andera INSIGHTS

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EDITORIAL

Towards Increased Resilience in an Uncertain Climate

The year 2023 has been marked by a climate of uncertainties on the macroeconomic, political, and geostrategic fronts. For Andera Partners, it has confirmed the relevance of a multi-specialist positioning and an approach aimed at asset transformation. A shield against turbulence, our strategy is structured around three essential items:

- Long-term Vision in Key Sectors:

At Andera Partners, we are exposed to some of the most promising sectors, at the heart of investors' agendas and supported by ambitious public policy initiatives: health, ecological transition, infrastructure... sectors that require colossal long-term investments. Being positioned in these segments, underpinned by sustainable development imperatives, is a resilience factor. Armed with these expertise, we present this month an overview of **trends in life sciences investment** and an analysis of a little-known and under-invested area of energy transition: **renewable heat.**

- Strategic Diversification:

Our carefully balanced portfolio is the fruit of a diversification strategy that embraces a variety of financial instruments and development stages: life sciences venture, financing of innovative and ecological infrastructure, minority stakes, majority LBOs, sponsorless mezzanine debt, co-investment... We are expanding our presence in Europe to develop a truly international approach, in terms of investment targets, diversification of LPs, and growth of our portfolio companies. This carefully constructed balance allows us to spread risk while seizing growth opportunities across different sectors and geographies. Our multi-specialist platform also gives us a privileged position to observe the financing ecosystem, as evidenced by our reflection this month on the **evolving role of banks in financing and supporting companies.**

- Asset Transformation:

Finance must be transformative! Beyond investment, we support our portfolio companies in all aspects of their scaling, structuring, and transformation. We believe that sustainable company growth and long-term value creation will come from investors' ability to positively guide management, investment and governance decisions to seize growth opportunities, embrace major trends such as decarbonization and digitalization, and adopt best practices in ESG. This is evident in the **current debates around SFDR:** distinguishing what is or is not a sustainable investment is not necessarily related to the nature of the invested asset but the capacity to transform it.

The heart of this strategy is also being close to the daily and long-term challenges of the entrepreneurs we support. François Lhoutellier, president of ERI Group, an Andera MidCap portfolio company, attests to this in this issue: Andera Partners has a true DNA of entrepreneurial development.

Our belief is that these different axes are the foundation of a strategy that not only withstands headwinds but also allows us to embrace and anticipate the underlying trends of a changing world. Specialization, diversification strategies, sustainable investments, and supporting companies in development and scaling efforts - these elements are not mere buzzwords but action principles that guide our approach daily.

Despite an uncertain climate, we remain committed, as a trusted partner, to targeting high-performing niches, balancing our strategy, and spreading risk... while supporting the transformation of assets, including "traditional" assets that should not be overlooked by investors.

As we begin the year 2024, we are pleased to share with you these reflections and an overview of our activities. Enjoy reading!

Laurent Tourtois and **Raphaël Wisniewski**, Managing Partners of Andera Partners

MARKET

What are the Prospects for Life Sciences Investment in 2024?

The biotechnology and health innovation sector has always stood out for its resilience or rebound in constrained or even hostile environments; 2023 was no exception. Despite economic turbulence, the solid foundations of this industry and its innovation potential outline promising prospects for 2024.

In other words, well-funded companies that have achieved their goals have fewer difficulties in continuing their financing, especially when they have a differentiated strategy and are positioned on trending topics - also meaning: able to attract pharma companies for a buyout.

2023: A Halt in Life Sciences Investment?

According to Pitchbook data, investment amounts in life sciences fell by 9% in Europe in the first nine months of 2023. The continuation of a high-interest rate environment and macroeconomic and geopolitical uncertainties meant that the investment momentum was not as strong as hoped, despite significant dry powder. As many funds were raised between 2020 and 2022 and have not yet been fully invested, they enable substantial funding rounds for the most promising startups.

In 2023, a decline in the number of transactions was indeed observed, but with a higher average ticket per company. In line with what is generally seen in private equity, there has been a polarization around some beautiful biotechs, which have managed to raise large amounts and attract new investors. A trend that could be summarized by the phrase "The winner takes it all"!

Which Therapeutic Areas are Attracting Investors' Attention?

