PRIVATE EQUITY & VENTURE CAPITAL

ANNUAL REVIEW **2014**

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Financier Worldwide canvasses the opinions of leading professionals around the world on the latest trends in private equity & venture capital.

INTRODUCTION

2014 was a notable year for the private equity industry, with buyout activity increasing considerably over the last 12 months.

Softening debt markets and dry powder reserves will be an issue for many firms in the months ahead. Estimates suggest that the level of dry power within the PE industry has now topped $1.6 trillion. Should quality assets prove hard to source during 2015, as they did at times during 2014, it will be tough for PE firms to put their existing funds to work.

In terms of exits, IPOs have become more prevalent in recent years, partly due to PE firms pursuing dual track exits from their investments. That said, trade deals and secondary buyouts are still the most popular forms of exit.

The fundraising outlook generally remained positive throughout the year, and this trend is likely to continue into 2015. An increase in new private equity funds emerging from China, as well as increased commitments from major pension and sovereign wealth funds, were notable developments in 2014. In Australia, for example, sovereign wealth funds emerged as the largest source of new commitments last year. For investors looking to allocate capital, the quality of fund managers remains paramount. Investors are seeking general partners with a proven track record demonstrating stability in the long run.

UNITED STATES

JEREMY DICKENS
SHEARMAN & STERLING LLP

Q HOW WOULD YOU CHARACTERISE PRIVATE EQUITY DEALMAKING IN THE US OVER THE LAST 12-18 MONTHS? WHAT KINDS OF TRANSACTION VALUES ARE APPARENT AND IS THERE STRONG COMPETITION FOR DEALS?

DICKENS: On a global basis, we have seen increasing activity across almost all geographies with particular activity in the United States, Europe and the Middle East. Transaction values vary depending on the type of transaction and by region, with smaller transactions, those under $250m being more typical in markets such as the Middle East and Asia. In the US and Europe, the most consistent level of activity has been in the middle market, with transaction values between $250m-$1bn, although there are, of course a handful of larger transactions.

Q TO WHAT EXTENT ARE BANKS EAGER TO PROVIDE FINANCING FOR LEVERAGED BUYOUTS? ARE 'NON-TRADITIONAL' LENDERS ALSO VISIBLE IN THE MARKET?

DICKENS: There is no doubt that bank capital is less available for larger private equity transactions than had been the case before the banking regulators in the United States began imposing significant leverage limits on commercial lenders. While the impact of these regulatory changes tends to affect only larger transactions where the buyers seek total leverage greater than 6x EBITDA, we have seen a number of alternative lenders beginning to compete aggressively to provide capital in lieu of commercial institutions. We believe that alternative lenders will only become more active in the debt markets.

Q COULD YOU OUTLINE THE MOST SIGNIFICANT LEGAL AND REGULATORY DEVELOPMENTS FACING THE PRIVATE EQUITY INDUSTRY? IN YOUR OPINION, HOW WILL THEY SHAPE THE ASSET CLASS IN THE LONG TERM?

DICKENS: In general, there are few, if any, legal and regulatory developments affecting private equity firms directly in the way in which they are executing transactions. Private equity transactions generally involve tried-and-true acquisition and financing techniques. To the extent regulatory pressures on commercial banks reduce the availability of bank capital, the private equity industry will adapt and work with alternative debt providers. Similarly, the expensive settlement of the 'collusion' lawsuits arising out of some of the very large 'club transactions' of the 2004-07 era has made it more difficult, but not impossible, for firms to join forces to

bid for assets. Private equity firms are simply more conscious of the need for transparency and upfront consultation with sellers and their advisers concerning their willingness to participate in particular transactions only if they are able to partner with other financial investors. Indeed, with the increasing level of direct investment activity by sovereign wealth funds, large pension plans and large family offices, private equity firms no longer have to rely solely on other private equity firms to provide a portion of the capital necessary to fund acquisitions. I suppose one might say that the private equity industry simply continues to showcase its ability to adapt as necessary in order to continue investing.

Q HOW ARE PRIVATE EQUITY FIRMS ACTIVELY REDUCING RISK AND IMPROVING RETURNS ACROSS THEIR PORTFOLIO?

DICKENS: The fundraising environment for private equity continues to be challenging, with an ever-increasing number of LPs choosing to make more concentrated investments with a smaller number of GPs. Naturally, this puts pressure on private equity firms to work as hard as possible to demonstrate attractive investment returns. One of the ways in which GPs reduce the risk in their portfolios is by being more selective about the transactions they pursue. In that regard, we have noticed an increased emphasis on upfront business and legal due diligence on potential targets and a greater willingness on the part of sponsors to walk away from marginal transactions. We also see sponsors devoting significant resources to monitoring their portfolio investments and a greater willingness to intervene when actual results deviate from expected results.

Q HOW ARE PRIVATE EQUITY EXITS PLAYING OUT IN THE US? IS THERE AN EMPHASIS TOWARD TRADE SALES, IPOS

DICKENS: Whether exits tend toward IPOs, secondary buyouts or trade sales is more a function of relative opportunities than a desire by a sponsor for a particular form of exit. According to conventional wisdom, a sponsor realises the highest theoretical value by selling a portfolio company to a trade buyer – largely because trade buyers can pay more

"We expect to see more LPs develop direct investing programs, in addition to seeking co-investment rights."

OR SECONDARY BUYOUTS, FOR EXAMPLE?

due to inherent operating synergies and a longer investment horizon than sponsors. But that requires trade buyers to actively look for acquisitions. As between an IPO and a secondary buyout, we tend to see sponsors being somewhat indifferent. From a sponsor's perspective, exiting via an IPO is more risky than a secondary buyout because a sponsor almost never is able to liquidate its entire investment at the time of the IPO. Instead, it typically takes a sponsor another 12-30 months to sell its remaining position, which means that the value of the remaining stake fluctuates with the markets and the company's performance. A secondary buyout offers an opportunity to sell all, or substantially all, of a sponsor's stake in one transaction. It simply comes down to which transaction – on a risk adjusted basis – is likely to produce a better outcome for the sponsor. We are currently seeing an increasing number of exits via trade sales, although there are still a number of exits via IPO or by secondary buyout.

Q COULD YOU PROVIDE AN INSIGHT INTO THE MAJOR ISSUES SHAPING THE RELATIONSHIP BETWEEN GENERAL PARTNERS (GPS) AND LIMITED PARTNERS (LPS)?

DICKENS: The relationship between GPs and LPs is evolving with a number of larger LPs, such as sovereign wealth funds, pension plans and large family offices, increasingly interested in co-investing with their existing GPs or engaging in direct investing activities where opportunities come to them from other sources, including via internal efforts to seek out opportunities. In years past, sponsors offered co-investment opportunities to their LPs, typically because they could not fund an acquisition without additional capital due to concentration limits in their underlying fund documents – that is, no more than X percent of committed capital may be invested in a particular portfolio company, or in a particular geography or particular industry. As time has progressed, many large LPs have insisted on co-investment rights because of the opportunity to deploy greater capital in a particular transaction and at an overall lower cost. An increasing number of large LPs, however, taking the knowledge gained through co-investing, have developed large and capable direct investment programs led by internal investment professionals who seek out investment opportunities. We expect to see more LPs develop direct investing programs, in addition to seeking co-investment rights. While many of these LPs will continue to be major investors in private equity funds, some of them will also compete directly with funds for investment opportunities.

Q LOOKING AHEAD, WHAT ARE YOUR PREDICTIONS FOR PRIVATE EQUITY FUNDRAISING IN THE COMING MONTHS?

DICKENS: We continue to be optimistic about the overall amount of capital available to private equity sponsors. However, we expect the trend to continue toward larger LP commitments and fewer GPs. As a result, we believe first-time funds will continue to experience significant difficulty raising capital, and established but smaller funds in the sub-$5bn range without clearly differentiated investment strategies will have a harder time raising capital even if past investment performance has been better than benchmarks. Of course, funds with poor investment performance will find it difficult to raise capital unless there is a convincing reason behind the lagging performance. Put another way, available capital is likely to flow most easily to the very largest funds, many of which now offer multi-asset classes under one umbrella organisation, or to larger funds with clearly differentiated strategies.

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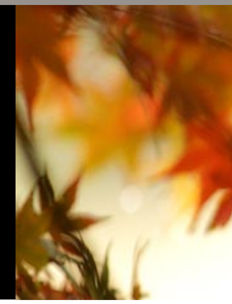
Jeremy Dickens, co-head of Shearman & Sterling's Private Equity Group, has represented private equity sponsors including Apax, Blackstone, Capital Z Partners, Hicks, Muse, Tate & Furst, Providence Equity Partners, Roundtable Investment Partners, The Olayan Group, Emirates International Investment Company, KIPCO and Texas Pacific Group, as well as their portfolio companies. Before joining the firm, Mr Dickens practiced 18 years at another international law firm where he was a member of the private equity practice and co-founder and co-head of its global capital markets practice. He also spent nearly six years as a corporate executive, entrepreneur and board member.

CANADA

BENJIE THOMAS
KPMG



Q HOW WOULD YOU CHARACTERISE PRIVATE EQUITY DEALMAKING IN CANADA OVER THE LAST 12-18 MONTHS? WHAT KINDS OF TRANSACTION VALUES ARE APPARENT AND IS THERE STRONG COMPETITION FOR DEALS?

