

There is a significant and unmet demand for high-quality credits with verifiable mitigation benefits, posing an opportunity for PE to step in and address the market. This is because the still-nascent voluntary carbon market suffers from a lack of standardization and, consequently, an opacity in credit quality. In this context, quality refers to the guarantee that a credit effectively offsets one ton of carbon dioxide. Lower quality credits often yield minimal to no positive climate impact, exposing companies to accusations of greenwashing. This has fueled an increase in the demand for high-quality credits, which has driven up their prices, according to BeZero Carbon. The growing market preference for quality assurance, evident from credits rated BBB or higher being retired at higher rates than those rated BB or lower, provides a robust incentive to PE firms to enter the business of high-quality carbon credits.

On the other side of the market, project developers have been seeking out PE firms to secure better terms for their tradable credits. By providing quality assurance to prospective buyers, who often demand high discounts to finalize a deal, PE firms can enhance the benefits developers receive. EnCap Investments, for instance, a Texas-based energy-focused PE firm, recently established Bildmore Renewables to support renewable energy projects and assist developers in selling the tax credits they generate. According to the Wall Street Journal, this new venture plans to invest $20–100 million per project and deploy up to $1 billion annually, a strategy that hinges on convincing customers of their ability to secure superior terms.

Additionally, PE firms recognize that emission trading systems (ETSs) and carbon credits, more generally, are in nascent stages, representing robust growth prospects. According to the World Bank, the proportion of global emissions covered by either a carbon tax or an ETS was 23% in 2023, a pronounced jump from 7% merely a decade ago. And, with 77% of global emissions currently falling outside the purview of any carbon credit scheme, there is significant room for growth, increasing the segment's attractiveness to investors. Additionally, according to the Global Infrastructure Hub, in 2022, approximately one-fifth of the world's 2,000 largest companies committed to achieving net-zero emissions by 2050. This pledge translates to a demand from buyers for 1.7 billion tons of carbon credits. The report forecasts corporate demand to soon escalate astronomically, driven primarily by the establishment of more net-zero targets.

Most notably, Bain Capital recently invested in Terra Natural Capital, a New Jersey-based investment firm specializing in financing projects that generate offsets; Private Group allocated 10–30% of its Royalties fund to projects aimed at generating carbon credits; and Stafford Capital Partners is in the process of raising a fund dedicated to investing in forest projects that could produce approximately 30 million carbon offsets. As the market continues to evolve, the trend of PE firms entering the space is expected to gain momentum.

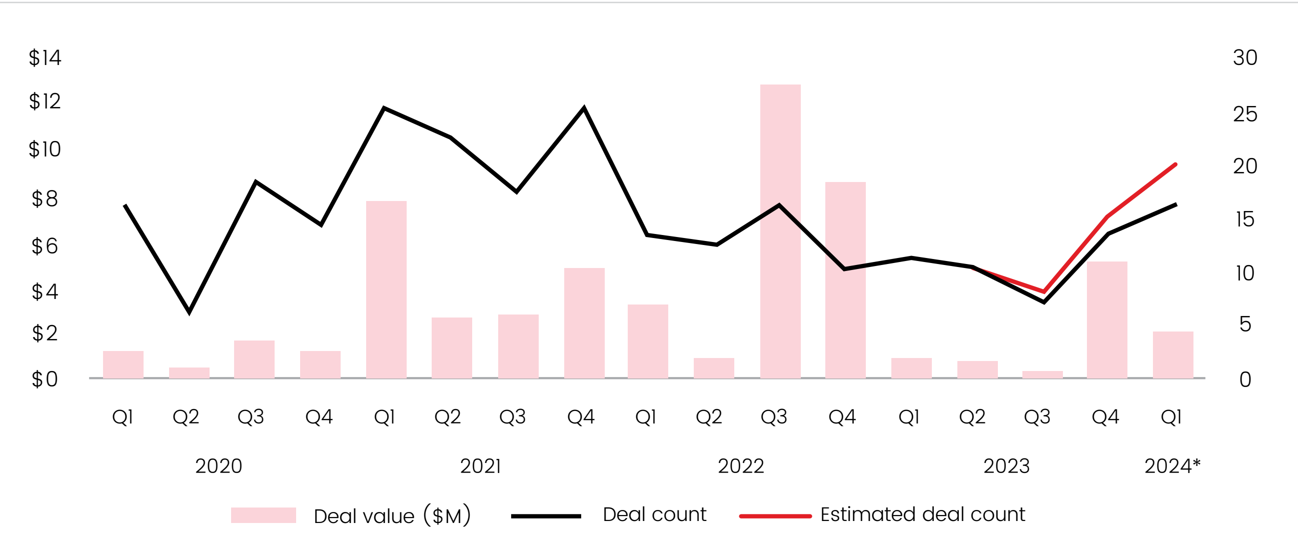
As climate change becomes an increasingly concrete reality, environmental awareness, corporate initiatives, and regulatory pushes for carbon taxes and ETSs are bound to increase the demand for high-quality carbon credits, consequently increasing the need for PE firms in the carbon market. PE stands poised to cement its position as a pivotal player in the burgeoning credits market, with demand originating from both the demand and supply sides.