The main investment areas in the biotech sector reflect the macro trends at work in health: more prevention, personalized medicine, as well as capabilities to treat chronic diseases affecting an increasing number of patients. Numerous innovations are emerging in the fields of oncology and chronic inflammatory diseases – working on improved treatment efficacy, aiming to extend life expectancy and improve patients' quality of life – and obesity, a development field that has become prolific – and very attractive to laboratories – in recent years. Among the most promising therapeutic approaches, on which many innovations rest and for which funding needs are crucial, include:

- Precision medicine: better characterization of populations among whom drugs are effective and targeted action on specific biomarkers open the door to promising treatments against neurodegenerative diseases or certain cancers.

- Research around replacement or regeneration, with gene therapies against rare diseases or cell therapies: the use of stem cells, in particular, is a promising field to address patients with Parkinson's disease, type 1 diabetes, or certain autoimmune diseases.

The intersections between biotechnologies and new technologies such as artificial intelligence and data science also open unprecedented paths to strengthen research and development programs.

2024: The Year of IPO Return?

The IPO market was timid in 2023. Among Andera Life Sciences' participations, Mineralys successfully entered Nasdaq in February 2023 to accelerate the deployment of its hypertension treatment in the American market. Abivax, meanwhile, was the only French biotech to enter Nasdaq in 2023. An operation that took place in a difficult market context, but which allowed a significant fundraising to finance its next phase III clinical trials - on its molecule dedicated to the treatment of ulcerative colitis - and phase II for Crohn's disease treatment, with the ambition to become a leader in the treatment of inflammatory bowel diseases.

IPOs in the United States remain one of the main ways for a biotech to accelerate, especially to quickly carry out clinical trials, unfortunately in the absence of a true "European Nasdaq" that would support the emergence and growth of European champions.

Despite a more difficult funding environment in 2023, life sciences remain an extremely promising investment field. The sector is able to seize and capitalize on growth opportunities, albeit with a stronger polarization that directs funding towards the best-oriented sectors and companies that have already achieved significant results. Biotechs, thanks to their agility and resilience, are a key link in supporting the evolution of tomorrow's healthcare.

"Investment in biotechnology still has bright days ahead. The innovation momentum does not weaken, particularly in oncology and against chronic diseases or pathologies associated with obesity. This is added to a convergence with new technologies that strengthen research programs. The sector has shown its resilience, with funding needs and high dry powder, boding well for 2024."

Raphaël Wisniewski, Managing Partner of Andera Partners

Will the Financing Crisis Ultimately "Debank" the European Economy?

A decline in transactions, barriers to external growth... Many companies face financing difficulties in a context of inflation, rising interest rates, and geostrategic uncertainties. As it becomes increasingly difficult for these companies to borrow money from banks, will banks cease to play their traditional banking role? The question is provocative, but it echoes the profound upheavals in economic financing.

Banks shape the economic landscape through their essential role as lenders. This is especially true in a highly banked economy like Europe's. However, the current macroeconomic context, starting with the sudden rise in interest rates, sows the seeds for a profound overhaul of the role of financial actors.

The sharp rise in rates: a shockwave

The financial world is accustomed to fluctuations, but the speed of these successive increases has been unprecedented in bankers' memory: rates going from 0 to 4% in just one year! Banks, whose structures were adapted to an era of stable rates, needed time to adjust their balance sheets, long optimized for low-rate contexts, and faced unprecedented tension: when rates increase, the profit and loss account structure initially deforms to the banks' disadvantage. The cost of capital has risen, making access to credit more expensive.

At the same time, regulatory authorities, seeking to strengthen the resilience of the financial system and prevent systemic failures, have increased prudential requirements in recent years.

Prudential constraints - to reduce losses and increase safety requirements - and rate constraints sometimes limit banks' financing capacity, effectively excluding the riskiest investments. They hinder the banks' ability to lend massively and lead to a transformation of the banking model, where the bank will be more of an advisor than a lender.

The role of banks will not decline: it will transform. This is all the more true as Europe is dominated by universal banking models and mutualist banks, which irrigate all aspects of the real economy.

Private Debt: A Growing Alternative

To continue investing and financing through alternative modalities, one option has become increasingly attractive for businesses: private debt. Emerging in Europe in 2013, private debt has since experienced phases of acceleration and withdrawal. In 2023, it is a more expensive option than a bank loan, but it guarantees flexibility and speed of execution. Less entangled in regulatory nets, it offers quick processing times and conditions adapted to borrowers' specific needs. It has fully entered the mindset of business leaders who can, in return for higher interest rates, quickly get the cash needed for their growth operations and thus move quickly in highly competitive global markets.

