KPMG Private Equity Forum

14 December 2023

01

Introduction

Steve Stormonth
Partner
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With you today

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Agenda

01 Private Equity trends and IPEV update

02 Local and international regulatory developments

03 ESG Trends and Regulation

04 Tax matters

05 Q&A

01

Private Equity trends and IPEV update

Sarah Hume
Director
Audit
Crown Dependencies

What to do going forward...

Some of the key ESG areas to focus on in the funds industry moving into FY24 are as follows:

Reflection on 2023

And thoughts from Jonathan Read

Areas to look out for in 2024

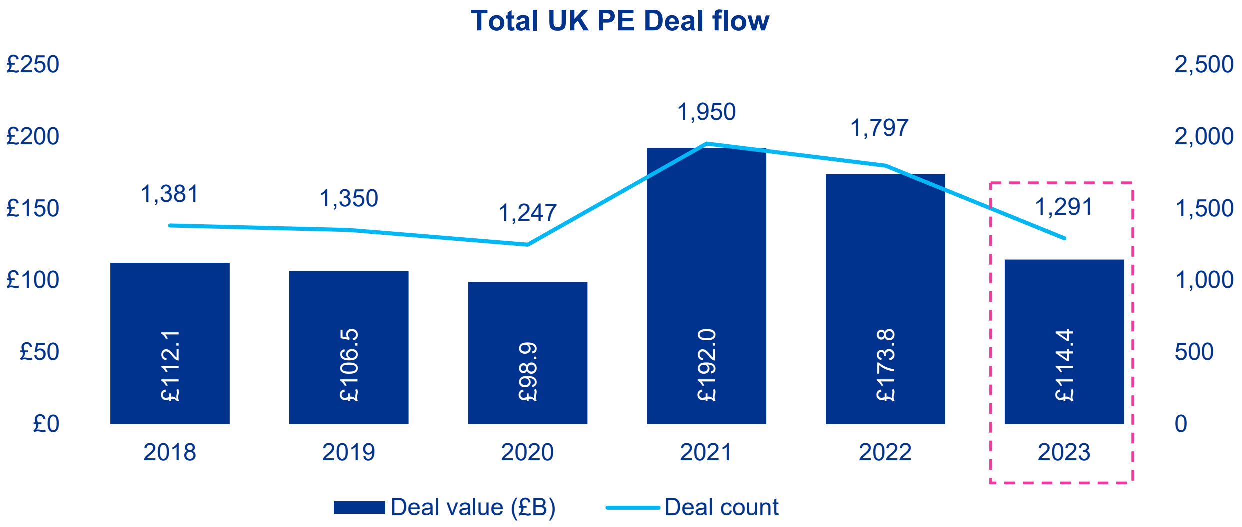
Overview of 2022 IPEV updates

2023 Reflections from Jonathan Read

Corporate Finance, KPMG UK

Watch the video here

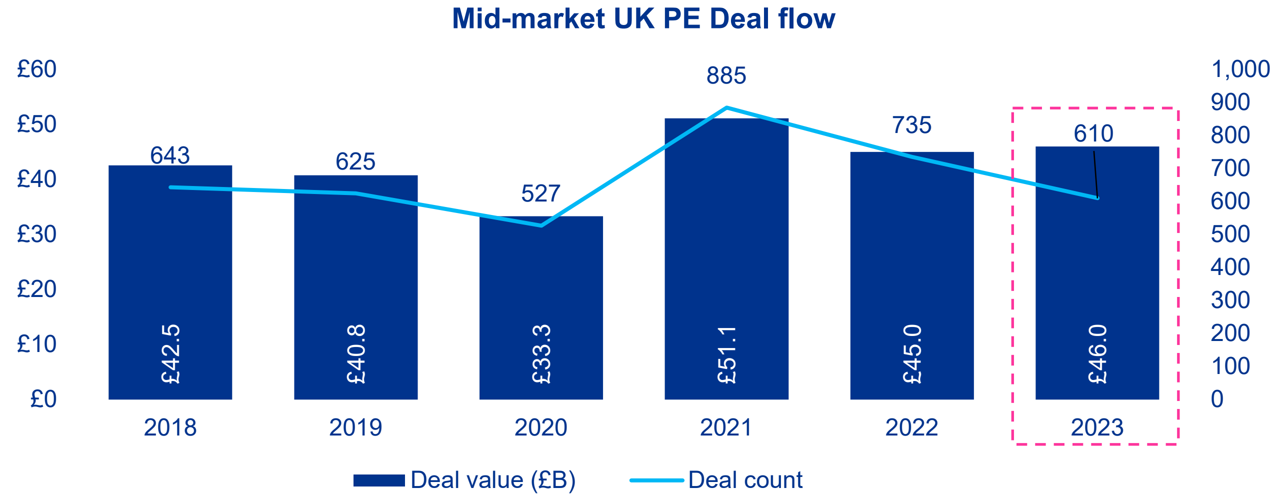
Total PE Flow – Annual



	2018	2019	2020	2021	2022	2023	% Change 2023 vs 2022	% Change 2023 vs 2021	% Change 2023 vs 2019
Deal value (£B)	£112.1	£106.5	£98.9	£192.0	£173.8	£114.4	*-34.2%*	*-40.4%*	*7.4%*
Deal count	1,381	1,350	1,247	1,950	1,797	1,291	*-28.2%*	*-33.8%*	*-4.4%*

- After a record breaking 2021 and a strong 2022, **the year 2023 saw significant decline in PE deal activit**y.
- Deal volumes in 2023 were down 28.2% and 33.8% versus 2022 and 2021, respectively. However, compared with pre-covid years, the volume was down 4.4% vs 2019 and 6.5% vs 2018.
- Total annual deal values were down 34.2% versus 2022 and 40.4% versus 2021. **However, 2023 total deal values were up 7.4% versus 2019.**

