



PREQIN SPECIAL REPORT: PRIVATE EQUITY FUND MANAGER OUTLOOK

H1 2017



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FOREWORD

In November 2016, Preqin surveyed 400 private equity firms globally in order to determine their views on the key challenges for the industry, the current level of competition in the market and their outlook for the year ahead. Valuations remain the greatest concern for fund managers; furthermore, 38% feel that pricing for portfolio companies is higher than it was 12 months ago, and 42% feel that there is currently more competition for transactions.

However, private equity is well positioned for another strong year in 2017, despite continuing economic concerns and wider political volatility. The private equity model is working, and in a low interest rate environment, the asset class will continue to appeal to investors looking for high absolute returns and portfolio diversification.

A record number of private equity funds are currently in market: 1,865 funds are seeking an aggregate \$624bn. This will bring challenges, particularly for first-time and emerging markets managers, in competing for investor capital as well as in meeting the demands of an increasingly sophisticated investor community. However, with the majority of LPs sitting very liquid as a result of continuing distributions and looking to maintain, if not increase, their exposure to the asset class, fundraising has rarely looked so appealing.

A significant proportion of assets invested prior to the Global Financial Crisis (GFC) are yet to be realized, so should market conditions remain favourable, it is likely that the fervent exit activity will continue in 2017. While pricing remains a very real concern, fund managers have record levels of capital available to them, and our survey results indicate that many are looking to increase the amount of capital they deploy over the next 12 months.

We hope you find this report useful, and welcome any feedback you may have. For more information, please visit www.preqin.com or contact info@preqin.com.

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Key Challenges

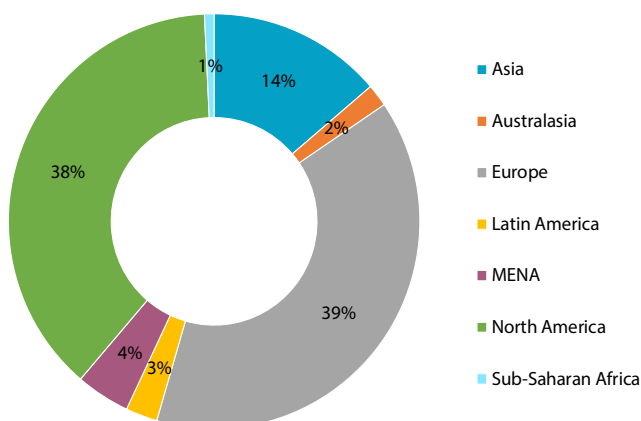
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Investor Appetite

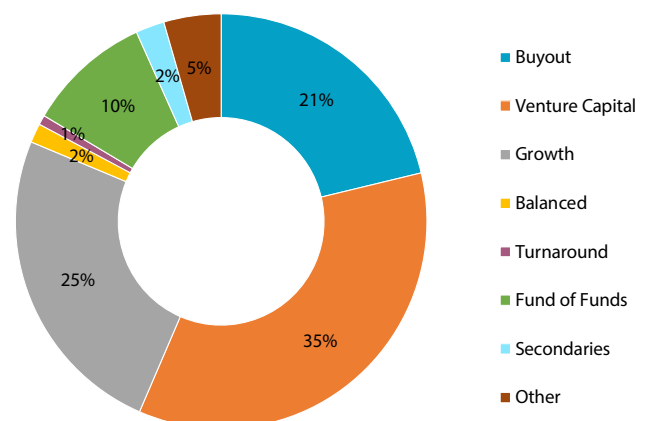
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Environmental, Social & Governance Policies

Survey Respondents by Headquarters Location



Survey Respondents by Primary Investment Strategy



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KEY CHALLENGES

While high company valuations remain the most widespread issue among surveyed GPs for the second consecutive year, many fund managers have cited concerns about the exit environment, fundraising, performance, and volatility and uncertainty in global markets as significant issues affecting the industry (Fig. 1).

