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MOFO GLOBAL PE TRENDS 2021 AND OUTLOOK FOR 2022

As the global economy recovers from the pandemic, what does 2022 have in store for the global PE market? In this annual report, MoFo partners from around the globe review the key PE trends from 2021 and make predictions from both global and regional perspectives for 2022.

2021 GLOBAL TRENDS

Most of our 2021 predictions came true. As a recap, below are some key trends that we identified and how our predictions fared:

Uptick in Deal Activity and Valuations: In 2021, there was a significant increase in deal activity and valuations, especially in Europe. Ample market liquidity, low interest rates, and a record-high number of PE firms have contributed to a tremendous amount of deal making.

Bountiful Fundraising: Fundraising has rebounded, with approximately US$937 billion raised, compared with US$857 billion in 2020.

Fierce Competition for Deals: With an estimated US$3.4 trillion of dry powder, an increase of 9.7% from 2020, waiting to be deployed, competition for assets has become even fiercer.

Continued Rise of ESG: As LPs increasingly required reporting of ESG metrics by GPs, PE sponsors have increased focus on ESG throughout the investment cycle. Increasingly ESG terms (particularly around climate) are baked into the transaction documents.

Surge in SPAC Transactions: In 2021, SPACs surged both in number and in value. PE sponsors competed for high quality targets. However, there were significant peaks and valleys for SPAC listings and de-SPACs as the market attempted to digest new statements and requirements from the SEC and the lackluster performance of certain SPACs.

Technology and Life Sciences Focus: The growing demand for IDCs, driven by e-commerce, fintech and virtual communication, and the focus on the life sciences sector as a result of COVID-19, drove an increase in PE transactions in these sectors.

Credit Markets Remained Red-Hot: While intense M&A activity powered the credit markets in 2021, other types of financings continued to grow as well (e.g., dividend recaps). Some parts of the world took a visible breather towards year end due to concerns over inflation and the potential impact on economies of Omicron.

2022 GLOBAL OUTLOOK

The momentum from 2021 is expected to continue through 2022. The following are our predictions for 2022:

Uptick in TMT Investments: According to the 2021 MoFo Tech M&A survey report, 2022 will be an exciting time for tech M&A. While PE firms have been upping their exposure to tech for years, the pandemic lit a fire under PE investment in this space, with nearly half of PE respondents indicating that they expect to do two to three tech deals in 2022.

Increasing Regulatory Challenges: The global rise of anti-trust enforcement, national security protections, and greater focus on data protection, will give rise to more complex deal-making.

Increased Focus and Scrutiny on ESG: First, more asset managers are raising separate funds to focus on impact/climate. Second, ESG is being used as a tool for deal selection for impact funds but also integrated with diligence, documentation, and portfolio management for mainstream funds. Third, LPs are starting to look at the ESG of the asset managers themselves. Finally, measuring, benchmarking, verifying and reporting on ESG is moving from a “nice to have” to a “must have.” Read more.

Continued SPAC Wave: SPACs will remain an important factor in the M&A marketplace and will continue to compete with PE funds for attractive assets. There are over 400 SPACs looking for targets. The PIPE market will continue to evolve to provide needed liquidity to targets looking to raise money through de-SPAC transactions. New SPAC listing regimes will continue to drive activities internationally. Read more.

Tax Law Uncertainty: With increasing regulatory scrutiny and the upcoming OECD tax reform, we expect a greater focus on how deals are structured from a tax perspective.

Debt Available Everywhere: Due in part to record fundraising for both buyout funds and credit funds in 2021, M&A activity will continue unabated in 2022. Lenders will continue to chase deals with a higher appetite for risk. We expect cov-lite to become more prevalent in the private loan market, as well as other sponsor-friendly provisions, with possible bumps in the road as LIBOR transitions out and SOFR transitions in.