Monthly News and Analysis

Payment Fintech Buyouts Trending Upward in the Past Two Quarters

PE buyout activity in the fintech sector has witnessed a notable uptick over the last two quarters, rendering it an especially enticing subsector for investors amid the resurgence of buyout dealmaking. According to Pitchbook, 1Q24 recorded 16 fintech PE buyouts, slightly up from 14 in 4Q23 and markedly higher than the 11 buyouts in 1Q23.

Figure 2: Quarterly Enterprise Fintech PE Buyout Deal Activity



Source: Pitchbook

The resurgence in fintech PE activity is primarily attributed to a narrowed bid-ask spread. Lower interest rates further facilitate market participants in reaching agreeable sale prices, as a significant rate reduction increases the price that PE firms can pay while still achieving attractive returns. Moreover, payment businesses have experienced significant growth due to robust consumer and business spending. In the middle-market PE space, payments combined with software continue to dominate, as noted by Pitchbook.

1Q24 emphasized that industry-specific payment tools, integrated with workflow software, have the potential to drive revenue growth and margins necessary for attractive buyout returns. More fintech buyout candidates are emerging in categories that offer essential services such as payments, whereas fintechs providing more niche services, such as wealthtech, regtech, and alternative lending, present fewer buyout opportunities. According to Pitchbook data over the trailing 12 months, the top three segments were enterprise payments (27%), capital markets (22%), and financial services infrastructure (20%). Pitchbook projects that PE fintech buyouts could increase to a run rate of 60 to 75 per year, up from the current 50 to 60, once short-term rates decline significantly, assuming a soft economic landing.

Carlyle Raises $2.8 Billion for Largest Japan Buyout Fund

The Carlyle Group raised ¥ 430 billion, or $2.8 billion, for its fifth Japan buyout fund, reflecting growing investor interest in the country despite a challenging global fundraising climate for PE. This fundraiser marks the largest for a buyout strategy targeting the Japanese market, according to Preqin.

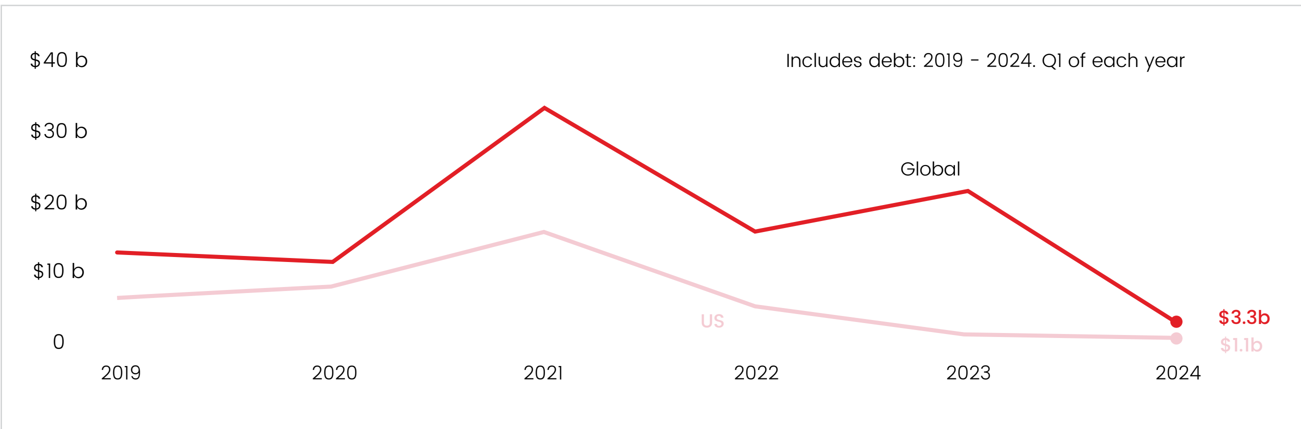
PE managers have been actively expanding their presence and integrating Japan into their investment strategies. The weakening yen, low interest rates, supportive government policies, and a wave of business succession opportunities due to aging business owners are drawing investors looking for opportunities in the Asia-Pacific region outside China.

