

A force for growth



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Glossary

AFIC	Association Française des Investisseurs en Capital (the French Private Equity Association)
AIFMD	Alternative Investment Fund Managers Directive
Asia Pac	Asia Pacific region
BRICS	Brazil, Russia, India, China and South Africa
CEO	Chief Executive Officer
DD	Due diligence
ESG	Environmental, social and governance
FMCG	Fast moving consumer goods
GCC	Gulf Cooperation Council
GDP	Gross domestic product
GP	General partner
HR	Human resources
ILPA	The Institutional Limited Partners Association
IPO	Initial public offering
IR	Investor relations
IT	Information technology
LATAM	Latin America
LP	Limited partner
M&A	Mergers and acquisitions
MENA	Middle East and North Africa (including Turkey)
N/A	Not applicable
PE	Private equity
PIPE	Private investment in public equity
PLC	Public limited company
SME	Small and medium sized enterprises
SWF	Sovereign wealth fund
TMT	Telecommunications, media and technology
UN PRI	The United Nations-backed Principles for Responsible Investment Initiative

The views and opinions in this report expressed by those private equity survey respondents providing comments or quotes are theirs alone, and do not necessarily reflect the views and opinions of Grant Thornton International Ltd or any of its member firms.

Key findings



MARTIN GODDARD
GLOBAL SERVICE LINE LEADER – TRANSACTIONS
GRANT THORNTON INTERNATIONAL

Over recent years, practitioners within the private equity industry might have been forgiven for thinking they were facing something of a perfect storm, with the industry being challenged on all sides. Globally, the competitive environment within the industry has become more intense with quality dealflow at a premium, while simultaneously Limited Partners (LPs) have become increasingly demanding and vocal, and the industry has also received greater scrutiny from the broader public and regulators alike. Compounding the industry's own internal growing pains – which in some of the oldest private equity markets has seen the validity of the whole model questioned – has been one of the toughest macro economic environments in recent history, with portfolio companies sucking in time and resource as they face up to the economic headwinds.

Three years in, the answer to the question of whether we are emerging from the global economic downturn or about to slip into a double-dip is still to be answered.

Through this, private equity has been asked to reflect on both its own place in the financial landscape and to face up to its often compromised public perception. There are real challenges here for the industry world-wide. In this report, we consider what it means to undertake private equity in the principal private equity markets around the globe – in terms of both the challenges and opportunities – and find an industry that, on many levels, is converging in terms of the way it goes about business. However, while operating a private equity firm in London, Sao Paulo, New York, Shanghai or Sydney may require increasingly similar skills, functions and approaches, the dynamics in those individual markets driving this convergence often remain quite different.

Three years ago, as the clouds gathered with the tightening of the debt markets, dealflow within the more developed private equity markets rapidly started to fall away. With the skies not having lightened that much in the intervening period, the consequent increased **competition** for quality deals has only been compounded by the return of strategic buyers, many of them keen to put healthy balance sheets to work. In the emerging markets, the sense of opportunity has seen something of a gold rush mentality with an influx of Western private equity firms seeking new areas of opportunity and the rapid development of domestic private equity industries also driving competition. Across the world, then, there has been a shortage of quality assets at reasonable prices for a private equity industry which had been accelerating its accumulation of funds over the course of the previous decade and, as a consequence, has a pent up need to deploy capital.

Just finding shelter and sitting out the storm hasn't been an option for private equity investors either. With the boom in investment activity in the run up to the downturn, private equity portfolios had grown considerably and have often been demanding of attention as the environment has become more challenging and unpredictable. Creating 'saleable' businesses with enhanced valuations is the endgame for private equity firms and, while the exit markets are showing some signs of life again, the torrid market for new investments of recent years has often been reflected in the exit markets too.

In the West, the challenging trading environment has seen a renewed focus for private equity in getting more closely involved in portfolio businesses – while leverage and multiple arbitrage might have worked in a rising market, come the downturn **performance improvement** is the order of the day. Many private equity firms have therefore been responding by 'tooling up' and establishing more formalised portfolio operations teams to add more strategic insight and even operational resource alongside the financial planning insight provided.

In many of the emerging markets, economic growth has been less of a concern – GDP growth of seven or eight percent plus might be difficult to imagine in Europe or North America, but markets such as Brazil, India and China have seen sustained growth and continue to drive forward even though the fear of over-heating is an

inevitable concern. However, in these markets too, private equity firms report the growing relevance of added-value approaches to portfolio management. These markets are often still characterised by growth capital investments, with low levels of leverage, meaning the focus too is on performance improvement. As these markets become more globalised, there is a recognition of the need to 'professionalise' businesses, with private equity firms seeing a key aspect of their involvement as the introduction of international standards of **governance** and ways of doing business in order to prepare companies for eventual sale.

Generating quality **exits** and returns has always been critical for private equity, but their significance has, if anything, increased as holding periods have been stretched. In developed markets, private equity firms are starting to bump up against the investment hurdles of their fund cycles which need to be negotiated even before new funds can be raised. In some of the more emerging markets, the development of the industry is still at an early stage, but there is again a sense that the enthusiasm and promise on the back of which these markets have grown now needs to come good in the form of demonstrable returns.

Historically, IPOs have often been a preferred exit route for private equity firms, and they do remain a viable option in parts of Asia, for example. However, this channel has been all but closed for some time in Europe and the USA; overall public investor sentiment and desire to invest might be the issue in some regions, but the perception of private equity has also acted as a particular brake on the IPO option in some countries largely due to perceived pricing issues. The return of strategic buyers might have added to the competitive pressure on the buy-side, but they have been a welcome sight on the horizon from an exit perspective. If corporates present the industry with something of a double-edged sword, so too does private equity's own 'internal' response to the need to both put money to work and generate returns – secondary buyouts. While many practitioners themselves remain very aware of the need to provide a clear rationale for such deals in order to convince investors that they are not just fuelling an internal market in private equity assets, they have become an established feature of the developed markets. However, even in the more growth-oriented emerging markets they are also gaining significance.

Maintaining a true course through such choppy waters was always going to present challenges for investing and exiting. But churn has also been a feature of the **fundraising** environment as well. Institutional investors have themselves faced considerable challenges in recent times, not least within their private equity programmes, which has led to a significant period of reassessing allocation strategies and the balance between investing via re-ups (repeat investments with an existing investee manager) and identifying new managers, potentially in new markets.

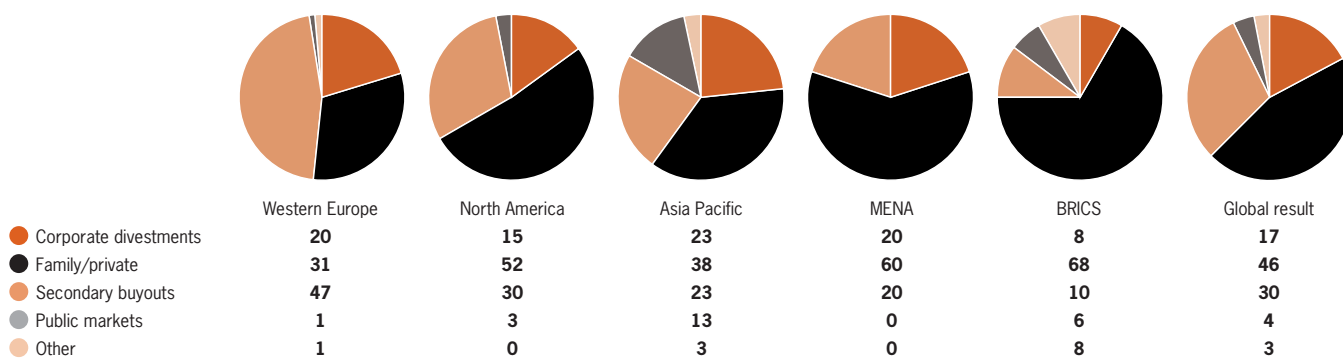
Private equity firms rarely fail and disappear overnight, but the ability to generate returns and raise new funds is the life-support machine that, if switched off, will see firms die slowly. There is still a clear sense that there will be winners and losers within the industry. The Darwinian process at work will undoubtedly ensure the long-term vitality of the industry, but many also believe that the increased intensity this has brought to the selection and monitoring of investments by LPs will continue to be felt by private equity firms around the world for a long time to come.

The more forensic approach being taken by institutional investors may bring with it a greater administrative burden for private equity firms, but it can be seen as an integral part of the longer-term trajectory of an industry that also includes being under the increasingly watchful eye of the regulators – given added momentum by the pressures exerted by the macro environment, for sure, but something that was already well underway. While some may worry that the inherent entrepreneurial spirit of the industry is under threat, others will see scrutiny and regulation as proof of an industry institutionalising as it plays a higher profile and more significant role in economies around the world. Undoubtedly in the West, as more high-profile businesses have come under private equity ownership, interest from the **regulatory authorities, politicians and the public** in general has increased markedly, and such attention is certainly not always favourable; indeed it sometimes feels as if it has become fashionable to criticise and blame private equity at the slightest opportunity, not least because of the industry's perceived opacity. Elsewhere in the world, the industry has more quickly gone down a similar path as the desire to promote private equity and growth has sometimes battled with a lingering scepticism about private equity practices and a desire to protect a culture of family-owned business.

Troubled waters perhaps, and ones which no doubt will see more casualties to come, but good helmsmanship and a solid crew (and a bit of luck here or there) still leave the chance to navigate through successfully. There is a strong sense within the industry, whether in developed or emerging markets, that it is a time to focus on the fundamentals of private equity investing – building relationships, getting your hands dirty alongside management at the coalface, focusing on performance improvement and proving the model through good exits and good company stewardship. This approach then needs to be effectively and continuously communicated, providing a stream of concrete examples to educate, and in the more developed markets perhaps re-educate, an ever-expanding range of stakeholders that the private equity model does work as a positive catalyst for change and value growth. With overall global economic sentiment making a shift in the wrong direction during the latter stages of this research project, perhaps even dampening some of the signs of cautious optimism evident throughout this report, the need to support and encourage such catalysts of wealth creation and economic development – **a force for growth** – is stronger now than ever before.

Global picture: Investment activity

FIGURE 1: SOURCES OF DEALFLOW
PERCENTAGE



- Firms in family and private ownership continue to be seen as the principal source of private equity dealflow.
- Secondary buyouts are a feature of all markets, but are expected to be particularly prevalent in the developed European arena.
- Respondents in the emerging markets of Asia Pac and BRICS have the most varied expectations in terms of deal sources.

“With origination you need to be able to get through every level of the process successfully. You need basic hygiene factors, some differentiating factors and some compelling factors. On the hygiene factors, you need money, a fair price, good processes and well-oiled due diligence. The differentiators are often linked to the people you have, your international networks, your understanding of the business, your relationship with management and your brand. The wow factors tend to come down to the individual leading the deal and the more personal factors.”

UNITED KINGDOM survey respondent

“Healthcare continues to be a key sector and we participate in its consolidation. Consumer and retail are very active, driven by large domestic demand. Energy and infrastructure are other sectors to watch, and ones where there has been a lot of competition from local and foreign strategic partners.”

TURKEY survey respondent

“Assuming that the economy will modestly improve, and not deteriorate, there should be an increase in both dealflow and completed deals. There’s a lot of pent up seller demand, and a lot of pent up buyer demand, and when those two things coincide, deal flow increases.”

UNITED STATES survey respondent

“It is significant that the consumer sector is cited as the most active. This could change if a double dip recession does occur.”

STEVE BRADY
PARTNER, HEAD OF TRANSACTION ADVISORY SERVICES
GRANT THORNTON, US

While the macro headwinds are still blowing around the world, there is a sense within the global private equity community of optimism. With caution still the watchword, approaching two-thirds of GPs included within this survey nevertheless believe that investment activity will increase over the coming year. It has been fashionable to talk of the rise of the East both inside and outside private equity, and although there's no doubt that the developed markets have suffered most, recent times have served as a reminder of the interconnectedness and mutual reliance of global markets in the modern era.

Globally, the principal impacts of the downturn have been to raise the spectre of an industry shake-out and to see levels of quality dealflow reduced. The reaction of the private equity industry has been to align itself with the best opportunities, wherever they may be. This flight to quality has resulted, inevitably, in increased levels of competition which has also kept prices for the best assets high. The strength of corporate balance sheets has served to intensify this competitive environment.

FIGURE 2: MOST ACTIVE SECTORS

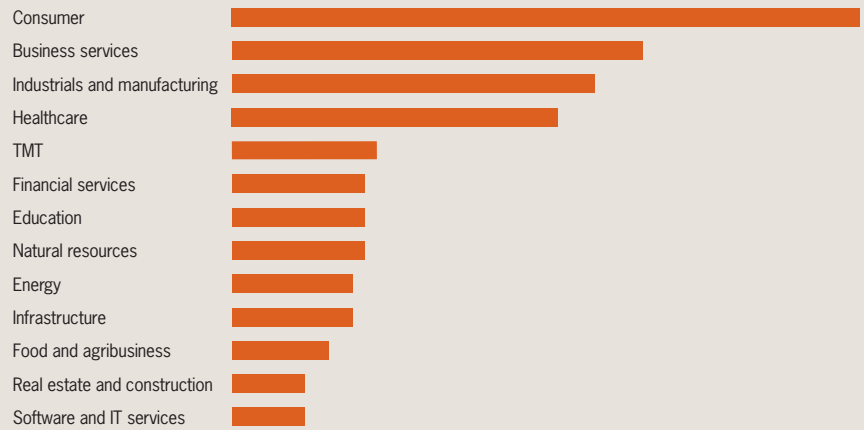
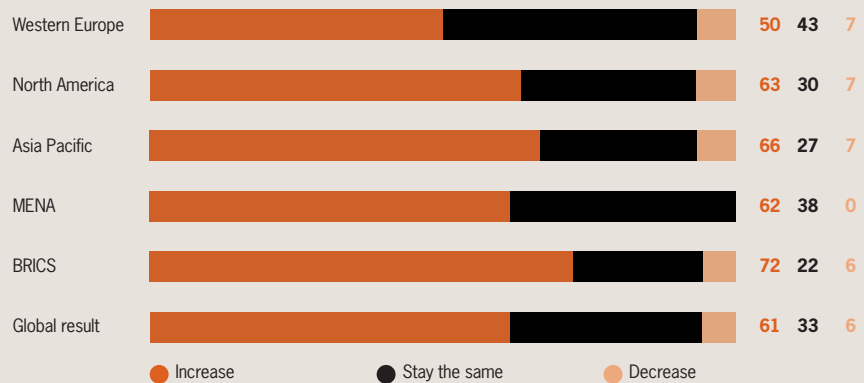


FIGURE 3: INVESTMENT ACTIVITY BY REGION

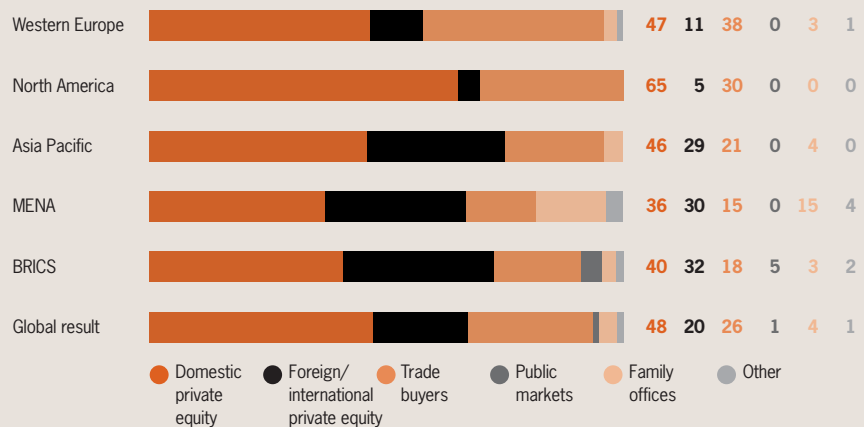
PERCENTAGE



- Over 60% expect an increase.
- Caution is most clearly expressed in Europe, where over 40% expect it to remain at current levels.
- BRICS respondents are most positive, driven particularly by respondents in Brazil and India.

FIGURE 4: SOURCES OF COMPETITION

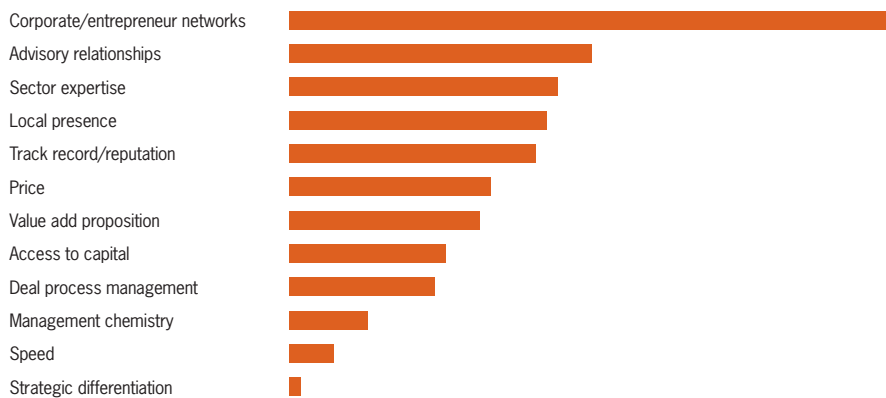
PERCENTAGE



“We’re seeing good private equity dealflow and a strong pipeline. Entrepreneurs and families are coming out of hiding and are looking for finance to support growth.”

ARNAUD LIMAL
PARTNER, CORPORATE FINANCE
GRANT THORNTON, FRANCE

FIGURE 5: KEY FACTORS IN IDENTIFYING AND WINNING DEALS



The reawakening of the corporate community, including the restructuring of larger businesses, means that the traditional channels of private equity dealflow, namely family- and privately-owned businesses and corporate divestments, are expected to remain the dominant sources. However, competition within the private equity industry itself has helped promote an environment where secondary transactions can take hold, with this being an increasingly relevant feature of both the developed and more nascent markets.

In this new landscape, everything points to the enhanced importance of networks. In emerging markets, this manifests itself in the need for local presence and an understanding of local business cultures. Whereas in more established markets, rising competition has emphasised the need to self-originate, act fast and develop an angle.

“It’s still a very competitive market and unfortunately that means that price matters most when competing for deals. In a hot market, it’s always price and terms, and then the probability of close. How strongly you can demonstrate that you can deliver.”

UNITED STATES survey respondent

“The two main sources of deals here are entrepreneur-owned businesses who are unable to access debt funding any more, and the public markets which are becoming interesting because of the stock market pricing.”

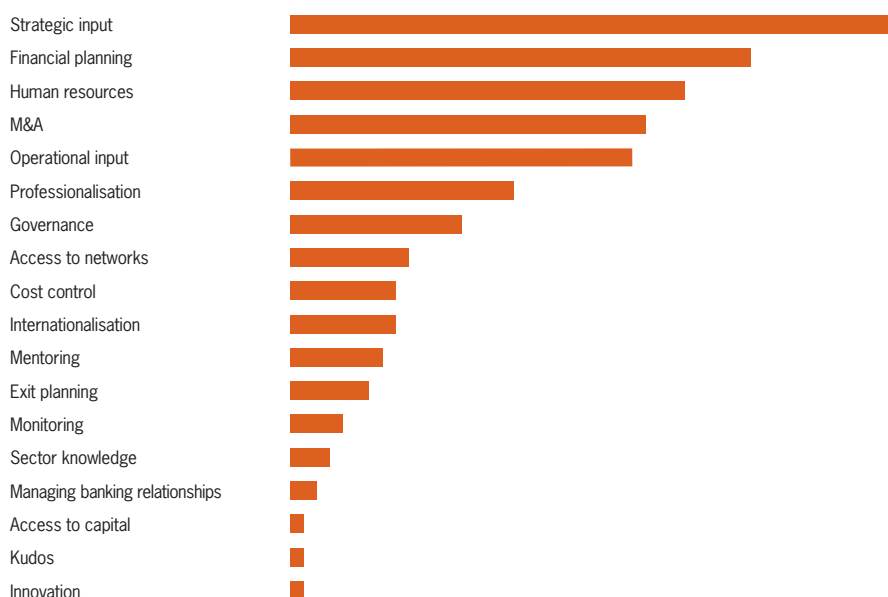
HONG KONG survey respondent

“I’d have to say that at this point in time we are more cautious than optimistic about the economy.”

CHINA survey respondent

Portfolio

FIGURE 6: AREAS OF HANDS-ON INVOLVEMENT



Throughout the downturn, private equity firms around the world have found themselves having to focus more on working with portfolio businesses in order to help strengthen their positions in an adverse climate. While the skills might have been honed in firefighting, they are now proving useful where private equity firms are operating in low-growth environments.

Given the low growth in some markets coupled with the lack of value uplift available from leverage or multiple arbitrage, many private equity houses stress the importance of performance enhancement as a value driver and highlight their input in a number of key areas in aiding this. In particular, strategic input is universally seen as central to the private equity offering. Around the world, the professionalisation of businesses as they develop under institutional ownership is something which private equity players can and do contribute to. Assistance with operational systems, financial planning and human resources are oft-cited benefits that private equity ownership can bring to companies.