REGIONAL PERSPECTIVE FOR 2022

CHINA

- The dust will settle on regulatory complications by Q3
- More take privates of U.S.-Listed China-based companies
- More aggressive terms for LBOs
- Increased interest in Chinese biopharma M&A

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SOUTHEAST ASIA

- Rising interest in biotech, healthtech and agtech
- Ongoing popularity of logistics and online services
- Focus on underserved markets
- More late stage/pre-IPO investment for SE Asia's unicorns
- More JVs with overseas data center specialist operators

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UK

- Impact of the National Security and Investments Act effective from January 4, 2022
- Increased deal appetite, especially in retail sector
- Continued traction in tech and healthcare sectors

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U.S.

- Ongoing popularity of Buy and Build strategies
- PE firms to become more selective in auction processes
- Warehousing investments to become more common

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EUROPE

- Tech and life sciences will continue to be popular sectors for PE investments
- Ready availability of cheap funding and high levels of dry powder will result in continued keen competition for assets
- ESG-linked financing will become less feasible under the strict timing requirements of highly contested auction processes

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LATIN AMERICA

- Higher valuations and more private capital available
- Continuing lure of tech sector particularly fintech, edtech, proptech and e-commerce
- High risk, high reward opportunities across region with potential inflation challenges ahead

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INDIA

- Start-up ecosystem buoyant with unicorns abounding
- Tech M&A by PE-backed companies remains strong
- Continued growth in domestic India IPOs
- Continued national security concerns

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JAPAN

- Expected growth through carve-outs, distressed assets and succession issues
- Increasing investment opportunities for international players
- More major PE funds entering the market

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U.S.

DRY POWDER: As expected a high level of dry powder, a strong financing market and other factors such as concerns about tax reform, drove record activity levels in 2021, and we expect high levels of deal activity to continue in 2022.

AUCTION DYNAMICS: As the market remains robust and processes competitive up and down the value chain, we anticipate PE funds will become more selective in how much time they invest in auction processes, passing early if full conviction isn't there but running extremely hard to preempt processes where it is. PE funds are willing to move fast, take on risk and pay a premium for the right targets, while investing far less time on businesses they are less convinced of.

ADD-ONS TO CONTINUE: Buy and Build strategies have been even more popular post-pandemic, and we expect that trend to continue. The new year should bring significant add-on activity as PE funds seek to grow and/or reshape their existing portfolio companies.

FUND FLEXIBILITY: Warehousing investments for newly raised funds and raising continuation fund vehicles for existing investments will become more commonplace as funds continue to manage market conditions requiring speed to closing, high multiples and potentially longer hold periods.

LATIN AMERICA

SOURCE OF CAPITAL: From 2020 to 2021, the deployment of private capital almost doubled and the prominence of venture capital investment continues to increase across the region. With this, the check size has grown significantly, and we expect to continue to see higher valuations and more private capital in the market in 2022.

THE LURE OF TECH: Similar to 2021, technology companies continue to lead with investors particularly interested in opportunities in hot sectors including fintech, edtech, proptech and e-commerce.

ONGOING BALANCE OF RISK AND REWARD: During 2021, as predicted, Brazil continued to receive the lion's share of investment activity and attention, with over 60% of all investment directed at the Brazilian market, with Mexico second. During 2021, currency fluctuations and inflation were major factors in each of Brazil, Mexico, Colombia and other major markets. National elections in late 2021 in Chile and upcoming in 2022 in Brazil may lead to some more short-term market volatility. Generally, investment interest in the larger markets of Brazil, Mexico and Colombia will remain high. High risk, high reward opportunities will continue to attract investors across the region in 2022, but LPs and sponsors may face more potential currency devaluation and inflation challenges ahead.

UK

NATIONAL SECURITY AND INVESTMENTS ACT: As we predicted, national security was a key feature of PE M&A and investments involving UK businesses in 2021. Effective from January 4, 2022, the National Security and Investments Act represents a wholesale change in the UK's national security review process for M&A and investment transactions. PE firms will need to consider the impact of this legislation on transaction timelines and whether the target business and their fund structure is likely to give rise to national security concerns.