THOMAS: After seeing modest growth in 2013, the Canadian private equity market (PE) really picked up in 2014. By the end of the third quarter last year, the total number of buyout-PE deals was almost 40 percent higher than the same period in 2013. Deal values were also considerably higher in 2014, which saw several large-cap transactions, including 3G Capital Inc's takeover of Tim Hortons Inc for $12.5bn. Traditional sources such as Canadian capital are providing a tremendous amount of capital but we are continuing to see more and more US PE firms enter the market. We are also seeing a healthy amount of competition among Canadian and US PE firms as well as corporate players, with the latter group increasingly going against PE players.

Q TO WHAT EXTENT ARE BANKS EAGER TO PROVIDE FINANCING FOR LEVERAGED BUYOUTS? ARE 'NON-TRADITIONAL' LENDERS ALSO VISIBLE IN THE MARKET?

THOMAS: Banks are aggressive and eager to provide financing for leveraged buyouts, with attractive interest rates and financing values that reflect their appetite for these types of loans. Non-traditional lenders are also active in the market. We are meeting with many Canadian and American lenders who specialise in senior and sub-debt financing for leveraged buyouts. There is ample capital available in the market right now, and banks as well as non-traditional lenders want to put this money to work.

Q COULD YOU OUTLINE THE MOST SIGNIFICANT LEGAL AND REGULATORY DEVELOPMENTS FACING THE PRIVATE EQUITY INDUSTRY? IN YOUR OPINION, HOW WILL THEY SHAPE THE ASSET CLASS IN THE LONG TERM?

THOMAS: Historically, the Canadian PE market has not been constricted by too many rules and regulations. In fact, most PE groups here do not register with their respective securities commissions unless they are launching multiple platforms on a regular basis. But with the United States taking steps to tighten regulation of PE funds in the aftermath of the recent financial crisis, we may see securities regulators in Canada following suit. We are seeing the impact of an external regulatory development, namely the Alternative Investment Fund Managers Directive. This new rule is making it more difficult for Canadian-based managers to raise capital from investors within the European Union.

Q HOW ARE PRIVATE EQUITY FIRMS ACTIVELY REDUCING RISK AND IMPROVING RETURNS ACROSS THEIR PORTFOLIO?

THOMAS: Today's PE funds are willing to invest more in process improvement in portfolio companies. They are focusing more on activities such as post-merger integration – which can make a significant difference in how these investments perform in the long run – and hiring consultants to drive specific projects in their portfolio companies. There is also a greater willingness among PE funds to turn over management quickly when a company underperforms and pull in very capable and experienced people with industry-specific expertise who can help improve returns and provide value to the business.

“There is a lot of capital out there, and we are going to see much more of it deployed in the months ahead.”

Q HOW ARE PRIVATE EQUITY EXITS PLAYING OUT IN CANADA? IS THERE AN EMPHASIS TOWARD TRADE SALES, IPOS OR SECONDARY BUYOUTS, FOR EXAMPLE?

THOMAS: Most exit transactions in the Canadian PE market are traditional PE to corporate, with strategic acquirers accounting for close to 60 percent of exits in 2013 and about 50 percent for the first three quarters in 2014. Historically, IPOs have not been a popular exit route in Canada, while secondary buyouts are usually the second most prevalent type of transaction after strategic sales. But in the last three years, we have seen more PE held companies going public. In 2011, IPOs represented less than 10 percent of PE exits. However, last year they accounted for about 30 percent of exits in the first three quarters.

Q COULD YOU PROVIDE AN INSIGHT INTO THE MAJOR ISSUES SHAPING THE RELATIONSHIP BETWEEN GENERAL PARTNERS (GPs) AND LIMITED PARTNERS (LPs)?

THOMAS: The introduction of PE guidelines by the Institutional Limited Partners Association (ILPA) started a trend of harmonising the terms of various funds, and served to shift thinking and power dynamics in the industry. The general result has been terms that tend to be more favourable for LPs, and better alignment overall between LPs and GPs. We have seen instances where waterfall calculations are being changed further back and carrying interest. We are also seeing terms in limited purchase agreements that are becoming more aligned and in compliance with ILPA guidelines. But I think it is safe to say that the relationship between GPs and LPs will ebb and flow depending on supply and demand. As well, those GPs with an established history and great track record can demand better terms as there are more people who want to invest with them. New managers, on the other hand, will have to build terms that are more LP-friendly.

Q LOOKING AHEAD, WHAT ARE YOUR PREDICTIONS FOR PRIVATE EQUITY FUNDRAISING IN THE COMING MONTHS?

THOMAS: When you look at the Canadian PE landscape, the ability to source capital has historically been a considerable challenge. But this is improving and will continue to do so – due, in large part, to international LPs' interest in diversifying risk and putting dollars in the Canadian marketplace. We saw evidence of this stronger fundraising environment in 2013, when Canadian PE fundraising rebounded to $5bn, with 2014 tracking to be one of Canada's best years ever, reaching $8bn through Q3 – already the highest amount since 2006 which finished with $10bn. There is a lot of capital out there, and we are going to see much more of it deployed in the months ahead.

KPMG
cutting through complexity

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Benjie Thomas is a partner in the Advisory Services practice at KPMG in Canada, and National Leader for the Private Equity practice. He has more than 13 years of experience helping private equity funds and strategic buyers plan and execute acquisitions, reorganisations and divestitures. Mr Thomas has been involved in a variety of transactions in several industry sectors including private equity, telecom, manufacturing, retail, and information and entertainment. He provides advisory services around mergers and acquisitions including financial due diligence, transaction management, disposition and financing. Mr Thomas is also a member of KPMG's Global Private Equity Team and Global Diversified Industrials Team.

BRAZIL

JOÃO BUSIN
TOZZINI FREIRE

Q HOW WOULD YOU CHARACTERISE PRIVATE EQUITY DEALMAKING IN BRAZIL OVER THE LAST 12-18 MONTHS? WHAT KINDS OF TRANSACTION VALUES ARE APPARENT AND IS THERE STRONG COMPETITION FOR DEALS?

BUSIN: Overall, dealmaking has been growing steadily in Brazil, although, according to data released by the Emerging Markets Private Equity Association, private equity fund managers executed 19 deals in Brazil in the first half of 2014, the fewest recorded in the first six months of a year since 2009. This may be attributed to the fact that Brazil hosted the FIFA World Cup 2014 and to the general feeling of uncertainty surrounding the presidential election of October 2014. Compared to other jurisdictions with more consolidated and sophisticated private equity industries, smaller deals normally account for a larger proportion of deals in Brazil. The most targeted sectors by private equity investors are technology, services in general, consumer, real estate, timber, agribusiness, industrials & manufacturing, energy & natural resources and infrastructure. Given Brazil's leading position in Latin America as the region's largest economy, there is fierce competition for the best deals. In order to adjust to this reality, some local GPs are starting to put effort into raising funds with a more diversified profile and larger deal tickets.

Q TO WHAT EXTENT ARE BANKS EAGER TO PROVIDE FINANCING FOR LEVERAGED BUYOUTS? ARE 'NON-TRADITIONAL' LENDERS ALSO VISIBLE IN THE MARKET?

BUSIN: Local private equity and venture capital deals are predominantly not leveraged at all, given that access to debt is still something difficult in Brazil. This is probably because debt is prohibitively expensive in Brazil, and there is a general cultural aversion of banks to the risk of defaults, caused by a past of hyper inflation and high interest rates. Brazilian banks and other local sources of debt are seldom prepared to offer sophisticated debt engineering suited to fit within the returns expected by a private equity investor. When used at all, the typical sources of finance are commercial banks, development banks and fostering organisations.

Q COULD YOU OUTLINE THE MOST SIGNIFICANT LEGAL AND REGULATORY DEVELOPMENTS FACING THE PRIVATE EQUITY INDUSTRY? IN YOUR OPINION, HOW WILL THEY SHAPE THE ASSET CLASS IN THE LONG TERM?

BUSIN: Two important changes were introduced to the rules governing private equity funds (FIPs), probably the main type of vehicle used in Brazil's private equity and venture capital industry. The changes, made through amendments to the rules governing private equity funds, allow fund managers to, on behalf of the fund, grant fiduciary guarantees, or cause the fund to be a co-obligor by any other means, provided that this is permitted under the fund's rules and approved via a majority vote taken by the fund's quota holders. In addition, according to the rules applicable to private equity funds, they must exercise effective influence on the decision making process of their portfolio companies. This should be accomplished via a shareholders' agreement or seat on the company's board, for example. As a result of an instruction from the Brazilian Securities Commission that also amended the rules applicable to private equity funds, the 'effective influence' requirement has been made more flexible for private equity funds that invest in companies listed under stock exchanges or over-the-counter markets special listing segments related to access markets. Finally, a new type of regulated fund was conceived by the Commission, the so-called Shares' Fund–Access Market. This is a type of fund aimed at investing a larger proportion of its net equity in shares issued by companies listed under the rules of listing segments dedicated to the access market. The first regulatory change mentioned above has been giving some more flexibility to funds, especially on exiting their investments. The second and the third amendments will boost the local access market, creating a more favourable environment for smaller companies to become listed companies.