“With the market as challenging as it is at the moment, adding value is the only way of really unlocking returns. Groups are finding they have to do more and work more closely with their portfolio management teams. Some got caught out before, and now there’s no going back – if you want to generate a return, you have to work for it.”

STEVE LUKENS
HEAD OF ADVISORY
GRANT THORNTON, US

“The value we bring is really about boosting growth initiatives, reinforcing corporate governance and strengthening management teams.”

SINGAPORE survey respondent

The likelihood that portfolio companies will be involved in M&A activity varies considerably by company and GP. However, there is a general sense that M&A levels will increase, with this likely to include cross-border acquisitions. While GPs are mindful of the challenges involved in making M&A work, and indeed the additional cultural and complexity challenges posed by cross-border deals, factors such as relatively cheap assets and opportunities to rapidly access growing markets are serving to encourage activity.

A further aspect of portfolio firm professionalisation in which private equity is playing a role is in relation to Environmental, Social and Governance (“ESG”). Governance, in particular, is an area of GP focus globally, both reflecting the ‘best practice’ aspect of this approach as well as a recognition of increasing pressure from other stakeholders, including LPs and regulators.

FIGURE 7: HANDS-ON PORTFOLIO INVOLVEMENT
PERCENTAGE

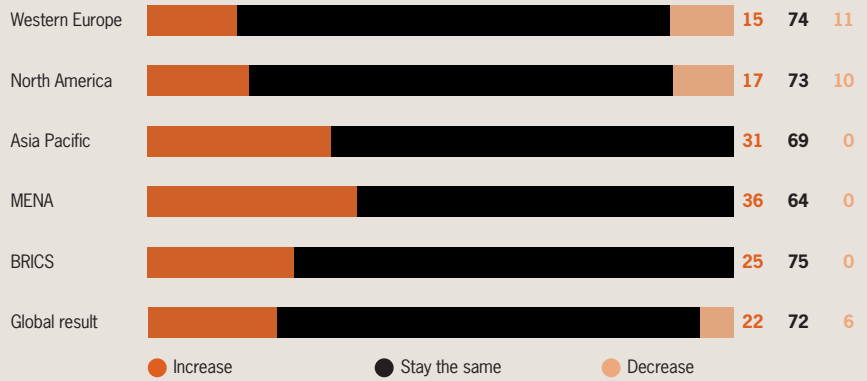


FIGURE 8: PORTFOLIO VALUE DRIVERS
PERCENTAGE

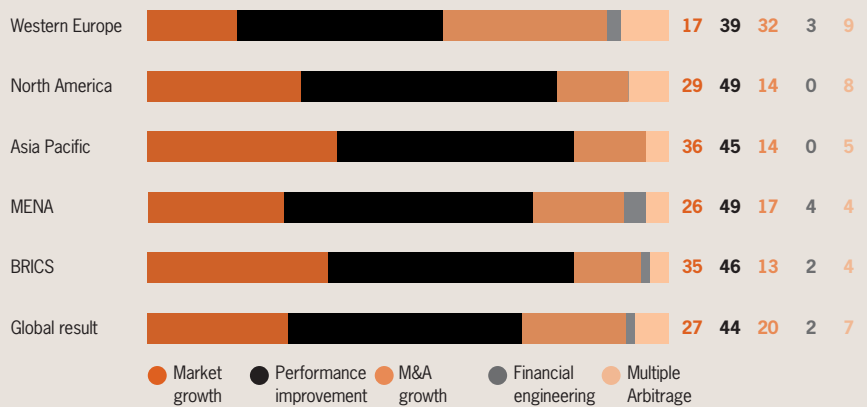
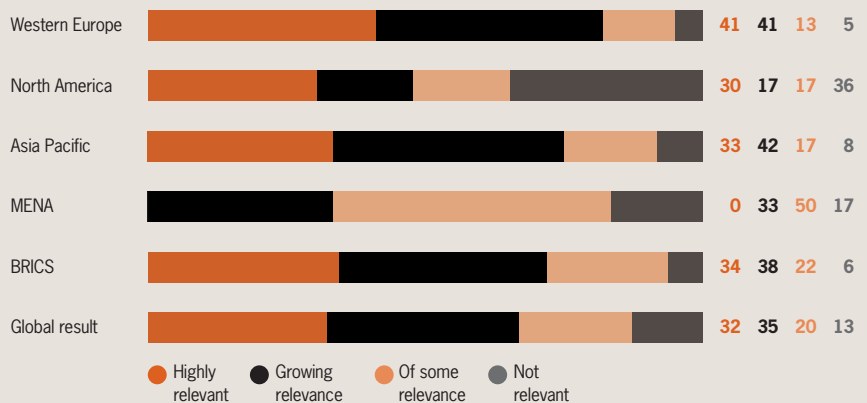
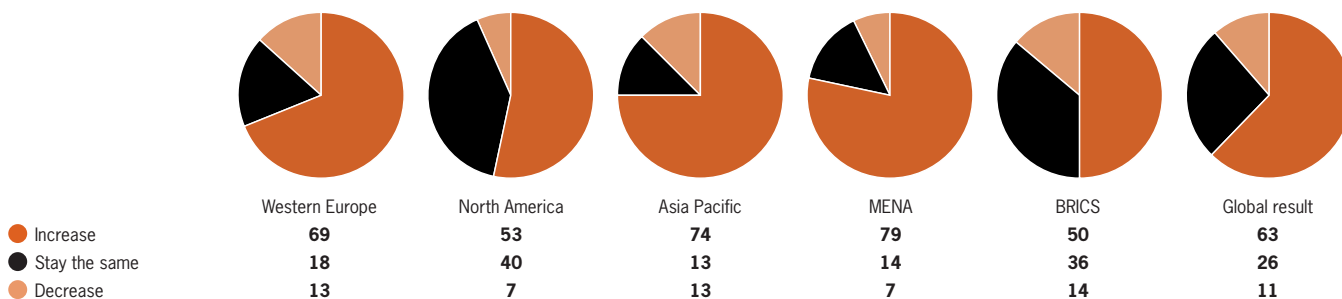


FIGURE 9: ESG
PERCENTAGE



Exit

FIGURE 10: EXIT ACTIVITY
PERCENTAGE



- Over 60% of respondents expect to see exit activity increase over the next 12 months.

With what was an accelerating population of private equity backed businesses leading up to the downturn, coupled with the closing of most viable exit routes at the peak of the crisis, the private equity industry has found itself with rapidly aging portfolios and, with fundraising looming in many cases, a need to achieve realisations. This is reflected in the fact that approaching two-thirds of GPs globally expect to see an increase in exit activity over the coming year.

The pressure to exit for some is, however, matched by the pressure to invest for others, namely those who have dry powder to deploy before the end of agreed investment periods. These push and pull drivers are the key factors in the increasing trend towards secondary buyout activity in recent times.

Inevitably, secondary buyouts provoke debate about their pros and cons. However, in those markets where they are an established feature, they have provided the lifeblood of the exit market in an environment where IPOs have been very difficult to achieve. In emerging markets, secondary buyouts are yet to achieve the same position, but are increasingly seen.

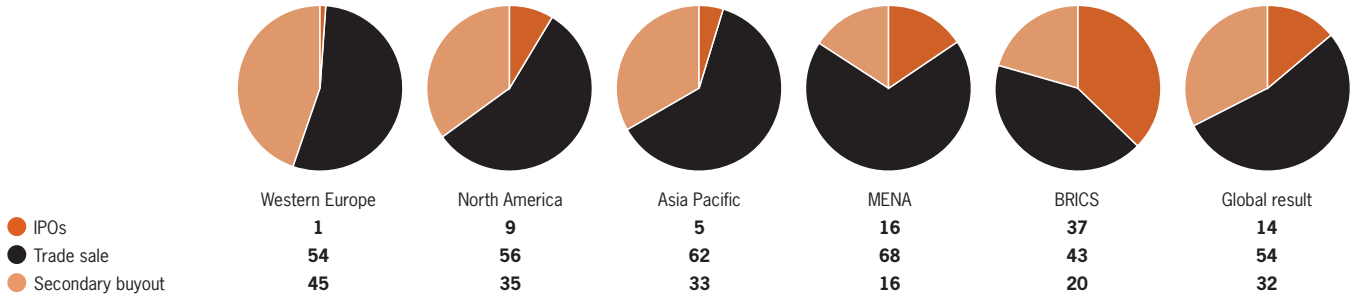
“Secondary buyouts work well here, but for different reasons. India is a growth market dominated by minority expansion investments. As a natural part of this, the businesses backed need larger capital injections as they grow and this presents good opportunities for financial investors up the scale.”

INDIA survey respondent

“The global financial crisis resulted in a lengthening of the holding period for portfolio companies and typically has led to a delay of 1-2 years in the investment cycle, which has been used to fix and repair portfolio companies. Now that these two years have passed, portfolio companies are ripe for exit.”

SOUTH AFRICA survey respondent

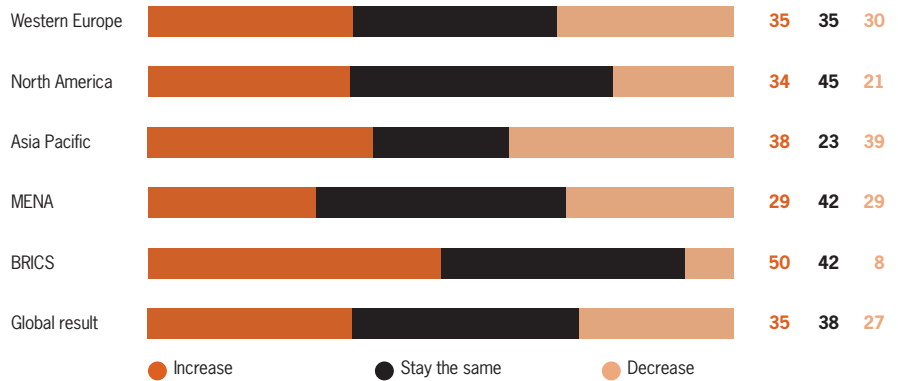
FIGURE 11: EXIT ROUTES
PERCENTAGE



The other saving grace for private equity firms in realisation mode has been the appetite of trade buyers. This highlights the positive side of the double-edged sword for private equity that is an acquisitive corporate community.

Given the range of competing factors at play, practitioners find it difficult to form a certain view as to the direction of returns for the industry. On the one hand, high entry prices, continuing global macro uncertainty and a shortage of debt have applied downward pressure. On the other, improving confidence, a buoyant secondary market and trade appetite keep optimism alive. Despite this, the prevailing view is that the coming period will see both winners and losers and it will be this that determines the shape of the industry going forward.

FIGURE 12: AVERAGE RETURNS
PERCENTAGE

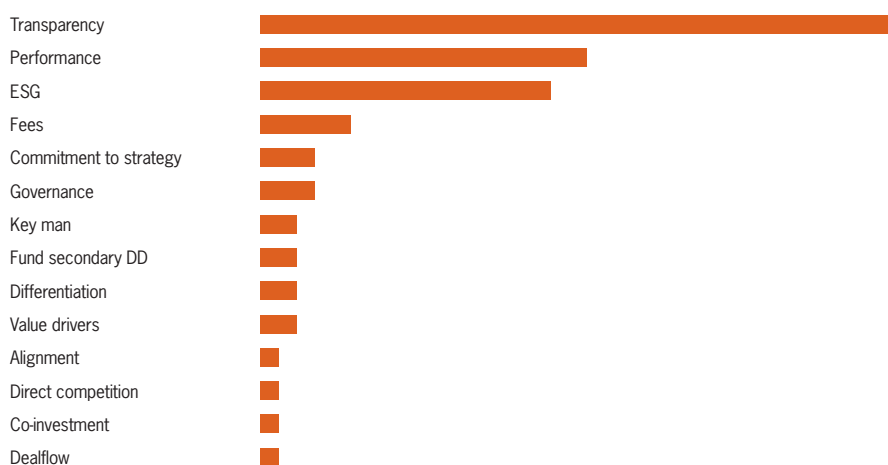


“There is optimism that exit activity will increase this year. The nature of private equity is such that investors measure performance against a benchmark and this is how LPs look at the world. GPs are engaged in an ongoing process of understanding what’s important to LPs; ultimately this comes down to getting capital back and churning portfolios.”

HARISH HV
PARTNER, HEAD OF TRANSACTION ADVISORY SERVICES
GRANT THORNTON, INDIA

Fundraising

FIGURE 13: AREAS OF INCREASING LP DEMANDS



“The fundraising environment is both positive and negative. There are plenty of firms hitting the fundraising jackpot and deservedly so, but equally there are many players who are really struggling. Ultimately, painful as it is for some, it’s probably a good thing for the industry.”

FRANCOISE NOEL-MARQUIS
PARTNER
GRANT THORNTON, FRANCE

“I think it’s a competitive fundraising environment. It’s better than it has been but people still have exposure to bad funds. The denominator issue is diminishing, as is the liquidity issue, but the overhang is still there and existing managers are scrapping for re-ups.”

UNITED STATES survey respondent

“The big problem for the local market is the total lack of returns made. There just haven’t been enough of them and as a result there are some very poorly-performing funds.”

VIETNAM survey respondent

For private equity firms heading out to market, the fundraising environment remains testing. Practitioners point to the increasingly polarised nature of the market in which high performers are able to raise, and even quite quickly, while others find it tough. This is linked to a flight to quality by LPs which has seen even some of the most longstanding relationships reassessed.

Simultaneously, the industry has seen a clear shift in the balance of the GP–LP relationship, with investors increasingly willing to demand more transparency and seek demonstrable performance, not least in newer private equity markets that have been sold hard in recent times and now need to prove they can deliver the promised returns. In developed markets, LPs have sought to find a collective voice with which to put their case. In particular, initiatives such as ILPA and the drive for a particular fund’s LPs to hold closed meetings without the GP present illustrate the more ‘forensic’ approach now being employed.

“Fundraising is pretty tough. A lot of people flooded into the market and there is possibly now a bit of a knee-jerk as people fear conditions are too overheated.”

BRAZIL survey respondent

“It is harder to raise funds now and we will continue to see a flight to quality. We’re in a situation where the better end of town will do well, but the rest will find it very tough. It is the same highly-selective environment on the deal side as well, with the lending banks definitely having an A list of GPs.”

AUSTRALIA survey respondent

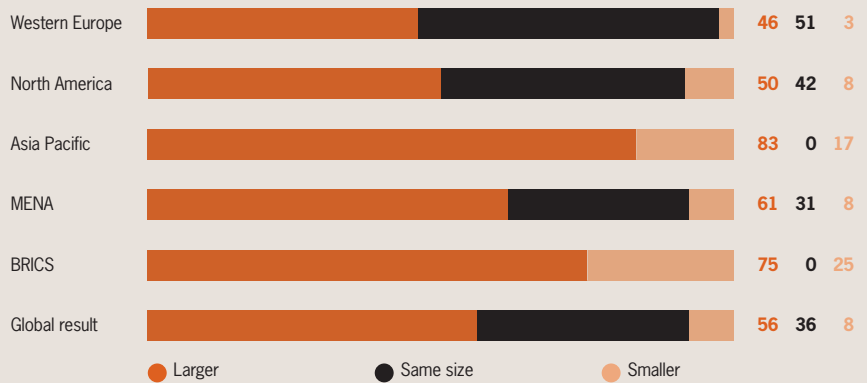
There are signs of longer-term confidence with many GPs expecting to be able to raise larger funds in the future. This is most notably a feature of emerging markets, with evidence of the process of fund size inflation having paused in developed markets.

A clear outcome of the changing sentiment in the investor community is the expectation amongst GPs globally that there will be a degree of churn within their LP bases. Pressures in this respect vary from country to country and fund to fund, but it is clear that while in some regions the opening up of domestic sources of capital is seen as an opportunity, in others the retrenchment of domestic LPs is forcing GPs to build increasingly international investor relationships. This is, in effect, leaving some GPs to compete for attention amongst a broader range of peers by convincing LPs of the attractiveness of their firm and market in an international arena.

“LPs are reducing both their allocations and the number of GPs they want to work with. They have learnt a lot in recent times and are more discerning about performance and the way they are treated by GPs. These days more than ever, strong performance and transparency are key.”

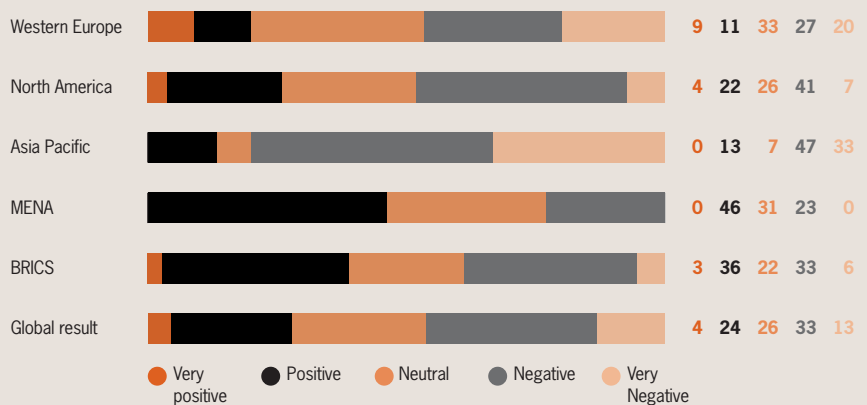
UNITED KINGDOM survey respondent

FIGURE 14: FUTURE FUND SIZE VERSUS PREDECESSOR
PERCENTAGE



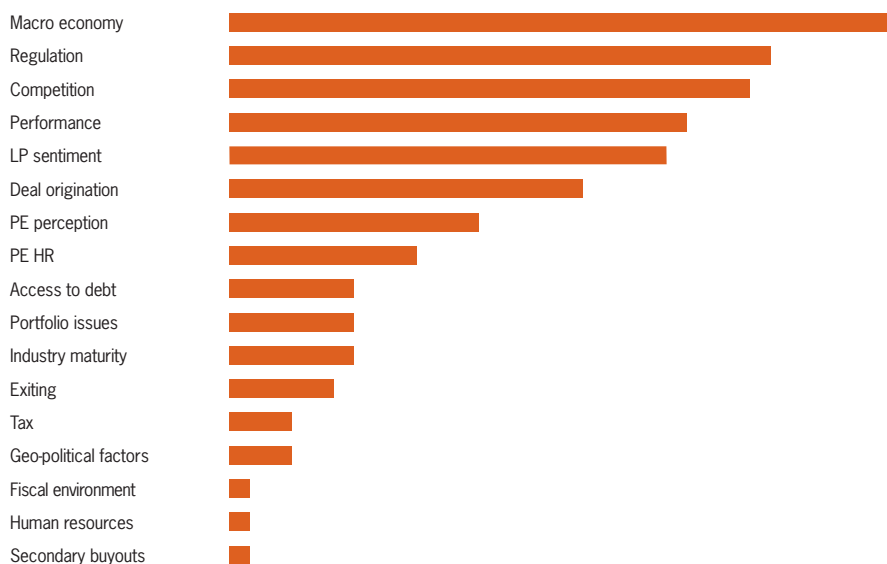
- Taking fund size as a measure of the likely future size of the industry suggests that emerging market PE firms are confident of future growth.
- Within the developed markets, the picture points more towards a stabilising of the industry size.

FIGURE 15: FUNDRAISING ENVIRONMENT
PERCENTAGE



Overall market outlook

FIGURE 16: KEY CHALLENGES FACING THE PRIVATE EQUITY INDUSTRY



With the global economic situation still very much in the balance, macro economic considerations are regarded as the greatest challenge currently facing the private equity industry worldwide. The fallout from the downturn has also triggered increased attention from national regulators seeking to drive more transparency from financial institutions. The inherent opacity of the private equity industry has made it a lightning rod in some instances, giving momentum to a process that had already begun on the back of concerns about job security and asset stripping as businesses with larger (often politically sensitive) stakeholder groups came under private equity ownership in some markets. This has added to the challenges faced by the industry, with firms noting the need to educate and sell the benefits of private equity on an ongoing basis.

“I think in general the industry has a problem in generating the types of returns to justify the asset class. There just hasn’t been the performance in recent times. Institutional investors are getting disillusioned. That’s a problem the industry needs to work on.”

CANADA survey respondent

“The reliance on leverage, and also the ability of private equity companies to differentiate themselves both present challenges.”

AUSTRALIA survey respondent

“One of the biggest issues for the industry is one of perception. Every time the industry puts its head above the parapet, it risks getting it shot off by either the press or the Government. I think it’s symptomatic of the fact that when times are hard, people look to blame someone.”

MARTIN GODDARD
GLOBAL SERVICE LINE LEADER – TRANSACTIONS
GRANT THORNTON INTERNATIONAL

“The big challenges to the industry all stem from regulatory issues and the fact that PE has been lumped together with the banks and hedge funds. All of the resulting scrutiny is leading to more and more admin – and that is not value-adding. There is massive pressure on resources and this will translate into problems for returns. There is also a problem associated with all the attention on fees and remuneration. If there is too much pressure here we will not be able to hire the top people and they will simply go to hedge funds.”