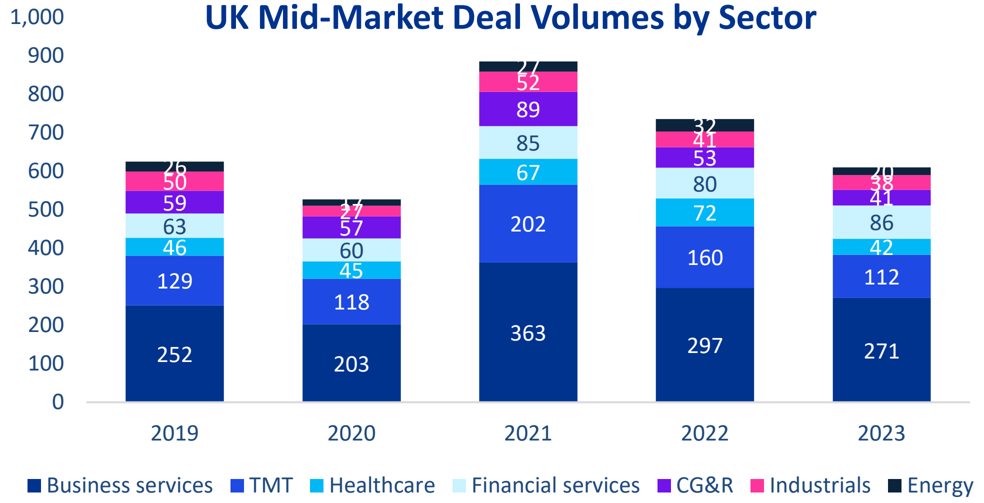
Mid-market PE Flow – Annual

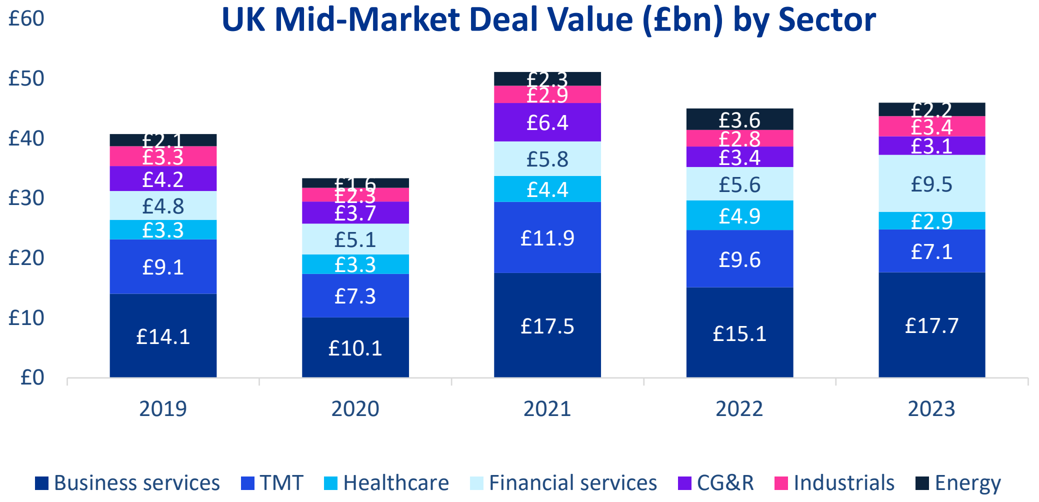


	2018	2019	2020	2021	2022	2023	% Change 2023 v 2022	% Change 2023 vs 2021	% Change 2023 vs 2019
Deal value (£B)	£42.5	£40.8	£33.3	£51.1	£45.0	£46.0	*2.2%*	*-10.0%*	*12.9%*
Deal count	643	625	527	885	735	610	*-17.0%*	*-31.1%*	*-2.4%*

- Deal volumes in the mid-market were down 17% versus FY 2022 at 610 deals. Against 2021 and 2019, full year mid-market deal volumes were down 31.3% and 2.4% respectively.
- Total annual deal values in the mid-market increased by 2.2% and 12.9% vs 2022 and 2019 respectively.