Q HOW ARE PRIVATE EQUITY FIRMS ACTIVELY REDUCING RISK AND IMPROVING RETURNS ACROSS THEIR PORTFOLIO?

BUSIN: Fund managers have become more active over the years, demanding more influence in the management of portfolio companies, seeking more guarantees from entrepreneurs against liability risks and focusing on clearer protections against these risks when preparing transaction documents. In addition, as Brazil has an aggressive and time consuming court litigation culture, choosing arbitration as the applicable dispute resolution mechanism

"The relatively slower growth of Brazil's economy, compared to recent years, has driven down valuations of local companies and it seems that Brazil is now entering a buyers' market."

has become very popular among fund managers. Additionally, as the industry progresses there are more and more professionals with experience in private equity, and fund managers are constantly surveying the market for these professionals. All these measures have been helping fund managers to improve returns across their portfolios. Also, as many private equity firms have now raised at least two funds and have therefore enhanced their track record, some firms have been able to increase their investment ticket, which allows them to aim at companies at higher development stages, with more realistic conditions of generating the returns expected by the funds' LPs.

Q HOW ARE PRIVATE EQUITY EXITS PLAYING OUT IN BRAZIL? IS THERE AN EMPHASIS TOWARD TRADE SALES, IPOS OR SECONDARY BUYOUTS, FOR EXAMPLE?

BUSIN: Trade sales have been the most common way of exiting private equity investments in Brazil. This is probably because there are various local markets that are still fragmented, offering strategic buyers opportunities to consolidate in these markets. Despite a relative slowdown in recent years, it is still possible to exit through an IPO. Since the turn of the century, Brazil's capital market has experienced significant growth. This is due to a combination of regulatory and macroeconomic factors. Since 2004, more than 150 Brazilian companies have become publicly-held corporations. Considering the local private equity industry is relatively young, particularly compared to the US and European industries, secondary buyouts are still rare.

Q COULD YOU PROVIDE AN INSIGHT INTO THE MAJOR ISSUES SHAPING THE RELATIONSHIP BETWEEN GENERAL PARTNERS (GPs) AND LIMITED PARTNERS (LPs)?

BUSIN: The main issues that normally require more attention in terms of interest alignment between GPs and LPs are the level of influence exercised by LPs in relation to the fund's matters – for instance, Brazilian LPs tend to demand a seat on the investment committee, better transparency, decision making processes in connection with portfolio investments and exits, clear criteria regarding calculation and payment of the fund's manager performance fees, less discretion in the investment decision, and rules and restrictions applicable to the fund manager in terms of time dedicated to the fund and its portfolio. There are even certain standards intended to address these issues, which were conceived by some non-profit associations, such as the self regulatory code of best practices to the market of regulated Private

Equity Funds and Venture Capital Funds, which was enacted by the Brazilian Venture Capital and Private Equity Association together with the Brazilian Financial and Capital Markets Association.

Q LOOKING AHEAD, WHAT ARE YOUR PREDICTIONS FOR PRIVATE EQUITY FUNDRAISING IN THE COMING MONTHS?

BUSIN: The relatively slower growth of Brazil's economy, compared to recent years, has driven down valuations of local companies and it seems that Brazil is now entering a buyers' market. Certain private equity houses have been looking at raising sizeable funds dedicated to investing in Latin America or even exclusively in Brazil. Advent has recently raised a $2.1bn fund for investing in Latin America, and Brazil in particular. Local private equity firm Patria has raised a $1.75bn fund dedicated to domestic investing. BNDESPar, the investment arm of the Brazilian Development Bank, has recently announced that it will invest a total aggregate amount of R$470m in five multi-sector funds, each managed by local private equity and venture capital houses. In addition to more realistic valuations, the country's urgent need for basic infrastructure will probably further attract investments.

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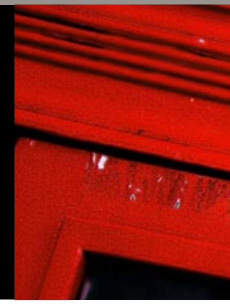
João Busin is a partner in Tozzini Freire's São Paulo office. With over 10 years of practice in the Corporate/M&A area, Mr Busin has been assisting local and foreign investors in transactions in a variety of different sectors. With experience in advising private equity and venture capital players, he is recognised for his ability to combine technical expertise and deep industry knowledge. Mr Busin previously worked as a foreign associate with Freshfields Bruckhaus Deringer LLP in its London office from 2011 to 2012.

UNITED KINGDOM



TOM WHELAN
HOGAN LOVELLS INTERNATIONAL LLP

Q HOW WOULD YOU CHARACTERISE PRIVATE EQUITY DEALMAKING IN THE UK OVER THE LAST 12-18 MONTHS? WHAT KINDS OF TRANSACTION VALUES ARE APPARENT AND IS THERE STRONG COMPETITION FOR DEALS?

WHELAN: Private equity activity in Europe has increased significantly over the last 12-18 months. The availability of debt, coupled with signs of economic recovery and growth have increased the confidence level of sponsors. This is most apparent in the number of sponsors looking to exit investments because of the current prices being paid on exit. Pricing around 10 times EBITDA is not uncommon at the moment, with fierce competition particularly evident in the technology and healthcare sectors, where higher prices have been paid in some cases. Added to this, the improved fundraising climate has encouraged sponsors to deploy the remaining capital in their existing funds and to go out and raise new funds. Sponsors, although more confident, continue to be wary of auction processes unless they have a real angle, and are less willing to incur significant costs until they have more visibility on their ability to consummate the deal.

Q TO WHAT EXTENT ARE BANKS EAGER TO PROVIDE FINANCING FOR LEVERAGED BUYOUTS? ARE 'NON-TRADITIONAL' LENDERS ALSO VISIBLE IN THE MARKET?

WHELAN: The availability of financing for leveraged buyouts has increased in the last 12-18 months. Although banks are more willing to provide debt for leveraged buyouts post economic crisis, there is now a lot more competition. Today sponsors have the choice of traditional bank financing, financing from credit funds – including unitranche – or tapping high yield bond markets. This competition has led to sponsors driving better deal terms on the debt they are looking to raise, which in turn has led to the return of more 'covenant-lite' lending, last seen back in 2006/07. Unitranche in particular offers more flexibility than traditional bank financing, with more headroom on covenants, allowing borrowers to repay the debt on exit, instead of over the term of the debt, and to make bolt-on acquisitions as part of any buy and build strategy. As a result of this competition, leverage of up to seven times EBITDA, is not atypical.

Q COULD YOU OUTLINE THE MOST SIGNIFICANT LEGAL AND REGULATORY DEVELOPMENTS FACING THE PRIVATE EQUITY INDUSTRY? IN YOUR OPINION, HOW WILL THEY SHAPE THE ASSET CLASS IN THE LONG TERM?

WHELAN: The scale of regulation has increased significantly in recent years and regulators are taking steps to hold sponsors to account for the actions of portfolio companies. Penalties for non-compliance can often be draconian. This has led to more sponsors hiring general counsel and compliance personnel to handle this increasing tide. Legal due diligence by sponsors on transactions regularly includes checking compliance with the UK Bribery Act 2010, and its US equivalent, and US and EU sanctions. There is also greater scrutiny around cartel and anti-competitive behaviour. In addition, tax structuring of investments by sponsors and tax compliance generally has also received a lot more focus given the heightened interest of both the media and tax authorities around the world which are attempting to fill shortfalls in tax revenues in the wake of the economic downturn. Such increased regulation should improve further corporate governance and result in better risk management, but will come with increased costs that may impact returns.

Q HOW ARE PRIVATE EQUITY FIRMS ACTIVELY REDUCING RISK AND IMPROVING RETURNS ACROSS THEIR PORTFOLIO?

WHELAN: Sponsors are proactively reducing the risk in relation to behaviour that could result in serious fines or criminal convictions and attendant loss of reputation for themselves or their portfolio companies. Risk mitigation efforts are being carried out by compliance personnel which include greater training and awareness raising. In some cases, sponsors are no longer prepared to invest in certain sectors or countries because of perceived risks associated with the same. Leverage is no longer seen as the only way of driving returns, and sponsors have focused much more on driving operational returns at the portfolio level and creating additional value through the use of buy and build strategies. In addition, major cost savings have also been delivered by adopting better systems and processes across portfolio companies, and

"The current fundraising market is reasonably buoyant and most sponsors are optimistic about their prospects of raising a fund to at least the same level as previous funds."

in some cases investors have looked at their brand and IP portfolios as ways of monetising or driving extra revenue. Incentivising management properly also plays a huge role in driving overall returns.

Q HOW ARE PRIVATE EQUITY EXITS PLAYING OUT IN THE UK? IS THERE AN EMPHASIS TOWARD TRADE SALES, IPOS OR SECONDARY BUYOUTS, FOR EXAMPLE?