GERMANY survey respondent

FIGURE 17: AREAS OF RECRUITMENT
PERCENTAGE

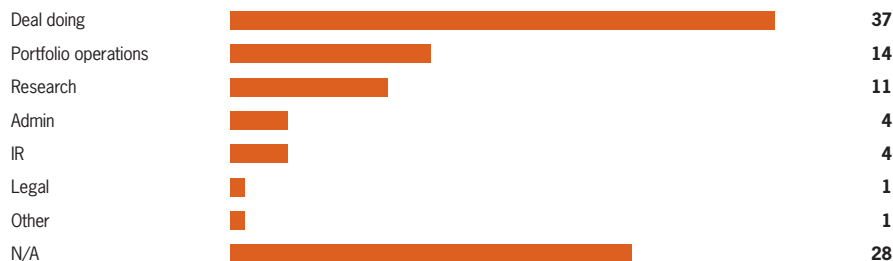
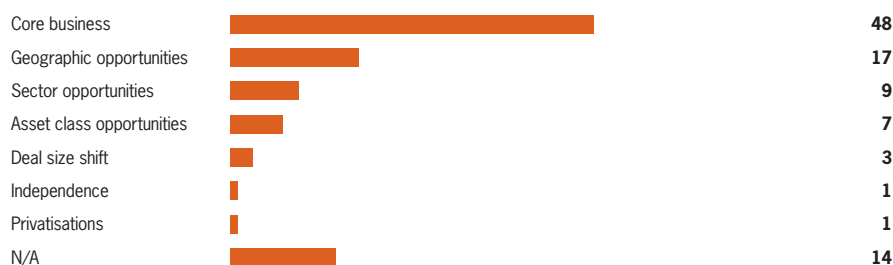


FIGURE 18: AREAS OF NEW BUSINESS DEVELOPMENT
PERCENTAGE

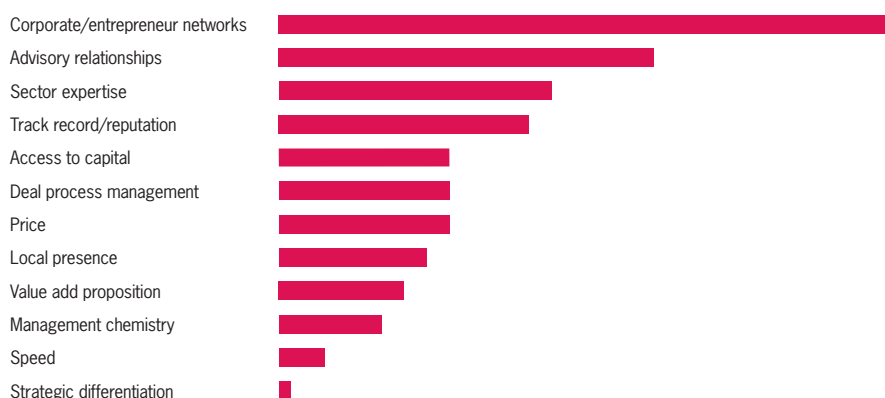


The bulk of the other key challenges faced by the industry relate to the need to demonstrate performance in today’s highly competitive environment. Given this backdrop, it is no surprise that the key focus of, and opportunities pursued by, private equity firms relate to their core business. While the drivers are somewhat different in the emerging and more developed markets, the shared outcome is a perceived need to sharpen deal origination and portfolio management processes, with many firms being in the process of augmenting their teams in these areas. In the mature markets, the long-term process of institutionalisation has seen teams expand in many areas to support larger portfolios and fundraising ambitions. Paradoxically, there is an opposing pressure to minimise back office costs. In the emerging markets, the rapid development of private equity has required GPs to work to ensure that their own development in human capital terms keeps pace.

GPs that are looking to diversify their areas of interest as the global macro trends play out are most likely to look for similar opportunities within new geographies. Wherever the focus, the common factor is the need for communication, whether that be introducing the asset class, re-educating stakeholders, or demonstrating the ability to generate returns.

Western Europe: Investment activity

FIGURE 1: KEY FACTORS IN IDENTIFYING AND WINNING DEALS



“I believe secondary and tertiary deals will continue to be very important, particularly for larger mid-market deals. In 2010 the largest proportion of deals above Euro 75m was accounted for by secondary buyout activity. Under Euro 75m a lot more deals were primary transactions. The fact is that we’re seeing corporates being less focused on divestiture, but much more acquisitive.”

UNITED KINGDOM survey respondent

“There’s more competition from trade buyers, and I expect this to continue to increase. Trade players are getting more confident, and unless the economy ends up in a double dip, I can’t see this changing – they’ll be out in force. There are lots of private equity houses with money, but this can only dwindle over the medium- to long-term, not increase.”

UNITED KINGDOM survey respondent

Confidence in the prospects for dealflow over the coming year is returning slowly amongst European private equity firms with around half expecting an increase in activity. Although this is the lowest level recorded in any of the key global markets, very few people actually expect to see investment levels decline. Anticipated sources of dealflow are particularly varied in Europe. However, most strikingly the importance of secondary buyouts is higher than in any other market.

With dealflow in the region being generally hard won, private equity firms have sought various ways to get ahead of the competition. In the first instance this involves building and consolidating networks both within the corporate and advisory communities. However, whilst track record is still very important, there is also an increased emphasis on building knowledge of markets and the dynamics of individual businesses and their management at an early stage in the process.

Ultimately, most deals will go through some form of intermediation and market testing of the price. This is the case not least because trade buyers have returned as a key competitor to private equity, and one with deep pockets for the right asset strategically.

“It’s a combination of factors, but really it comes down to your networks, increasingly your sector knowledge and focus, rigour, discipline and tenacity. Clearly you can’t discount the value of intermediary networks, but GPs are spending a lot more time on non-intermediated deals these days. There will always be auctions, but you want to try to avoid them if you can, or at least make sure you have a head start.”

UNITED KINGDOM survey respondent

“Deal sourcing is the same now as it’s always been for us. It’s about being as early as you can on an asset, and not waiting for the pitch from banks. It’s about spending more time with management teams and vendors to understand the asset before it comes to market, which means you’re more prepared and can move faster.”

FRANCE survey respondent

“The market in Italy is split between those deals that are marketed above and below the radar. For the former you obviously need to have a strong relationship with the intermediaries, but these are more commodities. The real key in Italy is to have a big network of contacts among the entrepreneurs.”

ITALY survey respondent

“It will mainly be secondaries. Most German corporates have completed their disposal programmes and entrepreneurs are reluctant to sell assets only to see their money get sucked into sovereign debt crises!”

GERMANY survey respondent

FIGURE 2: SOURCES OF DEALFLOW
PERCENTAGE

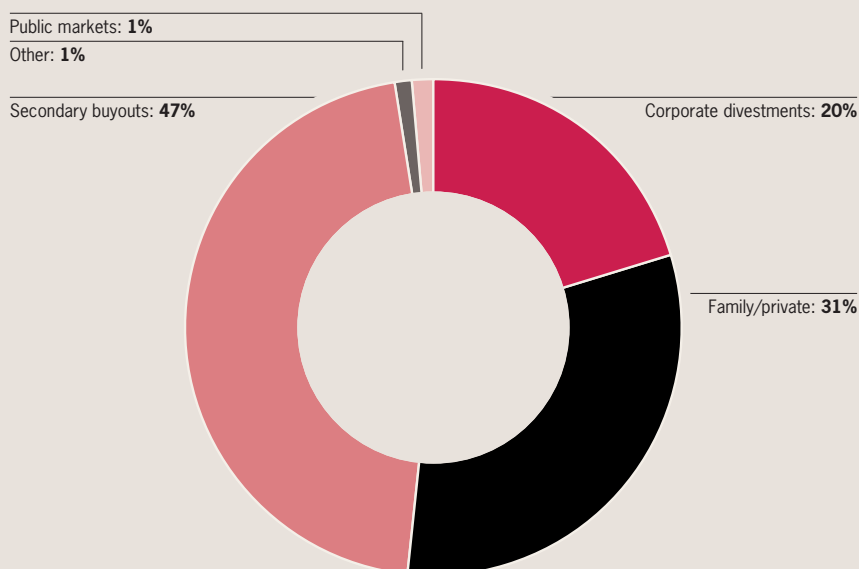
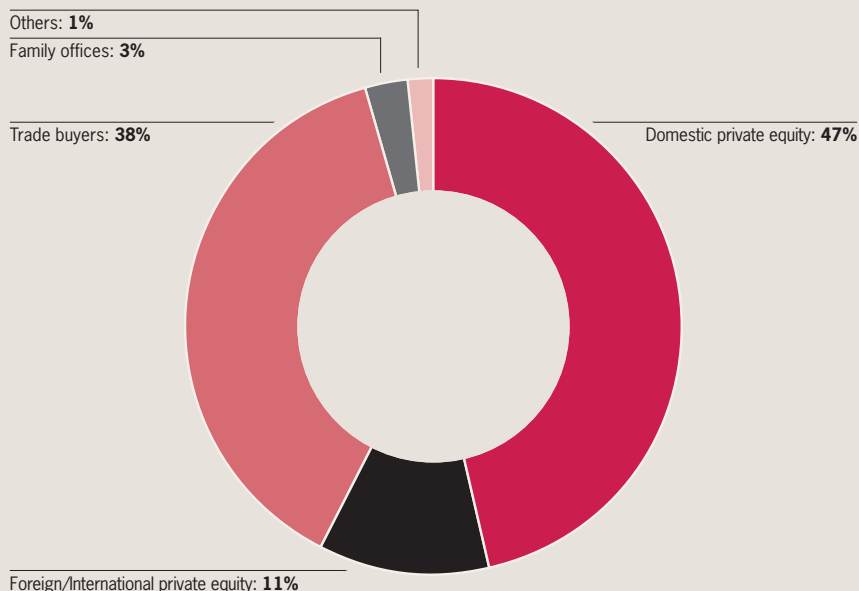


FIGURE 3: SOURCES OF COMPETITION
PERCENTAGE

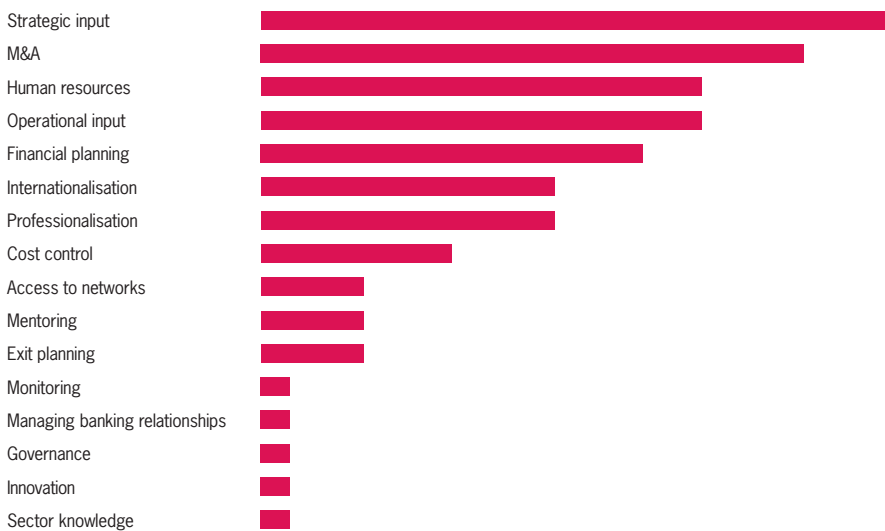


“Speed is key in deal origination. It is a very competitive market and so getting to deals early is crucial. Strong relationships with intermediaries is a key part of this.”

PAR EKENGREN
HEAD OF CORPORATE FINANCE
GRANT THORNTON, SWEDEN

Portfolio

FIGURE 4: AREAS OF HANDS-ON INVOLVEMENT



Hands-on involvement with portfolio investments has risen to relatively high levels in Europe versus other parts of the world and is expected to remain so, with the key focus of GP efforts typically on strategic input and M&A. Assistance with financial planning has also been significant, with the majority of GPs reporting that debt renewal will not be an issue over the next 12 months.

European private equity firms are more cautious regarding portfolio prospects than their counterparts in other parts of the world, with the macro economic environment being cited as the chief driver of sentiment.

“The nature of the value drivers depends on the business and what you’re trying to do to it. In some cases it could be a mixture of multiple arbitrage and M&A; in others it might be more organic. You need to build a growth strategy to suit the individual company.”

MO MERALI
PARTNER, HEAD OF PRIVATE EQUITY
GRANT THORNTON, UK

“Growing market share through innovation is fundamental. The businesses I like are in big markets with lots of players, some big groups with lots of legacy systems, and you find someone smaller with an innovative approach. The majority of deals we do like this would succeed even if the market stayed flat in my personal view.”

UNITED KINGDOM survey respondent

Portfolio M&A support is seen to be more important amongst European private equity firms than elsewhere. In particular, crossborder M&A is seen as an increasingly relevant feature. However, with this comes the additional challenges of cultural issues and relative complexity. These are perhaps thrown into even sharper relief when transactions are being considered beyond European borders in markets such as China, which is now on the radar for an increasing number of GPs.

“There are massive cultural differences between China and the West. You can’t afford to ignore China and you need to understand it as best you can. Doing business in China is not to be taken lightly.”

UNITED KINGDOM survey respondent

“The benefits of cross-border M&A really depend on the company – if the company is already international, then it is almost business as usual... they will understand what they are doing and there is a good basis of due diligence to draw upon. If the company is venturing abroad for the first time or it is the first acquisition, it is more tricky. There is more work to be done with the management team to convince them and us that it is a good thing to do.”

FRANCE survey respondent

FIGURE 5: PORTFOLIO VALUE DRIVERS
PERCENTAGE

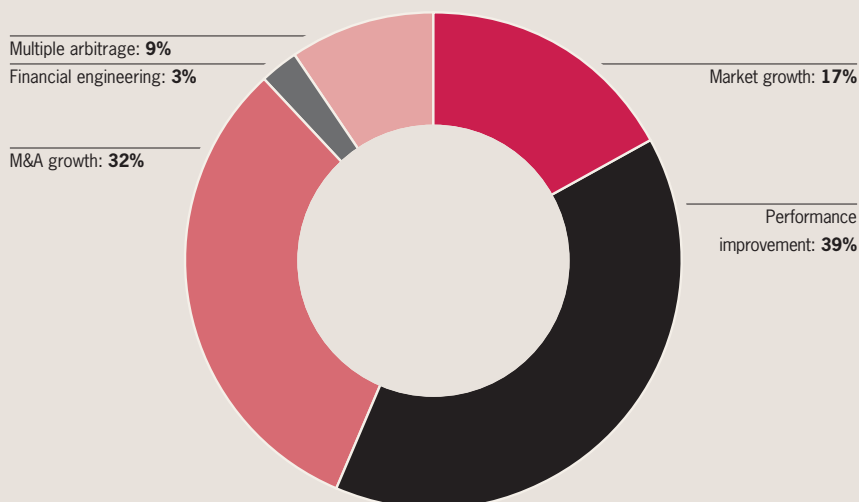
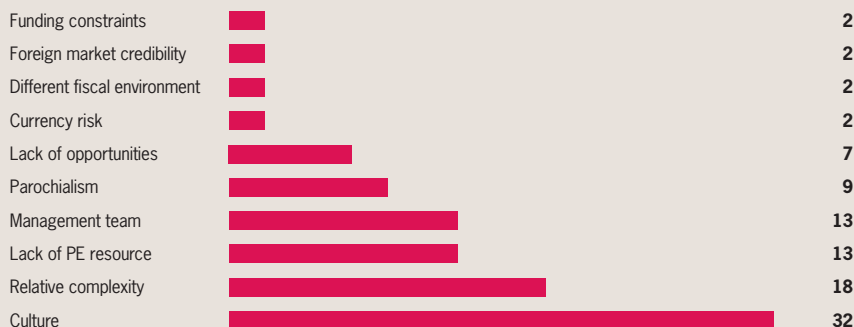


FIGURE 6: CHALLENGES TO CROSS BORDER M&A
PERCENTAGE



“The main thing is to get the right strategic equity story to be developed and executed. We are keen to pursue a long-term plan that is signed off by both the management and ourselves.”

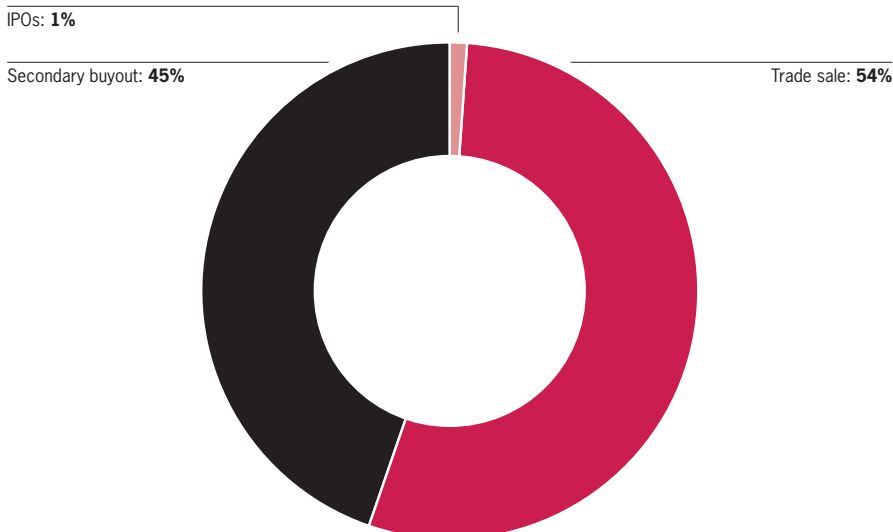
GERMANY survey respondent

“As a whole, and not just in terms of the weak GDP announcements recently, the economy is shaky and confidence is low – I just don’t think it feels good.”

UNITED KINGDOM survey respondent

Exit

FIGURE 7: EXIT ROUTES
PERCENTAGE



Sentiment regarding prospects for the exit market are generally positive, with a window of opportunity seen to have opened up over the last year. Around three-quarters of European respondents also expect exit levels to continue to increase over the coming year, which compares favourably with their counterparts elsewhere.

“Secondaries are driving the market because on one side you have people who need to return capital in order to fundraise and on the other you have people who need to deploy capital.”

SWEDEN survey respondent

“The main cons of secondary buyouts are that they almost always come via highly contested auctions and are therefore expensive. On top of that, the former owner has normally done a good job with the business making it difficult to see further growth. Sometimes though, it is just a question of fit and it can really work better for the second buyer than the first.”

GERMANY survey respondent

The two key drivers of these exit trends are: first, the return of trade buyers, which, while increasing competition on the buy-side, is also proving a willing source of liquidity for private equity assets, and; second, the pressures being felt by many private equity firms in relation to their own fundraising cycles and the need to both deploy capital and demonstrate returns. The IPO window is seen to be very firmly shut in Europe, with the consequence that, in comparison, secondary buyouts have taken on an added significance.

The cocktail of competition and pressure to exit is resulting in considerable variation in expectations for returns going forward. There remains a sense that there will be winners and losers and that a final shake out within the industry is still to happen.

“Returns have, fundamentally, been pretty strong. If the exit markets aren’t great then, by and large, private equity firms just sit on investments for longer and wait until they can get value.”

KAI BARTELS
SENIOR PARTNER, HEAD OF M&A
GRANT THORNTON, GERMANY

“I think returns will stay the same in the short term, but longer term they will decrease. The best performers will maintain their high returns, but the discrepancy between the best and the worst will increase.”

FRANCE survey respondent

“I think exit levels will increase because of the maturity profile of portfolios at the moment. There have certainly been some great exits recently. The challenge is always having the patience to allow companies to mature.”

UNITED KINGDOM survey respondent

Fundraising

FIGURE 8: AREAS OF INCREASING LP DEMANDS



Unsurprisingly, European private equity practitioners continue to regard the fundraising environment as tough by historical standards. With many investing institutions still working through their own problems, while they remain positively disposed towards private equity, they are having to look closely at the number and size of their commitments to the asset class.

For GPs, this sentiment means higher levels of LP churn within their investor bases as institutions contemplate future funds. GPs are readying themselves for the prospect of needing to identify a higher proportion of new investors than in the past and the likelihood of a stagnation in fund sizes.

In addition, GPs are reporting a higher degree of LP engagement. A greater desire amongst investors for transparency and depth of information is the key trend here. While areas such as performance clearly continue to be of key importance to LPs, there is also an increasing focus on ‘new areas’ such as ESG and the management of the private equity firm itself.

“It’s very difficult at the moment. But if you look at the past, LP appetite has normally returned 9-12 months after M&A activity has kicked back into gear and liquidity rises. With any luck that will be felt in the next year.”

GERMANY survey respondent

“We’ve just come off a fundraising and it’s incredibly competitive out there. Pretty much every LP in the world is reducing the number of GP relationships they have and will only consider re-ups and new relationships with top-tier managers, so it’s very very tough.”

UNITED KINGDOM survey respondent

“ESG matters are becoming much more important. We signed the UN PRI last year and contributed to AFIC’s White Paper on ESG. We have a dedicated in-house team and are doing a big appraisal on the subject now. It is extremely important for the image of the industry and to satisfy the LPs.”