With each regional private equity market at a different stage of development and presenting different opportunities to investors, the issues faced by GPs across different regions are not identical; of the managers surveyed, those based in the more developed markets of North America and Europe cited portfolio company valuations (49% and 43% of respondents respectively) as the biggest issue facing the market in 2017, while fundraising

Top Three Issues for the Private Equity Market in 2017 by Fund Manager Location:



Source: Preqin Fund Manager Survey, November 2016

FUND MANAGER VIEWS ON PRICING FOR PORTFOLIO COMPANIES COMPARED TO 12 MONTHS AGO



was the key concern for Asia-based GPs (56%) and ranked highly for managers outside the aforementioned regions (38%). Managers based in the rest of the world were mainly concerned with market uncertainty and volatility, and 38% of Europe-based GPs cited the same, possibly a result of the Brexit vote and continuing political and economic challenges across the eurozone.

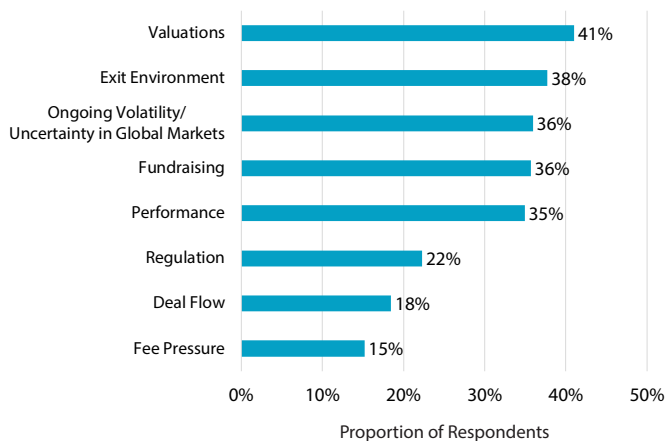
A COMPETITIVE MARKET

Recent high distributions have driven investor appetite for the asset class, with more GPs coming to market to meet the demand. This puts pressure on managers

that are fundraising and affects the level of competition for acquisitions and investment, particularly when combined with the increased participation from strategic and institutional investors and increased demand for co-investment structures. Approximately a third of respondents are finding it more difficult to find attractive investment opportunities compared to a year ago (Fig. 2), and similarly, many are having to review more opportunities per investment (Fig. 3).

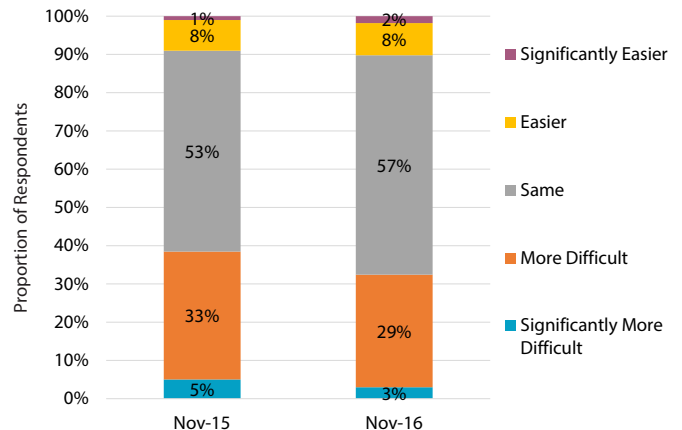
As such, 42% of surveyed fund managers have seen an increase in competition for private equity assets over 2016 (Fig. 4).

Fig. 1: Key Challenges Facing Private Equity Fund Managers in 2017



Source: Preqin Fund Manager Survey, November 2016

Fig. 2: Fund Manager Views on the Difficulty of Finding Attractive Investment Opportunities Compared to 12 Months Ago, 2015 vs. 2016



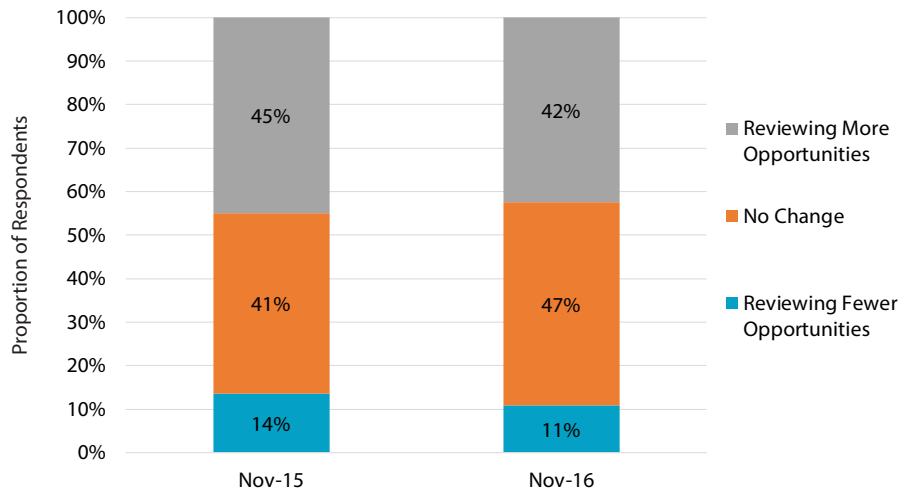
Source: Preqin Fund Manager Survey, November 2015 - November 2016