WHELAN: The strength of European capital markets has allowed many sponsors to employ a dual track exit strategy to depart their investments. This approach has resulted in significantly more IPO exits over the past two years than in prior years. Where exits have occurred as a sale, cash rich trade players have often outbid competing private equity bidders. Trade players from Asia, new private equity funds emerging out of China and major pension and sovereign wealth funds looking to make their own direct investments have added to the competition. Although secondary buyouts are still a feature of the exit landscape, they are not as prevalent as they used to be due to the significant increase in competition from trade players and the IPO market. Overall, most exits still occur by way of a trade sale or secondary buyout, rather than an IPO, which is viewed by sponsors as a partial exit.

Q COULD YOU PROVIDE AN INSIGHT INTO THE MAJOR ISSUES SHAPING THE RELATIONSHIP BETWEEN GENERAL PARTNERS (GPs) AND LIMITED PARTNERS (LPs)?

WHELAN: Although there has been increased alignment in the respective interests of GPs and LPs over the last five years, recent surveys show that LPs think more needs to be done. The 'old chestnut' issues of management fee levels, and paying fees on committed but uninvested capital, continue to remain high on the agenda for LPs. In addition, governance issues and increased transparency, covering not just portfolio company information, but also what fees and expenses are being charged to the fund, are increasingly seen as key matters for significant LPs. After the upheaval experienced by some GPs, stability of the management team and sound succession planning is also of great importance when making the decision to commit to a fund. Finally, for the more noteworthy LPs, the prospects of being offered attractive co-investment opportunities will also be a key factor.

Q LOOKING AHEAD, WHAT ARE YOUR PREDICTIONS FOR PRIVATE EQUITY FUNDRAISING IN THE COMING MONTHS?

WHELAN: The current fundraising market is reasonably buoyant and most sponsors are optimistic about their prospects of raising a fund to at least the same level as previous funds. However, where the track record of managers has been poor, those managers will continue to struggle to raise new funds. Equally, many managers who leave to set up their own new funds are also likely to struggle. For investors, the quality of the managers is the key fundamental, based on their track record. Sponsors are therefore continuing to focus on what they are good at, known for and can deliver on when fundraising, as investors are more likely to understand the story. It is noticeable that many sovereign wealth funds and their equivalents are making more direct investments or co-investing, rather than investing money into traditional private equity funds – accordingly, they may not be the source of capital for private equity funds that they once were.

Tom Whelan

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Tom Whelan regularly advises private equity sponsors, management, general corporates and banks on UK and international investments, mergers and acquisitions, disposals and restructurings. These include management buyouts, management buy-ins, BIMBOs, secondary buyouts, public to privates, exits and refinancings, as well as bolt-on acquisitions for portfolio companies and debt for equity swaps. Mr Whelan has worked on transactions in many industry sectors throughout his career including the financial services, transport/logistics, infrastructure, healthcare, hotels, media and telecoms, retail, real estate, water and energy sectors.

GERMANY

STEVE ROBERTS
PWC

Q HOW WOULD YOU CHARACTERISE PRIVATE EQUITY DEALMAKING IN GERMANY OVER THE LAST 12-18 MONTHS? WHAT KINDS OF TRANSACTION VALUES ARE APPARENT AND IS THERE STRONG COMPETITION FOR DEALS?

ROBERTS: The past 18 months have shaped up to be a seller's market, with significant dry powder available and favourable financing conditions leading to very competitive auctions for what has been a surprisingly low level of deal flow. There has been a healthy number of large cap assets on the market, from both corporates looking to divest non-core businesses and reorganise and restructure themselves, as well as from private equity exits. Mid-cap deals continue to be scarcer, following the trend from recent years. Small-cap deals have continued to develop healthily, with venture capital experiencing a revival in Germany. While equity to debt ratios have remained at higher levels than the pre-crisis period, the proportion of debt did begin to increase in the second half of 2014.

Q TO WHAT EXTENT ARE BANKS EAGER TO PROVIDE FINANCING FOR LEVERAGED BUYOUTS? ARE 'NON-TRADITIONAL' LENDERS ALSO VISIBLE IN THE MARKET?

ROBERTS: Banks continue to be very keen to provide financing for LBOs, which in a lower deal flow environment, is an area of the market which is becoming increasingly competitive. Allocating liquidity to alternative asset classes such as private equity has become an important component of asset allocation for banks and LPs alike. Consequently, we have seen a substantial increase in equity co-investments with other PE houses, and in particular LP direct investments, as PE houses seek to diversify their equity risk, and at the same time offer their LPs the opportunity for higher returns.

Q COULD YOU OUTLINE THE MOST SIGNIFICANT LEGAL AND REGULATORY DEVELOPMENTS FACING THE PRIVATE EQUITY INDUSTRY? IN YOUR OPINION, HOW WILL THEY SHAPE THE ASSET CLASS IN THE LONG TERM?

ROBERTS: Regulators have introduced changes in recent years that have impacted the private equity industry significantly. The most prominent changes were introduced with the AIFMD, which, broadly speaking, places more regulatory pressure on private equity houses and results in a higher cost base. This higher base is a result of rising legal costs and expenditure on reporting, compliance and risk management measures. In the long term, this may lead to a decrease in the number of smaller private equity houses and potentially result in significant consolidation within the industry.

Q HOW ARE PRIVATE EQUITY FIRMS ACTIVELY REDUCING RISK AND IMPROVING RETURNS ACROSS THEIR PORTFOLIO?

ROBERTS: Private equity firms have adapted their business models by shifting their focus toward operational improvements and sustainable growth, with the days of cost-cutting and short-term efficiency gains now a thing of the past. This is reflected in longer holding periods across all industries and asset sizes, as today private equity houses need longer to implement their value creation strategies in order to realise the respective equity stories. The validation of these equity stories in the due diligence phase has become a significant focus and reemphasises the need for solid upfront investigation. This is being reflected in the extended sales periods that we are seeing today, which are lasting longer than before.

Q HOW ARE PRIVATE EQUITY EXITS PLAYING OUT IN GERMANY? IS THERE AN EMPHASIS TOWARD TRADE SALES, IPOS OR SECONDARY BUYOUTS, FOR EXAMPLE?

ROBERTS: Private equity has sought to benefit from the status quo of favourable market conditions for sellers, which has resulted in a number of exits over the last couple of years. Trade sales have dominated the small and mid-cap transactions space, while either secondaries or IPOs have been more prevalent with larger assets. The IPO window was open throughout 2014, and we have seen a considerable trend toward exits via this route – 64 percent of IPOs in Germany in 2014 were of private equity portfolio companies.

Q LOOKING AHEAD, WHAT ARE YOUR PREDICTIONS FOR PRIVATE EQUITY FUNDRAISING IN THE COMING MONTHS?

ROBERTS: The fundraising outlook remains good, but increasing reserves of dry powder remains an issue for PE funds. Quality assets are becoming more difficult to find in the current market, which in turn makes it difficult to put funds to work. Nevertheless, we are likely to see an increase in funds raised, as institutional investors will continue to allocate capital to private equity in an effort to escape low interest rates, proving that private equity is still a highly profitable asset class, albeit the level of returns are more challenging to maintain.

> **"Trade sales have dominated the small and mid-cap transactions space, while either secondaries or IPOs have been more prevalent with larger assets."**

Steve Roberts

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SPAIN

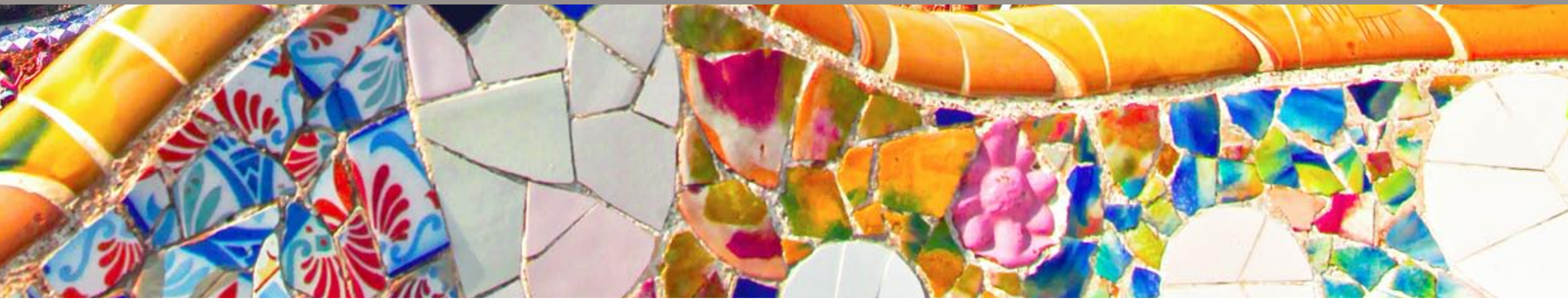
GONZALO NAVARRO MARTÍNEZ-AVIAL
ROCA JUNYENT

Q HOW WOULD YOU CHARACTERISE PRIVATE EQUITY DEALMAKING IN SPAIN OVER THE LAST 12-18 MONTHS? WHAT KINDS OF TRANSACTION VALUES ARE APPARENT AND IS THERE STRONG COMPETITION FOR DEALS?