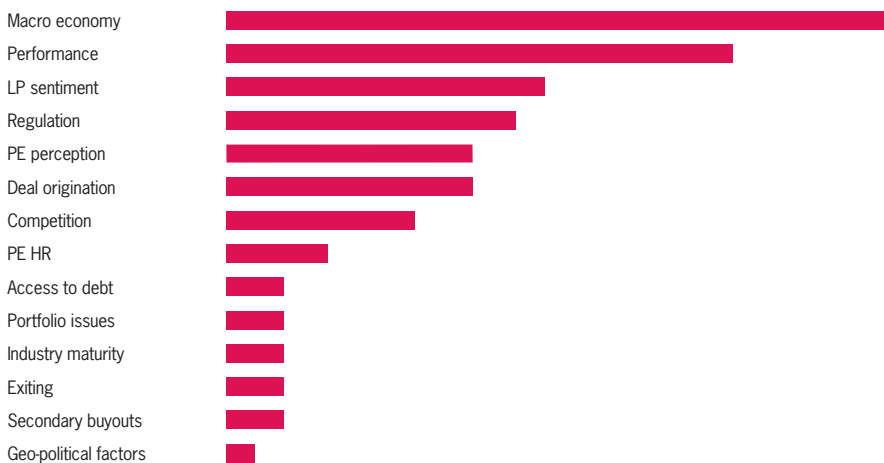
FRANCE survey respondent

“LPs are drilling into companies more than they have in the past – what makes them tick, why we did the deal, where the key threats are. However, most LPs have 70-80 fund interests, and they just don’t have time to sit down with every one of their GPs and go through things in such detail.”

UNITED KINGDOM survey respondent

Overall market outlook

FIGURE 9: KEY CHALLENGES FACING THE PRIVATE EQUITY INDUSTRY



“Regulation is terrifying. The mindset out there is that what private equity does is terrible. How we combat this I don’t know. What is certain is that regulation of the industry is going to become a lot more rigorous.”

UNITED KINGDOM survey respondent

“We are working on increasing our build-up programme for the portfolio and trying to profit from the fact that very good companies are struggling to raise bank funding and therefore are turning to growth capital providers for the first time.”

SPAIN survey respondent

Reflecting the underlying positive sentiment with regard to expected deal and exit activity, private equity firms are building capacity in order to capitalise on the opportunities ahead. In particular, around two-thirds of European respondents are planning to increase their head count over the coming year, with this predominantly being in the core area of front-line deal-doing.

With increased emphasis being placed on self-origination strategies and recruitment, it is no surprise that the majority of private equity firms stress the importance of focusing on their core business of identifying quality businesses within their target market.

Private equity players are currently faced with a plethora of challenges, some private equity specific, some regulatory, and others reputational. However, the most significant factor relates to the challenges presented by the state of the macro economy.

Regulatory matters are high on the agenda of GP concerns, not least the introduction of the AIFMD. This particular initiative is expected not only to lead to higher levels of bureaucracy and increased costs, but also to frustrate the dynamism of the industry by raising barriers to entry for first time managers and spin-outs.

“We have been through the worst downturn since WWII and companies have demonstrated they have the DNA to survive in a market that gets little support from government. The main opportunity is to harness the strength of those businesses and help them into new markets.”

ITALY survey respondent

“You can see that the AIFMD represents a challenge, but it will help generate a better understanding of the industry.”

SWEDEN survey respondent

“Competition is the biggest issue facing the industry. You can really see the need for consolidation in the market – there are too many players with too much committed capital. Those funds with capital still to invest will be under pressure, and this will drive up prices.”

RAINER WILTS
PARTNER
GRANT THORNON, GERMANY

FIGURE 10: IMPACTS OF EU REGULATION
PERCENTAGE

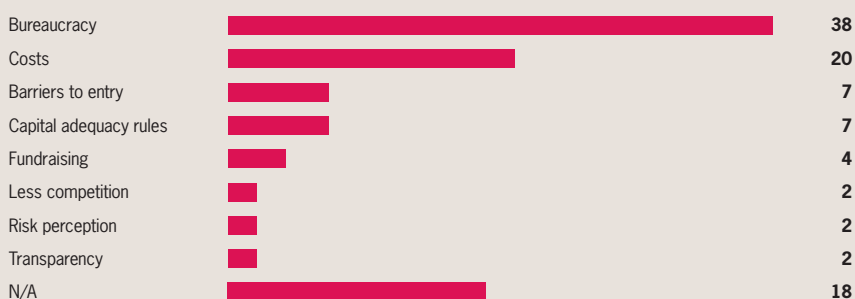
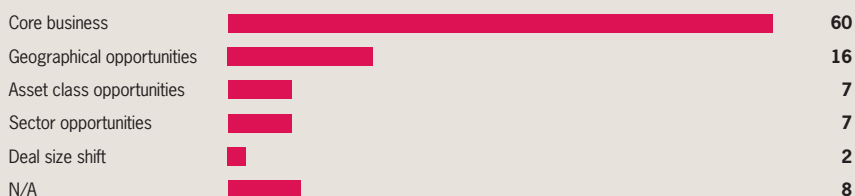


FIGURE 11: AREAS OF NEW BUSINESS DEVELOPMENT
PERCENTAGE

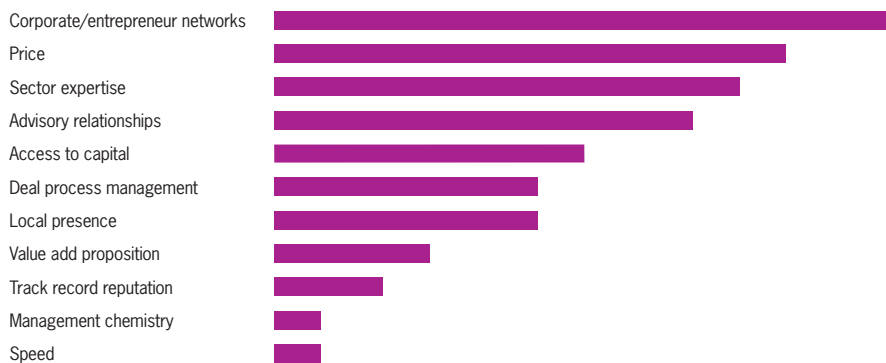


“In these difficult economic times, private equity is faced with not only an origination issue, but also pressure from investors, regulators and the broader public. The industry is therefore being challenged to visibly prove the model and demonstrate it can add value regardless of broader economic conditions.”

THIERRY DARTUS
HEAD OF TRANSACTION ADVISORY SERVICES
GRANT THORNON, FRANCE

North America: Investment activity

FIGURE 1: KEY FACTORS IN IDENTIFYING AND WINNING DEALS



“I think PE investment activity over the next 12 months will be increasing. I still think there’s lots of dry powder out there and banks are still lending as the debt markets have softened a bit. The economy is in good shape in Canada but it’s all subject to company availability – whether there are companies available to buy. Valuations are strong so vendors are getting what they’re looking for and generally there’s a willingness to transact.”

CANADA survey respondent

“Origination is sector led. We’re calling on companies in specialist areas where we’ve invested before and built domain knowledge, that’s how we differentiate. We’re proactive in terms of identifying companies we’re interested in and building up relationships over time, several years prior to any investment opportunity. By the time an opportunity does arise, we already know each other, and that provides an advantage.”

UNITED STATES survey respondent

Price remains king in North America’s highly intermediated and efficient market and is seen by many as the key factor in winning deals. However, evidence suggests a GP’s sector expertise, as well as the quality of its corporate networks, are central elements of their approach to deal origination.

“I think there are two key areas in terms of deal sources: sponsor-to-sponsor deals will be the biggest area, followed by independent family-owned businesses. For sponsor-to-sponsor, the market’s been so negative that they haven’t been able to sell and so now’s the time. Independent family-owned businesses may be a driver of deals as there’s uncertainty around so this may drive things through.”

UNITED STATES survey respondent

“As it always has been, winning deals comes down to who pays the highest price. Of course, you need to be in front of the right intermediaries, but price is by far the biggest determinant of success.”

CANADA survey respondent

Within the North American market, the private equity industry is well engrained as a key funding source – some estimates suggest that around half of US mid-market companies are owned by private equity. North America is one of the most bullish markets at present with regard to anticipated investment activity levels, and certainly seems to be a step ahead of Europe in terms of confidence.

Reflecting this, and its position as the most established private equity market, the region is seeing high levels of competition between domestic private equity groups, either on a national basis or within particular regional markets. As a result, there is evidence of some groups increasingly casting their net wider for indefinite opportunities including in some US cases looking north of the border into Canada.

Family- and privately-owned companies are expected to be the principal source of deals this year. Secondary buyouts are also a significant feature reflecting sophistication and competition within the market.

“I think most competition will definitely come from competing PE firms due to the capital overhang – this needs to be put to work in the next 18-24 months. There’s lots of competition on the sponsor front. Strategics are also a competitive force – they have lots of cash on the balance sheet and can come in and pay a premium; they can swoop in at the last minute.”

UNITED STATES survey respondent

“For us it comes down to finding the right qualified CEOs to do deals with. That’s the key to our business, and hence more networking and research continues to be what we focus on to try and seek out opportunities.”

UNITED STATES survey respondent

FIGURE 2: SOURCES OF COMPETITION
PERCENTAGE

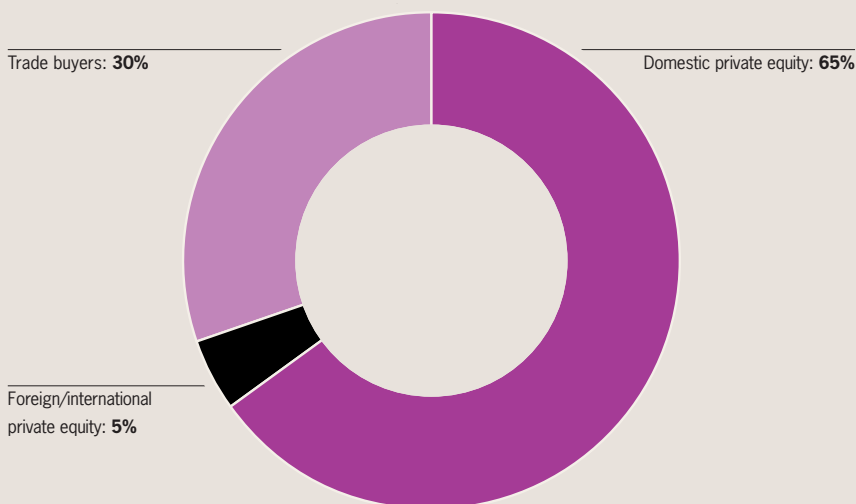
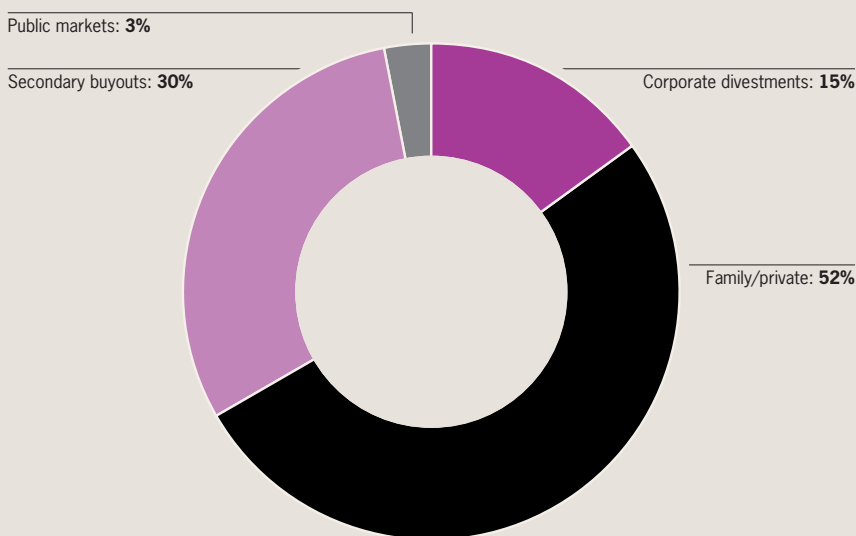


FIGURE 3: SOURCES OF DEALFLOW
PERCENTAGE

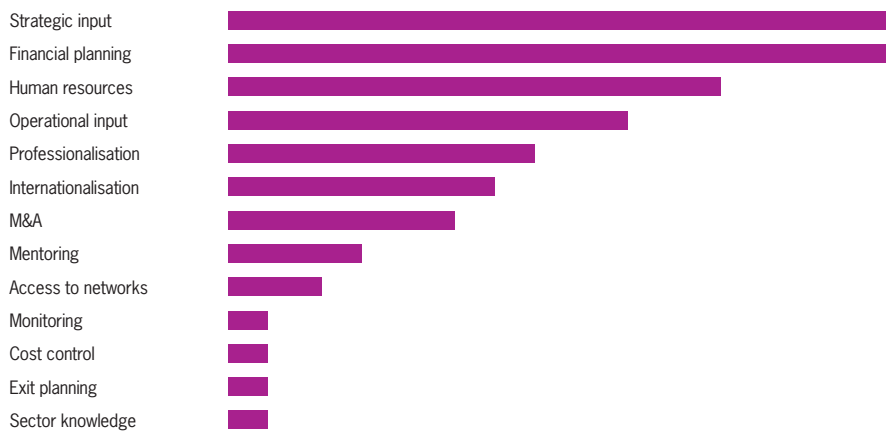


“Competition for deals over the next 12 months will come from other PE houses due to the large number of funds with money that are approaching the tail-end of their investment periods. There’s an urgency to get deals done and this has led to larger funds moving down-market.”

EMILIO IMBRIGLIO
PARTNER, HEAD OF ADVISORY SERVICES
GRANT THORNTON, CANADA

Portfolio

FIGURE 4: AREAS OF HANDS-ON INVOLVEMENT



North American groups typically regard themselves as hands-on investors, and don't expect this to change. Key areas of portfolio value add are the strategic input that GPs can bring, plus financial planning skills. Given the focus of private equity groups on actively driving organic growth within portfolio companies, M&A input appears to be relatively less significant in North America than in Europe.

Despite this, cross-border M&A within private equity portfolios is expected to increase by 40% of North American responding GPs, with this typically being focused on the US and Canadian markets. There are lower expectations of international acquisitions beyond North America, often as a result of the perceived relative complexity and cultural issues associated with such deals, and a lack of dedicated resource on the ground to overcome these challenges.

"Firstly, we have a disciplined 100-day plan that we like to put in place with all our companies. Secondly, we ensure there's an appropriate capital structure in place and strong financial engineering. Thirdly, we share a strong sense of discipline with our portfolio companies."

CANADA survey respondent

"Building value comes down to market growth and performance improvement, not multiple arbitrage. Value-add is definitely rooted in the portfolio management expertise that you can bring to bear, but also from the buy-and-build philosophy – tuck-in acquisitions that solidify your standing as an industry leader."

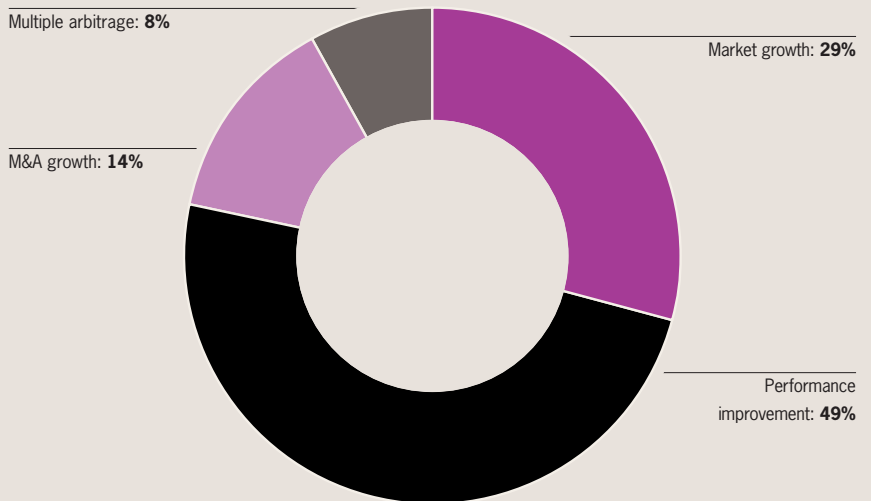
UNITED STATES survey respondent

"The key drivers of value growth come from operational improvements such as sales and marketing processes and resource, production and sourcing. You can get a big acceleration in profit growth this way, particular when the market is less robust."

UNITED STATES survey respondent

On balance, North American private equity firms are amongst the most bullish about the prospects for their portfolios given the current macro economic scenario. Value is seen to be driven largely by company performance improvement with sponsors actively engaged in this process, often via the deployment of dedicated portfolio management executives.

FIGURE 5: PORTFOLIO VALUE DRIVERS
PERCENTAGE



“We help to round out a management team. Smaller, private businesses tend to have core strengths as well as areas of weakness. For instance, a company might be strong on sales and marketing, but weak on operations, or have failed to take care of the financial side of things. We help to recruit and evaluate new talent to strengthen the executive team. Secondly, we also help to prioritise initiatives, initially through 100-day planning. We then evaluate what we can do to support these initiatives.”

UNITED STATES survey respondent

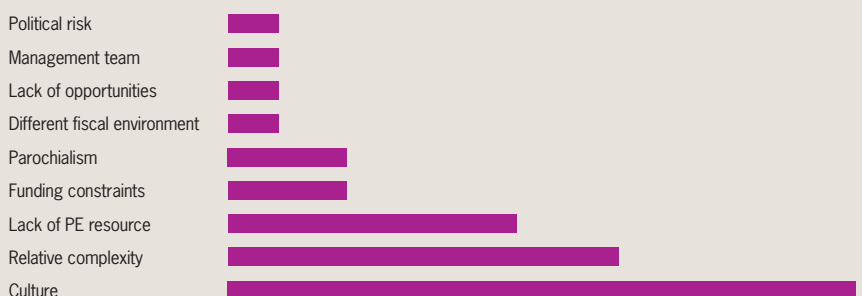
“How do you add value? It’s about building professionalism within the team, putting the right systems in place to monitor and manage performance and being able to drive growth.”

MENDY KWESTEL
PARTNER, TRANSACTION ADVISORY SERVICES
GRANT THORNTON, US

“The biggest complexity with cross-border M&A is that you have no team on the ground. Integration is an issue. It’s a huge investment by the management team, the time it takes to get on a plane and go where you need to be. There are cultural differences and nuances too.”

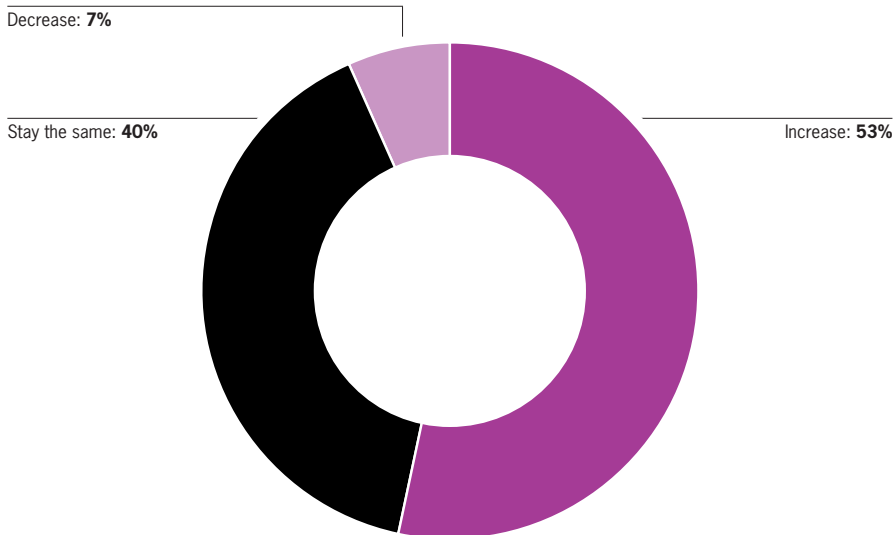
UNITED STATES survey respondent

FIGURE 6: CHALLENGES TO CROSS BORDER M&A



Exit

FIGURE 7: EXIT ACTIVITY
PERCENTAGE



While over half of North American private equity firms surveyed anticipate an increase in exit levels, this proportion is lower than the global average. However, this year has seen a relatively benign exit environment, with respondents believing that conditions will remain positive. Interestingly, North American GPs have the lowest expectations globally of exit volumes from their own portfolios over the coming year, possibly as a result of their anticipated focus on completing new deals.

Sponsor-to-sponsor deals and sales to strategics are expected to dominate the exit market, with IPOs less likely, despite showing promise at the start of 2011.

Expectations for returns amongst private equity firms remain reasonably positive, with almost 40% of respondents predicting rising returns going forward. However, some highlight potential downward pressure on returns, reflecting high entry valuations, while others note that any increase will be from a low level, with portfolio valuations having been marked down in many cases in recent times.

“Private equity firms need to demonstrate realisations to get LPs to commit to the new funds, and the opportunities to exit are as good as they’ve been in the last five years. It’s the flip side of the high levels of competition amongst PE houses. Added to the strong demand amongst financial buyers is the growing demand amongst trade.”

TROY MACDONALD
NATIONAL CORPORATE FINANCE PRACTICE LEADER
GRANT THORNTON, CANADA

“Returns are on the way up. Most folk have marked their valuations down hard and they don’t want to have to write anything down twice. So many assets are probably being held on books for less than market value. It’s going to be good for investors when assets are sold and that will boost returns figures.”

CANADA survey respondent

“I think average returns will get a little better. The economy has been tough and the long term trend has been compression. Last year there was a smart snap-back in value.”