Make no mistake: **despite current challenges, banks remain pillars of the economy, endowed with proven adaptability.** As the environment stabilizes, they will be able to reposition their offerings, becoming as competitive as private debt has become in the troubled context we know. The rapid rise in rates, the evolution of the regulatory framework, and the emergence of private debt have created a changing financial landscape. Traditional bank financing and private debt will coexist, and this diversity of financing methods will present numerous advantages for businesses.

As private debt gains ground, a major challenge arises for France: **the ability to promote and consolidate a robust French private debt industry, capable of competing on the international stage.** For France, the current changes are both a challenge and an opportunity. By fostering innovation, strengthening its private debt sector, and adapting its financial institutions, France can not only successfully navigate these turbulent waters but also assert its position as an indispensable financial player on the global stage.

ESG

SFDR: What to Expect from the European Commission's consultation

The European Commission has initiated a consultation on the evolution of the **SFDR** (Sustainable Finance Disclosure Regulation), particularly seeking market players' opinions on a possible new classification of funds. *What could be the potential impact of such a consultation? What are the developments under consideration? Does the current form of SFDR fulfill its role in sustainable finance?*

SFDR is an EU regulation that aims to enhance transparency in sustainable finance. Adopted in 2019 and coming into effect in 2021, it requires financial entities to disclose information on how they consider sustainability issues in their investment decisions.

Two years after the SFDR came into force, the European Commission, led by Commissioner Mairead McGuiness, launched a consultation that concluded on December 15, 2023. Through this consultation, the Commission aims to address market players' concerns while strengthening the sustainable finance framework. The feedback from this consultation will be crucial in determining the future of the SFDR and accelerating the transition to a sustainable economy in Europe.

Limitations of the Current Regulation

Indubitably, the SFDR regulation has significantly accelerated the integration of ESG considerations within funds. However, it has been subject to some criticisms:

- Its rigorous implementation is made difficult by its complexity and the evolving nature of the regulation.
- The requirements for each product category, being difficult to understand for the uninitiated, have led to strong criticisms regarding greenwashing risks and eroded public trust.
- While the SFDR was part of a European regulatory package consisting of three regulations (the SFDR, the CSRD, and the Green Taxonomy), the mismatch between their implementation schedules, different definitions of the same concept, and the multiplication of delegated regulations and other regulatory clarifications (annexes, templates, etc.) ultimately created a regulatory cacophony, far from the EU's intentions of harmonization.

Article 8 and Article 9 classifications, often perceived as labels, have been a source of confusion for investors. The SFDR, in its new form, should align more closely with its original purpose as a transparency regulation.

Additionally, the continuous evolution of the regulation poses challenges for financial actors: ESG professionals within investment companies spend significant time on reporting and compliance, sometimes at the expense of guiding portfolio companies in their decarbonization and sustainable transformation trajectories.

What should be expected from this consultation?

Two potential strategies emerge today:
- Clarify how Articles 8 and 9 are defined.
- Create new types of investment categories, which might see classifications completely disappear from the framework.

The new consultation suggests four new categories of sustainable investment funds to replace the current article 6, article 8, and article 9 categories:
1. Investments focused on environmental and social solutions.
2. Investments promoting a sustainable approach (waste management, diversity, emission reduction, etc.).
3. Investments excluding companies with a negative impact.
4. Investments in transitioning companies with defined improvement plans.

The Commission is also seeking feedback on reporting requirements, potential simplification, and the general information obligation for all funds. A better definition of key concepts, such as sustainable investment, is also under consideration. Some managers believe the current gray area is preferable, allowing funds to adopt methodologies aligned with their investment strategy.

An unstable duality challenged by greenwashing

Many actors exploit the current regulation's gray areas to present "article 8" funds as sustainable investments, which can resemble greenwashing and has raised alerts from several financial supervision bodies, including ESMA.

Article 8 funds should drive the transformation of companies, meaning that management companies must tackle the social and environmental issues they face to meet the expectations of their multiple stakeholders, especially in decarbonization trajectories.