NAVARRO: As a general rule, investments by private equity in Spain have stabilised over the last 12 months, following the path set by the Spanish economy. 2013 was perhaps one of the toughest years for private equity since the onset of the economic crisis, with investment volumes considerably down on 2012. Total investment for 2013 amounted to €2.3bn over a total of 543 transactions. However, the final quarter of 2013 and 2014 has provided cause for optimism within the industry. We have seen renewed energy in the private equity market, with investment in private equity funds rallying impressively over the course of 2014. The main news has been the launch of the FOND-ICO Global public fund of funds and the improvements seen in the country's ailing economy. The main economic indicators have revealed that the country is at a positive juncture – the economy has been gaining ground over recent months and has been outpacing analyst's expectations. Private equity is being driven forward by this climate. These factors point to the fact that 2014 is likely to have been a year of slow but sustained recovery for both the Spanish economy and the domestic private equity market. The first nine months of 2014 alone saw private equity investment up 38 percent on the same period of 2013.

Q TO WHAT EXTENT ARE BANKS EAGER TO PROVIDE FINANCING FOR LEVERAGED BUYOUTS? ARE 'NON-TRADITIONAL' LENDERS ALSO VISIBLE IN THE MARKET?

NAVARRO: Debt financing was very hard to come by in 2013, and this triggered a significant slump in the number of leveraged transactions, which stood at just 12, down considerably from the 32 reported in 2011. Improved access to bank borrowing has yet to feed through to private equity. During the first nine months of 2014, 45 percent of total volume was invested in nine LBO deals. The widespread lack of access to borrowing has ensured that the majority of deals have been financed with equity, thus impacting investor returns. We believe the outlook for LBOs is likely to undergo significant changes in the months ahead.



Q COULD YOU OUTLINE THE MOST SIGNIFICANT LEGAL AND REGULATORY DEVELOPMENTS FACING THE PRIVATE EQUITY INDUSTRY? IN YOUR OPINION, HOW WILL THEY SHAPE THE ASSET CLASS IN THE LONG TERM?

NAVARRO: Private equity is heavily regulated in Spain and firms are supervised by the Spanish Securities Market Commission (CNMV). A new law was enacted in November 2014 which ushered in a new regulatory framework for private equity firms, other closed-ended collective investment schemes and closed-ended collective investment scheme management companies. This new law transposes AIFMD, which the drafters have relied on in order to reform Spain's existing private equity law. The main reasons for the reform stem from the desire to favour direct sources of financing for companies through more flexible arrangements, while lowering the Spanish economy's reliance on banking, particularly during the early stages of development and expansion. The new law introduces a new legal concept for SME private equity firms, relating to schemes that invest at least 75 percent of their equity in SMEs. Those schemes can now utilise equity instruments, participating loans and debt instruments to provide financing to these companies. Moreover, the financial frameworks governing private equity companies have been adjusted to improve their operation. These tweaks include greater use of participating loans, added flexibility in calculating periods in which the compulsory investment ratio must be met, and the fact that private equity funds can now distribute profits periodically. The new law also establishes a European framework of conditions governing authorisation, commercialisation, conduct and organisation of the managers of these investment funds at a European level. The enactment of a major reform to existing tax law in Spain was due in December 2014; going forward, the reform is expected to have a sizeable impact on corporate income tax for companies.

Q HOW ARE PRIVATE EQUITY FIRMS ACTIVELY REDUCING RISK AND IMPROVING RETURNS ACROSS THEIR PORTFOLIO?

NAVARRO: Increasingly, firms have been applying a responsible investment model to their portfolios. This has been done in a bid to maximise long-term returns, while seeking out short-term opportunities in areas such as cost savings and commercial differentiation. Similarly, the remuneration policies of firm's management teams have been brought closer in line with the interests of shareholders. Primarily, however, risk has been reduced through the diversification of portfolios and international investment and expansion.

Q HOW ARE PRIVATE EQUITY EXITS PLAYING OUT IN SPAIN? IS THERE AN EMPHASIS TOWARD TRADE SALES, IPOS OR SECONDARY BUYOUTS, FOR EXAMPLE?

NAVARRO: Divestment has been one of the variables that fared best in 2013 after several years of very little activity. The most commonly seen exit mechanism was sales to third parties, followed by a buyback by the company's original shareholders. It should also be noted that after various years of seeing no stock market listings as a means of exiting funds, there have finally been a number of important cases. In 2014, divestments were up 220 percent on 2013. Of these, sales to third parties accounted for 74 percent of exit mechanisms, while sales on the stock market represented 15.4 percent, and 4.4 percent came from sales to other private equity companies.

Q COULD YOU PROVIDE AN INSIGHT INTO THE MAJOR ISSUES SHAPING THE RELATIONSHIP BETWEEN GENERAL PARTNERS (GPs) AND LIMITED PARTNERS (LPs)?

NAVARRO: There is one objective to the governance of any entity including private equity funds – aligning the interests of different stakeholders. Aligning interests between a GP and an LP in a fund has always been a difficult matter. Previously, there has been a tendency to increase the alignment of both the LP and GP in order to have an impact on fundraising, and offer transparency to private equity entities. However, historically there has been considerable friction between these two figures. Largely this is due to LPs demanding returns and profits from GPs in hugely testing periods and the latter being wholly unable to comply. This has prompted LPs to lower and, in certain cases, even breach their investment commitments.

"The remuneration policies of firm's management teams have been brought closer in line with the interests of shareholders."

Q LOOKING AHEAD, WHAT ARE YOUR PREDICTIONS FOR PRIVATE EQUITY FUNDRAISING IN THE COMING MONTHS?

NAVARRO: Fundraising for investment purposes remains the key priority for the private equity sector in Spain. Most Spanish investors have curtailed their contributions in Spain over recent years, with many of them having been major investors out of the country. Arguably, fundraising in Spain is over the worst of it, and the measures which have been rolled out mean that the sector is becoming increasingly optimistic. However, it is generally accepted that recovery to acceptable levels of activity will be slow and gradual. Recent news pointing to macroeconomic improvements – improved competition, domestic consumption and foreign investment – and the major changes in fundraising for investment purposes, mean that there are likely to be significant changes over the next four years, with growing investment in terms of both volume and number of transactions. After an intensive first six months of 2014 of hectic fundraising by Spanish private equity firms, it would appear that the pace dropped off somewhat in the third quarter.

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LUXEMBOURG

PHILIPPE NEEFS
KPMG LUXEMBOURG

Q HOW WOULD YOU CHARACTERISE PRIVATE EQUITY DEALMAKING IN LUXEMBOURG OVER THE LAST 12-18 MONTHS? WHAT KINDS OF TRANSACTION VALUES ARE APPARENT AND IS THERE STRONG COMPETITION FOR DEALS?

NEEFS: Private equity global players continued to use Luxembourg for their deal structuring at the investment portfolio level, but less and less for fundraising through SICAR or other alternatives vehicles, such as SIF or offshore fund structures. These vehicles typically use Luxembourg's SPV for acquisitions and investments. We wait to see how AIFMD will impact this trend. Today, the majority of growth is on the debt side rather than the asset side – in fact, the debt market is booming. In many respects this market is plugging the gap left by the banks in the wake of the September 2008 financial crisis. Today, the debt market provides the majority of the financing for small and mid-size enterprises. The US is leading this market due to higher volume and liquidity. The private equity industry is also expected to play an important role in the financing of a number of large infrastructure project financings going forward, while a number of private equity houses have been keen to invest in real estate projects.

Q TO WHAT EXTENT ARE BANKS EAGER TO PROVIDE FINANCING FOR LEVERAGED BUYOUTS? ARE 'NON-TRADITIONAL' LENDERS ALSO VISIBLE IN THE MARKET?

NEEFS: Private equity buyers have begun to access bank debt financing. Indeed, it seems that banks are increasingly keen to offer financial support to leveraged buyouts by providing a substantial amount of debt.

Q COULD YOU OUTLINE THE MOST SIGNIFICANT LEGAL AND REGULATORY DEVELOPMENTS FACING THE PRIVATE EQUITY INDUSTRY? IN YOUR OPINION, HOW WILL THEY SHAPE THE ASSET CLASS IN THE LONG TERM?

NEEFS: The most significant legal and regulatory development that the Luxembourg private equity industry is facing is the implementation of the European Alternative Investment Fund Managers Directive (AIFMD). This law transposed the existing regulations and favours the use, as funding vehicle, of a new Luxembourg limited partnership regime. The most recent development in tax structuring is trending towards more transparency and morality, which will have a significant impact on the way that private equity houses are structured. To that end, actions two and six in the OECD's Base Erosion and Profit Shifting reports will, over time, reshape the way in which private equity houses are funded. With respect to the avoidance of treaty abuse – action six – funds may have to be classified as Collective Investment Vehicles (CIVs) or non-CIVs, or as regulated or non-regulated. This may impact their eligibility to double tax treaties. The final reports to be issued by the OECD in 2015 will provide more guidance. US FATCA rules targeting non-compliance situations by US taxpayers using foreign accounts may also have an impact on certain Luxembourg private equity houses.

Q HOW ARE PRIVATE EQUITY FIRMS ACTIVELY REDUCING RISK AND IMPROVING RETURNS ACROSS THEIR PORTFOLIO?

NEEFS: Private equity houses can reduce risk and improve returns by increasing the quality of their due diligence process and making decisions on the basis of reliable financial information. Operational control of the investment is crucial. We see more and more former chief executives being hired as representative board members. Due to regulatory constraints, increasingly private equity houses will have to incorporate greater costs. Larger funds, through economies of scale, will be able to act as multi-asset managers. Smaller funds, however, will need to specialise in specific markets and sectors.