INCREASED DEAL APPETITE: Approaches by PE firms to UK-listed companies continues to increase, buoyed by low interest rates and increased levels of dry powder Bids from PE houses often outstrip bids by trade buyers and lead to boards signalling their approval more easily.

TECHNOLOGY AND HEALTHCARE: Tech and healthcare – including agtech and foodtech – continue to attract some of the highest valuations from PE houses.

BREXIT: Although there is still a lot of work to be done to ensure that the Brexit trade deal functions properly, it has been sufficient so far to provide certainty for PE investors and has not held back transactions in businesses involved in the cross-border trading of goods.

EUROPE

TECH AND LIFE SCIENCES INVESTMENTS: As we predicted last year, investments in tech and life sciences have continued to rise, in particular in digital healthcare businesses. Pressure on deployment of funds remains high. SMCs have opened up for M&A as targets are scarce and purchase prices multiples high.

LOW INTEREST ENVIRONMENT: The current market dynamics are driving a lot of mid-cap PE investment activity, by giving sponsors good access to cheap money. Concurrently, funds' dry powder is growing, target multiples are growing, and competition for targets is increasing. Consequently, we expect to see more occurrences of pre-emption, where high offers are made at the beginning of an auction process to eliminate competition.

ESG-LINKED FINANCING: ESG-linked financings have become more widespread over the past few years, allowing sponsors to look out for favorable terms. However, we predict these financings will become less likely to happen in this format if there are strict timing concerns, such as an auction process. Liquidity in the form of undrawn RCFs is primarily provided by banks, mostly in super senior positions, to make up for the pricing, which tends to be not very profitable.

CHINA

RISING GOVERNMENT CRACKDOWNS ON SPECIFIC INDUSTRIES: As we predicted, China's success in taming COVID-19 resulted in PE investors in China having a robust deal pipeline, with M&A in H1 2021 up 88.5% over H1 2020. However, a spurt of new regulations in H2 2021 resulted in a slowdown in deals. We expect that by Q3 2022 the dust will have settled and funds will have made necessary adjustments to their China investment strategies.

TAKE PRIVATES OF CHINA-HEADQUARTERED COMPANIES CONTINUING: As of December 6, 2021, seven PE-backed take privates of U.S.-Listed, China-headquartered companies have been announced. Take privates will accelerate in 2022, as the threat of delisting of these companies under the Holding Foreign Companies Accountable Act looms even larger and the U.S./China tensions continue to increase.

BUYOUTS: With record fundraising by PE firms for capital to be deployed in APAC and low interest financing, we expect to see aggressive terms for LBOs in 2022.

CHINESE BIOPHARMAS: As predicted, healthcare/biopharma M&A was exuberant in 2021, with M&A transaction value exceeding US$ 9.7 billion, a 32% increase in transaction value. In 2022, we anticipate leading healthcare PE/VC funds will increasingly incubate new companies through multiple rounds of KPI-driven structured financings.

SOUTHEAST ASIA

RISING INTEREST IN BIOTECH, HEALTHTECH, AND AGTECH: We expect to see continuing interest in biotech start-ups, particularly in Singapore, as well as healthtech and agtech businesses.

POPULARITY OF LOGISTICS AND ONLINE SERVICES: Demand for e-commerce and other online services, such as digital banking and virtual communication, is higher than ever. As in 2021, this will continue to drive demand in adjacent industries, including logistics warehousing, delivery platforms and data centers. All nine of the Singapore-based businesses that achieved unicorn status in 2021 are highly technology-driven, and more than half are in e-commerce and logistics businesses.

FOCUS ON UNDERSERVED MARKETS: We expect investors will continue to focus on opportunities in underserved markets such as Vietnam where fundamentals are strong, growth has been robust and mobile/Internet adoption is high.