Mid-market PE Deal Volume by Sector



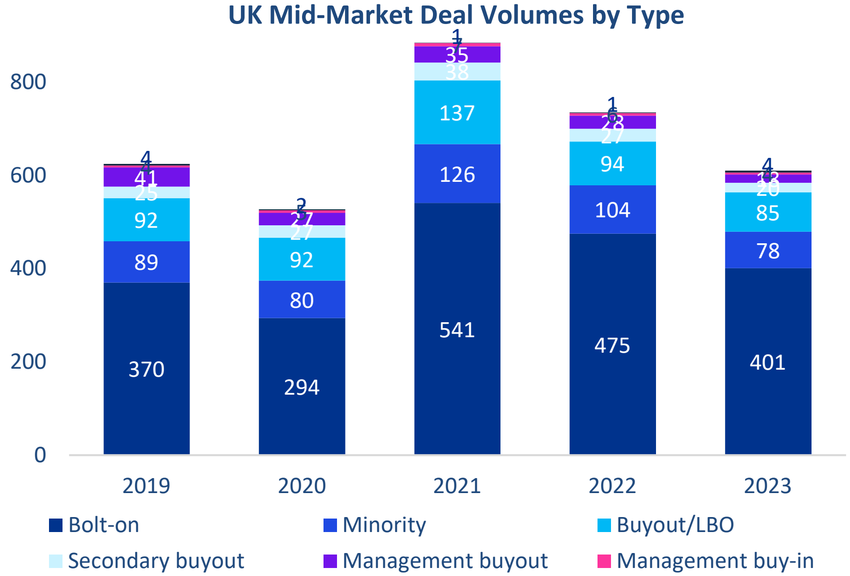


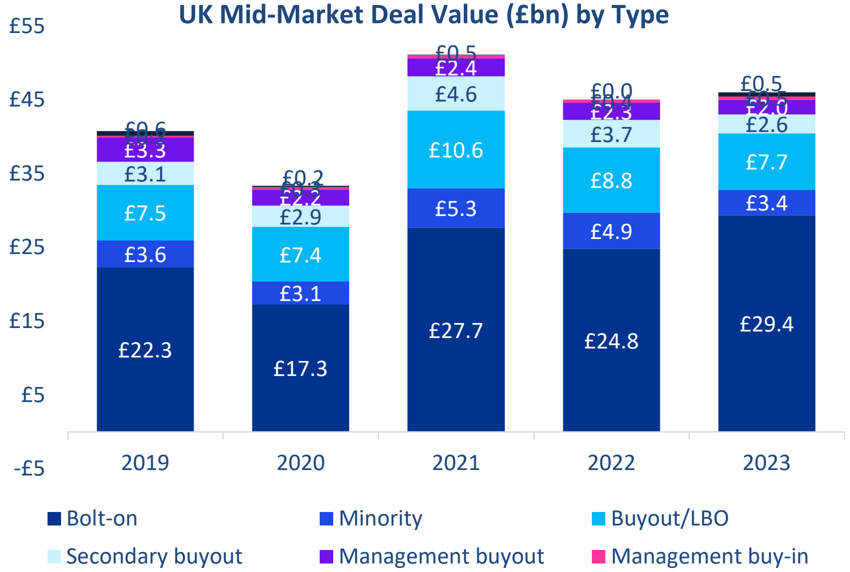
	2021	2022	2023	% Change 2023 V 2022	% Change 2023V 2019
Business services	363	297	271	*-8.8%*	*7.5%*
TMT	202	160	112	*-30.0%*	*-13.2%*
Healthcare	67	72	42	*-41.7%*	*-8.7%*
Financial services	85	80	86	*7.5%*	*36.5%*
CG&R	89	53	41	*-22.6%*	*-30.5%*
Industrials	52	41	38	*-7.3%*	*-24.0%*
Energy	27	32	20	*-37.5%*	*-23.1%*

	2021	2022	2023	% Change 2023 V 2022	% Change 2023 V 2019
Business services	17.5	15.1	17.7	*16.8%*	*25.5%*
TMT	11.9	9.6	7.1	*-25.6%*	*-21.4%*
Healthcare	4.4	4.9	2.9	*-40.4%*	*-9.7%*
Financial services	5.8	5.6	9.5	*71.6%*	*99.2%*
CG&R	6.4	3.4	3.1	*-9.4%*	*-25.5%*
Industrials	2.9	2.8	3.4	*20.4%*	*1.8%*
Energy	2.3	3.6	2.2	*-37.2%*	*9.0%*

- While all sectors experienced slowdown in 2023, Financial Services is the only sector that saw 7.5% increase in volume (86 deals in 2023) vs FY 2022. In terms of deal value, Financial Services witnessed 71.6% and 99.2% increase vs 2022 and 2019 respectively.

Mid-market PE Deal Volume by Deal Type





	2021	2022	2023	% Change 2023 V 2022	% Change 2023V 2019
Bolt-on	541	475	401	-15.6%	8.4%
Minority	126	104	78	-25.0%	-12.4%
Buyout/LBO	137	94	85	-9.6%	-7.6%
Secondary buyout	38	27	20	-25.9%	-20.0%
Management buyout	35	28	18	-35.7%	-56.1%
Management buy-in	7	6	4	-33.3%	0.0%
Public to private	1	1	4	300.0%	0.0%

	2021	2022	2023	% Change 2023 V 2022	% Change 2023 V 2019
Bolt-on	27.7	24.8	29.4	18.4%	31.5%
Minority	5.3	4.9	3.4	-30.4%	-5.5%
Buyout/LBO	10.6	8.8	7.7	-13.2%	1.7%
Secondary buyout	4.6	3.7	2.6	-31.1%	-17.8%
Management buyout	2.4	2.3	2.0	-15.6%	-40.2%
Management buy-in	0.5	0.4	0.5	26.9%	112.6%
Public to private	0.0	0.0	0.5	1245.3%	-14.1%

- Bolt-ons have remained the largest component of mid-market activity for quite some time and are holding steady.
- In 2023, bolt-ons continue to make up majority of investments in mid-market PE, accounting for 66% of the total PE mid market volume share. In terms of deal value, Bolt-ons witnessed the highest levels of growth with 18.4% increase over 2022 and 31.5% increase over 2019.

Other 2023 reflections

M&A Market

- Still recovering from downturn, but may be turning corner. Some increased pipeline in Q4 2023 with advisor pitches being scheduled;
- Very challenging deal making conditions & sluggish first 3 quarters of 2023 ;
- With inflation now slowing down and LPs putting pressure on houses to start exiting assets, some tempered confidence deal making may become more appealing ;
- Some desire by some business owners to close deals prior to the election. New government could bring changes to CI.

Exits

- Exits followed low trend and have remained low all year ;
- Houses holding onto assets for longer. "Wait and see approach" if multiples will recover to the previous high points ;
- Firms focusing on Valuation Creation in existing portfolios, while waiting to see if conditions to improve before selling
- The less desirable assets, investors may be holding off on deals and holding off to more favourable environments return.
- Some large deals drawing attention, which achieved elevated multiples. Likely these are high quality businesses that attract that premium.

Fundraising

- Really tough fundraising environment ;
- small number of sponsors have made headlines with record closings, across the board fundraising has been challenging ;
- Level of diligence investors are undertaking ahead of making commitments has increased, expanding time it takes to raise and close a fund ;
- GP demand for capital is still greater than the LP supply. Many LPs capital is tied up in other funds;
- Track records and proven ability important ; and
- As distributions have been limited – it is likely that 2024 may still be challenging.