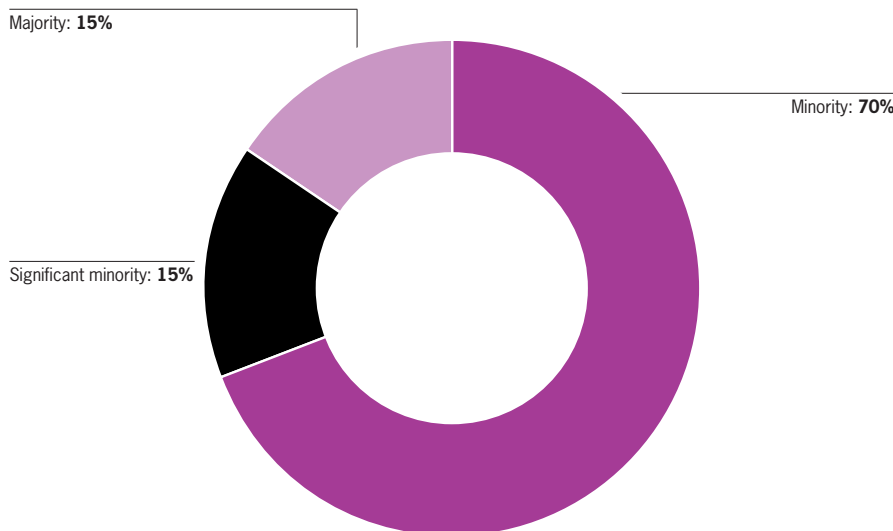
UNITED STATES survey respondent

“Sponsor to sponsor deals will be key as we’re coming up to the end of the investment periods for lots of funds. I don’t think it’ll be IPOs, not after what’s happened in recent times. Strategics will also be an important exit route.”

UNITED STATES survey respondent

Fundraising

FIGURE 8: PROPORTION OF LIKELY FIRST TIME INVESTORS IN NEXT FUND
PERCENTAGE



Fundraising is characterised as having been tough and likely to remain so, with about half of respondents seeing the environment as negative and none as very positive. Given this, it is unsurprising that there is some evidence of stagnation in fund sizes, with under half of private equity firms expecting their next fund to be larger than its predecessor.

North America's institutional investor community is undoubtedly the world's largest and most sophisticated. Proximity to this pool of capital is reflected in North American GPs having a high proportion of domestic investors and also a relatively high level of confidence in their ability to generate strong re-up levels.

However, the more sophisticated investors have been at the forefront of efforts, such as ILPA, to bring greater transparency to the LP-GP relationship. Half of respondents report that LP demands continue to increase, with the depth and breadth of GP reporting being the principal focus of attention.

"In the area of reporting, LPs want greater clarity and commitment to strategy. They want manager alignment with their interests and they're being more demanding about written documents. As for negotiating on management fees, if it's not the 'standard deal' then LPs won't look at you. You've got to be doing it the standard way; you've got to tick the box."

CANADA survey respondent

"Fundraising seems to have improved recently but it's still very challenging. The Canadians need to raise from sources outside of Canada because so many of the big investors have their own direct operations. This makes it an extra struggle."

CANADA survey respondent

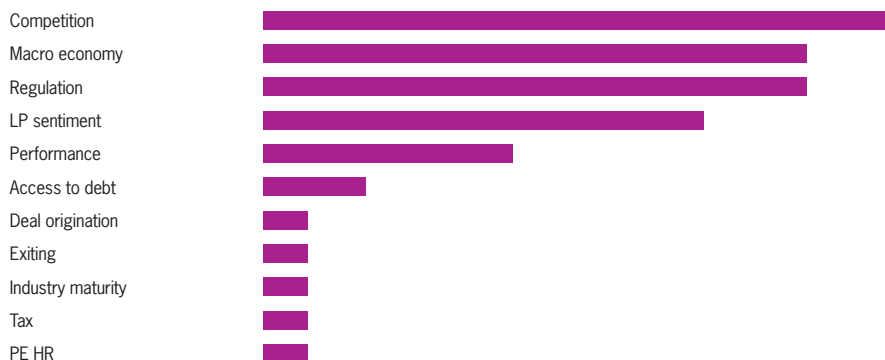
"I think LPs are looking for more specific differentiation of strategy and more realised returns. It used to be the case that you could fundraise with a strong mark-to-market portfolio. Now LPs want to see deals that have been sold."

UNITED STATES survey respondent

Overall market outlook

Not surprisingly, competition is ranked as the most significant challenge facing North American private equity players, whereas across all global respondents concerns about the macro economic situation remain paramount.

FIGURE 9: KEY CHALLENGES FACING THE PRIVATE EQUITY INDUSTRY



“Certainly the competitive outlook is much greater than ever. There’s an enormous capital overhang, coupled with low lending rates, coupled with strategics. When you add all those things together it leads to valuations that are beyond what we think is rational. On the regulatory side, I think that is threatened rather than actual. We’re hearing about Dodd-Frank, but it’s similar to the talk on carried interest and tax, we haven’t seen it yet.”

UNITED STATES survey respondent

“I don’t think the US PE market is diminishing, but there is a definite elimination of lesser performing funds. There’s an excess of funds right now in the US and so there’s a purging going on.”

CANADA survey respondent

“Our firm is really focusing in on the regulatory environment. ILPA pales into the background when you consider registration issues. We’ll be investing in the back office in terms of how documents are stored, how data is stored, how we report to LPs. We’ve been transparent in this regard but now that it’s coming directly from the Government it’s going to be a headache for our team. It will drastically affect our business – just the cost of being in business.”

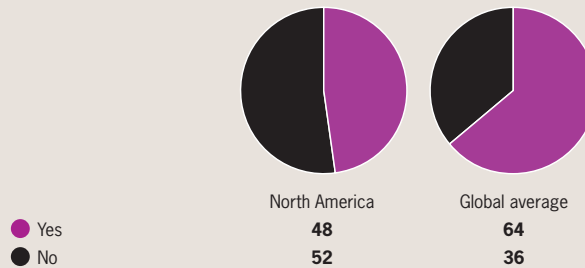
UNITED STATES survey respondent

In a market which is as highly competitive as that of North America, GPs' plans largely reflect the perceived need to stick to what they know and ensure that they are able to compete on every front. US GPs are typically more sophisticated organisationally than firms in other parts of the world, but half of the North American respondents do still expect to increase head count over the next 12 months. While this proportion is slightly lower than elsewhere, it involves a broader range of appointments, including in areas of portfolio management and back office research, as well as front line deal doing.

"I think we'll grow our headcount a little bit but not by too much. We'll probably take on one new junior, one mid-level career, and one person in operations. We're going out to market again next year so we want to be ready."

UNITED STATES survey respondent

FIGURE 10: HEADCOUNT INCREASE PERCENTAGE



"To remain ahead in today's uneasy and highly regulatory environment, the core focus of private equity firms should be looking to the fundamental strategies to facilitate a constant and incremental plan for growth and improvement – whether that be through operational improvements, origination, deal making, or overall portfolio management. There is always going to be a big market in the US. It remains inherently attractive, with stability and liquidity. It will always be attractive."

WINSTON WILSON
PARTNER, ASSET MANAGEMENT SECTOR LEADER
GRANT THORNTON, US

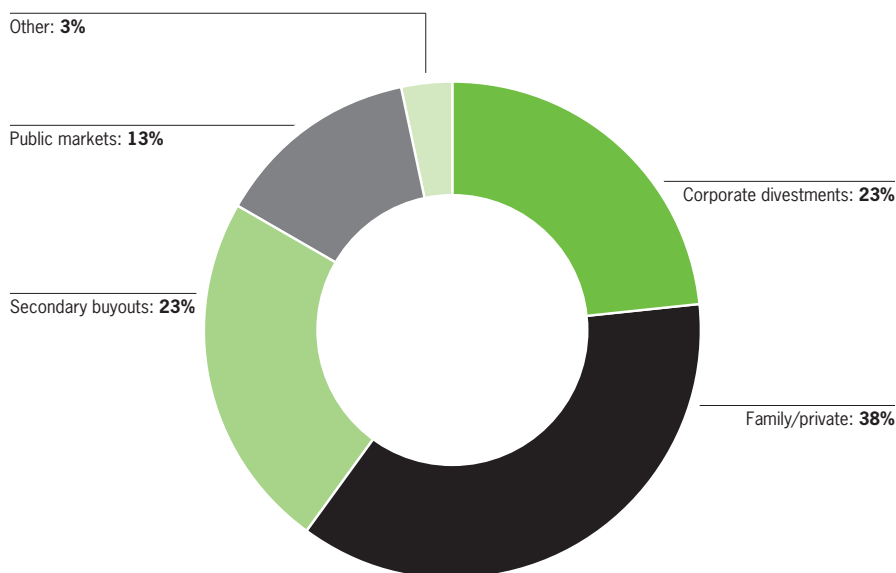
Asia Pacific: Investment activity

Approaching two-thirds of Asia Pac respondents expect deal activity levels to increase over the coming year, with the region receiving increased attention as concerns of over-heating have crept into the larger neighbouring Chinese market. This is supported by the belief that foreign investors will be increasingly active in South East Asia in particular.

The emerging nature of many of the Asia Pac markets is perhaps reflected in the fact that GPs in the region expect to originate from a broader range of sources than is evident in other markets. Linked to this is the clear need for strong networks and a presence on the ground. Also the ability to demonstrate a track record is seen as a differentiator in a market where such experience is still being built.

The Asia Pac region incorporates a diverse set of markets, both in terms of their economies and the nature of their private equity industries. This is highlighted in a couple of areas, including sector trends, with areas such as mining and healthcare presenting opportunities in Australia, while the burgeoning middle classes of South East Asia are driving interest in consumer businesses. While Australian private equity firms predict a decline or plateauing of entry multiples, there is more evidence of upward pricing pressures elsewhere in the region.

FIGURE 1: SOURCES OF DEALFLOW
PERCENTAGE



“I think corporate and private vendors, public markets and secondary buyouts will all be important sources of deals over the next year. In particular, I suspect if you look out over the coming 12 month period you’ll see corporate divestments and public-to-private deals as particularly significant.”

AUSTRALIA survey respondent

“In Australia, the two-speed economy is alive and well. On the slow-speed side, there will be very little activity in a sector like retail, with the exception being defensive areas such as budget retailers and healthcare. Most activity is going to be in the fast-speed areas such as mining – certainly you can’t get away from mining.”

AUSTRALIA survey respondent

“You need to get out and get your hands dirty to find the quality deals in this market. The key thing is to have access to a good network of contacts. There are hundreds of potential deals there, but the trick is identifying the few good ones.”

KON YIN TONG
CORPORATE FINANCE DIRECTOR
GRANT THORNTON, SINGAPORE

“Without giving away any trade secrets, I’d say that overseas funds that want exposure to the resources sector in Australia presents a big opportunity. There are a lot of people that want to get a piece of this right now.”

AUSTRALIA survey respondent

“The attraction of the FMCG sector is driven by the rising spend capacity of the middle class in this part of the world.”

SINGAPORE survey respondent

“It’s a difficult market and information is very closed so you need a strong research capability, good local network and understanding of the local business culture in order to find deals.”

VIETNAM survey respondent

“I see the main sources of deals as being the de-listing of PLCs, corporate M&A and also PIPE deals.”

SINGAPORE survey respondent

FIGURE 2: ENTRY MULTIPLES
PERCENTAGE

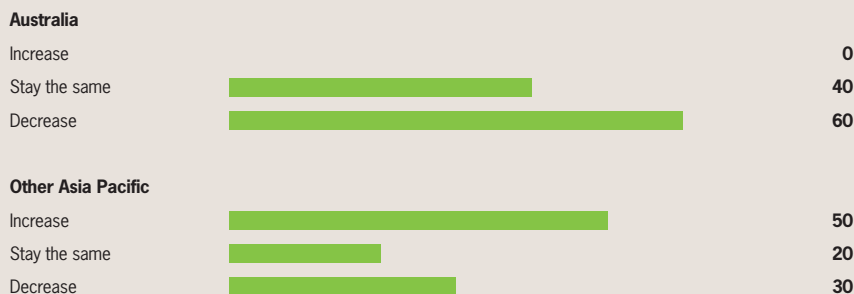
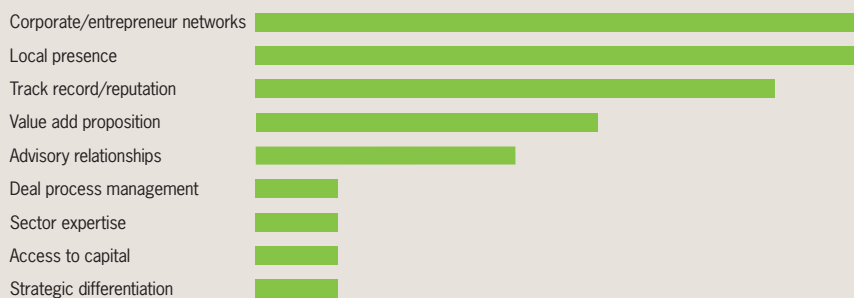


FIGURE 3: KEY FACTORS IN IDENTIFYING AND WINNING DEALS
PERCENTAGE (MULTI RESPONSE QUESTION)



“Dealflow will come mainly from entrepreneurial businesses needing capital. Interest rates are very high so private equity is an attractive source of funding.”

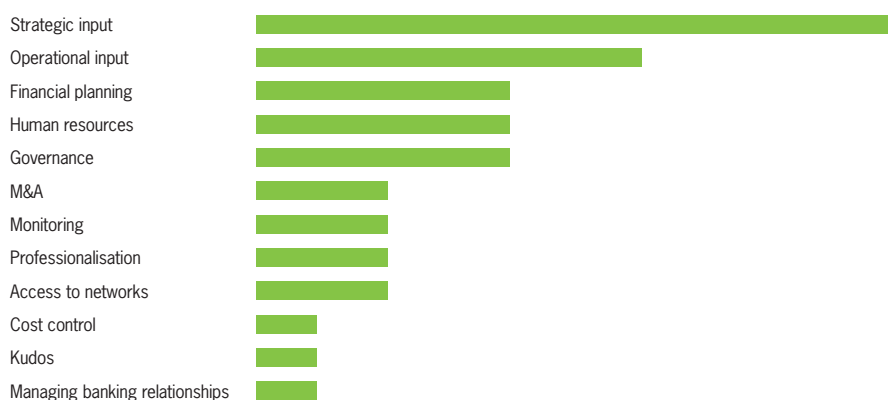
VIETNAM survey respondent

“The key factors you need for accessing deals here are dealflow networks, an ability to add value, track record and a strong brand name.”

SINGAPORE survey respondent

Portfolio

FIGURE 4: AREAS OF HANDS-ON INVOLVEMENT



“Given the size of business we back, it tends to be the first time they’ve been owned by anyone other than the family or founders. So a lot of our resource goes into putting in place the right systems and infrastructure. Many of them haven’t had regular boards and reporting regimes, so we work with the managing director and financial director to introduce a lot more rigour to the reporting. It’s not that we spend three months looking backwards, but having a historically accurate picture of trading performance helps you to make more informed decisions about the future.”

AUSTRALIA survey respondent

Despite the non-control nature of many South East Asian transactions, around a third of respondents from the region are seeking to increase their level of hands-on involvement, with a number also having established dedicated portfolio management teams to work alongside deal executives.

While ‘governance’ remains the most important element of ESG for private equity houses in the region, mounting pressure from the LP community, together with perceptions of ‘best practice’, are putting the spotlight on social and environmental issues as well. In Australia, in particular, the political climate has served to reinforce this with the Green Party holding the balance of power.

With much of the Asia Pac region, at least outside Australia, characterised by growth capital transactions, it is unsurprising that market growth is a common driver of value. While company performance improvement is still relevant across the region, it is much more likely to be the dominant value driver in Australia.

“There are counter-balancing factors at work. We continue to see strong growth in China, fuelled by domestic consumption. However, with the continual turmoil in the US and the Euro-zone, South East Asia may not be fully insulated given the export nature of the region.”

SINGAPORE survey respondent

“We take controlling interests and have two or three people on operations. We will be increasing this operational resource because we see it as an advantage for us. That said, it is not without its challenges and some others will say that they see their job as backing good management teams, rather than getting operationally involved themselves.”

AUSTRALIA survey respondent

“The most important thing we bring is the capital the company needs (and anyone who says otherwise is falling prey to their own marketing hype). Then it is about helping the businesses improve their corporate governance and making them more sophisticated, so that they are ready to go public. Thirdly, it would be the brand association.”

VIETNAM survey respondent

“Governance is very important and LPs are increasingly interested in the green/sustainable credentials of your firm and your portfolio companies.”

AUSTRALIA survey respondent

“The key factor in driving growth is buying scalable businesses and successfully growing them. Receiving a boost from valuation arbitrage should be considered a bonus.”

TARO ISODA
PARTNER, HEAD OF ADVISORY SERVICES
GRANT THORNTON, JAPAN

FIGURE 5: IMPORTANCE OF ESG
PERCENTAGE

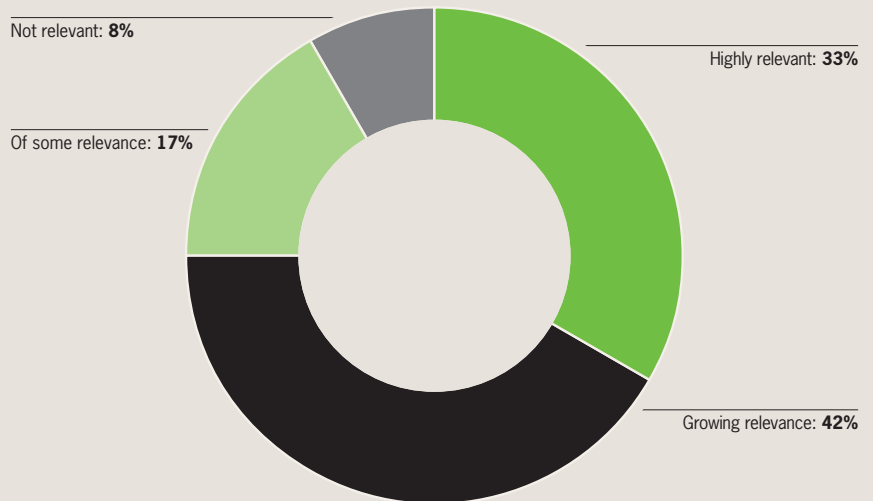
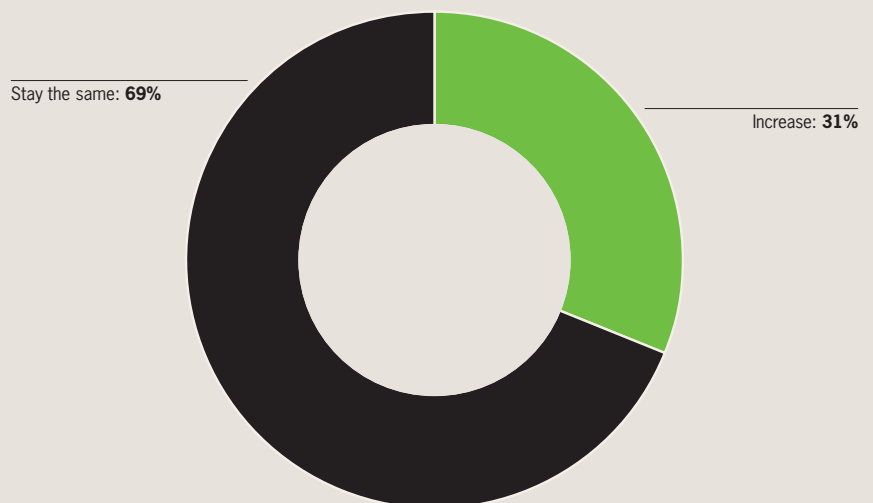


FIGURE 6: HANDS-ON PORTFOLIO INVOLVEMENT
PERCENTAGE



“ESG is growing in importance. We have created a position internally to look after our vision of sustainability and we are putting more measures in place. But for the investees it is too early for anything to have changed significantly.”

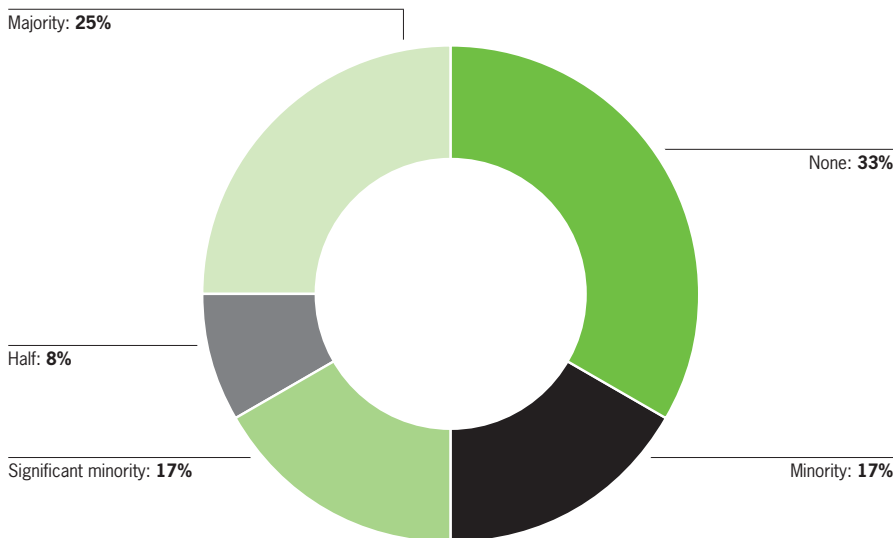
VIETNAM survey respondent

“We bring our network, cross-border acquisition experience, ability to make HR improvements and operational knowledge.”