In 2023, Japan's deal value nearly tripled, increasing by 183% compared to the annual average from 2018 to 2022, while Asia-Pacific deals dropped by 35%, reaching their lowest level since 2014, according to Bain. In 3Q23, Japan secured $27 billion in investments from PE and VC, making 2023 one of the largest years for private capital investment in the country, as per Pitchbook. This surge contrasts with the global PE landscape, where activity is slowing. Japan's momentum is expected to continue into 2024 as companies aim to enhance shareholder value and are more open to working with buyout firms. However, challenges remain, including hiring local talent and managing currency risks. Bain Capital and KKR, in line with Carlyle, have included Japan in their investment strategy planning.

PE Investments Hit a Multiyear Low in the Consumer Industry

PE investments in the consumer industry have reached a multiyear low, both globally and in the US, according to the London Stock Exchange Group (LSEG). Major firms such as Carlyle, Warburg Pincus, and KKR have halted investments in consumer retail. This withdrawal has resulted in less competitive processes and a decline in overall deal activity within the sector.

Figure 3: Total PE Deal Value in the Consumer Industry



Source: Axios

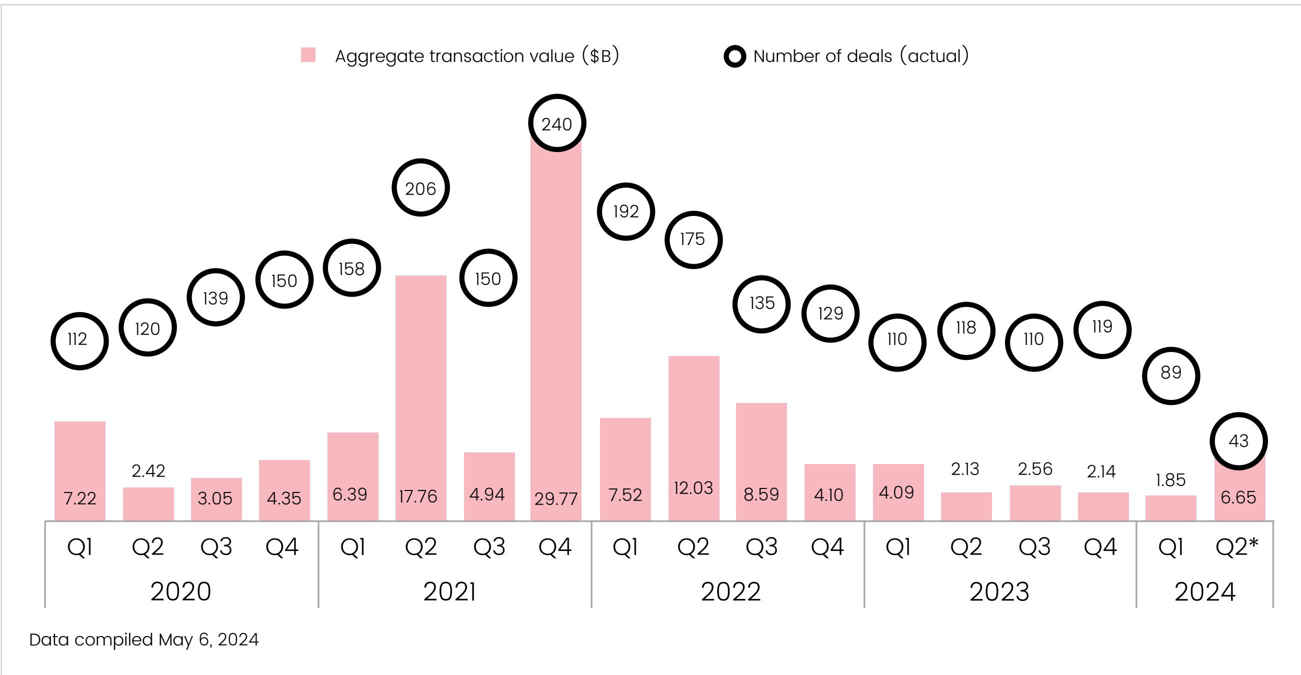
Investments in retail and consumer companies represented only 7% of the total US PE deal volume over the last decade, compared to nearly 15% in the previous decade, according to Dealogic data. PE invested nearly $1.1 billion in 1Q24, down from $1.7 billion in the same period in 2023, as per LSEG. This decline contrasts sharply with the overall PE activity, which increased by 54% year-over-year (YoY).

