The HUB

NEWS AND VIEWS FOR INSTITUTIONAL INVESTORS

Navigating The Macro Environment

Why acceleration capital is well-positioned on the private equity spectrum

Marc Romano
Head of Impact Private Equity Funds
Mirova

The economic cycle is turning and investors of all stripes are reassessing which asset classes they are exposed to.

While private equity is sometimes regarded as a single asset class, in reality it is an umbrella term. At the "top" end, at least in terms of volumes of assets and size of deals, buyout funds may look vulnerable to rising interest rates and looming recession. With the end of "free cash", the heavy leverage loads carried by buyout companies will raise their costs. Declining economic activity will apply further pressure, holding back the organic growth of mature companies.

At the other end of the size spectrum are VC-sponsored companies. To build out their businesses, they are dependent on raising debt and equity, both of which are in shorter supply in the current environment. "Lower-quality VC-backed companies will undoubtedly see a higher death rate than in the past," says Marc Romano, head of Mirova impact private equity funds.

What then of growth funds?

The outlook for growth capital

Along the private equity spectrum, growth funds – or acceleration capital – sit between VC and buyout funds, and are the missing piece of the funding puzzle.

"Our view is that the growth stage will be less impacted, since growth companies have lower levels of debt and higher growth rates," says Romano. "Even if their growth rate is reduced, they are dynamic companies and their growth will still be significant."

Mirova, an affiliate of Natixis Investment Managers, specifically provides acceleration capital to companies that are able to make a positive impact on environmental sustainability. This makes its portfolio companies more resilient to cyclical headwinds, Romano believes. "Because the type of company we invest in innovates to create positive impact, they surf strong trends that supersede cyclical trends," he says. "Our portfolio companies are not green for the sake of being green, but to solve the economic pain-points of their customers."

These pain-points include the need for more plentiful supplies of clean energy, more efficient water consumption on farms, agricultural innovation and buildings which are built with sustainable materials that are cheaper to maintain and heat.

New fundraising to become scarcer

As cash becomes more expensive and economies contract, greater diligence is needed in the way portfolio companies are selected and managed.

Amid a more challenging fundraising environment in which retained profits are more likely to drive expansion than follow-on fundraising rounds, companies must have robust business models for both the short and long terms.

Key takeaways:

- Growth companies have lower levels of debt and higher growth rates. Even if their growth rate falls, their dynamism means expansion will still be significant.
- Companies addressing key sustainability issues surf strong trends that supersede cyclical trends. These include the need for clean energy, efficient water consumption and sustainable buildings.
- Retained profits are more likely to drive expansion than fundraising, so companies must have robust business models. This favours companies with little leverage and few capex requirements.

This favours companies with little or no leverage and those which do not have significant capex requirements. The business plan must also be more conservative given increases in the costs of operating – notably higher salaries and more expensive raw materials.

"Portfolio managers should challenge companies' expected growth rates and incorporate contingencies, especially for companies directly exposed to economic cycles," adds Romano.

Mirova's acceleration capital approach, which dates from before the current crisis, is to map a clear route to profitability for each portfolio company within the typical holding period of five years.

If there has been a change in Mirova's approach since the current crisis erupted, it is in communicating to companies and advisers the critical importance of the operating model. Romano says: "We need to make sure our message is taken seriously by management and their financial advisers."

The key message is that new fundraising rounds will be harder to achieve and that emphasizes the need for managements to finetune their strategies for sourcing materials and managing labour costs.

Impact expertise as a differentiator

Dealflow in private equity is still strong, but less fluid than before. This inevitably leads to greater competition for well-run companies, with weaker companies left behind. In this environment, Mirova's focus on companies which have a positive impact on sustainability issues has enabled it to get access to better deals.

Romano says: "The fact that we are different and can bring a strong value added in terms of our knowledge of impact investing and ability to engage with the issues, is allowing us to win deals without having to resort to unrealistic offers. We tend not to win on pricing alone but, as a proven impact player, on what we can add to each company."

No change in return outlook

Despite changes in the operating environment, Mirova feels no need to change its outlook for its impact acceleration capital portfolio. Its aim has been to search for ideas that have the potential for generate 3x returns and this is still the case.

One of its advantages is that it is in the early stage of its drawdown phase and is fare to have deployed all of its capital. "For teams in the exit phase, reduced pricing across the board is not great news. But for us, it means we can buy good companies at cheaper entry multiples," says Romano.

There is sufficient time for companies to weather the current downcycle, grow and then be divested when the cycle is more favourable, leading to good exit multiples.

Despite the positives, Mirova's overall approach is tinged with caution, given current conditions. "We are more conservative about exits right now," says Romano. "So we naturally have to be more conservative about the entry point."