SINGAPORE survey respondent

Exit

FIGURE 7: PROPORTION OF PORTFOLIO DUE TO EXIT IN NEXT 12 MONTHS
PERCENTAGE



“Exit volumes will certainly increase. There’s real momentum in the market towards exits at the moment driven by the need for GPs to generate returns and the general maturity of a number of private equity portfolios.”

BILL HUTCHISON
PARTNER
GRANT THORNTON, VIETNAM

“In this market I suspect it will be an even split between secondaries and trade sales in terms of the key channels to exit.”

SINGAPORE survey respondent

“The IPO markets are shut at present, while at the same time some foreign trade buyers can pay top prices as their cost of capital is much lower.”

VIETNAM survey respondent

Private equity practitioners in the Asia Pac region are expecting to see increasing levels of exit activity over the next year. Pressure to achieve realisations in Australia, in particular, and the general maturation of portfolios throughout the region has resulted in 80% of respondents stating that an increase in exits is likely. However, at a micro level, while a larger proportion of private equity firms than in other markets expect to see exits from their own portfolios (over 30% expect to exit half or more in the coming year), it is also the case that more private equity firms in Asia Pac expect to achieve no exits than is the case elsewhere.

With IPO markets remaining difficult, and in Australia at least confidence dented by high profile disappointments, trade sales are expected to provide the dominant channel for realisations.

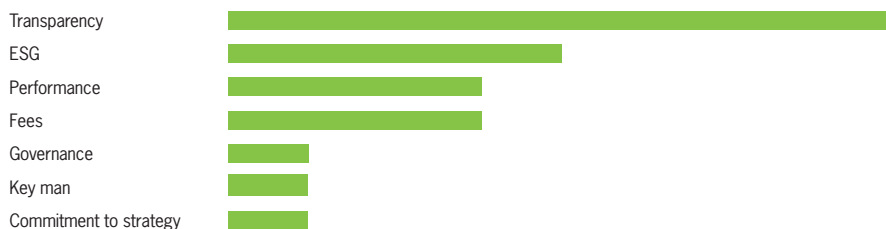
The range of expectations for the direction which private equity returns will take is broader in Asia Pac than in other regions. An equal proportion (circa 40% each) expect an increase or a decrease, with the latter largely driven by expectations in the Australian market.

“I suspect exit activity will go up. There are a number of funds that need to demonstrate exits in order to raise capital. There are some with portfolios that are highly geared and coming to the end of their terms.”

AUSTRALIA survey respondent

Fundraising

FIGURE 8: AREAS OF INCREASING LP DEMANDS



“The fundraising environment is very difficult. The economic situation is not encouraging and international investors have other regional alternatives to look at.”

VIETNAM survey respondent

“LP demands are definitely increasing, no doubt about it, particularly in areas such as transparency, reporting standards and, most importantly, fees!”

SINGAPORE survey respondent

“I view the current fundraising market as negative. There are a number of different factors at work. (1) Local Australian investors are reducing their exposure to alternatives in some cases; (2) there is still a perception that there is uncertainty over the tax regime; (3) Then there is the individual track record of groups. The total amount raised within the industry is likely to be lower going forward.”

AUSTRALIA survey respondent

GPs report increasing levels of LP engagement, with demands for greater transparency topping the list but growing pressure also in areas such as ESG and fees.

Private equity players in the Asia Pac region tend to be more negative about the current fundraising environment than their counterparts in other regions. While across the board this reflects the broader economic environment, in Australia GPs also point to certain specific factors such as the reduced exposure to the asset class of local superannuation schemes, tax issues and concerns over track record. Elsewhere in the region, while interest continues to grow, the markets remain ‘frontier’ in nature and outside the comfort zone of many currently cautious LPs.

Despite this, there is evidence of growing confidence, not least that a significant proportion of private equity firms expect their next funds to be larger in size. However, achieving this is likely to involve the capture of a significant number of new investors, given that an element of LP churn within investor bases is expected in many cases. In Australia, for example, GPs are having to compete more for international capital as domestic LPs, traditionally significant supporters of the local industry, retrench.

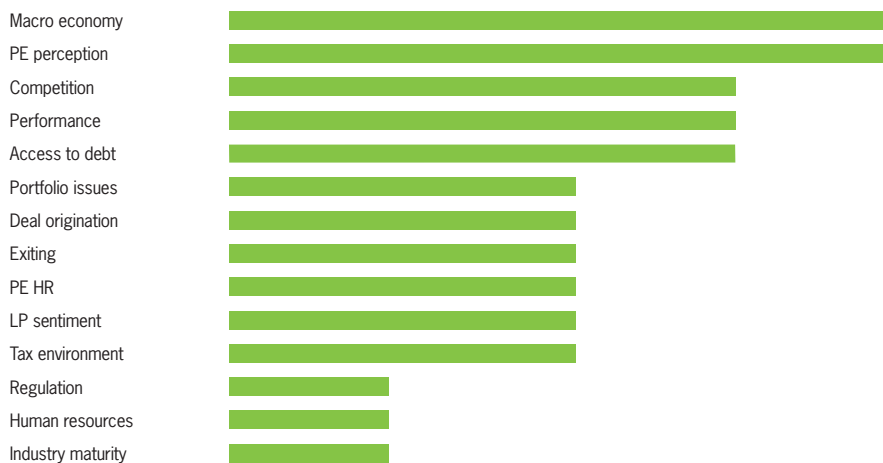
Overall market outlook

On one level, the prospects for private equity development in the Asia Pac region are undoubtedly positive. Consumer-driven opportunities, a wealth of natural resources, and geographic proximity to the huge markets of China and India are all factors lining up in the region's favour.

However, other underlying factors are tempering the speed at which these opportunities can be realised and this is reflected to a degree in the current fortunes of the private equity industry. Respondents to this study point to the often poor public perception of private equity in the region, as well as the lack of debt funding and a shortage of demonstrable track record in some of the newer markets. In addition, there are regulatory pressures, driven by an individual country's political backdrop and/or the financial authorities.

These factors, the current difficult economic environment, and the relatively young nature of the private equity industry in the region mean that the majority of investors plan to focus their attention particularly on the opportunities presented within their core business area over the coming year. This will include making sure they fully understand where their key strengths lie and where improvements can be made.

FIGURE 9: KEY CHALLENGES FACING THE PRIVATE EQUITY INDUSTRY



“We’re interested in the idea of investing in other/new alternative asset classes and innovating in terms of new types of investment.”

SINGAPORE survey respondent

“I think globally, the challenge is the perception of the asset class. The reason why we can’t IPO at the moment is that the media picks up on every bad thing, but they don’t overplay any success. They like to knock the private equity industry even though there are plenty of success stories. It impacts on IPOs and on the trustees of boards that are setting asset allocations.”

AUSTRALIA survey respondent

FIGURE 10: AREAS OF NEW BUSINESS DEVELOPMENT



“Perhaps more than in many other markets there are signs of clear industry-led opportunities, be it service related opportunities to the natural resources sector in Australia or the consumer-led growth in parts of South East Asia.

Challenges remain for private equity investors in the Asia Pacific region, namely the volatility of international debt and equity markets and its flow on effects in funding deals, raising new funds and achieving suitable exits. However, as we have seen in previous cycles, the funds that can raise capital and deploy it successfully should emerge as the winners.”

PAUL GOOLEY
CORPORATE FINANCE PARTNER, HEAD OF PRIVATE EQUITY
GRANT THORNTON, AUSTRALIA

“The big challenges are the macro-economic environment and its effect on deal flow. Lots of entrepreneurs are looking at the conditions and the low multiples and are persuaded to bide their time until they can get a better deal.”

VIETNAM survey respondent

“Key issues for this market are the ludicrous price expectations out there and the fact that it is not a liquid market. The lack of debt financing for deals is also a problem.”

SINGAPORE survey respondent

“I see the biggest challenges as being competition for deals, regulatory pressure and the difficulties that PE firms experience in finding new talent.”

SINGAPORE survey respondent

“In the more frontier markets, I think that the regulatory environments are not as clear as they need to be. We do explore these markets and look at the deal environment, but with a sceptical eye. We won’t invest unless the environment is right, but when it is, we will want to be there!”

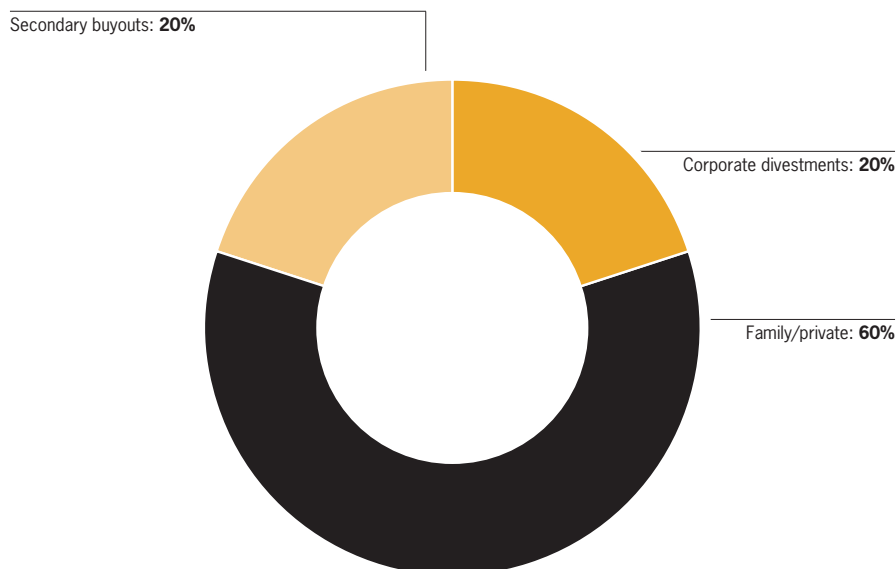
AUSTRALIA survey respondent

MENA: Investment activity

Private equity in the region is still characterised by growth capital transactions, usually sourced from family owners and private vendors. As a result, GPs' networks amongst the corporate and entrepreneurial communities are seen a critical factor in sourcing deals, with local presence also key.

Despite the rapidly shifting landscape in the region, not least as a result of the Arab Spring, private equity practitioners in MENA are broadly positive regarding the outlook for new deal activity over the coming year. Around two-thirds expect to see increasing activity, although the drivers vary from country to country within the region.

FIGURE 1: SOURCES OF DEALFLOW
PERCENTAGE



“In terms of origination, the key sources are local, family-owned businesses seeking a non-family partner and intending to expand on a regional basis using non-organic growth routes. Privatisations are also important in a few sectors.”

BAHRAIN survey respondent

“The most significant source of dealflow will be private companies, either family- or entrepreneur-owned. Other sources will be less important. Private equity is relatively new in Turkey so, while there might be some scope for secondaries, it is not as important as the other sources.”

TURKEY survey respondent

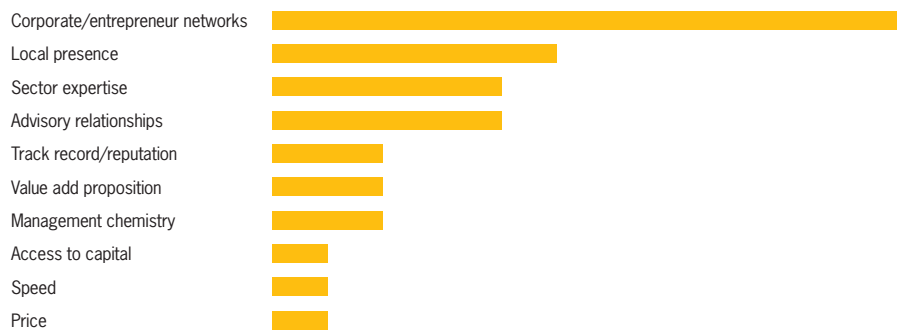
“A lot of factors are important in winning deals, not least of course having capital. Sector knowledge helps a great deal as it provides better judgement and know-how. Also any tangible and intangible knowledge gained via other portfolio companies also helps. Relationships and reputation are critical – being close to local business partners can be an advantage over other PE houses not based locally.”

TURKEY survey respondent

Within MENA in general, there is a sense that after taking a hit during the downturn and the recent political upheaval, activity levels will start to build gradually. Within Turkey, respondents point to a positive economic outlook coupled with a growing recognition of private equity.

The notable diversity of the competitive landscape is highlighted by the significance of non-institutional money in the form of family offices, Sovereign Wealth Funds (SWFs) and corporate groups across the whole region. However, opinions remain divided regarding the likely direction that entry multiples will take; the unanimous view in Turkey that prices will stay at current levels is not reflected elsewhere, reflecting the changing GP landscape and few recent comparables.

FIGURE 2: KEY FACTORS IN IDENTIFYING AND WINNING DEALS



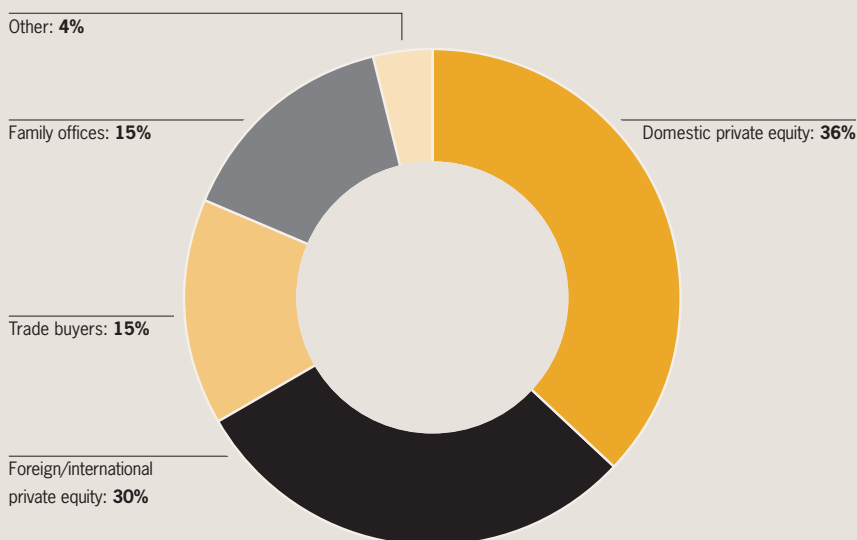
“Primarily, proprietary networks drive dealflow, although you cannot just rely on your networks. Sector expertise is important too, although it is not sufficient to have that alone. You need the investment banking guys who have the networks in place as well.”

UNITED ARAB EMIRATES survey respondent

“In Kuwait, both proprietary networks and well-established intermediary relationships are important in finding and winning deals in this market. A strong local presence, coupled with sector expertise, are also key ingredients.”

ABDULLATIF AL-AIBAN
PARTNER
GRANT THORNTON, KUWAIT

FIGURE 3: SOURCES OF COMPETITION
PERCENTAGE



“In Egypt, the recent political upheavals have led to an extremely volatile situation which has led to a reduction in deal flow. However, we are confident that when stability returns to the market place a number of opportunities will present themselves.”

HOSSAM EL BESHER
PRINCIPAL PARTNER
GRANT THORNTON, EGYPT

“Prices are decreasing, multiples are going down. There is less capital available in the market and that pushes prices down.”

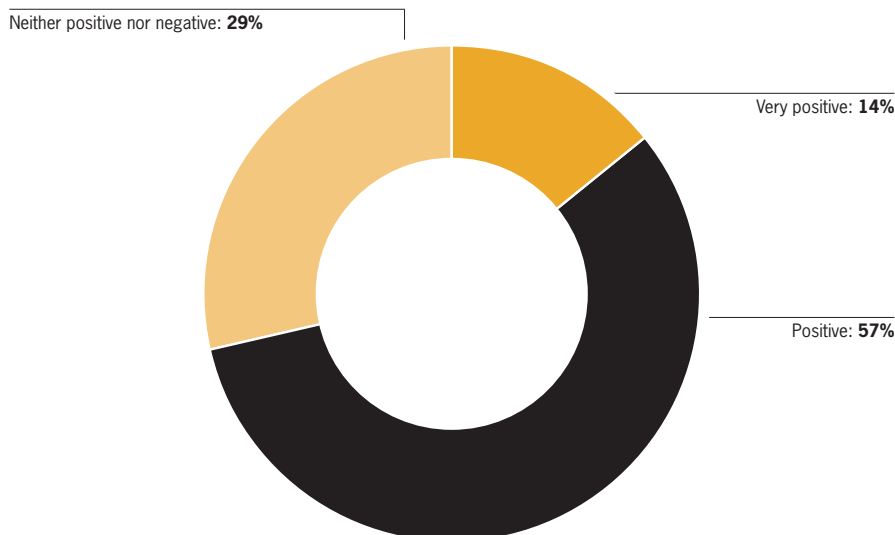
UNITED ARAB EMIRATES survey respondent

“SWFs get the first look-in on potential deals, followed by semi-Sovereigns, the big PE houses, the local PE players, then the locally-based foreign PE houses. If you are not here, you miss out; not having a presence on the ground causes people to question your experience.”

UNITED ARAB EMIRATES survey respondent

Portfolio

FIGURE 4: ECONOMIC OUTLOOK FOR PORTFOLIO BUSINESS
PERCENTAGE



From a portfolio company perspective, there is also growing optimism. There is a sense that macro economic prospects are improving throughout the region (although this is often from a low base), while at the same time, private equity practitioners increasingly are confident about the state of their own portfolios, helped by typically low levels of debt. Likewise, many players highlight the level of maturity of their current portfolios, not least as a result of higher levels of hands-on involvement with these businesses over recent times – something that they expect to continue.

Input from investors in the MENA region tends to focus on strategic discussions as well as on more specific areas that help to professionalise portfolio businesses, including HR and governance. Some also point to the expertise that they can bring in the area of M&A, and indeed just over a third of respondents expect cross-border M&A levels to increase at their portfolio firms.

“Value uplift is about top-line growth of the business. In this region, a typical private equity investment is a growth capital investment so there is less value growth from financial engineering and multiple arbitrage. We do use financial leverage, but much less than is typical in some other regions.”

TURKEY survey respondent

“We focus on family businesses and buy and build acquisitions. For us, therefore, it is very much about organic growth – purchasing the business and then creating a higher value over time.”

UNITED ARAB EMIRATES survey respondent

“We are hands on, on all levels, as it’s not just about financing deals. We are about growth capital, not financial engineering, and it is a collaborative effort that involves both operational and strategic input.”

UNITED ARAB EMIRATES survey respondent

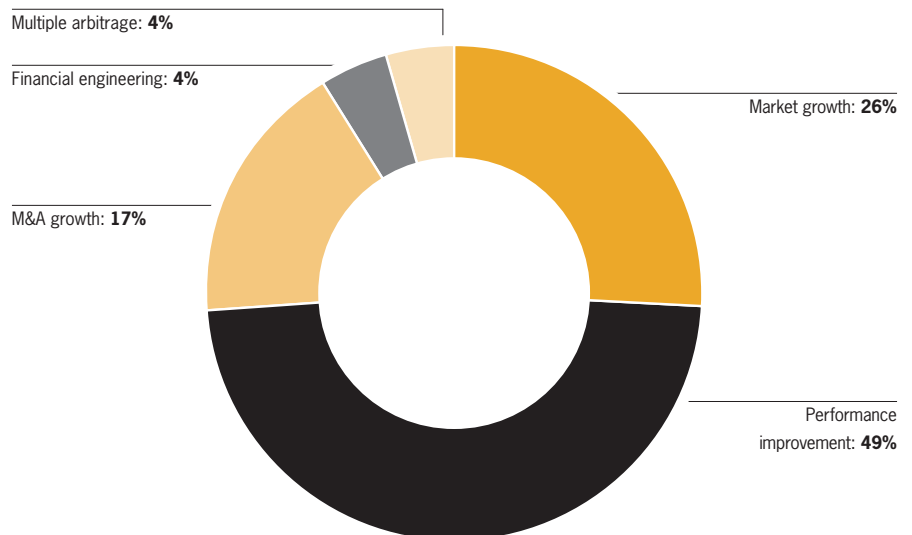
“My belief is that the fundamentals of the region are very strong. These include high oil prices; the low number of distressed banks; stabilising real estate market including in hard-hit Dubai; a young population of sophisticated consumers seeking quality services from foreign and indigenous brands; the need for governments to encourage business in infrastructure, education and healthcare, and to get SMEs more involved in the economic cycle to spur growth and create employment.”

BAHRAIN survey respondent

“In Saudi, the national economy is growing and there is a relatively stable situation in terms of the macro-economic and political outlook. A combination of growth and stability creates a positive outlook.”

NASSER BARAKAT
CONSULTANCY DIRECTOR
GRANT THORNTON, SAUDI ARABIA

FIGURE 5: PORTFOLIO VALUE DRIVERS
PERCENTAGE



“The issue for a lot of companies is how to execute and position yourself in a rapidly growing market. Market growth may be a key driver, but the challenge is the strategy and tactics you are going to adopt as the market evolves.”