Noëlla de Bermingham, Sustainability Director at Andera Partners, explains, *"Article 8 remains very vague in its approach, and it includes everything: ambitious funds with numerous criteria and others that operate solely by excluding certain sectors."*

Meanwhile, Article 9 funds, due to the nature of the invested assets, may not reflect the most profound transformation approaches or the funds' impact approach.

Transparency, coherence and transformation approach

An evolution of the current framework is necessary to promote better coherence among all existing devices, particularly with the **taxonomy.**

Whatever the future of Article 8 and Article 9 classifications, the dual challenge is:

- To have recognized tools to distinguish a genuinely sustainable investment strategy.
- To overcome "Article 9-washing" and continue valuing the efforts made by funds to support the decarbonization of their portfolio. While targeting investments on assets that are inherently sustainable is relevant, equally important is the transformation of assets that do not yet meet all sustainability criteria but can play a crucial role in the transition. In this regard, the strategy chosen by Andera Infra, which invests exclusively in infrastructure dedicated to the energy transition while supporting the transformation of companies to maximize their impact, is particularly emblematic.

The European Commission's consultation is an important opportunity to evolve the sustainable finance framework in Europe – although with the deadline of the 2024 European elections, significant changes are not expected before 2025-2026. The selected evolutions will have a major impact on the pace and modalities of the transition to a green economy in Europe. Transparency, coherence, and the fight against greenwashing remain at the heart of this evolution.

Renewable Heat: An Overlooked Pillar of the Energy Transition?

The energy transition is reshaping the global landscape and is at the heart of public debates and policies. Beyond just images of wind turbines and solar panels, this transformation involves many facets. Among these, a source of energy often remains in the shadows, despite its considerable potential: renewable heat.

Often relegated to the background, overshadowed by the spotlight on renewable electricity, renewable heat, however, has immense potential in terms of efficiency and impact.

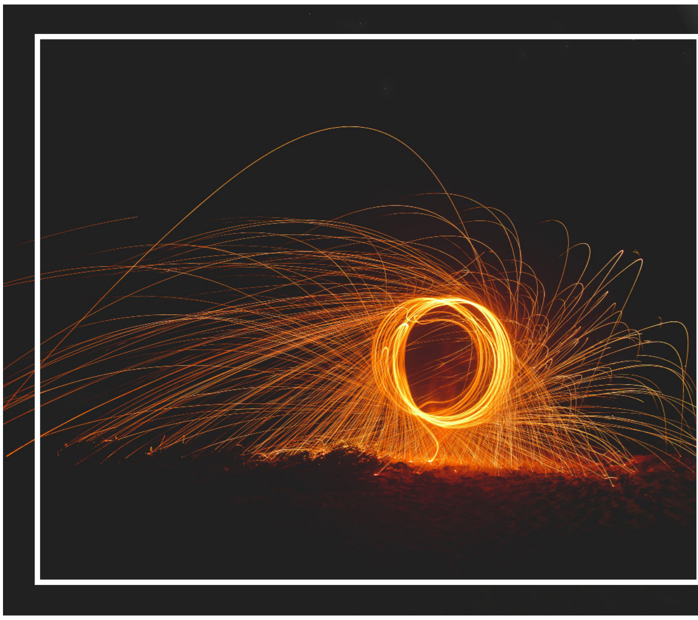
Where does this lack of knowledge or even disinterest come from? Focus on this underrecognized actor in our energy future.

The paradox of renewable heat

In France, heat consumption accounts for nearly half of final energy consumption. This sector is still largely carbon-intensive (gas, fuel oil, and coal represent over 60% of heat production) and is therefore a major challenge for the decarbonization of the economy.

Historically, renewable heat has always been considered the poor relation of the energy transition, lagging other energy sources that capture more media attention and often benefit from more generous subsidies, such as wind or photovoltaic solar... or worse, natural gas while we seek to reduce our dependence on this energy source! The reason often lies in the complexity associated with renewable heat, whether technological, logistical, or simply conceptual. For example, the public can more easily understand how a solar panel works than a geothermal heat pump.

But an essential element is often overlooked: a euro invested in renewable heat has four times more impact than if it is invested in renewable electricity. Why? Because heat is a "base" energy that is generated constantly, unlike renewable electricity. However, it transports poorly, so proximity between places of use and generation is necessary, leading to stronger local involvement and increased efficiency.