Since the COVID-19 pandemic, the industry has faced constant upheaval, including volatile consumer demand, inflation, and supply chain disruptions. Additionally, traditionally resilient to market volatility, consumer goods companies are now more vulnerable due to the rise of e-commerce, lower barriers to entry, and high acquisition costs. Despite these challenges, consumer spending accounts for most of the US's GDP, presenting ongoing opportunities for investors. A new wave of middle-market and growth-equity investment firms, such as SKKY Partners and Forward Consumer Partners, is targeting small-scale consumer and retail companies to fill the gap left by larger sponsors. Additionally, some large firms remain active in the consumer sector. Sycamore Partners and Ares were among the top five retail investors last year, as per Reuters.

Thoma Bravo Secures $1.5 billion Cybersecurity Exit

Thoma Bravo announced the sale of Venafi, a Utah-based cybersecurity company, to CyberArk for $1.54 billion. Venafi specializes in software that manages machine identities, ensuring secure connections and communications between machines. Thoma Bravo's significant involvement in the cybersecurity domain, exemplified by numerous acquisitions, such as the recent privatization of British cybersecurity entity Darktrace for approximately $5 billion earlier this year.

Figure 4: PE/VC-backed Investments in Cybersecurity



Source: S&P Global

PE has been actively embracing the disruptions unfolding in the cybersecurity sector. According to S&P Global, the total value of PE and VC investments in cybersecurity companies for 2024 has reached $8.51 billion as of May 5, 2024, marking a remarkable 91% surge from the $4.46 billion recorded during the same period in 2023. This surge underscores the sector's urgent efforts to adapt as corporate data, once confined within networks, shifts to the cloud. Furthermore, a wave of new vendors is entering the scene, offering cybersecurity solutions specifically designed for cloud environments from inception, thereby diversifying the landscape. The demand for innovative cybersecurity strategies and tools is driving significant investment as these new players enter the market. Despite the unprecedented levels of investment, ongoing innovation remains crucial to address emerging cyber threats, and this dynamic is expected to sustain the momentum of investment in innovation.

Blackstone to Expand Equity Ownership to Employees in Future Buyouts

According to the Wall Street Journal, Blackstone intends to distribute equity in its US portfolio companies to the employees of those companies. The initiative is set to kick off with Copeland, a climate-tech company acquired from Emerson Electric by Blackstone for $14 billion in 2023. With approximately 700,000 employees spread across its 230 globally owned companies, the firm aims to extend this equity-sharing approach to enhance employee engagement and alignment with company performance.

Blackstone isn't the first to introduce this initiative. In 2011, KKR adopted comprehensive employee-ownership initiatives across its industrial companies, eventually expanding them to encompass all its US portfolio companies. Established in 2022, a nonprofit called Ownership Works is dedicated to advocating for shared ownership and assisting companies in implementing broad-based stock programs. Among its founding partners, the nonprofit includes 19 PE firms such as KKR, Apollo Global Management, Ares Management, Silver Lake, and TPG. Each firm has committed to introducing shared ownership in at least three companies by the end of 2023. Embracing broader ownership has the potential to help the PE industry attract and retain more workers amid a competitive labor market, while also reducing regulatory pressures. Advocates argue that it enables lower-level employees to accumulate wealth and fosters better alignment of their interests with those of management and shareholders. Companies that have embraced shared ownership report higher levels of employee engagement and decreased turnover rates.