Furthermore, GPs were asked about the level of competition in distinct parts of the market:

- Venture Capital:** an average of 37% of surveyed GPs saw an increase in competition across all stages of venture capital investment over 2016, although the largest proportions across every stage had seen no change. Larger proportions of GPs are seeing less competition in earlier stages (seed: 25%; early stage: 22%), a reflection of the large pool of start-up companies these firms look to target.
- Growth:** more GPs have observed increased competition for growth investments than for venture capital, making growth one of the most competitive markets in private equity; while 45% of respondents saw no change in competition over 2016, 43% witnessed more, behind only mid-market (51%) and large (44%) buyouts.
- Buyout:** as expected, GPs face the most competition for mid-market opportunities, where surveyed investors see the best opportunities at present. More than half of respondents active in the area saw an increase in competition for mid-market assets over 2016. Significant levels of capital secured by the largest private equity firms at the higher end of the market mean that competition for large buyout transactions has intensified.

The low interest rate environment has reduced the cost of borrowing for GPs:

Fig. 3: Fund Manager Views on the Number of Opportunities Reviewed per Investment Compared to 12 Months Ago, 2015 vs. 2016



Source: Preqin Fund Manager Survey, November 2015 - November 2016

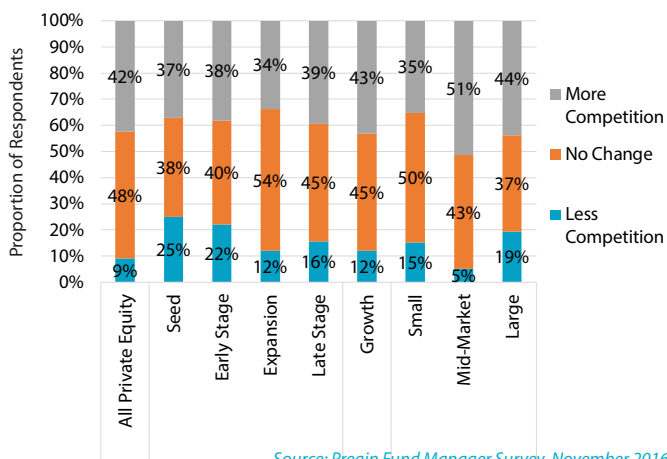
85% of firms surveyed have seen the terms of debt financing for private equity investments remain the same or improve over 2016. Combined with greater levels of capital raised annually and record levels of dry powder available for investment, this has pushed valuations up: 38% of surveyed GPs have seen an increase in pricing over the past 12 months, with only 19% witnessing lower entry prices. This puts pressure on GPs that usually have three- to five-year investment periods before exiting investments. However, respondents are confident in the exit opportunities available in the year ahead: while the largest proportion believe exit activity will remain the same over 2017, more respondents predict exit activity will increase than decrease. Thirty-five percent of fund managers surveyed believe there will be greater activity in the venture

capital exit market over 2017, compared with 24% that believe there will be less; for exits in the rest of the private equity market, 30% believe there will be more activity in the year ahead compared to 23% that believe there will be less.