The unrecognized value of renewable heat

The cost-effectiveness of renewable heat is thus eloquent, for several reasons:

- *Proximity:* As heat is produced and consumed locally, transport-related losses are limited.
- *Valorization of waste heat:* Industry emits a lot of heat. Reused, it can supply urban heating networks or industrial processes. In terms of impact, the valorization of this waste heat could translate into significant savings and improved energy efficiency. It's also a step towards a circular economy.
- *Diversity of sources:* Biomass, geothermal, solar thermal... the sources of renewable heat are numerous and adapted to different territorial contexts.

A new deal for the heat fund

While in March 2022, the budget of the Heat Fund, the main financial support mechanism for the development of renewable heat production in France managed by ADEME (French Agency for Ecological Transition in Paris), was already increased from 370 million euros to 520 million euros, the 2024 Finance Bill presented by the government at the end of September 2023 plans an additional increase of nearly 300 million euros.

This is a strong signal that anticipates a collective awareness and recognition of the potentials and advantages of renewable heat. This additional budget could thus promote the emergence of new technologies and the development of suitable infrastructures and additional renewable thermal installations: heat pumps, heating networks, biomass, geothermal...

Enough to propel France among the European leaders in renewable heat?

European overview: A heterogeneous model

Europe has long favored renewable electricity. However, some countries like Sweden, Denmark, or Finland understood the importance of renewable heat very early on. These nations have heavily invested in urban heating networks powered by renewable sources. In Germany, biomass is a major resource for heat, while in Italy, geothermal energy takes advantage of the country's volcanic potential. The United Kingdom has implemented a Renewable Heat Incentive, an operating aid paid for 20 years, which has helped develop renewable heat alternatives. The Netherlands also set up an economic initiative with the SDE/SDE+, a subsidy program for renewable energies offering additional remuneration per kWh.

France, although it has accumulated some delay, has all the assets to become a major player in renewable heat in Europe. The country's geographical diversity offers vast potential in terms of resources: geothermal in the Paris region, biomass in forest regions, or solar thermal energy in the south.

Towards a new era for renewable heat?

With political momentum, incentive mechanisms, targeted investments, and collective awareness, renewable heat could well find itself in the spotlight, playing a central role in tomorrow's energy transition.

In addition to its efficiency, it promotes local employment, strengthens energy independence, and contributes to the fight against climate change.

The recent impetus given by the increase in the Heat Fund's budget is encouraging, but it is essential not to stop there. The 'Marshall Plan' presented last April to Agnès Pannier-Runacher, Minister of Ecological Transition, by the Renewable Heat Club goes in this direction. This organization, comprising several major players in the sector – AMORCE, AFPG, ATEE, CIBE, ENERPLAN, FEDENE, and several unions – proposes several measures with the objective of transforming, by 2030, 54% of the heat consumed in France into renewable, local, and competitive energy.

While this is a step in the right direction, several challenges remain to be addressed:

- Awareness: It is crucial to inform the public and train professionals in the specifics of renewable heat.
- Territorial integration: Each region has its specificities. Local action plans are necessary to make the most of local potential.
- Research and innovation: To remain competitive and optimize existing technologies, investment in research is essential. Sustainable Economic Support for the Sector: It is important to support producers and entrepreneurs in the sector in their development.

A complementary remuneration system, such as the one adopted by Europe to reform the electricity market, would generate additional projects in France. With the right combination of investments, awareness, and innovation, renewable heat could well become a major player in the European energy transition. The ball is now in the court of decision-makers, actors, and supporters of the sector, such as Andera Partners, which through its team dedicated to energy and ecological transition, Andera Infra, invests in this promising field.

Specializing in the co-development, financing, and management of renewable heat production and energy saving projects, Kyotherm has been active for over 10 years across all renewable heat production technologies, including biomass, geothermal, and solar thermal. The company is among the leaders in these areas, with a presence in over 100 sites across 10 countries in Europe and the United States. Kyotherm currently boasts a substantial portfolio of 60 projects, totaling 230 MW of capacity in operation or under construction.

The company also invests in energy efficiency projects, focusing on energy savings and the valorization of waste heat for large industrial groups such as ArcelorMittal and Faurecia, or through lighting and building insulation projects.