Deals Flash

Haveli Acquires ZeroFox

Haveli, an Austin-based PE firm, has acquired ZeroFox, a Maryland-based cybersecurity company in a take-private transaction valued at approximately $350 million. ZeroFox stockholders will receive $1.14 per share in cash upon the transaction's completion, representing a 45% premium over the volume-weighted average price for the 90 days ending on February 2, 2024. As a privately held entity, ZeroFox will benefit from Haveli Investments' strategic support, guidance, and capital to expand its global presence in line with its mission to create a safer digital world. This investment will enable ZeroFox to enhance its leading cybersecurity platform, explore new market channels, and accelerate innovation to better protect its customers.

Blue Point Acquires National Safety Apparel

Blue Point Capital Partners, an Ohio-based PE firm, has acquired National Safety Apparel (NSA), an Ohio-based manufacturer of protective apparel for industrial safety workers. Founded in 1935, NSA is a market leader in flame-resistant clothing, electrical PPE and products, thermal and industrial PPE, workwear, and uniforms. NSA's double-digit annual growth over the past decade has solidified its position as a leader in the industry, with the resources and vision for continued success. Blue Point's capital support and operational resources will drive NSA's organic growth through new product introductions, geographic expansion, and strategic mergers and acquisitions.

EQT in Talks to Buy Keyword Studios

EQT is in advanced discussions to acquire Keywords Studios, a Dublin-based video game services company, for £2.2 billion ($2.79 billion), according to Reuters. EQT is considering a potential cash offer of £25.50 per share for Keywords, representing a premium of approximately 73% over Keywords' closing share price of £14.70 on May 17, 2024. Founded in 1998, Keywords Studios is a global provider of creative and technology-enabled solutions for the video games and entertainment industries, with over 70 facilities in 26 countries. Under Britain's takeover rules, EQT has until June 15 to either make a firm offer or withdraw.

Blackstone Acquires Majority Stake in Priority Software

Blackstone has acquired a majority stake in Priority Software, a provider of mission-critical business software based in Tel Aviv, Israel. Blackstone's investment aims to strengthen Priority Software's leading position in the ERP software market and support its continued growth across various industries and markets. Priority Software offers comprehensive business applications and ERP solutions that enhance business management through innovative, cloud-based applications. The company serves more than 17,000 customers and over 300,000 end users across multiple sectors. Priority Software employs over 500 people across five offices in Israel, the US, and Belgium.

Warburg Pincus to Acquire Shriram Housing

Warburg Pincus, through its affiliate Mango Crest Investment, is set to acquire Shriram Housing Finance Ltd (SHFL), an India-based housing finance organization, for ₹4,630 crores ($557 million). SHFL, a leading player in the affordable housing segment in India, has established a strong growth trajectory and has played a transformational role in the Indian housing finance industry. The company has reported a robust AUM growth rate of 56% CAGR over the past four years. Following the completion of this transaction, SHFL will operate as a standalone entity, continuing to enhance value for its stakeholders while preserving its heritage and mission to provide housing finance solutions to the underserved population of the country.

Goldman Sachs Acquires Xpress Wellness

Goldman Sachs Alternatives has acquired Xpress Wellness, an Oklahoma-based provider of urgent care and other healthcare services to rural communities, from Latticework Capital, a Dallas-based PE firm. This acquisition positions Xpress Wellness to accelerate its already strong growth by expanding urgent care services to more underserved communities. The company will leverage Goldman Sachs' global network and resources to further develop new and existing markets and to build out additional, adjacent healthcare services. Xpress Wellness, in conjunction with its subsidiary, Integrity Urgent Care, delivers healthcare solutions to rural and underprivileged communities spanning Oklahoma, Kansas, and Texas. It currently operates 58 clinics, 39 of which are certified Rural Health Clinics.