UNITED ARAB EMIRATES survey respondent

“Our main areas of portfolio input include corporate governance, expansion into new markets, and add-on acquisitions.”

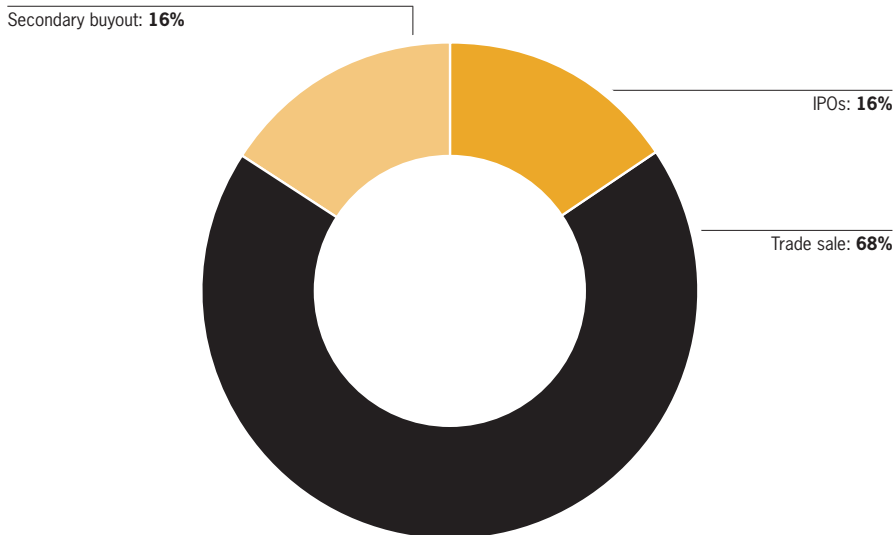
BAHRAIN survey respondent

“The MENA economy is growing at a decent rate (5% GDP) compared to Western markets. The market could be doing much better, but then I am not complaining, as it is still better than it could be considering the general macro-economic state.”

UNITED ARAB EMIRATES survey respondent

Exit

FIGURE 6: EXIT ROUTES
PERCENTAGE



With private equity players in the region having invested time and effort professionalising and growing portfolio companies, there is an expectation that the next 12 months will see a renewed focus on divestments. Many point to more positive conditions for exiting, with improved liquidity and buyer interest, which is welcome news for groups that need to show realisations prior to any forthcoming fundraising programme.

As is the case elsewhere, the appetite of corporate buyers is fundamental to the success of divestment programmes at this point in time. However, unlike in many other markets, there is more interest in IPOs and belief that this channel is a viable exit route. Conversely, key sponsor-to-sponsor deals are not yet a big feature of the market, although some practitioners do expect to see them become more relevant in the future.

With market fundamentals beginning to look more positive – rising valuations and portfolio companies in better shape – practitioners believe that the longer-term prospects for returns are positive. However, with the stuttering macro economy keeping a brake on things, current views on the outlook remain somewhat mixed.

“Prospects for returns are good. Private equity valuations are up, return on equity is moving higher.”

UNITED ARAB EMIRATES survey respondent

“IPOs are available but are not the most preferred route because of the lengthy lock-in periods.”

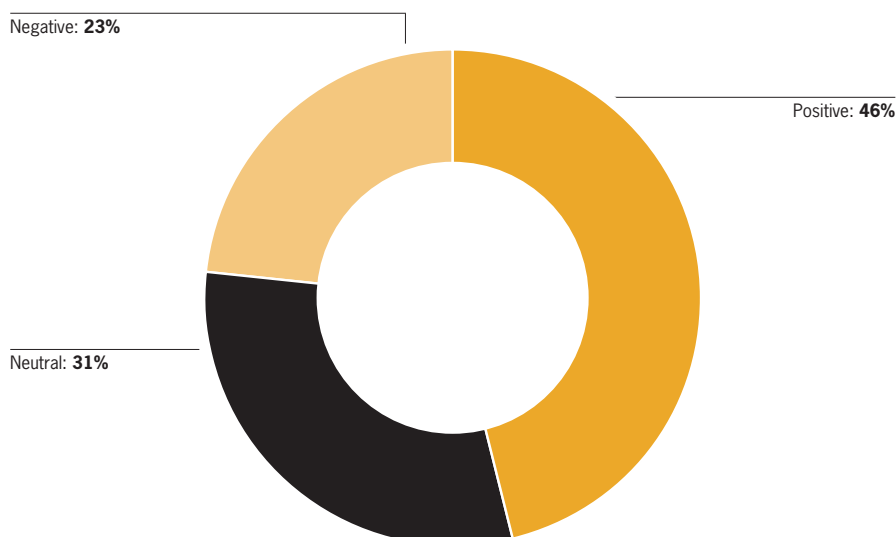
BAHRAIN survey respondent

“Strategic sales and IPOs will be the most prevalent exit route. Secondaries will happen but won’t be the most important source yet.”

TURKEY survey respondent

Fundraising

FIGURE 7: FUNDRAISING ENVIRONMENT
PERCENTAGE



“I’m negative on fundraising due to the retrenchment of regional investors from capital markets in the wake of the global crisis (including from alternative assets such as PE).”

BAHRAIN survey respondent

“LPs being increasingly demanding is not so much of an issue. However, as the market matures over the next 3-4 years, there will be increasing interest in the secondary buyout market, and you will see greater demands made by LPs as a result.”

UNITED ARAB EMIRATES survey respondent

“The fundraising environment will improve from what we have seen so far this year. It is difficult to say how things will play out; it is tough convincing investors to part with their money as PE is very much about long term investments – investors have to wait for their money to work.”

UNITED ARAB EMIRATES survey respondent

Private equity practitioners across the MENA region are broadly positive about the outlook for fundraising over the coming year, despite the fact that they also tend to be predicting considerable churn within their own LP bases going forward.

The MENA region, in general, is one in which, to date, international money has accounted for a significant proportion of private equity capital. However, changes in the availability of domestic capital for private equity funds are driving concerns over fundraising in some quarters and optimism in others. On the one hand, domestic money in Turkey has the potential to be an increasingly significant part of the landscape; while in other parts of the MENA region, retrenchment of domestic groups that have previously been investors in private equity is highlighted as a negative feature of the market.

Against this backdrop, as with private equity markets across the world, GPs report that LPs are becoming more demanding.

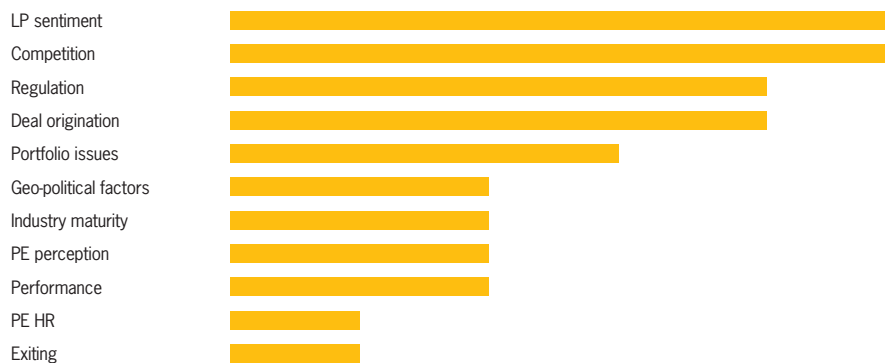
Overall market outlook

As sentiment begins to improve across the MENA region, private equity players are showing signs of augmenting their teams in preparation for the opportunities that lie ahead. Three quarters of players expect to increase head count over the coming year, particularly in the area of front-line deal doing. This focus on transactional team enhancement reflects the expectation that GPs' principal focus over the coming year will be on their core business, as well as seeking deal opportunities in neighbouring geographical markets.

Somewhat surprisingly, given the overall positive expectations regarding fundraising, LP sentiment is seen by MENA GPs as the biggest challenge faced by the industry at this time. However, it appears that this concern is linked to perceived LP views on the lack of GPs with a demonstrable track record in the MENA region, rather than a reflection on the respondents' own fundraising prospects.

The recent political unrest witnessed across parts of the MENA region is felt, broadly, to be having at least some impact on the prospects for private equity in the region. While the dust has yet to settle, the mood is one of believing that the undeniable short-term disruption will ultimately give way to enhanced opportunities.

FIGURE 8: KEY CHALLENGES FACING THE PRIVATE EQUITY INDUSTRY



“Yes, the political unrest has impacted the region in a big way. Political issues are a big factor in the decision-making process for potential investors, and the recent turmoil has slammed the brakes on investment returns – people don’t want to take that big a risk, particularly SWFs. However, in the long term it will be business as usual as this region has the potential to be hugely successful for PE.”

UNITED ARAB EMIRATES survey respondent

“In the long term the unrest that this region has seen will have a positive impact as it will bring stability and growth, although it will mean short term volatility. Although the next 12 months will be disruptive, the short term volatility will lead to mid-term opportunities.”

DAVID FISHER
 CEO
 GRANT THORNTON, MIDDLE EAST ADVISORY SERVICES

“The challenges are fundraising, finding and winning deals (family businesses to invest in), and the fact that, in general, the PE market is still young in this region. The industry needs to be able to demonstrate good results to illustrate a track record of delivering.”

UNITED ARAB EMIRATES survey respondent

“Turkey is still on a learning curve and entrepreneurs are still trying to understand what PE does and brings beyond money. In a short time we will see an exponential growth in PE-backed deals. Competition will remain tough especially for good deals as this is not yet a mature market so the number of transactions are limited.”

TURKEY survey respondent

FIGURE 9: AREAS OF NEW BUSINESS DEVELOPMENT
 PERCENTAGE

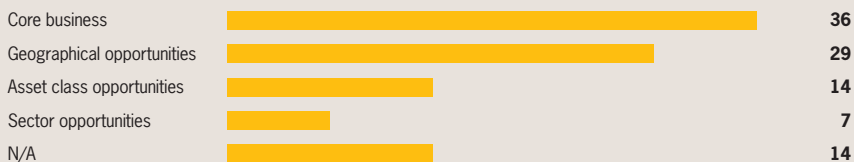
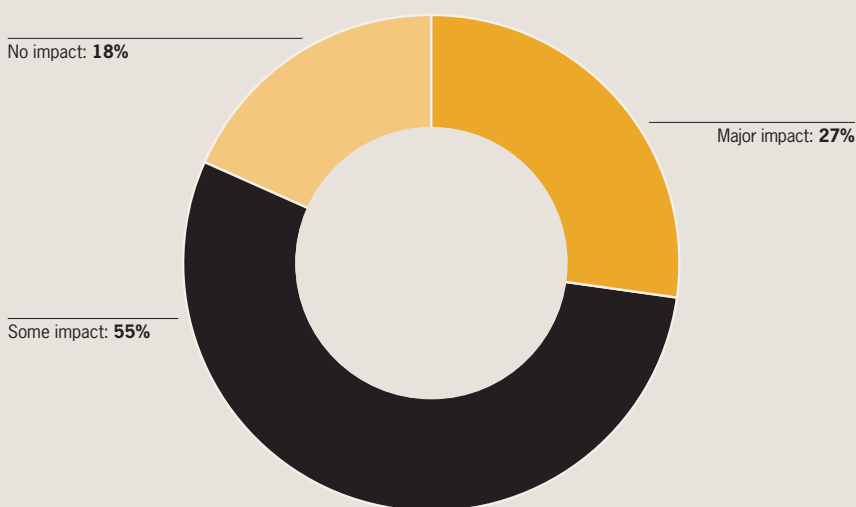


FIGURE 10: LASTING IMPACT OF POLITICAL UNREST
 PERCENTAGE



“The Middle East country that has really been affected by the recent political unrest is Egypt, where there were meaningful levels of private equity activity. The other countries affected, namely Libya and Syria, did not have much PE activity. In countries like Turkey and Saudi there has been no real change – they are very stable and private equity activity continues. We are looking to do investments in the GCC economies.”

UNITED ARAB EMIRATES survey respondent

“We see the SME space as a growth opportunity in the region, focusing on growth capital deals rather than buyouts for small- and medium-sized enterprises.”

TURKEY survey respondent

“The key challenge for private equity in this region is to develop the value proposition beyond the money. A lot of funds are very domestic and a lot of what is being done does not have a value-add component. Business owners and institutions have access to different sources of capital so private equity needs to demonstrate what its value-add is in real and measurable terms.”

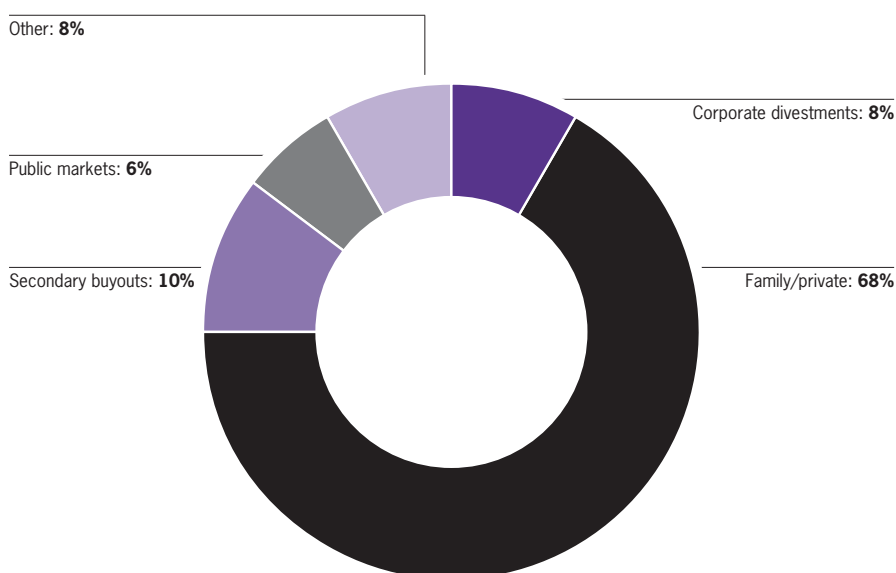
UNITED ARAB EMIRATES survey respondent

BRICS:

Investment activity

The BRICS countries are the most bullish with regard to expectations for rising activity levels, with Brazilian GPs the most positive of all. The BRICS countries continue to be predominantly growth capital markets in private equity terms, the exception perhaps being South Africa where a more established buyout market exists. Family and private businesses provide the key source of dealflow and, as such, GPs put particular emphasis on their own corporate and entrepreneur networks in identifying opportunities. While a host of other factors are also listed as significant, many of the top ranked are in some way linked to the importance of self-origination and finding a successful angle in these competitive markets.

FIGURE 1: SOURCES OF DEALFLOW
PERCENTAGE



“Deals are likely to originate mainly from private businesses looking to raise capital from private equity for the first-time. There is an increased awareness and willingness to do so.”

BRAZIL survey respondent

“In China the key deal source is private/family-owned companies. Growth equity deals will remain the main source of dealflow. It will definitely not be the public markets or corporate divestments.”

CHINA survey respondent

“The competition is from domestic PE houses and international PE players. The public markets are depressed so there is limited competition from that quarter at the moment.”

CHINA survey respondent

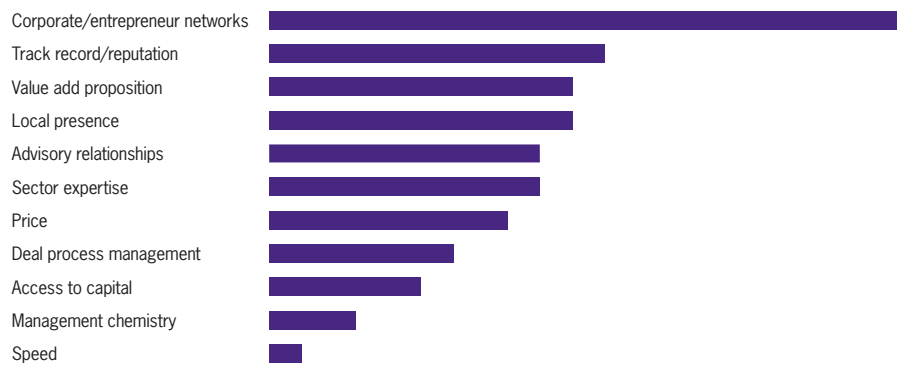
“There is competition from domestic and international PE houses. Strategic buyers will also start to come back. Typically, they have deeper pockets than PE houses and can add value by creating synergies so will be willing to pay a higher price for assets.”

SOUTH AFRICA survey respondent

“In India, family- and privately-owned businesses are the key source of private equity dealflow. As a result, a whole range of factors are important in sourcing deals, including networks, intermediary relationships, sector knowledge, local knowledge, track record and proven speed of execution.”

SID NIGAM
PARTNER, HEAD OF M&A
GRANT THORNTON, INDIA

FIGURE 2: KEY FACTORS IN IDENTIFYING AND WINNING DEALS



“Where PE firms are under pressure to get realisations on deals you are seeing some secondary buyouts. The public-to-private market is tough. Overall, it’s generally the smaller deal market where activity is happening.”

SOUTH AFRICA survey respondent

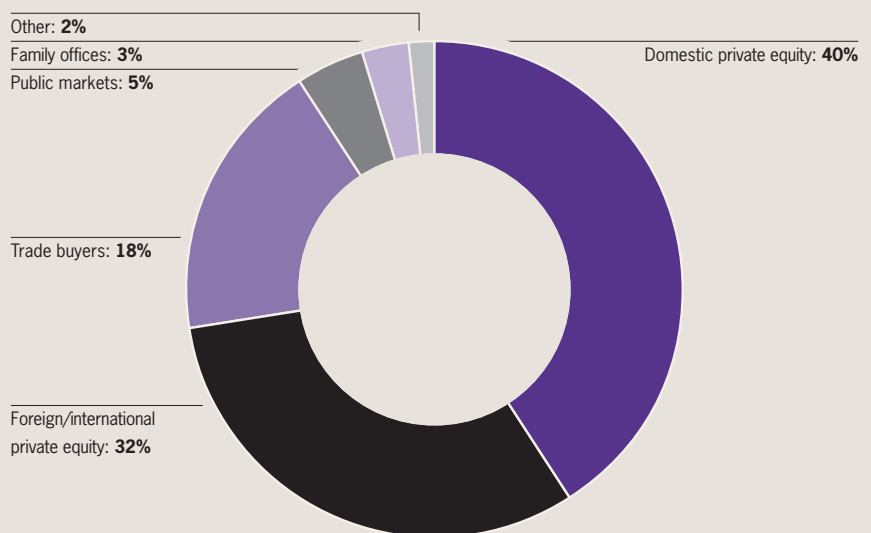
“Colombia is probably the safest of the newer markets, though Peru also has promise. Chile has issues but is still an important area. Further down the line there may be potential to move into Spain and Portugal, reversing the main trend currently.”

LATAM survey respondent

The main sources of competition remain private equity specific throughout the BRICS, with many players attracted to the consumer-related opportunities of these growth economies, as well as development-linked sectors such as infrastructure, particularly in Brazil and India. With the volume of opportunities available within the BRICS markets themselves, the tendency is for GPs to focus their efforts in their domestic region. Where they do cross borders, it tends to be to countries still within the same cultural sphere of recognition.

Competing pressures on pricing include strong economic growth and rising competition versus a fear of overheating.

FIGURE 3: SOURCES OF COMPETITION
PERCENTAGE



"Reputation, longevity and a proven ability to execute deals are all important in finding opportunities. If you have that, the intermediaries will show you everything, but if you fail a few times that will change. Once in, you have to show that you can connect with the entrepreneurs and relate to their realities. They have quite a choice of PE houses to look at and good news travels."

INDIA survey respondent

"There is more deal intermediation than there used to be, due to less differentiation in the markets. PE firms need to be more market savvy, with greater experience and business knowledge. We are seeing the early stage evolution of what happened in the UK and US when PE firms became established there."

HONG KONG survey respondent

"In terms of competition, for growth capital it is the proliferation of local and international PE funds that have sprung up. In the emerging buyout area it is still the large international houses."

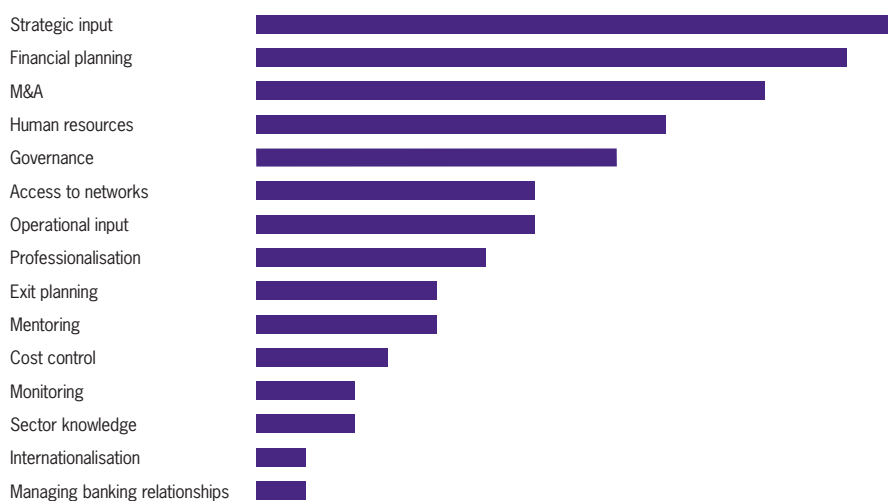
INDIA survey respondent

"Prices will start to weigh in favour of PE, as the market softens. However, competition is increasing so that will offset the lower prices to a degree."