Deal structures

- Traditional buyouts harder to come by, some interesting structures are emerging and becoming prevalent ;
- PE firms getting more deals in form of add-ons, take privates, corporate carve outs and continuation vehicles ;
- Continuation funds. Important part of PE toolkit in low-liquid environment. Allowing firms to hold trophy assets while allowing realisations in older funds; and
- Take privates.

Current PE Valuation Trends & Challenges

Valuation Shelf Life

- While PE has been historically less susceptible to volatility, current economic volatility reduces the shelf life of valuations and may increase the demands for more frequent views;
- Increasing need for portfolio valuations to be considered through full quarterly cycles (including recent acquisitions); and
- Investor needs for timely valuations to reflect current economic conditions.

Volatile inputs

- Contraction and flattening of discount rates;
- Trends for Venture Capital markets indicate "down rounds";
- Potential for further slow down of exits and holdings periods increasing, as interest rates rise and length of time to reach target returns increases;
- Maintainable EBITDA and revenue run rates may be more judgemental; and
- Risk of non compliance with debt covenants and need to be mindful on potential impact on valuation.

Access and availability of debt

- Portfolio companies refinancing in the short and medium term, may face challenges accessing debt;
- Increase costs of financing and interest levels may impact valuation; and
- Potentials for GPs to look at secondary solutions to generate liquidity.

Independence and valuation governance

- Unobservable inputs increasingly become focal points for outside scrutiny. Market volatility likely to bring greater challenges;
- Increased estimation uncertainty and likely to drive a more complex valuation process;
- Importance of documenting views as part of valuation process including points of difference" and "calibration" analysis;
- Best practice valuation governance regimes use independent internal valuation committees and/or external advisers to review methodologies, significant inputs and fair value estimates for reasonableness; and
- Valuation guidelines and terms of reference.

Areas to look out for in 2024

Regulation

- FCA probe ;
- SEC warning highlighting valuation as one areas where vulnerability could emerge ; and
- More regulatory scrutiny in PE feels inevitable

Deals

- Significant dry powder in funds waiting to be deployed
- Firms and investors have become meticulous with due diligence
- Investors appear to be holding off on deals and hoping more favourable environment may return.

Debt

- Higher interest rates impact ability of companies to extend capital structure – or refinance
- Given move in rates – businesses may be able to support less leverage.

Valuation adjustment on horizon?

- Bid-ask spread, is that it has been causing deal flow stagnation
- In 2022 & 2023 well documented deals achieved elevated multiples, likely these are high quality businesses that attract that premium.

Impact and EGS funds

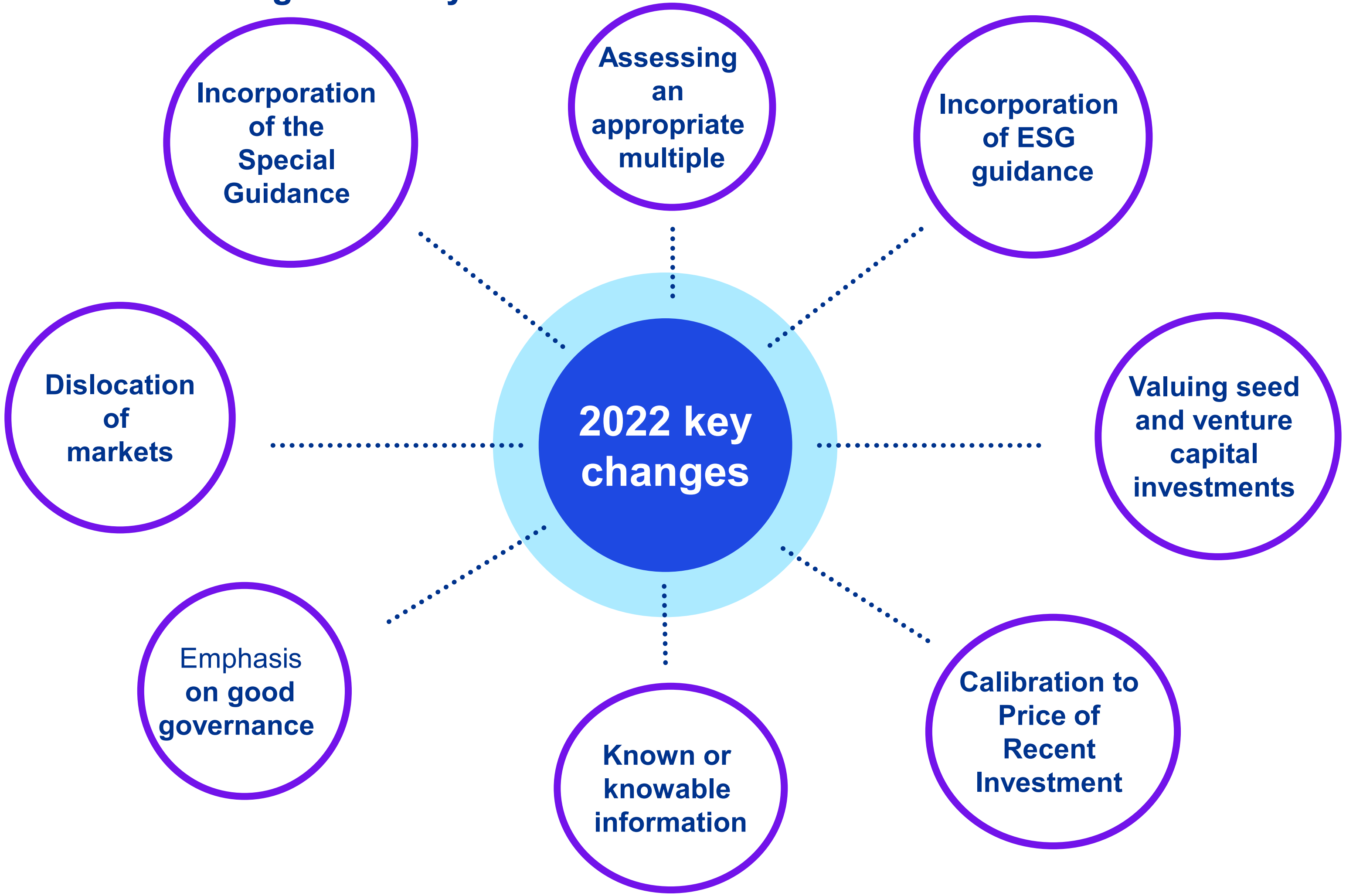
- Raises and closings of large impact funds have been the outlier to 2023 trends and set to continue ; and
- LPs desire for investing in impactful businesses.