"There will be a greater focus on adding value through increasing earnings in underlying portfolio companies and therefore greater intervention in the portfolio."

Q HOW ARE PRIVATE EQUITY EXITS PLAYING OUT IN LUXEMBOURG? IS THERE AN EMPHASIS TOWARD TRADE SALES, IPOS OR SECONDARY BUYOUTS, FOR EXAMPLE?

NEEFS: Exits have picked up strongly of late with the funds returned from those exits being recycled into new fundraising. Improved corporate valuations also drove those exits. However, it seems that there is still a mismatch in price expectation between sellers and buyers. We are also seeing many exits structured as secondary buyouts, providing GPs with further investment opportunities.

Q COULD YOU PROVIDE AN INSIGHT INTO THE MAJOR ISSUES SHAPING THE RELATIONSHIP BETWEEN GENERAL PARTNERS (GPs) AND LIMITED PARTNERS (LPs)?

NEEFS: Private equity players are adapting their operating model to lower arbitrage returns. There will be a greater focus on adding value through increasing earnings in underlying portfolio companies and therefore greater intervention in the portfolio. Private equity players will likely need to rebalance their skills to take best advantage by calling on people who are familiar with running companies and who have operational and change management experience. Many GPs are already going in that direction as we are seeing more specialised advisers, portfolio managers and industrial partners. Private equity players are adapting their operating models to likely lower arbitrage returns. There will be a greater focus on adding value through increasing earnings in underlying portfolio companies and therefore greater intervention in the portfolio. Private equity players will likely need to rebalance their skills to take best advantage, calling on people who are familiar with running companies and have operational and change management experience. Many GPs are already going in that direction as we are seeing more specialised advisers, portfolio managers and industrial partners.

Q LOOKING AHEAD, WHAT ARE YOUR PREDICTIONS FOR PRIVATE EQUITY FUNDRAISING IN THE COMING MONTHS?

NEEFS: It is likely that we will see an increasingly competitive market for fundraising. Investors are becoming more and more selective with a lot of sellers and far fewer buyers. Investors want more control. Northern Europe should still do well going forward, however Southern and Eastern Europe has not fully recovered, mainly due to local banking conditions. Investment into emerging markets like China and India is declining whereas there seems to be an increasingly large appetite investment in Africa, which may become the next go-to investment destination. Some GPs and LPs believe they may have problems exiting minority positions in both the Chinese and Indian markets, as market conditions are making IPOs difficult and are leaving investors with unrealised positions. A new trend is also surfacing in online deal platforms.

KPMG
cutting through complexity

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As head of private equity at KPMG Luxembourg, Philippe Neefs leads a team of tax, advisory and audit professionals serving the private equity industry in Luxembourg and abroad. He has over 15 years of experience in advising on the taxation of private equity houses and other alternative investment vehicles. He is also the KPMG Luxembourg transfer pricing leader. He is fellow at the Catholic University of Louvain (Belgium) and is a certified accountant. He is also a member of the KPMG Luxembourg K-Start Program, aiming to advise Luxembourg start-up companies.

AUSTRALIA

QUENTIN OLDE
FTI CONSULTING

Q HOW WOULD YOU CHARACTERISE PRIVATE EQUITY DEALMAKING IN AUSTRALIA OVER THE LAST 12-18 MONTHS? WHAT KINDS OF TRANSACTION VALUES ARE APPARENT AND IS THERE STRONG COMPETITION FOR DEALS?

OLDE: Private equity deals made up just 6 percent, by volume, of all Australian deals in 2014. Recorded volumes and values for the year were broadly similar to 2013 levels, though they were low compared to the US and UK markets for which private equity deals accounted for 25 percent of deal activity. This may reflect the historic weighting of the Australian economy to resources, property and infrastructure which do not necessarily lend themselves to PE investment. While smaller deal volumes have been robust, larger LBOs, such as KKR's and TPG's recent failed $3.4bn bids for wine producer Treasury Wine Estates, have proven harder to convert. This has been particularly true for public-to-private deals with high vendor price expectations and regulatory disclosure requirements. Investments over $150m accounted for just 3 percent of PE deals, albeit 34 percent by deal value. Average PE investment size fell to $25m in 2014 reflecting the rise in follow-on expansion deals. Overseas funds continue to show a strong interest in the Australian market, with inbound investment 45 percent higher in 2014 than in 2013. Prominent deals included US private equity fund Platinum Equity's $454m acquisition of a 70 percent stake in Telstra's directory business, Sensis. Private equity and special situations players also favour Australia as a place to source distressed debt deals. Recent examples include Centerbridge Partners' and Oaktree Capital's refinancing of iconic surf wear brand Billabong and Centerbridge again with mining services provider Boart Longyear.

Q TO WHAT EXTENT ARE BANKS EAGER TO PROVIDE FINANCING FOR LEVERAGED BUYOUTS? ARE 'NON-TRADITIONAL' LENDERS ALSO VISIBLE IN THE MARKET?

OLDE: Credit conditions remain positive with debt markets generally supportive of private equity. However, lack of debt commitments among our big four domestic banks to support some of the larger deals in the Australian market, coupled with the retreat of foreign banks post-GFC, has been cited as a challenge in some processes. A recent development has seen many larger corporates, including portfolio companies such as cinema operator Hoyts backed by Pacific Equity Partners, bypass local

banks and raise money from the US leveraged loan markets attracted by the higher leverage multiples, long tenures and covenant-lite structures on offer. As mentioned, we have seen private equity and special situations groups bridge the debt capital markets on restructuring deals such as Billabong and Boart Longyear, whilst alternative lenders such as ICG and Babson Capital, have grown their presence.

Q COULD YOU OUTLINE THE MOST SIGNIFICANT LEGAL AND REGULATORY DEVELOPMENTS FACING THE PRIVATE EQUITY INDUSTRY? IN YOUR OPINION, HOW WILL THEY SHAPE THE ASSET CLASS IN THE LONG TERM?

OLDE: Last July's interim report from the government's Financial System Inquiry – the 'Murray Inquiry' – sparked a regulatory debate about transparency and the fees charged by private equity firms rather than the above-average net returns the industry would prefer to focus on. As superannuation funds demand more flexible and cost-effective exposure to private equity, we are seeing a push for direct investments and co-investments, and may even see the emergence of in-house private equity teams in time. At the smaller end of the deal spectrum, the Murray Inquiry called for improved tax treatment of Venture Capital Limited Partnerships (VCLPs) which, alongside government reforms to the Significant Investor Visa program, aim to encourage early stage venture capital investment.

Q HOW ARE PRIVATE EQUITY FIRMS ACTIVELY REDUCING RISK AND IMPROVING RETURNS ACROSS THEIR PORTFOLIO?

OLDE: Some sectors remain highly fragmented in Australia and private equity houses are using their firepower to consolidate these to build sizeable groups ripe for IPO. Examples include Crescent Capital's travel insurance buy-and-build play, Cover-More, and Cura Day Hospitals Group backed by Archer Capital and now ICG. Other sectors being targeted include agribusiness, aged care and wealth management. Refinancing and recapitalisation transactions, encouraged by low interest rates and supportive credit conditions, continue to be a favoured route to extract value from portfolio companies.

"2014 was a favourable exit environment for Australian private equity across a wide spectrum of sectors, with divestment proceeds rising to their highest in five years."

Q HOW ARE PRIVATE EQUITY EXITS PLAYING OUT IN AUSTRALIA? IS THERE AN EMPHASIS TOWARD TRADE SALES, IPOS OR SECONDARY BUYOUTS, FOR EXAMPLE?

OLDE: 2014 was a favourable exit environment for Australian private equity across a wide spectrum of sectors, with divestment proceeds rising to their highest in five years. Supported by strong equity capital markets, 2014 was the most active year on record for IPO exits in Australia. Notable listings included credit scoring provider Veda Group by Pacific Equity Partners, consumer electronics retailer Dick Smith by Anchorage Capital, and international payments service provider OzForex by Carlyle Group and Accel Partners. In a shift that aligns Australia with overseas markets, more sponsors are retaining meaningful stakes post-IPO. Secondary buyouts also rose to their highest level in the last decade whilst trade exits, many to overseas buyers, remained the most popular route. Average hold periods remained steady at around five and a half years.

Q COULD YOU PROVIDE AN INSIGHT INTO THE MAJOR ISSUES SHAPING THE RELATIONSHIP BETWEEN GENERAL PARTNERS (GPs) AND LIMITED PARTNERS (LPs)?

OLDE: One of the major challenges facing the sector is the continued decline in the local flow of capital to the asset class in Australia. Only around 1 percent of the nation's burgeoning $1.8 trillion superannuation savings pool is invested in domestic private equity, compared to around 10 percent in the US. This has forced firms to look offshore, often to sovereign wealth funds, for funding. Offshore hedge funds and US loan investors have been the winners with less concern over lack of liquidity. Post-GFC, there is an unwillingness among LPs to pay the traditional 1.5 percent to 2 percent management fees whilst firms sit on huge amounts of dry powder. In a rare response to this issue, Archer Capital recently released investors from $300m of commitments from its $1.5bn 2012 fund.