Sterling Partners Acquires Keypath Education

Sterling Partners, a Japan-based PE firm, has acquired Keypath Education, an Illinois-based education technology company in a take-private transaction valued at approximately $186.8 million. Sterling Partners will purchase all outstanding shares of Keypath common stock it doesn't already own for $0.87 in cash per share, marking an 88.3% premium over Keypath's six-month volume-weighted average price of $0.46 as of May 23. Following the transaction's closure, Keypath is set to become a wholly owned subsidiary of Sterling Partners, planning to delist from the ASX and deregister from the US Securities and Exchange Commission (SEC). The company has made significant contributions to over 4,000 higher education institutions, enhancing their ability to support students and alumni in the US, Canada, the UK, and Australia.

Advent in Talks to Acquire Stake in Prometheus Group

Advent International is nearing a deal to acquire a stake in Prometheus Group, a North Carolina-based industrial software company, in a transaction valued at more than $4 billion, according to Bloomberg. Established in 1998, Prometheus specializes in developing software for plant maintenance and optimization across various sectors such as oil and gas, paper, mining, metals, and utilities. In 2019, Genstar acquired majority ownership in Prometheus for over $1 billion from Francisco Partners, and in 2022, it explored options for selling the company. The increasing demand for industrial software solutions, driven by the need for digital transformation across industries, has led to elevated valuations for providers such as Prometheus.

Encore Consumer Acquires Chalet Desserts

Encore Consumer Capital, a San Francisco-based PE firm, has completed the acquisition of Chalet Deserts, a Sacramento-based frozen desserts and baked goods company. Encore views Chalet as a leading player in its category and intends to foster its expansion through additional acquisitions, organic growth strategies, and investments in production capacity. Chalet distributes its frozen bakery desserts and baked goods to in-store bakeries in supermarkets and convenience stores, as well as serving the food service and ingredient markets. Its product lineup encompasses a variety of offerings including flavored cake pops, ice cream-based treats, cheesecake, and brownie pieces.

Tinicum Acquires KGM

Tinicum, a New York-based PE firm, has acquired KGM, a Tulsa-based distributor of natural gas products to utilities and commercial & industrial customers, from Compass Group Equity Partner, a St. Louis-based PE firm. Management shareholders have retained a significant interest in the company. KGM's product portfolio comprises gas meters, instruments, regulators, valves, and other related equipment and parts. Additionally, KGM offers value-added services such as technical support, training, testing, and calibration, as well as product repair and refurbishment. This acquisition will enable KGM to leverage its strong technical expertise, longstanding partnerships with OEM suppliers and customers, and its unique ability to provide tailored and comprehensive solutions to customers' needs.

Upcoming Events

California LP Summit	June 11, 2024	Monarch Beach Resort N, Dana Point
Operating Partners Forum Napa	June 13–14, 2024	The Meritage Resort and Spa, Napa
Bloomberg Invest Summit	June 25–26, 2024	New York