Deeply committed to combating climate change and promoting low-carbon energies and energy savings, Kyotherm's commitment is reflected in the choice of technologies and projects that have a maximal impact on reducing greenhouse gas emissions. The company estimates that, with its current portfolio capacity, it will be able to avoid the emission of over 4.3 million tons of CO_2 over the duration of these projects.

4 Questions with François Lhoutellier, President of Groupe ERI

François Lhoutellier is President of the ERI Group, a company specialising in energy-efficient buildings, low-carbon mobility infrastructures and physical and digital security. The ERI Group, which celebrated its 100th anniversary in 2023, has been supported by the Andera MidCap teams since 2022.

1. Could you describe your journey leading up to your role as President of Groupe ERI and what led you to this position?

Over a 25-year career marked by leadership roles in various key industry sectors, I had the opportunity to work in areas as diverse as construction, maintenance, building, and energy infrastructure, holding managerial positions in large companies like Bouygues, Cegelec, and Schindler.

However, my entrepreneurial drive led me to make a strategic decision in 2018. The opportunity to leave the world of large corporations and join a mid-sized company in an LBO situation presented itself as a boon. This decision led me to the presidency of Groupe ERI, a responsibility I have proudly held for five years now.

Since 2018, the Group has achieved major milestones, including the conclusion of an LBO with Latour Capital. Since April 2022, we have been working closely with Andera Partners on developing a secondary LBO. This phase represents an important milestone in our growth and innovation strategy, confirming our commitment to keep ERI at the forefront of its sector.

2. Your sector is rapidly developing and transforming with increasingly pressing energy performance and security challenges. What are your major strategic challenges?

The journey that led me to the helm of Groupe ERI is intimately linked to a series of global transformations and unprecedented challenges. We are at a historic crossroads where changes are occurring at a dizzying pace, involving major transitions for both businesses and society as a whole.

On the energy front, we are faced with an imperative need for adaptation. This approach aims to respond to the surge in energy costs and the growing power of environmental, social, and governance (ESG) standards, which are redefining our industry's boundaries.

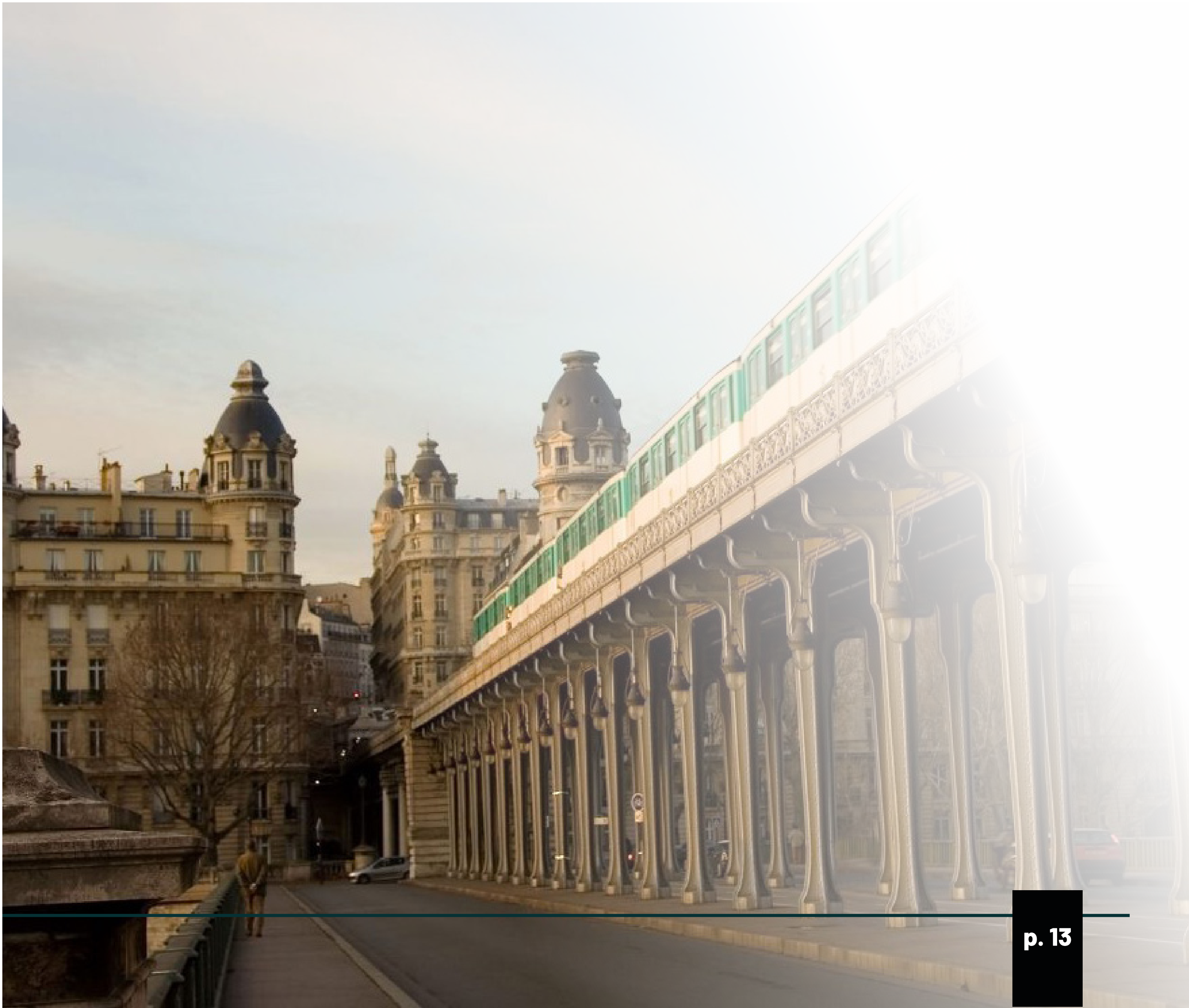
The digital transition, in turn, is revolutionizing our safety and security standards, bringing its share of challenges and opportunities. At the heart of this revolution, security issues – whether it's video surveillance, anti-intrusion systems, combating cyberattacks, or fire safety devices – have become paramount. These aspects are now crucial components of our strategy, as part of our security continuum.