Published in July 20222

This material has been provided for information purposes only to investment service providers or other Professional Clients, Qualified or Institutional Investors and, when required by local regulation, only at their written request. This material must not be used with Retail Investors.

To obtain a summary of investor rights in the official language of your jurisdiction, please consult the legal documentation section of the website (im.natixis.com/intl/intl-fund-documents)

In the E.U.: Provided by Natixis Investment Managers International or one of its branch offices listed below. Natixis Investment Managers International is a portfolio management company authorized by the Autorité des Marchés Financiers (French Financial Markets Authority - AMF) under no. GP 90-009, and a public limited company (société anonyme) registered in the Paris Trade and Companies Register under no. 329 450 738. Registered office: 43 avenue Pierre Mendès France, 75013 Paris. Italy: Natixis Investment Managers International Succursale Italiana, Registered office: Via San Clemente 1, 20122 Milan, Italy. Netherlands: Natixis Investment Managers International, Nederlands (Registration number 000050438298). Registered office: Stadsplateau 7, 3521AZ Utrecht, the Netherlands. Sweden: Natixis Investment Managers International, Nordics Filial (Registration number 516412-8372- Swedish Companies Registration Office). Registered office: Kungsgatan 48 5tr, Stockholm 111 35, Sweden. Provided by Natixis Investment Managers S.A. or one of its branch offices listed below. Natixis Investment Managers S.A. is a Luxembourg management company that is authorized by the Commission de Surveillance du Secteur Financier and is incorporated under Luxembourg laws and registered under n. B 115843. Registered office of Natixis Investment Managers S.A.: 2, rue Jean Monnet, L-2180 Luxembourg, Grand Duchy of Luxembourg. Germany: Natixis Investment Managers S.A., Zweigniederlassung Deutschland (Registration number: HRB 88541). Registered office: Senckenberganlage 21, 60325 Frankfurt am Main. Belgium: Natixis Investment Managers S.A., Belgian Branch, Gare Maritime, Rue Picard 7, Bte 100, 1000 Bruxelles, Belgium. Spain: Natixis Investment Managers, Sucursal en España, Serrano n°90, 6th Floor, 28006 Madrid, Spain. **In Switzerland:** Provided for information purposes only by Natixis Investment Managers, Switzerland Sàrl, Rue du Vieux Collège 10, 1204 Geneva, Switzerland or its representative office in Zurich, Schweizergasse 6, 8001 Zürich.

In the British Isles: Provided by Natixis Investment Managers UK Limited which is authorised and regulated by the UK Financial Conduct Authority (register no. 190258) - registered office: Natixis Investment Managers UK Limited, One Carter Lane, London, EC4V 5ER. When permitted, the distribution of this material is intended to be made to persons as described as follows: **in the United Kingdom:** this material is intended to be communicated to and/or directed at investment professionals and professional investors only; in Ireland: this material is intended to be communicated to and/or directed at professional investors only; **in Guernsey:** this material is intended to be communicated to and/or directed at only financial services providers which hold a license from the Guernsey Financial Services Commission; **in Jersey:** this material is intended to be communicated to and/or directed at professional investors only; **in the Isle of Man:** this material is intended to be communicated to and/or directed at only financial services providers which hold a license from the Isle of Man Financial Services Authority or insurers authorised under section 8 of the Insurance Act 2008. **In the DIFC:** Provided in and from the DIFC financial district by Natixis Investment Managers Middle East (DIFC Branch) which is regulated by the DFSA. Related financial products or services are only available to persons who have sufficient financial experience and understanding to participate in financial markets within the DIFC, and qualify as Professional Clients or Market Counterparties as defined by the DFSA. No other Person should act upon this material. Registered office: Unit L10-02, Level 10 ,ICD Brookfield Place, DIFC, PO Box 506752, Dubai, United Arab Emirates **In Japan:** Provided by Natixis Investment Managers Japan Co., Ltd. Registration No.: Director-General of the Kanto Local Financial Bureau (kinsho) No.425. Content of Business: The Company conducts investment management business, investment advisory and agency business and Type II Financial Instruments Business as a Financial Instruments Business Operator. **In Taiwan:** Provided by Natixis Investment Managers Securities Investment Consulting (Taipei) Co., Ltd., a Securities Investment Consulting Enterprise regulated by the Financial Supervisory Commission of the R.O.C. Registered address: 34F., No. 68, Sec. 5, Zhongxiao East Road, Xinyi Dist., Taipei City 11065, Taiwan (R.O.C.), license number 2020 FSC SICE No. 025, Tel. +886 2 8789 2788. **In Singapore:** Provided by Natixis Investment Managers Singapore Limited (company registration no. 199801044D) to distributors and qualified investors for information purpose only. **In Hong Kong:** Provided by Natixis Investment Managers Hong Kong Limited to professional investors for information purpose only. **In Australia:** Provided by Natixis Investment Managers Australia Pty Limited (ABN 60 088 786 289) (AFSL No. 246830) and is intended for the general information of financial advisers and wholesale clients only . **In New Zealand:** This document is intended for the general information of New Zealand wholesale investors only and does not constitute financial advice. This is not a regulated offer for the purposes of the Financial Markets Conduct Act 2013 (FMCA) and is only available to New Zealand investors who have certified that they meet the requirements in the FMCA for wholesale investors. Natixis Investment Managers Australia Pty Limited is not a registered financial service provider in New Zealand. **In Colombia:** Provided by Natixis Investment Managers International Oficina de Representación (Colombia) to professional clients for informational purposes only as permitted under Decree 2555 of 2010. Any products, services or investments referred to herein are rendered exclusively outside of Colombia. This material does not constitute a public offering in Colombia and is addressed to less than 100 specifically identified investors.