LATE STAGE/PRE-IPO INVESTMENT: Southeast Asia's unicorns and large pan-regional businesses have seen high levels of investment, with large secondary rounds being raised. Regional businesses are focused on tapping the international capital markets.

MORE DATA CENTER OPERATOR JVS: We expect to see increased demand from more overseas data center specialist operators to form JVs with partners that have operating experience in Southeast Asia.

JAPAN

GROWTH THROUGH CARVE-OUTS, DISTRESSED ASSETS, AND SUCCESSION ISSUES: As we predicted last year, there has been an uptick in the small and mid-market segments. We expect over-diversified Japanese companies will continue to look for opportunities to carve out non-core business assets and an increasing number of businesses will look to unload distressed assets or obtain rescue financing – creating opportunities for PE buyers. Japan's aging population continues to result in new investment opportunities for PE buyers in family-run Japanese companies facing business succession issues.

GROWTH INVESTMENT: While historically growth investment has been largely dominated by domestic funds, international players are beginning to explore opportunities in Japan, including through minority investment. We expect this trend to continue, particularly as Japan's start-up ecosystem continues to gain steam.

MAJOR PE FUNDS ENTERING JAPANESE MARKET: As we predicted for 2021, several major international PE sponsors have launched new funds specializing in Japanese investments. We expect this trend to continue, especially in relation to the Japanese buy-out market, where we are beginning to see signs that new entrants are preparing, in the near term, to enter the market in earnest.

INDIA

UNICORNS ABOUND: In 2021, the number of Indian unicorns grew by nearly 125%. As we predicted, edtech, fintech, and e-commerce were hot sectors for PE investments in India. We expect the start-up ecosystem to remain strong in 2022 with the addition of several new unicorns.

INCREASED DEAL-MAKING: Several large PE investors have announced plans to deploy substantial capital in India. Sectors like insurance (buoyed by recent policy changes allowing foreign investments), construction, real estate, tech, SaaS, fintech and healthtech will attract substantial investments. Tech M&A by PE backed companies will remain strong due to the push to digitization.

INDIAN IPOS: We expect investors to continue to achieve exits from PE investments in Indian companies through listings of those companies on the domestic public capital markets, due to delays in expected amendments to the regulatory framework to allow foreign listings by Indian companies.

CONTINUED NATIONAL SECURITY CONCERNS: The restrictions imposed by the Indian Government on foreign equity investments from jurisdictions sharing land borders with India will continue, thwarting the ambitions of, for example, Chinese PE houses intent on investing in Indian companies. However, investments from such jurisdictions where the beneficial ownership is below 10% is expected to continue to be permitted.

FOCUS ON ESG

ESG remains a hot topic for PE firms with the following themes impacting investment strategies around the globe:

Rise of New Corporate Structures: Investors are shifting their interest from time-limited investment vehicles to permanent asset vehicles, enabling managers to invest in long-lived assets with long-term growth that allows for greater focus on ESG. Targets and SPAC sponsors are also utilizing new corporate forms (primarily the Delaware Public Benefit Corporation) with its dual fiduciary duties and requirement of consideration of stakeholders, in addition to shareholders.

Focus on Investor Governance: As asset managers increase their commitment to ESG in investments, institutional investors are evaluating the ESG of the managers themselves, particularly in terms of DEI, climate and compensation.

Rise of Compliance: ESG is viewed as driving PE returns but also increasingly as a compliance requirement, with regulations on human rights, DEI and climate being addressed in a similar way to other compliance issues such as FCPA, anti-money laundering, privacy and cybersecurity.

Disclosure Requirements: The largest standard setters (SASB, GRI, CDP and CDSB) have joined forces as part of the ISSB established by the IFRS, consolidating their recommendations on ESG performance disclosure, which is increasingly required by LPs. The focus has been on methodology to avoid accusations of greenwashing and on third-party verifications and certifications.

Development Finance Institutions: DFIs play an important part in promoting the uptake of sustainable financing, particularly in Asia and Africa, by requiring the integration of ESG factors into the investment decision-making process, as well as ongoing ESG management and reporting, as a prerequisite for their investment.