MORE INVESTMENT IN THE YEAR AHEAD

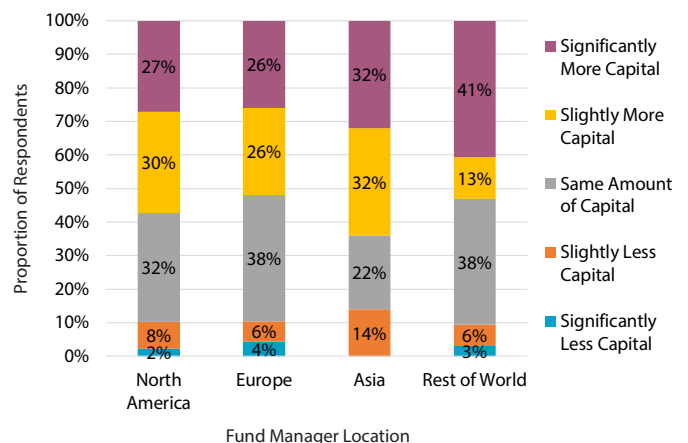
Despite more than half of GPs experiencing no change in the level of difficulty in finding attractive opportunities over 2016, the majority of surveyed managers across all regions expect to increase the amount of capital they deploy in private equity assets over the next 12 months (Fig. 5). This includes more than a quarter of respondents in each of North America and Europe, a third of Asia-based GPs and 41% of managers in the rest of the world that will invest significantly more capital than in 2016.

Fig. 4: Fund Manager Views on the Level of Competition for Transactions Compared to 12 Months Ago



Source: Preqin Fund Manager Survey, November 2016

Fig. 5: Amount of Capital Fund Managers Plan to Deploy in Private Equity Assets in 2017 Compared to 2016 by Fund Manager Location



Source: Preqin Fund Manager Survey, November 2016



INVESTOR APPETITE

Fund managers generally reported a favourable fundraising environment, with 58% of fund managers stating that they had noticed an increase in investor appetite for private equity over the past 12 months (Fig. 6). In contrast, only 18% witnessed a decrease in appetite.

Increased investor demand has come from family offices in particular – 62% of fund managers reported increased appetite from this investor type – while significant proportions of fund managers also noticed increased appetite from wealth managers (37%), private sector pension funds (37%), sovereign wealth funds (36%) and

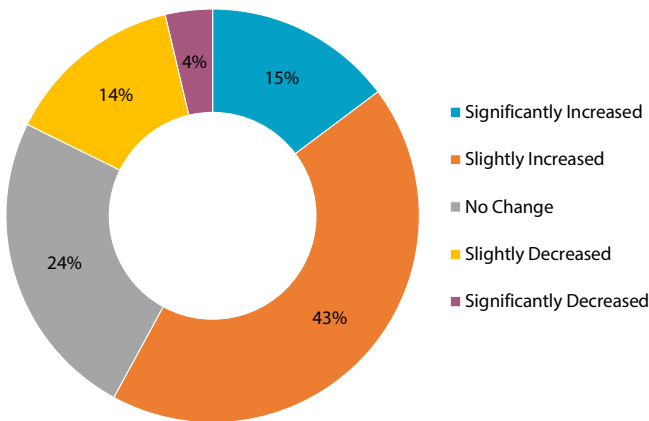
public pension funds (35%, Fig. 7). With many banks having already reduced their activity in private equity due to regulatory changes such as the Volcker Rule, 30% of respondents noted a further decrease in appetite for private equity from these investors over the past 12 months.

Over half (53%) of fund managers reported an increase in appetite from Asia-based investors, while only 4% felt that it had decreased (Fig. 8). A considerable proportion of managers also felt that demand had increased from investors based in North America (39%) and Europe (38%); a greater proportion of

fund managers stated that demand had increased rather than decreased from all other regions except Sub-Saharan Africa.

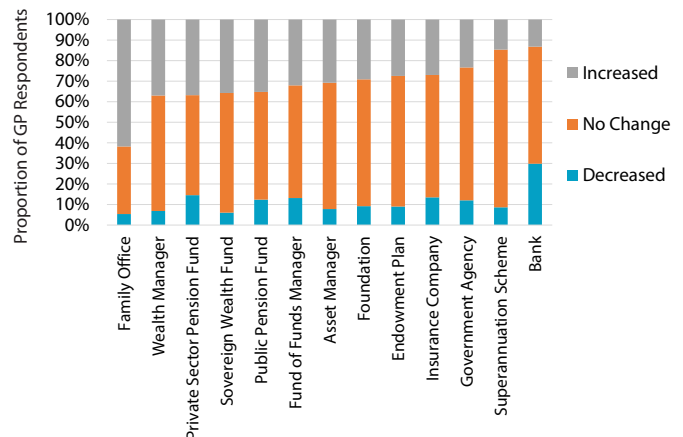
Nevertheless, with a record 1,865 private equity funds in market, competition for investor capital remains fierce: 73% of fund managers reported an increase in competition over the past 12 months (Fig. 9). However, with 48% of investors surveyed by Preqin planning to increase their allocations over the longer term, it is likely that we will see continued opportunities to raise capital.