HONG KONG survey respondent

Portfolio

FIGURE 4: AREAS OF HANDS-ON INVOLVEMENT



Governance is a further area highlighted in terms of PE input to portfolio firms, and an appreciation of the issues around ESG appears to be on the rise across the BRICS countries. The key driver of this is the perception that it represents ‘best practice’, but there are also evident pressures from a number of sources, eg LPs, portfolio managers, regulators, that are at play here.

Many BRICS-based GPs stress that hands-on involvement in investees is important. Particularly noteworthy is the range of areas in which GPs see themselves getting involved, with the key inputs including strategic direction and financial planning, the latter being relatively more significant within the BRICS countries than elsewhere, and often focused on areas such as budgeting and cost management.

“Market growth is the main driver of value, but we also try to make operational improvements to our portfolio companies.”

CHINA survey respondent

“PE firms really need to be hands-on to deliver value, and many are. I don’t see that changing. The key areas are strategic input and financial planning.”

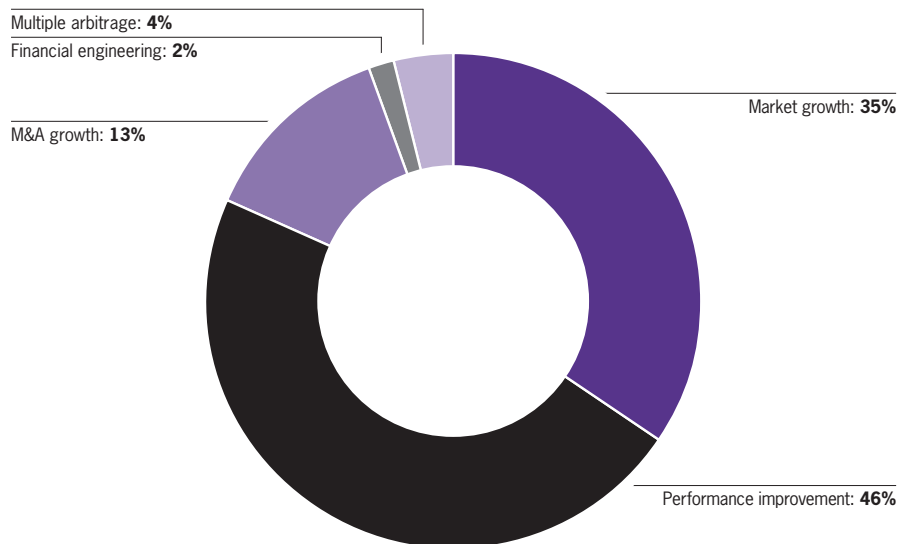
BRAZIL survey respondent

“Top line is the most important driver of growth. Beyond that, working capital improvements and expansion also drive value growth. Financial engineering will contribute, but this is not significant since mid-market deals have lower levels of debt and lower multiples have been paid for them.”

SOUTH AFRICA survey respondent

Overall, performance improvement remains the most important value driver at portfolio firms but private equity practitioners based in the BRICS countries are broadly positive about the economic outlook and its impact on their portfolios, with those based in Brazil and India generally the most positive of all. The typically low levels of leverage in BRICS PE deal structures has also meant that debt has not been a cause of stress for too many companies. However, this optimism is laced with an element of caution relating to potential slow down and perceived market volatility. Despite this, market growth is still seen as a relatively more important value driver in BRICS countries than elsewhere.

FIGURE 5: PORTFOLIO VALUE DRIVERS
PERCENTAGE



“Generally speaking, the consciousness of ESG issues is increasing amongst Indian entrepreneurs, but it is very much a work in progress.”

INDIA survey respondent

“In China, building value comes down to earnings growth. Private equity firms cannot rely on arbitrage in the current climate. They need to demonstrate that they have delivered tangible improvements to the business, such as improvements to the performance and strengthening of the management team.”

LIU DONGDONG
PARTNER, NATIONAL LEADER – ADVISORY SERVICES
GRANT THORNTON, CHINA

“Put simply, we identify the drivers of growth for each individual company and then help them to execute a business plan. The key is getting the management team sold into the plan.”

RUSSIA survey respondent

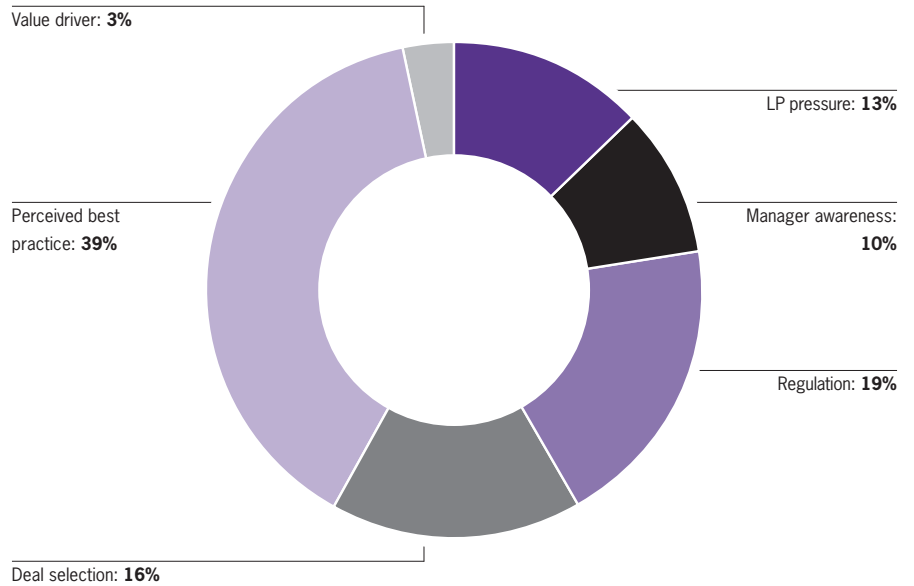
“Even five years ago, ESG issues were not as closely followed, but now, driven by the LPs and the larger international players, it is growing rapidly. It forms part of our due diligence process, our compliance process and the post-deal activities. It’s perhaps not as widespread among smaller local investors, but it will be.”

BRAZIL survey respondent

“We focus on strategic rather than operational issues. The main areas of involvement are governance systems, financial controls and developing management teams. We also help portfolio companies with growth and acquisition opportunities in new markets.”

SOUTH AFRICA survey respondent

FIGURE 6: IMPORTANCE OF ESG
PERCENTAGE



“There is an increased need for improvement in governance standards. We assist investee companies in becoming more socially responsible and investor friendly.”

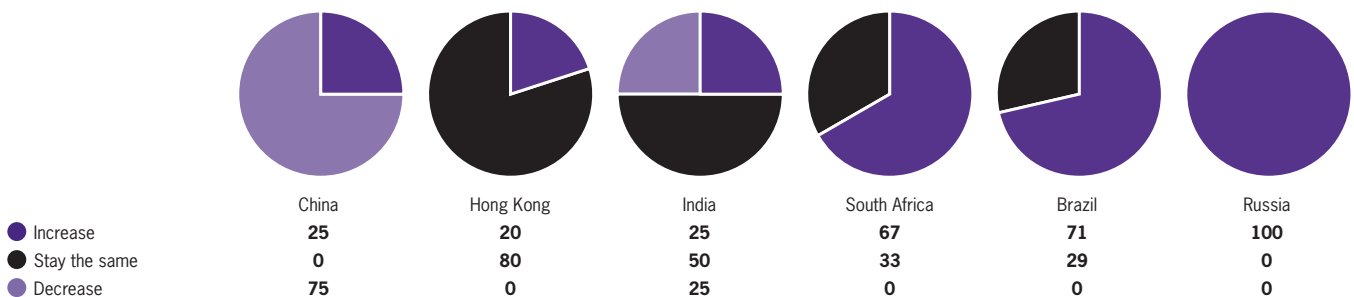
HONG KONG survey respondent

“ESG issues are not very important in China, although increasingly compliance needs to be in order.”

CHINA survey respondent

Exit

FIGURE 7: EXIT ACTIVITY
PERCENTAGE



Expectations for exit activity vary between the BRICS countries, highlighting the differing points in the evolution of the private equity industry reached in each. While half of all BRICS-based respondents expect to see increasing exit levels over the next 12 months, many GPs in mainland China and India expect to see falling levels of realisations. The mood within these larger, more established markets, which already have some track record of exits, is more subdued than in areas such as Brazil, where many portfolios are only now completing their first cycle.

Distinctions can also be drawn within some countries, with Hong Kong GPs slightly less pessimistic than their mainland counterparts. This is primarily a reflection of the state of the IPO markets. Across the BRICS countries, the importance of IPOs as an exit route is notably higher than in other regions. But, while public market sentiment is perceived to be working in private equity's favour in places such as Brazil, Hong Kong and India, this is currently less likely to be the case in mainland China, Russia and South Africa.

This complex picture is echoed in the varying expectations regarding future returns. GPs in countries such as Brazil and India are particularly negative in this respect, often expecting downward pressure as a result of high entry prices in recent times.

“Exits will increase. There are lot of portfolios reaching maturity in Russia and this will be the main driver.”

RUSSIA survey respondent

“I believe exit activity will decrease, mainly because of the weak sentiment in the market. It’s a buyer’s market not a seller’s market at the moment.”

INDIA survey respondent

“With the region predicted to have one of the fastest growing economies, and private equity being increasingly viewed as a viable option, we are expecting high levels of activity in the South African private equity market in the next three to five years.”

JEANETTE HERN
HEAD OF CORPORATE FINANCE
GRANT THORNTON, SOUTH AFRICA

“IPOs and trade sales are key here. Also, the secondary market is growing in Asia, but is still small at the moment.”

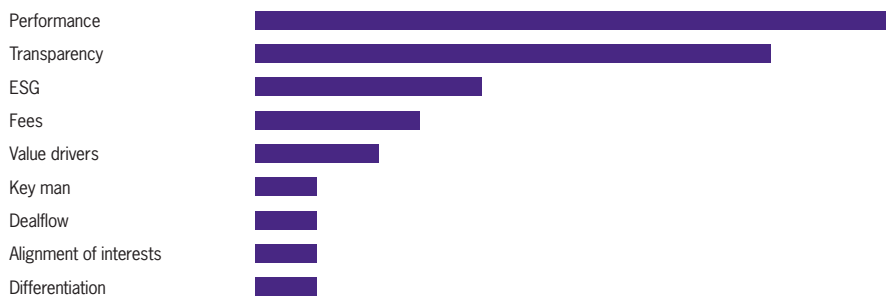
HONG KONG survey respondent

“I think there will be downward pressure on returns. Because of the very high multiples paid over the last couple of years the likelihood is that they will fall.”

BRAZIL survey respondent

Fundraising

FIGURE 8: AREAS OF INCREASING LP DEMANDS



“The overall fundraising story is probably negative. There are lots of people raising and while the macro story might be good, the actual track record for returns is very patchy and some firms will struggle.”

INDIA survey respondent

“Fundraising remains tough and as challenging as it has been in the last few years. Until money is returned to LPs from older investments, fundraising will remain challenging.”

SOUTH AFRICA survey respondent

“LP demands are increasing. Dealing with them is never an easy process, even if you have a good track record.”

CHINA survey respondent

“LPs are increasing the pressure in terms of reporting, terms and perhaps most importantly in trying to generate the metrics that will help them to differentiate the good performers from the not so good performers.”

BRAZIL survey respondent

“More than ever, you need to have a track record and LPs want to know the management team in depth.”

HONG KONG survey respondent

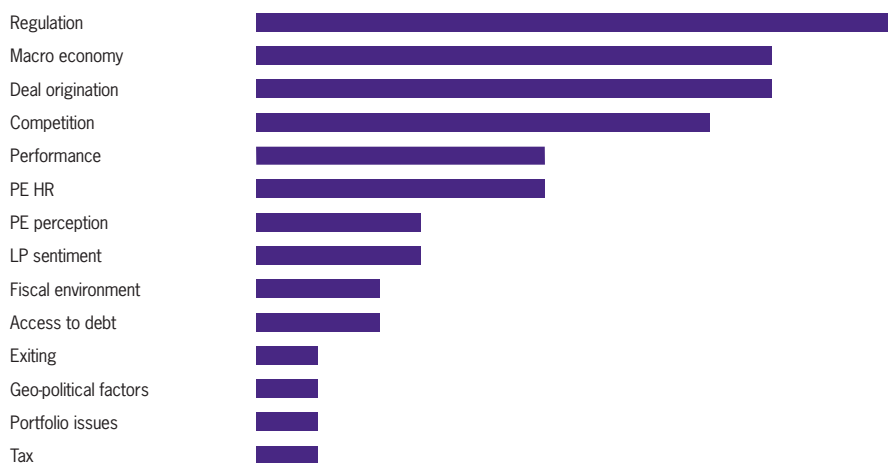
Ultimately, performance is king in private equity and no more so than in markets that have been sold on the promise of high rewards and are now faced with realising this potential in tougher economic times. Unsurprisingly, therefore, GP performance and its communication are the key areas in which LPs are seen to be applying pressure.

The increasingly critical eye being turned by LPs on private equity means that the initial sense of opportunity in the now ‘more emerged’ markets, such as China and India, is to a degree being replaced by a more pragmatic appreciation of the risks, particularly as competition levels in these markets have risen. At the same time, the importance of international money in all these regions leaves an individual country’s GPs vulnerable to LPs shifting their attention to the latest highest growth markets.

Despite the challenges, GPs in the BRICS countries expect to raise larger successor funds, highlighting the ongoing potential of these markets as they continue to develop.

Overall market outlook

FIGURE 9: KEY CHALLENGES FACING THE PRIVATE EQUITY INDUSTRY



Regulatory matters are seen as the biggest challenge facing the BRICS private equity markets. With the rapid growth of the private equity sector within these markets, they have also received increased attention from financial regulators keen to ensure controlled growth. But even without the watchful eye of the authorities, these markets would still find themselves wrestling with the challenges internal to the industry of rapid growth, namely high levels of competition and a shortage of talent.

“As the market develops people will have to think harder about their strategy. In the past they did well in multiple arbitrage between public and private markets, but things have changed.”

CHINA survey respondent

“We will be recruiting in the areas of portfolio management and also analysts at entry level. I would also say it is difficult recruiting good quality private equity staff with suitable experience and knowledge in deal doing.”

SOUTH AFRICA survey respondent

“We are definitely expanding. We have already moved from two to four partners in the last year, and over the next 12 months we will look to add further mid-level investment professionals.”

INDIA survey respondent

“Following the presidential elections there will hopefully be less corruption and local government intervention, and this will result in opportunities.”

RUSSIA survey respondent

“LATAM as a whole needs to show that it can deliver good exits as well as interesting investment opportunities. There is some macro economic risk for Colombia, especially on the appreciating currency, but it’s not major.”

LATAM survey respondent

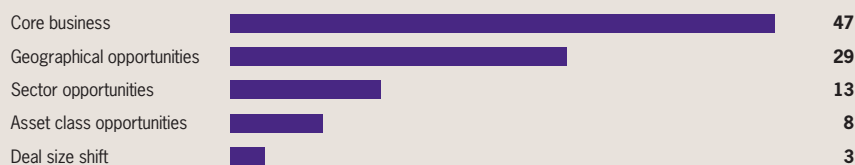
As some of the BRICS countries arguably move from being ‘emerging’ to ‘emerged’, there are signs that many of the players in the market are institutionalising by building their core teams as well as ‘supporting infrastructure’. More GPs plan to increase headcount in the BRICS countries than elsewhere, including areas such as research, portfolio management and investor relations. This is nowhere more the case than in China.

The emphasis on building investment teams reflects the most oft-cited focus of private equity firms over the coming year, namely sticking to core business and proving that they can deliver returns. Also in markets such as India, China and South Africa, GPs point to the importance of new geographies as they seek to identify opportunities.

FIGURE 10: AREAS OF RECRUITMENT
PERCENTAGE



FIGURE 11: AREAS OF NEW BUSINESS DEVELOPMENT
PERCENTAGE



“China, India, Brazil – these are all now major markets on the private equity stage. As they cement their positions they need to continue to build track record, proving that they can add value to their investments and generate strong returns.”

LINK COSTA
PARTNER
GRANT THORNTON, BRAZIL

“The big opportunity lies in the improvement of prospects for Africa. Finally it's getting its act together – politically and economically – i.e. legals, regulations and ease of doing business are slowly getting better. This is coupled with the African consumer spending more. If all this continues we hope to fundraise by June 2012.”

SOUTH AFRICA survey respondent

“It is a very large market and there are tremendous opportunities to find companies that were completely below the radar 3 or 4 years ago but which are growing very strongly. But they are still not necessarily that visible and that means you have to look outside of the tier 1 cities to find them and therefore need to expand and develop your network.”

INDIA survey respondent

“The main challenge is maintaining a strong investment discipline: India has a record of seeing spikes in activity and this could affect returns and hinder development. The second area is regulatory risk. But this is not a new thing in the market and the best investors can turn it into an advantage by the way they are able to deal with often unpredictable changes.”

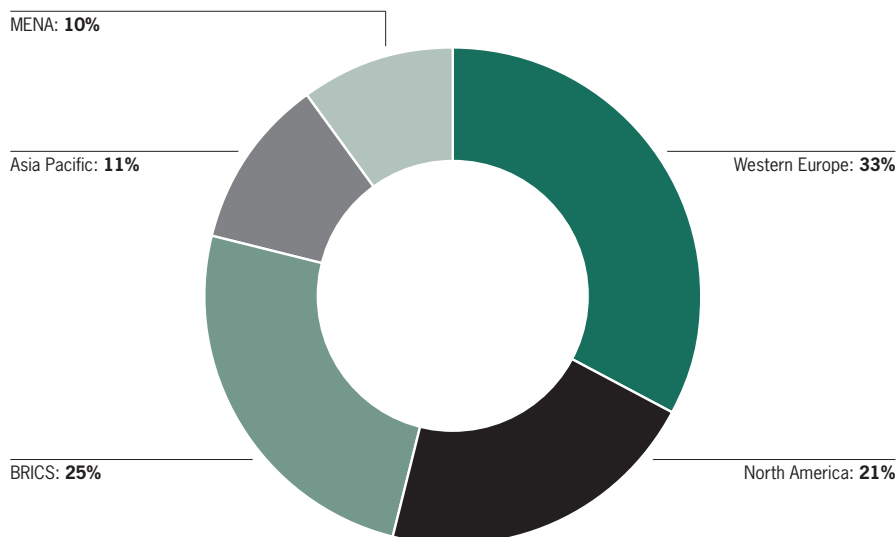
INDIA survey respondent

“We will be needing to increase our team size, primarily in terms of investment staff and also on the compliance side. On this latter point, the local financial regulator has brought in onerous new compliance standards which we will have to meet.”

LATAM survey respondent

Sample and methodology

FIGURE 1: SAMPLE PERCENTAGE



This report provides a global snapshot of the opportunities and challenges within the private equity industry as seen from a practitioner's perspective. The differences in what it means to be an active player in specific global markets are examined, as are the key themes that resonate around the world.

During autumn 2011, 144 interviews were conducted with top executives from private equity firms. Respondents included industry GPs in five principal regions/categories:

- Western Europe
- North America (USA and Canada)
- Asia Pac (Australia and South East Asia)
- MENA (including Turkey)
- BRICS, Brazil (and broader LATAM), Russia, India, China, South Africa.

Participants were identified from a number of sources including industry associations, market directories and contact networks.

The interviews were conducted on an unattributed basis and were structured loosely around the various stages of the private equity cycle, incorporating new investment activity, portfolio management, exiting and fundraising. This approach enabled detailed exploration of likely trends throughout the cycle and identification of key pressure points within the chain.

Interviews included a mixture of quantitative and qualitative questions. This report includes graphs and charts derived from both the quantitative data and, where appropriate, the coding of responses to qualitative questions to provide statistics highlighting key trends. Some charts will also reflect multi response questions.

FIGURE 2: WESTERN EUROPE
PERCENTAGE



FIGURE 3: NORTH AMERICA
PERCENTAGE



FIGURE 4: ASIA PAC
PERCENTAGE



FIGURE 5: MENA
PERCENTAGE



FIGURE 6: BRICS
PERCENTAGE



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Grant Thornton contacts

Global overview and Western Europe

Martin Goddard

Global service line leader – Transactions
Grant Thornton International
T +44 (0)20 7728 2770
E martin.a.goddard@uk.gt.com

North America

Steve Lukens

Head of Advisory
Grant Thornton US
T +1 212 542 9640
E steve.lukens@us.gt.com

Asia Pacific

Bill Hutchison

Advisory services partner
Grant Thornton Vietnam
T +84 8 3910 9100
E bill.hutchison@vn.gt.com

MENA

David Fisher

CEO
Grant Thornton Middle East Advisory services
T +971 (0) 4 447 3874
E david.fisher@ae.gt.com

BRICS

Harish HV

Head of Transaction advisory services
Grant Thornton India
T +91 80 2430 800
E harish.hv@in.gt.com



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