Overview of the 2022 IPEV guidelines

Effective for periods ending 31 December 2022

IPEV Guidelines – 2022 key changes

Effective for periods commencing 1 January 2023 onwards



02

Local and international regulatory developments

Matthew Stubbington
Director
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FCA's review of private market valuations

UK regulator to launch review of private market valuations

FCA would look at the "disciplines and governance" over valuations.

This includes looking at who within a firm is accountable for valuations, how information about those valuations is passed upwards to the relevant management committee and board, and what other governance procedures are in place.

Fund managers who invest in private markets typically have a greater discretion over the valuation of their own assets because their holdings are not subject to the daily swings of public market sentiment.

Private assets are often valued using models that are typically slower to respond to deteriorating market conditions than listed assets.

If the governance processes are not robust, the FCA can call out failures.

Opaque practices await UK regulators in private asset valuations probe

Critical moment of scrutiny for a sprawling asset class that pension funds and other investors piled into as they hunted for returns during the long era of low interest rates.

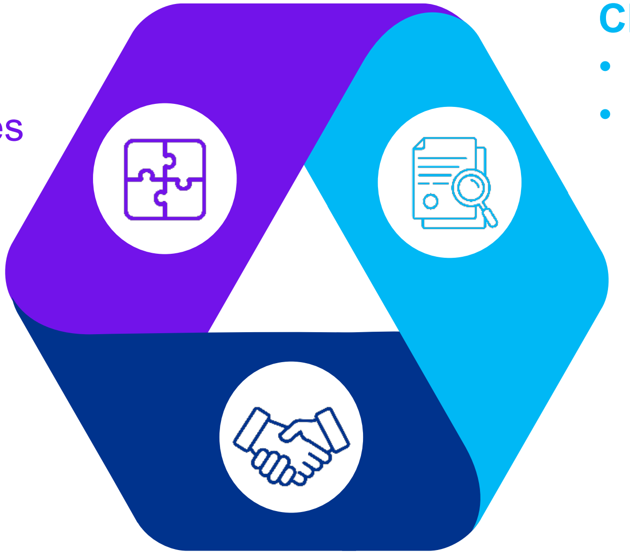
Judgement carries risks, especially when managers are incentivised to present a rosy picture for as long as they can, particularly if they are seeking to raise money from investors. It often also suits investors to cling on to upbeat, but stale, valuations.

FCA review reflects growing concern from global regulators about the potential for shocks in private assets.

Rising interest rates and slowing economic growth represent a danger to some private equity models, which recently warned about difficulties in refinancing assets and potential fire sales.

SEC Private Fund Adviser Reforms: Final Rules at a glance

Disclosures
- Quarterly Statement Rules



Checks
- Private Fund Audit Rule
- Adviser – Led Secondaries Rule

Restrictions
- Restricted Activities Rule
- Preferential Treatment Rule

Purpose

The SEC states that the rules are designed to address the three factors for risks and harms in an adviser's relationship with Private Funds and their investors:

- Lack of transparency
- Conflicts of interest
- Lack of effective governance mechanisms for client disclosure, consent, and oversight.

SEC Private Fund Adviser Reforms: Final Rules at a glance

The new rules and amendments are designed to protect Private Fund investors by increasing transparency, competition, and efficiency in the private funds market.

Quarterly Statement Rule

- Fee and expense disclosure
- Performance disclosure
- Preparation and distribution

Private Fund Audit Rule

- Obtain annual audit
- Audit under PCAOB or AICPA auditing standards
- US GAAS
- Annually within 120/180 days

Adviser – Led Secondaries Rule

- Choice between fairness opinion or valuation opinion
- Written summary of any material business relationships

Restricted Activities Rule

- Restricted activities with disclosure-based exceptions
- Restricted activities with certain investor consent exceptions

Preferential Treatment Rule

- Preferential redemptions
- Preferential transparency
- Other preferential treatment and disclosure of preferential treatment

Recordkeeping Rule

Compliance Rule

SEC Private Fund Adviser Reforms: Final Rules at a glance

Scope of Advisers Subject to the Final Rules

The Final Rules apply only to "Private Funds," as defined under the Investment Advisers Act. As defined for purposes of the Advisers Act. Private Funds include only funds that would be investment companies except for Section 3(c)(1) or 3(c)(7) of the Investment Company Act.

Private Fund Advisers that are SEC - Registered Investment Advisers (Private Fund RIAs)

Private Fund Advisers regardless of registration status

Offshore Private Fund Advisers and Advisers to Offshore Private Funds

Securitised Asset Fund Managers

FCA's review of private market valuations (1/2)

UK regulator to launch review of private market valuations

Fund managers who invest in private markets typically have a greater discretion over the valuation of their own assets because their holdings are not subject to the daily swings of public market sentiment.

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This includes looking at who within a firm is accountable for valuations, how information about those valuations is passed upwards to the relevant management committee and board, and what other governance procedures are in place.

Private assets are often valued using models that are typically slower to respond to deteriorating market conditions than listed assets.

If the governance processes are not robust, the FCA can call out failures.

Source : Financial Times
Date : 27 September 2023

The Financial Conduct Authority (FCA) is set to kick off a review of private market valuations amid a rising interest rate environment and an economic downturn.