Finally, the imperative for decarbonization and the evolution of the country and major cities towards new modes of transport stimulate the growth of the infrastructure market. Cities are transforming, marked by rapid urbanization, increased compliance requirements, and a pressing need to renew aging infrastructure. These developments also lead to a complete transformation of mobility – individual and in public transport – particularly illustrated in the Île-de-France region by the doubling of the size of the public transport network: trams, electric buses, RER, metros, or intercity trains.

3. How does ERI stand out from its competitors?

Groupe ERI positions itself as a central player in the fields of digital transitions, energy security, renovation for improved energy performance, and mobility. It is currently the only group in the Île-de-France region capable of simultaneously addressing all these needs with a single entity. No other intermediate-sized company is agile enough to offer such comprehensive assistance to its clients across all these topics.

With these unique features, Groupe ERI is growing strongly, with three notable acquisitions this year: TAC, specializing in the treatment and reinforcement of wooden structures; Groupe Horus, an expert in security devices; and the takeover of Avenel, specializing in railway signaling and energy renovation. With the ongoing intention to expand our range of trades, our client base, and our customer segments, we aim to complete this dynamic of external growth in combination with organic growth. For instance, TAC and Horus primarily operate in the condominium syndicates segment, previously underrepresented within Groupe ERI. Since the 2022 LBO, the group has already scaled up, with turnover increasing from 180 to 220 million euros, including these transformative external growth operations.



4. How would you describe the strength of the partnership between Groupe ERI and the teams of Andera Partners?

Before the start of our joint venture in 2022, my goal was to find the best partner to support the development of ERI. This quest concluded with a heartfelt choice, and we mutually chose each other to start a secondary LBO. Beyond the usual financial underpinnings, we quickly had the desire to undertake this journey together.

From our first meetings, I was impressed by the entrepreneurial development DNA of Andera Partners. We share this common obsession with transforming and developing Groupe ERI, which I still feel today after 18 months of "shared life"!

But what truly differentiates the support we receive from Andera Partners is their 360-degree approach, going far beyond the traditional role of a majority shareholder. This support is embodied by a team of four people, each bringing their sensitivity, expertise, and richness. This team challenges and enriches us in designing, deploying, and managing the risks of a transformation program that is essential when scaling up, but even more so for a centenarian like ERI. We benefit from their support in strategy, positioning, transformation, and development of ERI, as well as in our HR, digitalization, and financial engineering issues during acquisitions.