In Latin America: Provided by Natixis Investment Managers International. **In Uruguay:** Provided by Natixis Investment Managers Uruguay S.A., a duly registered investment advisor, authorised and supervised by the Central Bank of Uruguay. Office: San Lucar 1491, Montevideo, Uruguay, CP 11500. The sale or offer of any units of a fund qualifies as a private placement pursuant to section 2 of Uruguayan law 18,627. **In Mexico:** Provided by Natixis IM Mexico, S. de R.L. de C.V., which is not a regulated financial entity, securities intermediary, or an investment manager in terms of the Mexican Securities Market Law (Ley del Mercado de Valores) and is not registered with the Comisión Nacional Bancaria y de Valores (CNBV) or any other Mexican authority. Any products, services or investments referred to herein that require authorization or license are rendered exclusively outside of Mexico. While shares of certain ETFs may be listed in the Sistema Internacional de Cotizaciones (SIC), such listing does not represent a public offering of securities in Mexico, and therefore the accuracy of this information has not been confirmed by the CNBV. Natixis Investment Managers is an entity organized under the laws of France and is not authorized by or registered with the CNBV or any other Mexican authority. Any reference contained herein to “Investment Managers” is made to Natixis Investment Managers and/or any of its investment management subsidiaries, which are also not authorized by or registered with the CNBV or any other Mexican authority.

In Brazil: Provided to a specific identified investment professional for information purposes only by Natixis Investment Managers International. This communication cannot be distributed other than to the identified addressee. Further, this communication should not be construed as a public offer of any securities or any related financial instruments. Natixis Investment Managers International is a portfolio management company authorized by the Autorité des Marchés Financiers (French Financial Markets Authority - AMF) under no. GP 90-009, and a public limited company (société anonyme) registered in the Paris Trade and Companies Register under no. 329 450 738. Registered office: 43 avenue Pierre Mendès France, 75013 Paris.

The above referenced entities are business development units of Natixis Investment Managers, the holding company of a diverse line-up of specialised investment management and distribution entities worldwide. The investment management subsidiaries of Natixis Investment Managers conduct any regulated activities only in and from the jurisdictions in which they are licensed or authorized. Their services and the products they manage are not available to all investors in all jurisdictions. It is the responsibility of each investment service provider to ensure that the offering or sale of fund shares or third party investment services to its clients complies with the relevant national law.

The provision of this material and/or reference to specific securities, sectors, or markets within this material does not constitute investment advice, or a recommendation or an offer to buy or to sell any security, or an offer of any regulated financial activity. Investors should consider the investment objectives, risks and expenses of any investment carefully before investing. The analyses, opinions, and certain of the investment themes and processes referenced herein represent the views of the portfolio manager(s) as of the date indicated. These, as well as the portfolio holdings and characteristics shown, are subject to change. There can be no assurance that developments will transpire as may be forecasted in this material. The analyses and opinions expressed by external third parties are independent and does not necessarily reflect those of Natixis Investment Managers. Past performance information presented is not indicative of future performance.

Although Natixis Investment Managers believes the information provided in this material to be reliable, including that from third party sources, it does not guarantee the accuracy, adequacy, or completeness of such information. This material may not be distributed, published, or reproduced, in whole or in part.

All amounts shown are expressed in USD unless otherwise indicated.

Natixis Investment Managers may decide to terminate its marketing arrangements for this product in accordance with the relevant legislation.

Mirova
Mirova is an affiliate of Natixis Investment Managers.
Portfolio management company - French Public Limited liability company
Regulated by AMF under n°GP 02-014
RCS Paris n°394 648 216
Registered Office: 59, Avenue Pierre Mendes France – 75013 – Paris.
www.mirova.com

Natixis Investment Managers
RCS Paris 453 952 681
Share Capital: €178 251 690
43 avenue Pierre Mendès France
75013 Paris
www.im.natixis.com

INT199EN-0722