TRENDS AND STATS

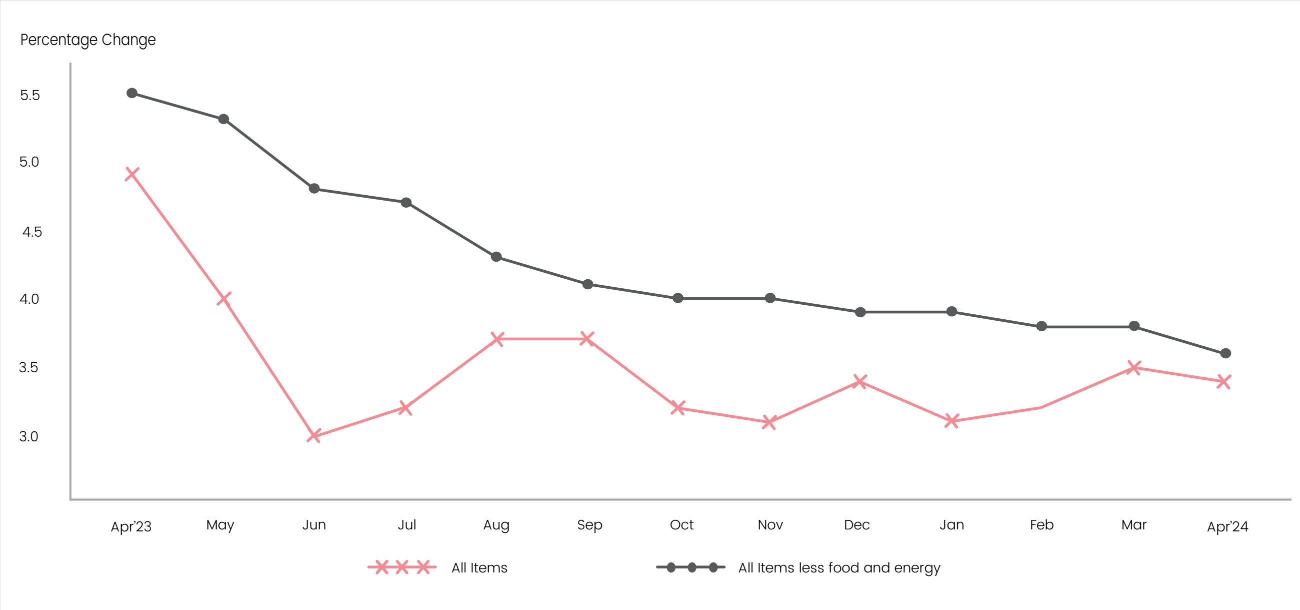
Data as of May 26, 2024

Thomson Reuters Private Equity Buyout Index

Thomson Reuters P...	4,599.09	+1,343.32	41.26%
S&P 500	5,304.72	+1,099.20	26.14%
Nasdaq Composite	16,920.80	+3,903.36	29.99%
DOw Jones Industries...	39,069.59	+6,026.81	18.24%

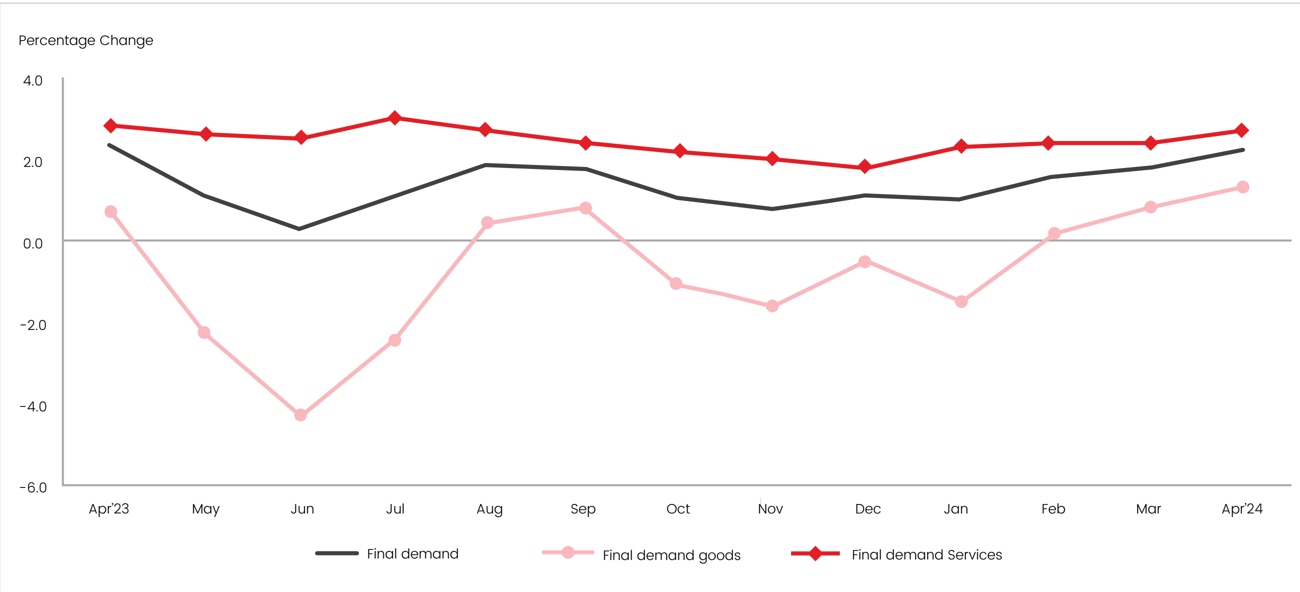
Index	Month-over-Month	YTD
Consumer Price Index	0.3%	3.4%
Producer Price Index	0.5%	2.2%