Fig. 6: Fund Manager Views on How Institutional Investor Appetite for Private Equity Has Changed over the Past 12 Months



Source: Preqin Fund Manager Survey, November 2016

Fig. 7: Fund Manager Views on How Institutional Investor Appetite for Private Equity Has Changed over the Past 12 Months by Investor Type



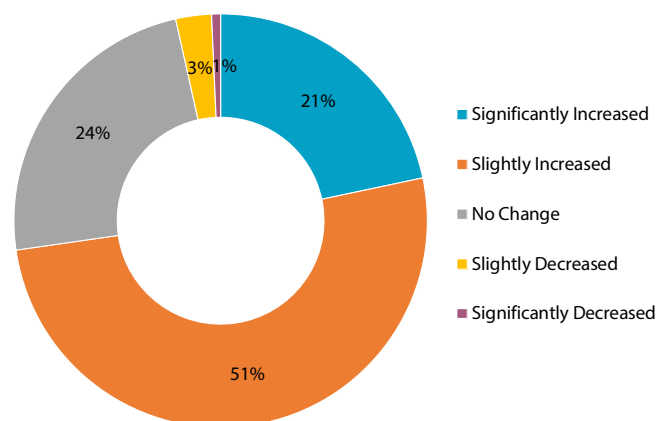
Source: Preqin Fund Manager Survey, November 2016

Fig. 8: Fund Manager Views on How Institutional Investor Appetite for Private Equity Has Changed over the Past 12 Months by Investor Location



Source: Preqin Fund Manager Survey, November 2016

Fig. 9: Fund Manager Views on the Level of Competition for Institutional Investor Capital Compared to 12 Months Ago



Source: Preqin Fund Manager Survey, November 2016

ENVIRONMENTAL, SOCIAL & GOVERNANCE POLICIES

Market conditions and shifting LP preferences mean that GPs are looking to further differentiate themselves from their peers in order to secure capital. One such area that has grown in prominence among LPs is the environmental, social and corporate governance (ESG) of a portfolio company, with investors wanting to know if there are any risks tied to the companies in which their capital will be invested.

Nearly two-thirds of GPs surveyed now consider ESG factors for at least some of their transactions, including 41% that consider ESG for all deals, despite the increased due diligence necessary to assess these factors (Fig. 10). To illustrate the increased importance of ESG factors to fund managers, and by extension investors, 65% of GPs surveyed have at some point decided not to invest in a company they otherwise would have because it did not fulfil their ESG criteria.

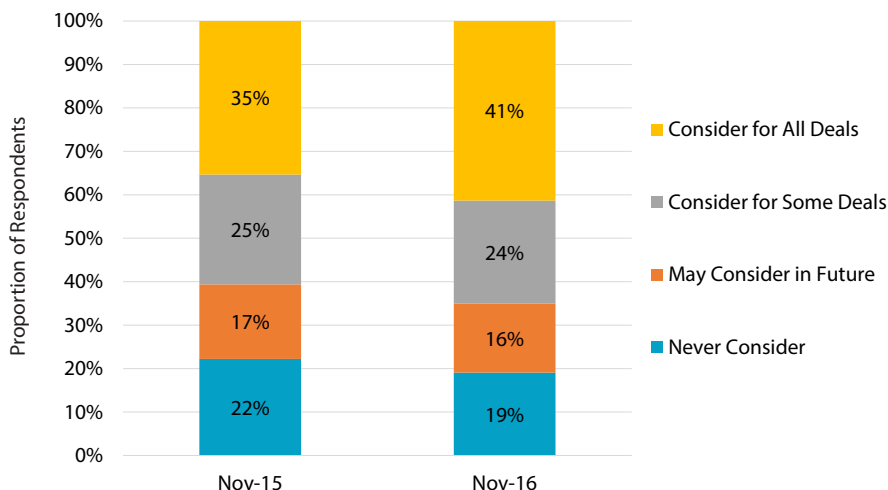
Regionally, Europe-based GPs are the most likely to consider ESG factors, with 73% of respondents in the region considering ESG for at least some of their deals, followed by GPs based in Rest of World (68%) and Asia (66%). North America-based fund managers are the least likely to consider ESG for at least some of their deals.