Why is the regulator interested in the valuation of private asset class?

- ❑ With the rising uncertainty in the market, there is divergence between public and private markets with the valuation of private assets being more resilient and at significantly higher fair values.
- ❑ There has been a significant increase in the private asset class in the last five years accounting for a record share of the global financial assets.
- ❑ There is a lot of subjectivity and judgement involved in valuing private assets carries risk. The accuracy of these valuations will only be determined when the asset is sold.
- ❑ There are limited disclosures in the annual report around valuation methodologies, significant inputs and the underlying estimates and judgement involved in arriving at fair values.

FCA's review of private market valuations (2/2)

Opaque practices await UK regulators in private asset valuations probe

Critical moment of scrutiny for a sprawling asset class that pension funds and other investors piled into as they hunted for returns during the long era of low interest rates.

Judgement carries risks, especially when managers are incentivised to present a rosy picture for as long as they can, particularly if they are seeking to raise money from investors. It often also suits investors to cling on to upbeat, but stale, valuations.

FCA review reflects growing concern from global regulators about the potential for shocks in private assets.

Rising interest rates and slowing economic growth represent a danger to some private equity models, which recently warned about difficulties in refinancing assets and potential fire sales.

Source : Financial Times
Date : 26 October 2023

What do we think the potential scope of the review to be?

The exact scope of the review is not yet clear but we expect this would include internal valuations and governance processes. This would largely cover the methodologies, timing and frequency of the valuation process, appropriateness of judgements made, consistency across the entire documentation and related disclosures.

This highlights the need for robust internal documentation.

03

ESG Trends

David Postlethwaite
Associate Director
Advisory - ESG
Crown Dependencies

ISSB: Overview and Structure

The International Sustainability Standards Board (ISSB) published **IFRS S1** and **IFRS S2** in June 2023. In July, IOSCO endorsed these and called on all 130 member jurisdictions to look at adoption into their national regulatory frameworks for corporate reporting.

What's the Issue?

- The standards mark the next step toward **equal prominence for sustainability and financial reporting.**
- **Based on existing frameworks** and standards, including TCFD and SASB.
- The aim is to create a **global baseline** for **investor-focused sustainability reporting** for local jurisdictions to build on.
- "**Materiality**" of sustainability issues: focus on investors and bottom line

What's the Impact?

- Provides a framework for companies to report on **all material sustainability topics** (not just climate).
- Requires **national implementation** but could create a **consistent global framework**.
- Would be connected to financial statements and so would be reported **at the same time as financial information**

What structure does it follow?

Key Trends for ESG in the funds space

01 ESG integration growing

- Financially material risks & opportunities
- Expanding ESG resources
- Majority of managers have or plan to have ESG Policies* but divergence remains

02 Polarisation of ESG

- Competing anti- and pro-ESG regulation in US States a challenge
- Europe remains main region for ESG
- Despite headwinds, **$98bn*** private ESG capital raised in 2022

03 Data remains a challenge

- PE Houses working to obtain consistent, reliable PortCo data
- Move away from manual processes to tech-driven solutions for data gathering

04 Materiality is key

- Focusing on the most relevant issues
- Prioritise most significant ESG risks and opportunities
- Use of standardised metrics (EDCI)

05 Gearing up for new disclosures

- Meaningful ESG reporting: "show, don't tell"
- Some managers now caught by mandatory disclosures…
- …But mostly *not* driven by regulation (yet)

06 Assurance on the rise

- Increased demand from PE houses – 50% of listed companies already obtain ESG assurance
- Driven by governance, LP expectations – not yet regulation but CSRD is coming
- Also a requirement for some lending facilities

***Source**: PreQin, *ESG in Alternatives 2023*

ESG in the PE Fund Lifecycle: Overview

01 02 03 04 05 06

Monitoring and Reporting support at every stage

01 HOUSE-LEVEL

- Clearly defined ESG polices & governance structure
- Building out internal ESG capacity
- Cementing a “show, don’t tell” approach
- Setting firm-level KPIs in line with investor expectations and standards
- Entity-level disclosures (SFDR/TCFD)
- CSRD analysis for e.g. AIFMs

02 FUNDRAISING

- Leverage ESG to access broader pool of LPs/capital
- PPM commitments and LP obligations
- Meeting LPs’ ESG demands under e.g. ILPA DDQs
- Ensuring compliance with mandatory ESG disclosures

03 ORIGINATION AND INVESTMENT

- ESG DD alongside financial DD
- ESG value perspectives – use of ESG/Climate factors to identify risks *and* opportunities in businesses
- Linking ESG to financing through sustainability linked lending
- ESG as a differentiator and to improve entry multiples

04 ONBOARDING AND 100 DAY PLAN

- Integrate & act on ESG/Climate DD findings
- Streamlining portfolio-wide onboarding, ESG data gathering, policy development implementation
- Secure PortCo commitment to help deliver fund/house objectives

05 OWNERSHIP PERIOD

- ESG value creation, improving PortCo performance against defined KPIs, develop consistent value narrative
- Clear decarbonisation pathways/targets (SBTs) & supporting PortCo autonomy on ESG issues, initiatives etc
- Data gathering to monitor progress, meet disclosure needs

06 EXIT

- Ensure PortCo’s exit-readiness on ESG topics, address any material gaps
- Integration of ESG into valuations (e.g. climate scenarios) and vendor DD assessments
- Prepare PortCo for ESG aspects of IPO journey (e.g mandatory climate reporting)

Regulatory update: Focus on the UK SDRs

The UK's FCA has issued final rules on UK Sustainability Disclosure Requirements (SDR) and investment labels.

What?

Policy statement by FCA (PS23/16)

- General anti-greenwashing rule
- Four new fund labels:
  - Sustainability Impact™
  - Sustainability Improvers™
  - Sustainability Focus™
  - Sustainability Mixed Goals™
- Naming, marketing, disclosure and information rules.