Figure 5: 12-month Percent Change in CPI For All Urban Consumers, Not Seasonally Adjusted



Source: US Bureau of Labor Statistics

Figure 6: 12-month Percent Change in Selected PPI Final Demand Price Indexes, Not Seasonally Adjusted



Source: US Bureau of Labor Statistics

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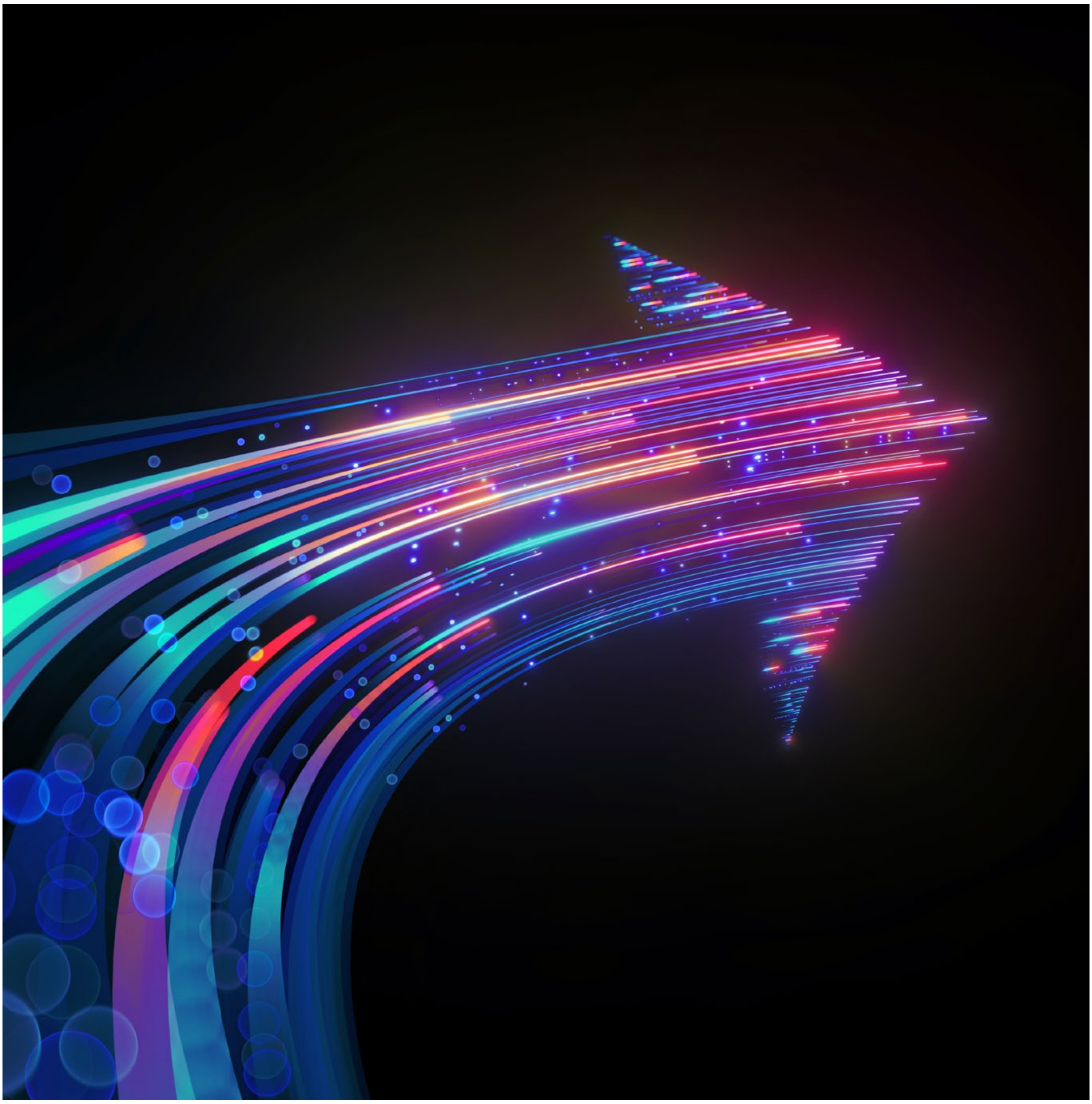

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