FOR MORE ESG INSIGHTS:

FOCUS ON SPAC

The SPAC wave will continue and new SPAC listing regimes will drive activities internationally. Some significant global trends include:

Evolving U.S.-Listed SPAC Market: SPACs will continue to evolve as sponsors and targets seek to solve the challenges of the availability of PIPEs. We expect to see more sponsors that have independent access to capital, and a continued growing interest in SPACs from investors providing structured solutions such as convertible debt and preferred shares. We also expect SPAC targets to be more mature and growing businesses.

Asia-Focused, U.S.-Listed SPACs: As predicted, 2021 was Asia's year of the SPAC. 13% of the total U.S. SPAC IPOs completed in 2021 were led by Asia-based sponsors. Southeast Asia's Grab completed its de-SPAC transaction in December 2021, becoming the largest-ever company to merge with a SPAC.

- **China:** On the other hand, many SPAC sponsors shied away from pursuing China-based targets as the flurry of new regulations from China and United States put up hurdles to such de-SPACs.
- **Japan:** While Japan remains still relatively virgin territory for SPACs and de-SPACs there are positive signs that the market is turning. We expect one or more de-SPACs with Japanese targets to be announced in the near future.
- **India:** Despite regulatory hurdles, one de-SPAC involving a U.S.-listed SPAC and an Indian target was completed in 2021. We expect to see a number of such de-SPACs in 2022.

New Asian SPAC Listing Regimes: Singapore and Hong Kong both launched new SPAC listing regimes in 2021, and there are signs that the Japan government may consider launching a Japanese SPAC regime as part of the country's growth strategy.

- **Singapore:** The features of the Singapore regime are closer to those of the U.S. SPAC regime, but overall Singapore stock exchange liquidity is likely to make the market less attractive for larger SPACs and SPAC targets.
- **Hong Kong:** On December 17, 2021, the Hong Kong Stock Exchange issued the final regulations on the Hong Kong SPAC regime, which unexpectedly compromised on some of the features of concern to market participants. It is possible that, given these changes, SPAC sponsors will be attracted to listing in Hong Kong in 2022 and China-based targets will favor de-SPACs with Hong Kong listed SPACs.

European SPACs: In 2021, the SPAC trend reached Europe, with about 35 SPAC listings in Europe and around US$7.6 billion raised. The most important stock exchanges for SPAC listings in Europe are Amsterdam, Frankfurt, and Stockholm. London did not play a significant role in 2021, but has liberalized its stock exchange rules in August, and the first major SPAC listings in London are expected in early 2022. The Swiss stock exchange have allowed SPAC listings since December 2021. The number and volume of SPAC listings in Europe in 2022 will grow moderately compared to 2021, while de-SPACs will increase significantly. Reportedly over 90 SPACs from Europe and the United States are still looking for European targets.

Latin America Focused, U.S.-Listed SPACS: In 2021, U.S. listings of approximately 20 SPACs targeting Latin America were completed, most of which have still not identified a target. Therefore, 2022 should be a big year for Latin America de-SPACs, although the market performance of some Latin American targets that have completed de-SPACs may dampen enthusiasm for this exit route.

FOR MORE SPAC INSIGHTS:

MOFO GLOBAL CONTRIBUTORS

HOW CAN MOFO HELP?

- For more information on our insights into global PE trends and 2022 outlook, please contact Marcia Ellis, Global Chair of Morrison & Foerster's Private Equity Group, or Mitchell Presser, Co-chair of Morrison & Foerster's Global Corporate Department.
- Subscribe to MoFo's PE Briefing Room to stay abreast of the hottest topics in the global PE space.

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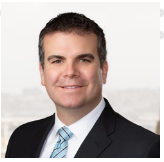
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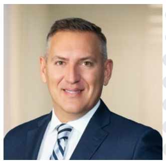
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