Q LOOKING AHEAD, WHAT ARE YOUR PREDICTIONS FOR PRIVATE EQUITY FUNDRAISING IN THE COMING MONTHS?

OLDE: 2014 saw a 30 percent overall increase in fundraising levels, dominated by Quadrant's $850m Fund No. 4. However, there was also concentration within the sector; fundraising activity was limited to fewer private equity firms as LPs become more selective. Most new money flowed to larger buyout funds. No new mid-market funds were raised but several deal-by-deal funds did emerge. Fundraising is expected to remain challenging throughout 2015 as superannuation funds restrict their allocations to the industry. Many firms are being forced to look overseas for future funding. For the first time, sovereign wealth funds became the largest source of new commitments in 2014. In parallel, we've seen Asian investors increase their commitments, partly due to the lower Australian dollar and partly because Australian private equity returns have consistently outpaced their counterparts in Asia.

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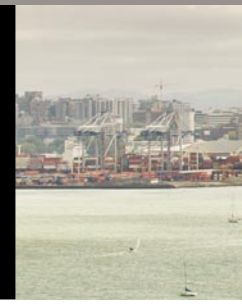
NEW ZEALAND

JOSH BLACKMORE
CHAPMAN TRIPP

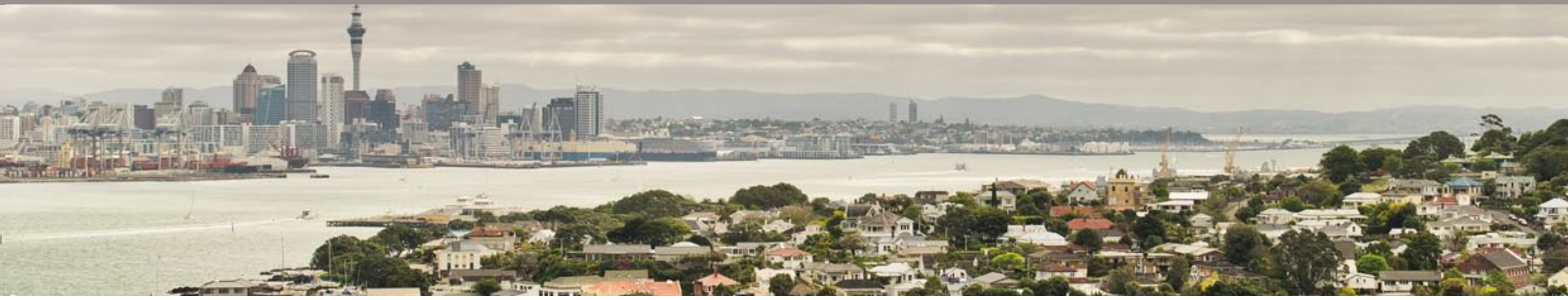


Q HOW WOULD YOU CHARACTERISE PRIVATE EQUITY DEALMAKING IN NEW ZEALAND OVER THE LAST 12-18 MONTHS? WHAT KINDS OF TRANSACTION VALUES ARE APPARENT AND IS THERE STRONG COMPETITION FOR DEALS?

BLACKMORE: New Zealand's economic performance has continued to be strong over the last 18 months and this has been reflected in strong deal flows, including in the private equity sector. Measured private equity investment for 2013 was NZ$456.2m and divestment NZ$665.4m, which compared favourably to 2012, which was a very subdued year. Though figures for 2014 are not yet available, we expect them to be similarly strong.

Q TO WHAT EXTENT ARE BANKS EAGER TO PROVIDE FINANCING FOR LEVERAGED BUYOUTS? ARE 'NON-TRADITIONAL' LENDERS ALSO VISIBLE IN THE MARKET?

BLACKMORE: New Zealand's traditional banks have gone through a long period where lending growth has been flat, and their balance sheets have shrunk. Accordingly, they are enthusiastic about identifying new asset-backed lending opportunities and are willing and able to lend for acquisition finance, although possibly still at lower loan-to-value ratios than in previous periods. The non-bank and mezzanine financing sector in New Zealand is underdeveloped compared to other jurisdictions, and so non-traditional lending for acquisition finance is generally rare in the New Zealand context. US investment banks will sometimes provide debt finance, although only where they are also involved in a deal in other capacities.



Q COULD YOU OUTLINE THE MOST SIGNIFICANT LEGAL AND REGULATORY DEVELOPMENTS FACING THE PRIVATE EQUITY INDUSTRY? IN YOUR OPINION, HOW WILL THEY SHAPE THE ASSET CLASS IN THE LONG TERM?

BLACKMORE: New Zealand has come through a once-in-a-generation reform in its capital markets framework, culminating in the Financial Markets Conduct Act 2013. This has liberalised our securities law in a number of key respects, and should facilitate capital raising activity, short of an IPO, for early-stage businesses, and make it easier for mature business owners to exit their business through the IPO process. Accordingly, private equity buyers in the mid-market space, which is traditionally popular with New Zealand based funds, may face more competition from alternative funding sources – though the flipside should be deeper, broader capital markets which should provide private equity owners with additional exit opportunities.

Q HOW ARE PRIVATE EQUITY FIRMS ACTIVELY REDUCING RISK AND IMPROVING RETURNS ACROSS THEIR PORTFOLIO?

BLACKMORE: There is an increased focus on asset classes with strong long-term prospects, including in the agricultural and health/aged care sectors, and on high-quality consumer brands – such as Pencarrow's acquisition of the historic Bell Tea & Coffee Company. Partnering between private equity investors is also seen as a way to mitigate the risks of large investments – this is particularly the case with and among iwi corporations, representing New Zealand's indigenous population, many of which have received large post-colonisation settlements under the Treaty of Waitangi.

Q HOW ARE PRIVATE EQUITY EXITS PLAYING OUT IN NEW ZEALAND? IS THERE AN EMPHASIS TOWARD TRADE SALES, IPOS OR SECONDARY BUYOUTS, FOR EXAMPLE?

BLACKMORE: New Zealand's capital markets have been on a particularly strong run, and this has been reflected by a number of private equity sell downs through IPOs and follow-on placements. Direct Capital's sell down of a large stake in Scales Corporation is a standout transaction, realising almost $120m for its owners, which included the government-owned NZ Super Fund and the Accident Compensation Corporation. Quadrant followed the successful IPO of Summerset Group by selling down its remaining stake, via a placement process, once the agreed escrow period expired. However, the failure by Next Capital to bring Hirepool through the IPO process shows that public offer exits are by no means risk free, particularly if institutional investors do not accept the indicative valuation of the firm.

Q COULD YOU PROVIDE AN INSIGHT INTO THE MAJOR ISSUES SHAPING THE RELATIONSHIP BETWEEN GENERAL PARTNERS (GPs) AND LIMITED PARTNERS (LPs)?

BLACKMORE: LPs have increasingly tended to club together to put downward pressure on fee arrangements in New Zealand. This approach draws on the overseas experience, but may not always translate to the New Zealand context as lower fund and deal sizes can make the overall economics for GPs less manageable. This is part of a broader swing towards LPs in bargaining power dynamics, which, in part, reflects the increased number of co-investments or direct investments by active institutional investors.

"New Zealand's capital markets have been on a particularly strong run, and this has been reflected by a number of private equity sell downs through IPOs and follow-on placements."

Q LOOKING AHEAD, WHAT ARE YOUR PREDICTIONS FOR PRIVATE EQUITY FUNDRAISING IN THE COMING MONTHS?

BLACKMORE: Pencarrow, Pioneer and Knox Investment Partners all closed funds in 2013. Fundraising activity has been subdued in 2014 as existing funds seek to allocate already raised capital. Although the success of the quasi-compulsory KiwiSaver retirement savings scheme, together with the expansion of the NZ Super Fund, ACC and iwi investors, means that, in the long term, significant amounts of capital will need an outlet, we do not see 2015 as a big year for private equity fundraising.

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NIGERIA

GBOLAHAN ELIAS
G. ELIAS & CO

Q HOW WOULD YOU CHARACTERISE PRIVATE EQUITY DEALMAKING IN NIGERIA OVER THE LAST 12-18 MONTHS? WHAT KINDS OF TRANSACTION VALUES ARE APPARENT AND IS THERE STRONG COMPETITION FOR DEALS?

ELIAS: Private equity dealmaking has been growing and we expect it to continue to grow significantly across virtually all sectors of the economy. There are more general partners today, both foreign and local, than previously. In addition, a number of Nigerian pension funds, which currently have more than $500m of available capital to deploy in the private equity space alone, have begun to test the waters. Transaction values have ranged from as little as $3m for some 'impact' investments in the healthcare sector to a recent telecommunications deal worth more than $2bn. As the market grows, valuations are also expected to climb into higher ranges in the near future. Increasingly, competition is being fuelled by the burgeoning Nigerian economy, by more actors within the space, the prevalence of larger funds operating within Nigeria, increasingly sophisticated knowledge of the local market and the risks it presents, and some very successful exits.

Q TO WHAT EXTENT ARE BANKS EAGER TO PROVIDE FINANCING FOR LEVERAGED BUYOUTS? ARE 'NON-TRADITIONAL' LENDERS ALSO VISIBLE IN THE MARKET?