When looking specifically at the individual factors considered by GPs:

Environmental Factors:

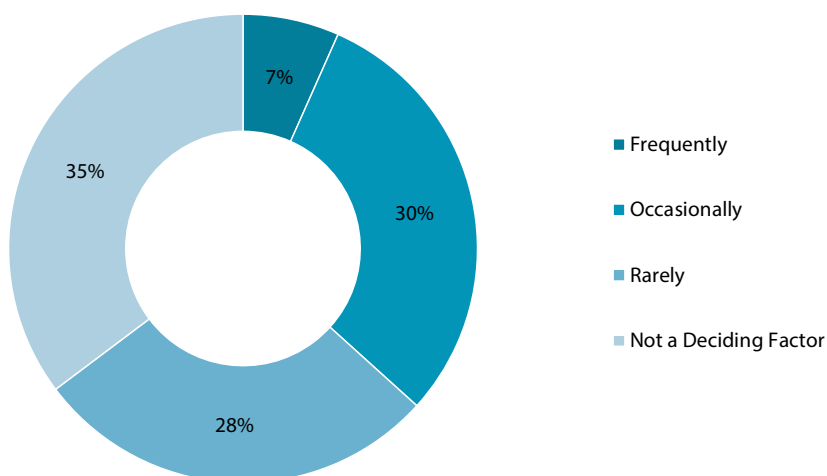
- Portfolio company energy consumption (66%), the sustainability of resources (63%) and the disposal of hazardous waste (59%) are factors considered by the majority of respondents that examine the environmental impact of these investments.
- Some focus on the external impact that a portfolio company would have; specifically, one manager cited “land use and the avoidance of deforestation”, while another was concerned with “pollution abatement”.

Fig. 10: Fund Managers that Consider ESG Factors as Part of the Deal-Making Process, 2015 vs. 2016



Source: Preqin Fund Manager Survey, November 2015 - November 2016

Fig. 11: Frequency with Which Fund Managers Have Not Invested in a Portfolio Company Due to ESG Factors



Source: Preqin Fund Manager Survey, November 2016

- Others examine the direct impact of the products, with one manager considering “the purity of ingredients and product safety”.

Social Factors:

- A large proportion of GPs surveyed that consider social factors engage with many different policies.
- The majority (77%) of respondents examine the health and safety policies of companies they are considering investing in, while 65% look at non-discriminatory practices, 60% employee equality and diversity,

54% child and labour servitude and 53% human rights policies.

Corporate Governance Factors:

- The majority of GPs will check that the company has a balanced management structure (75%), look at the incidences or likelihood of bribery and corruption (71%), or examine employee relations (66%) and executive remuneration (66%).

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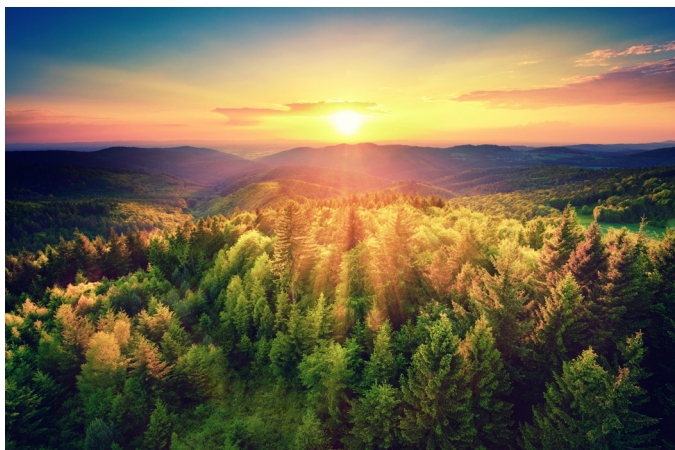


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