PRIVATE EQUITY – ESG TRENDS

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HCVT

HOLTHOUSE | CARLIN | VAN TRIGT LLP

HCVT OVERVIEW

- Largest CPA firm based in Los Angeles
- More than **800 team members**, including **over 100 partners and principals**
- **13 offices** across Southern California, Northern California, Texas, Arizona, and Utah
- **Tax**, **audit, business management** and **advisory** services to:
  - Privately held companies
  - Private equity and their portfolio companies
  - High-net-worth individuals and families and their related entities
  - Family offices

EXPANDED ADVISORY SERVICES - ACROSS THE DEAL LIFECYCLE

- **We have advised on over 700 middle market deals in the last 4 years**

Mergers & Acquisitions (M&A) Advisory Services

Buy-side and sell-side transaction support pre-closing, during and post-closing

Valuation Advisory Services

Valuations for compliance (tax and GAAP), M&A, shareholder transactions and disputes

CFO Advisory Services

Fractional FP&A, accounting and strategic support

CURRENT PRIVATE EQUITY LANDSCAPE

- Record dry powder of $2.6 trillion as of Q4 2023
- However, dealmaking has slowed significantly
  - Buyout activity declined by nearly 50% in 2023
  - Rising interest rates, recessionary concerns, increased regulation
- Pressure on PE firms to deploy capital effectively
- ESG emerging as a key differentiator and value driver

THE EVOLUTION OF ESG IN PRIVATE EQUITY

- Few years ago: ESG largely a box-ticking exercise for most firms
- 2024: ESG now central to investment and management strategies
  - LPs incorporate ESG in allocation decisions
  - LPs consider ESG in manager selection
  - PE firms conduct ESG screening during due diligence
  - PE firms increasingly decline investments due to ESG concerns
- Significant growth in dedicated ESG and impact fund assets
- ESG-focused PE/VC assets grew from $6B to $150B (2015-2020)
- ESG has become a strategic necessity for PE firms

DRIVERS OF THE ESG SHIFT IN PRIVATE EQUITY

- Mounting evidence of the link between ESG and financial performance
- Growing LP pressure to prioritize and integrate ESG
- LPs use ESG factors in capital allocation
- LPs encourage ESG initiatives even at the expense of short-term returns
- Longer hold period of 5-7 years
- Tightening regulatory requirements and societal expectations
- Stricter ESG disclosure rules from the EU and SEC
- Strong ESG performance now critical for competitiveness in PE

ESG-RELATED OPPORTUNITIES FOR PRIVATE EQUITY

- Enhance fundraising prospects
- ESG-oriented PE assets to reach $11 trillion by 2026
- Identify undervalued targets and gain a competitive edge in transactions
- ESG analysis can uncover hidden potential in companies
- Strong ESG track record can be a deciding factor in winning deals
- Drive value creation in portfolio companies through active ownership
- Implement initiatives to reduce emissions, develop human capital, increase diversity
- Build more resilient, valuable businesses well-positioned for exit
- Develop persuasive ESG narratives to maximize exit valuations
- Capitalize on the rapid growth of sustainable products and services
- Sectors such as renewable energy, green buildings, upcycling and plant-based foods

ESG-RELATED RISKS FOR PRIVATE EQUITY

- Portfolio companies vulnerable to ESG-related challenges
- Potential impact of carbon pricing, water scarcity, shifts in customer preferences
- Risks associated with inadequate ESG disclosures and greenwashing
- Heightened scrutiny of ESG claims by regulators and stakeholders
- Potential financial penalties, litigation, and reputational damage
- Widening gap in fundraising prospects between ESG leaders and laggards
- LPs increasingly shunning managers perceived as weak on ESG
- Potential for ESG-related issues to erode portfolio company value
- Artificial separation of ESG and core business strategy

CONCLUSION AND IMPLICATIONS

- ESG has rapidly transitioned from a peripheral issue to a core strategic priority for PE
- Reflects a fundamental shift in how the industry creates value
- More than a transitory trend – a new paradigm for PE
- Significant rewards for PE firms that demonstrate authentic ESG leadership
- Expanded access to capital, sourcing advantages, stronger portfolio, successful exits
- Considerable downside risks for firms that fail to adapt
- Greenwashing and inaction increasingly untenable in the face of rising expectations