Who?

Firms who make sustainability-related claims

- All FCA-authorised firms are caught by anti-greenwashing rule
- Labels, disclosure, naming and marketing rules apply to UK asset managers in respect ofauthorised AIFs, UCITs etc.
- FCA has clarified that non-UK AIFS (eg a Jersey-domiciled fund) are **out of scope** but…
  - Entity-level disclosures may still apply
  - FCA and HMT will consult on overseas funds

When?

Coming in 2024, subject to further consultation

- To end Jan 24: Consultation on anti-greenwashing guidance
- 31 May 24 – anti-greenwashing rule n force
- 31 July 24: fund labels for use
- 2 December 24: naming and marketing rules with accompanying disclosures
- 2 December 25 – product/entity level disclosure for firms with AUM over £50bn (followed by £5n from Dec 2026).

Next Steps for Managers:

- Anti-greenwashing analysis
- Scoping and product classification exercise
- Impact and Gap Analysis
- Labelling Operating Model
- Disclosure Production

Other things to watch out for:

- Review of EU's SFDR and possible labelling regime introduction
- SEC final climate rules and further ESG disclosures (e.g. Private Fund Advisor rule)
- UK Green Taxonomy

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- The aim is to create a **global baseline** for **investor-focused sustainability reporting** for local jurisdictions to build on.
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What's the Impact?

- Provides a framework for companies to report on **all material sustainability topics** (not just climate).
- Requires **national implementation** but could create a **consistent global framework**.
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What structure does it follow?

ISSB: Path to Adoption

Available for adoption 1st Jan 2024, with initial transition relief

Up to local jurisdictions to adopt (e.g. UK planning to adopt)

Rapid adoption is expected with strong support from IOSCO (what will Jersey do?)

Adoption Guidance

Adoption Options

Full adoption, partial adoption, or adoption with local enhancements possible

Adoption could be phased based on regulatory licence, size, or sector to focus on key businesses first

Can also phased based on topic, i.e., climate standard first with other topics over time

For UK, those in scope would likely be (initially) large listed companies with over 500 employees and £500m in turnover, much like TCFD

Regulations in Guernsey?

2021

Amendment of the Finance Sector Code of Corporate Governance in 2021 – Section 5.2.1 Climate Change – "*The Board should consider the impact of climate change on the firm's business strategy and risk profile and, where appropriate in the judgement of the board, make timely climate change related disclosures.*"

2022

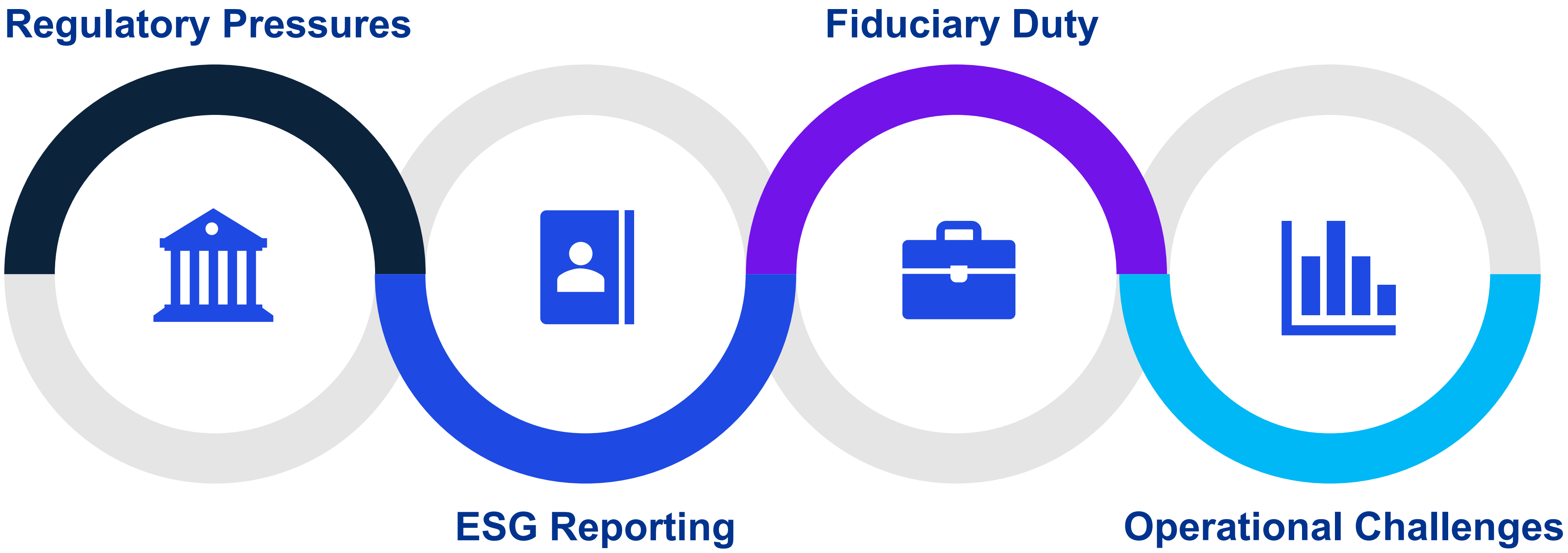
GFSC Annual Report for the Year Ended 31 December 2021 – Director General's Statement – "*All firms, following our environmental amendments to the Code of Corporate Governance in 2021, need to consider how to adapt their business models as a matter of urgency as international standards on environmental sustainability are quite likely to be promulgated over the course of 2022.*"

2023

GFSC Annual Report for the Year Ended 31 December 2022 – Director General's Statement – "*In the next year, we are likely to see the **International Sustainability Standards Board** mature its draft standards for reporting around both climate change and nature. We will look to see the speed with which those standards, once finalised, are adopted by IOSCO and other international bodies as international financial services standards. We will then consider, in conjunction with other official sector actors and industry, at what point after 2023 it might be sensible for the Bailiwick to consider a balanced adoption of those international standards.*"

Key Challenges

The rise of ESG in PE is met with several challenges across various aspects of the PE business model. Those that have made the most of the opportunities that ESG offers have adapted to overcome these challenges and found ways to utilise ESG to differentiate themselves from their competitors, manage risks, and identify opportunities to drive value creation in their portfolio. Some of the key ESG challenges facing the PE sector are as follows:



What to do going forward...