ELIAS: Local commercial banks have been comfortable lending to finance leveraged M&A activity. Foreign commercial banks, however, have been more reticent. The appetite of the latter for Nigerian risk is not what it was prior to the international financial crisis of 2008-2009. Africa-centred multilateral lending institutions have been visible in the Nigerian market of late. The African Export-Import Bank and the Africa Finance Corporation have been especially visible in the financial services, oil & gas and electric power sectors.

Q COULD YOU OUTLINE THE MOST SIGNIFICANT LEGAL AND REGULATORY DEVELOPMENTS FACING THE PRIVATE EQUITY INDUSTRY? IN YOUR OPINION, HOW WILL THEY SHAPE THE ASSET CLASS IN THE LONG TERM?

ELIAS: Perhaps the three key challenges facing the sector are the lack of income tax relief on investments, the rule that pension fund managers can invest no more than 5 percent of pension fund monies in private equity, relatively high fees for the registration of GPs and funds and the rule that a GP cannot carry on business in Nigeria without becoming incorporated in Nigeria. Nigerian law is favourable on the issues of allowing foreigners to own 100 percent of most companies, investment protection and the remittance of proceeds in foreign currency. That our courts work slowly does not appear to have been much of a concern.

Q HOW ARE PRIVATE EQUITY FIRMS ACTIVELY REDUCING RISK AND IMPROVING RETURNS ACROSS THEIR PORTFOLIO?

ELIAS: Firms are improving their returns in a variety of ways. Indeed, there are several reasons that they have been successful. Among them are: the benefit of experience, better choice of sectors to invest in, wiser choice of companies to invest with, better tax and foreign currency remittance structuring, and improved selection of warranties and indemnities in investment agreements.

Q HOW ARE PRIVATE EQUITY EXITS PLAYING OUT IN NIGERIA? IS THERE AN EMPHASIS TOWARD TRADE SALES, IPOS OR SECONDARY BUYOUTS, FOR EXAMPLE?

ELIAS: The exits market has been strong in Nigeria, as private equity funds established around 2005 have been winding down. Today there are as many exits in Nigeria as there are new investments. Eight years ago exits were, understandably, few and far between. To maximise price without wasting too much time, the clear preference is for firms to exits their investments via trade sales, usually after auctions. Secondary buyouts are not unknown but are uncommon. IPOs are rare.

Q LOOKING AHEAD, WHAT ARE YOUR PREDICTIONS FOR PRIVATE EQUITY FUNDRAISING IN THE COMING MONTHS?

ELIAS: Going forward, it is expected that fundraising will increase and the funds will get bigger. There seem to be greater fundraising opportunities today in Nigeria than ever before. Furthermore, previously overlooked industry sectors, which have now become better understood, are attracting more fundraising interest. Going forward, there will likely be a multitude of investment opportunities in the healthcare, e-commerce and energy sectors.

"Going forward, there will likely be a multitude of investment opportunities in the healthcare, e-commerce and energy sectors."

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Gbolahan Elias is the presiding partner at G. Elias & Co, a pre-eminent Nigerian business law firm. He is a Senior Advocate of Nigeria and a former Junior Research Fellow of Merton College, Oxford. He was called to the Nigerian bar in 1981 and New York Bar in 1989. He worked at Cravath, Swaine & Moore, a Wall Street law firm, before setting up his practice in Nigeria. Over the years he has worked regularly on private equity transactions and has led the firm's teams on most of its private equity deals.

EAST AFRICA

RODDY MCKEAN
ANJARWALLA & KHANNA

Q HOW WOULD YOU CHARACTERISE PRIVATE EQUITY DEALMAKING IN EAST AFRICA OVER THE LAST 12-18 MONTHS? WHAT KINDS OF TRANSACTION VALUES ARE APPARENT AND IS THERE STRONG COMPETITION FOR DEALS?

MCKEAN: It is fair to say that there has been an increasing amount of interest from GPs in the East Africa region over the last 18 months. This interest has converted into a very active period for dealmaking. Much of the activity has taken place across a wide range of industry sectors. There has been activity in a number of diverse industries, including FMCG, healthcare, financial services, logistics, IT and real estate. Much of this is based on the 'consumer story'. The region's middle class is expanding, has access to more disposable income and is participating in the rampant urbanisation of the population. In the East African region, the sweet spot for deal size is relatively small. Deals typically are in the $5m to $15m range, though there are a number of funds focusing on investments below this level.

Q TO WHAT EXTENT ARE BANKS EAGER TO PROVIDE FINANCING FOR LEVERAGED BUYOUTS? ARE 'NON-TRADITIONAL' LENDERS ALSO VISIBLE IN THE MARKET?

MCKEAN: The most preeminent type of PE investment in this region, very much like the rest of Africa, is development or growth capital. In these types of investment, GPs are typically taking a 20 percent to 30 percent stake in firms, along with the founder shareholders. This allows GPs a level of control rights through the shareholders agreement. This reflects the current state of the market where investments are focused on taking the company to the next level, either regionally or into other markets, as well as improving governance issues. There is therefore little leverage used in these types of deal. We tend to only see leverage where investors acquire 100 percent of a business and leverage is then used to improve returns.

Q COULD YOU OUTLINE THE MOST SIGNIFICANT LEGAL AND REGULATORY DEVELOPMENTS FACING THE PRIVATE EQUITY INDUSTRY? IN YOUR OPINION, HOW WILL THEY SHAPE THE ASSET CLASS IN THE LONG TERM?

MCKEAN: There have been a number of regulatory developments which have impacted generally on PE deals. As well as national competition regulators, we now have a new regional Competition Commission in the COMESA region which covers 15 countries in Eastern and Southern Africa. The thresholds were initially set at zero so that any acquisition touching two COMESA countries involving *any* degree of control, *regardless* of percentage shareholding, would require a formal approval or dispensation. The CCC recently relaxed their thresholds and this will help at the smaller end of the deal pipeline. Although the East African community is looking to harmonise its laws, at present the tax regimes are different in each country and so each must be approached separately. Kenya is re-introducing CGT in 2015, albeit at a low level of 5 percent, yet this is likely to scale up in the future. The natural resources sector is also the subject of increasing tax and local content legislation, so we will see a much more punitive developed market regime being introduced over time.

Q HOW ARE PRIVATE EQUITY FIRMS ACTIVELY REDUCING RISK AND IMPROVING RETURNS ACROSS THEIR PORTFOLIO?

MCKEAN: We have seen a number of GPs use their portfolio companies to make further investments, particularly on a regional basis. This clearly delivers strategic synergies and reduces risk by building existing businesses rather than using a string of unconnected greenfield investments. Given the importance and challenges around exits in African PE, we have also seen GPs being much more proactive about planning and structuring exit strategies as part of the initial deal consideration.

Q HOW ARE PRIVATE EQUITY EXITS PLAYING OUT IN EAST AFRICA? IS THERE AN EMPHASIS TOWARD TRADE SALES, IPOS OR SECONDARY BUYOUTS, FOR EXAMPLE?

MCKEAN: The vast majority of exits are still by way of trade sales to strategic investors. Given the fact that many of the stock exchange markets in the region are generally illiquid, there are relatively few exits by means of an IPO. IPOs in those circumstances can only be viewed as a first step in an exit process as there is generally no possibility to offload the listed shares quickly. We are certainly seeing signs of a growing secondary market given that many of the current investments approaching the five to seven year investment horizon are in the small to mid range, and as some of the bigger PE players come into the market they are looking for opportunities at that kind of level.

Q COULD YOU PROVIDE AN INSIGHT INTO THE MAJOR ISSUES SHAPING THE RELATIONSHIP BETWEEN GENERAL PARTNERS (GPs) AND LIMITED PARTNERS (LPs)?

MCKEAN: The major issue remains that development finance institutions (DFIs) are still providing the majority of funding to East African GPs. This is particularly true for first time funds where track record and a strong management team are key considerations. LPs are more demanding in their terms, and often require co-investment rights, which can be time consuming for GPs when trying to coordinate their fundraising activities across the spectrum of potential investors.

"The major issue remains that development finance institutions (DFIs) are still providing the majority of funding to East African GPs."

Q LOOKING AHEAD, WHAT ARE YOUR PREDICTIONS FOR PRIVATE EQUITY FUNDRAISING IN THE COMING MONTHS?

MCKEAN: It is likely that going forward we will continue to see the majority of funding for GPs coming from the DFIs, and as such fundraising will continue to be as challenging as in other parts of Africa. Those GPs who have been in the game for the last few years have developed real skills and expertise on the ground. Their solid track records will be important in raising second or third time funds. New entrants without track records will find raising capital to be a difficult and time consuming process.

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Roddy McKean is a director in the M&A/Private Equity Group at Anjarwalla & Khanna. He has over 30 years of experience in M&A, private equity, restructurings, joint ventures and other corporate transactional work. Prior to joining the firm in 2013, Mr McKean headed Webber Wentzel's Africa Practice and was based in Johannesburg for over six years. He is an Africa specialist who has been involved in investments and transactional deals in over 30 African countries. His experience in working in emerging markets in Africa and Asia has positioned him well to understand how to successfully conclude deals in challenging environments.

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