Some of the key ESG areas to focus on in the funds industry moving into FY24 are as follows:

- Stay up-to-date on the fast moving regulatory landscape
- Build on data collection capabilities
- Look to ESG for Value Creation
- Build upon and improve existing ESG reporting

04

Tax matters

Matt Thomas
Senior Manager
Tax
Crown Dependencies

Lessons from 2023

Domestic developments

- Partnership reporting
- Economic Substance audits / AEOI audits
- 2024 Budget Amendments

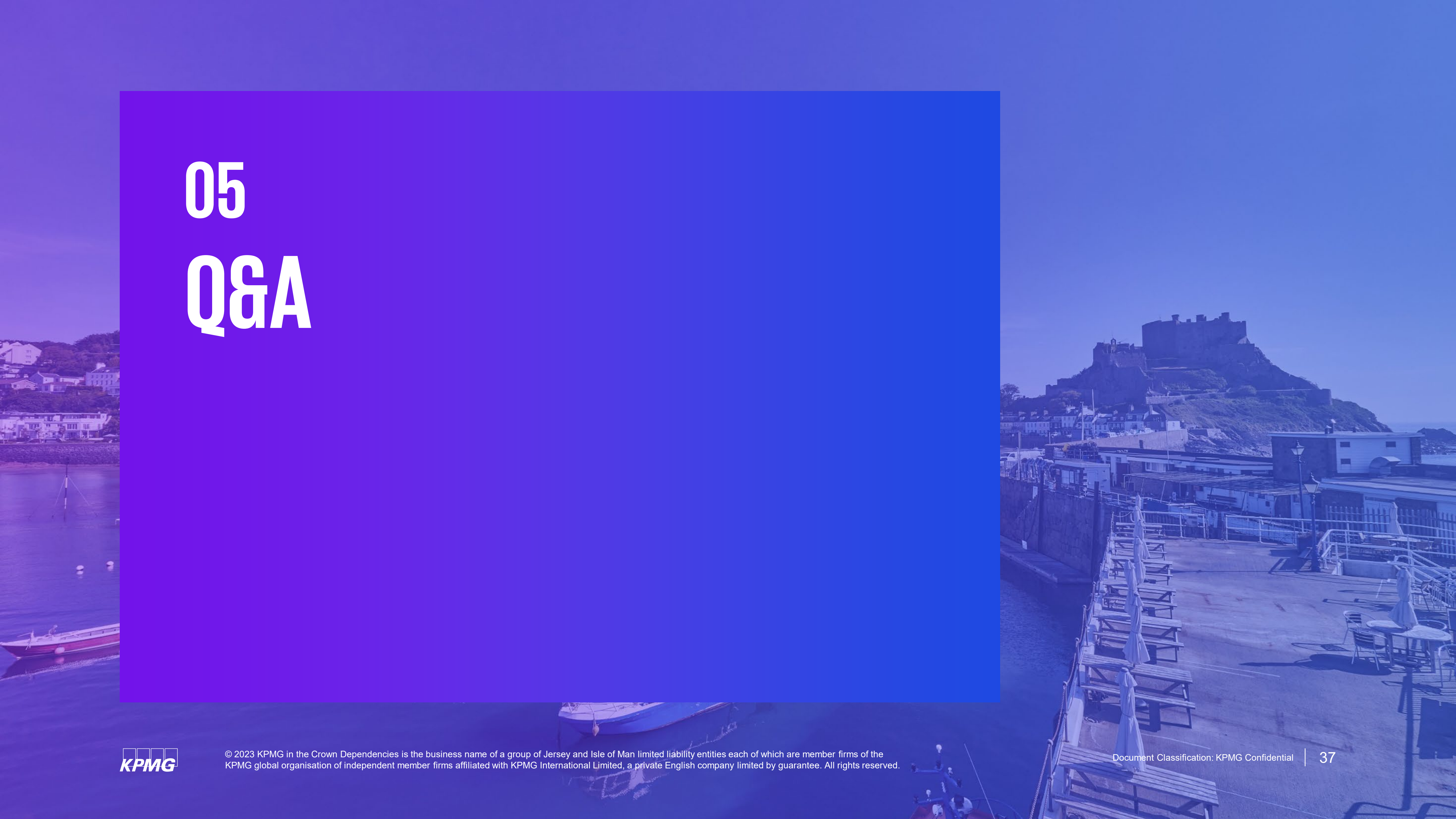
International developments

- BEPS Pillar 1 and 2
- Non-cooperative jurisdictions list - “Annex I – Black list/Annex II – Grey list”
- ATAD III – Un-shell directive
- UK Autumn Statement
- Harrington Review of Foreign Direct Investment
    - “The government should commit to a consistent, long-term approach to tax that is clearly signalled to business, within a system that seeks to reduce complexity for business”.

Horizon for 2024?

International outlook

- Crown Dependencies decisions on Pillar 1 and Pillar 2
- ATAD III – will the EU make progress?
- Non-cooperative jurisdictions list - “Annex I – Black list/Annex II – Grey list”
- UK general election
- Challenges of cross border working – PE and payroll reporting risk
- Tax risk policy review – ESG?
- Tax reporting – digital transformation



05

Q&A

KPMG

Merry Christmas & Happy New Year

kpmg.com/cds