GLOBAL PRIVATE MARKETS UPDATE

US BUYOUT & VENTURE

The **US Buyout** market had normalized from a fundraising and investing perspective through June 2018, as managers focused on generating liquidity against a backdrop of high valuations. US buyout fundraising is tracking below the 10-year average, as several mega-cap managers completed oversubscribed fundraises in 2017. New investment activity for buyout managers has remained in line with 2017 levels, which are well below pre-crisis peaks. However, transaction values have decreased as smaller add-on activity has been a catalyst for deal volume. Competition for attractive deals has been driven by a growing surplus of dry powder and new entrants to the market, leading to historically high pricing across US private markets. Many managers have taken advantage of this pricing dynamic to generate liquidity, benefitting primarily from strategic acquirers that are looking to buy for growth, and as a way to access new markets and geographies. As a result, M&A exit activity remained robust as managers seek full liquidity while favorable pricing remains. Further, the availability of inexpensive credit has allowed these managers to generate intermittent liquidity through dividend recapitalizations. Buyout managers have sought to create value by embracing complex transactions and pursuing buy-and-build strategies, which can also serve to dampen average purchase prices. This focus on complex transactions, as well as a continued emphasis on operational improvements and high growth, should continue to drive strong returns for investors.

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On the **US Venture** side, managers remained active in terms of raising, deploying, and returning capital, with year-to-date metrics in each category on track to surpass 10-year averages. Through June, fundraising was tracking ahead of 2017 activity, as firms raise larger funds to reserve capital for later-stage growth financings. Venture managers are on pace to invest a record amount of capital in 2018, surpassing the previous mark set in 2017. Competition for attractive deals has been driven by a growing surplus of dry powder and new entrants to the market, such as SoftBank's Vision Fund, which has led to historically high pricing. Venture managers have increasingly sought to maintain ownership of perceived winners through follow-on financing rounds, in an effort to achieve operating scale, market leadership, and strong returns. Through June, venture-focused IPOs had been resurgent after several years of muted activity. High-profile technology IPOs have received strong public market valuations, inducing others to pursue liquidity via the public markets. M&A volume and valuations have also increased, as large incumbents have been willing to pay for growth.

(**Sources:** Bain & Company; PitchBook Data)

EUROPEAN MARKETS

Private markets throughout **Europe** have shown continued strength across fundraising, liquidity, and investment activity, supported by five years' of favorable market dynamics. Fundraising fell by 16% during the first half of 2018 compared to the same period in 2017, with just under €25 billion worth of funds raised. This was due predominantly to fewer mid-market funds being raised. As a result of strong investor demand for premium quality managers, however, the best-performing managers continue to raise heavily oversubscribed funds, with 68% of 2017 vintage funds (globally) being raised in less than 12 months. After an exceptionally strong year for liquidity in 2017, the exit environment through June was characterized by continued interest from strategic acquirers seeking new growth opportunities. There was, however a 37% fall in the value of M&A exits compared to the first half of 2017, while more volatile public markets reduced the level of private equity-backed IPO issuance across Europe. Overall, the value of exits through June was down 39% year-on-year.

In Europe, the exit environment through June was characterized by continued interest from strategic acquirers seeking new growth opportunities.

Managers remain cognizant of prior market cycles and have been selective in the current high valuation environment by focusing on premium assets, as well as operational and strategic improvements. Nevertheless, transaction values in Europe increased 61% during the first half compared to the same period in 2017. This was almost entirely due to an increase in investments in transactions with over €1 billion of enterprise value, with more than €58 billion worth of deals completed during the first six months of 2018. This compares to a figure of €51 billion of similar-sized transactions for the whole of 2017. The figure through June 2018 includes sizeable headline transactions, such as Carlyle's €10.1 billion acquisition of Akzo Noble Speciality Chemicals, and KKR's €6.8 billion acquisition of Unilever spreads. In order to generate returns in the current environment, managers are increasingly focused on developing formal plans for implementing operational improvements and value creation, particularly systematic execution of commercial excellence in sales, in order to drive top-line growth and digital innovations within portfolio companies.

(**Sources:** Thomson Reuters; Preqin)

ASIA PACIFIC MARKETS

Through June, **Asia Pacific** private markets were on pace for another record year with fundraising, investment, and exit activity all on track to eclipse 2017 figures. Fundraising activity remained strong with $44 billion raised, half of which was driven by China. Investment activity continued to increase with $75 billion invested, supported by large deals in Japan and China. Asia Pacific exit transaction value totaled $28 billion, with the largest deals coming from venture exits in China.

(**Source:** AVCJ)

China's economy expanded 6.8% year-on-year through June, with growth remaining stable over the last three years. Tertiary industries, predominantly within the services sector, continued to drive growth, accounting for 54% of the overall economy. The government continued to deepen supply-side structural reform, which benefited sectors such as industrials, retail, and agriculture. As the largest private equity market in Asia, consumption-related investment themes continue to be a key focus given continued urbanization and further growth of China's middle class. The ongoing US-China trade friction continues to be a risk for the region.

(**Source:** China National Bureau of Statistics)

Australian GDP grew 3.1% over the year ending March 2018, exceeding market estimates. The Reserve Bank of Australia (RBA) expects the economy to strengthen over the next 12 months, supported by positive business conditions and an increase in both non-mining and public infrastructure spends. Despite previous expectations of rate hikes in 2018, the RBA has continued to hold the cash rate at its record low of 1.5%, citing global trade tensions and record Australian household debt levels as key risks. Australia is still one of the most mature buyout markets in Asia, where private equity fundraising has remained strong. Investments have been focused on key sectors such as healthcare, food, agriculture, and technology.

(**Source:** Reserve Bank of Australia)

India remains one of the fastest-growing economies in the world on the back of rising consumption and the ongoing digitization of the country's financial infrastructure. Businesses are now seeing the benefits of demonetization and tax reform, which have created a more accountable and attractive corporate environment ahead of upcoming elections in 2019. **Japan's** economy has rebounded in the past year, driven by global growth and an increase in exports due to a weak yen. The growth outlook for **South Korea** is similarly positive, with an anticipated rebound in investment and strong demand for its exports, especially electronics. Countries in Southeast Asia also continue to benefit from global trade growth, together with increased infrastructure spending in countries like **Indonesia** and the **Philippines.**

(**Sources:** Deloitte, Bloomberg)

EMERGING MARKETS

Between 2012 and 2016, the world's **Emerging Markets** endured a challenging cycle caused largely by expectations of tighter monetary policy from the US Federal Reserve, slowing growth in **China,** and significant commodity price declines. That cycle led to material declines in the value of many emerging markets currencies against the US dollar, and, more broadly, heightened risk aversion towards emerging markets assets generally.

> In what has been a more benign global growth environment, many emerging markets economies have resumed a positive growth trajectory.

Investor sentiment towards emerging markets started to improve in 2017 against a backdrop of firmer commodity prices and relatively gradual interest rate hikes in the US. While this has resulted in greater foreign exchange stability in a number of currencies, political factors remain a key driver of investor sentiment. The **Turkish** lira, for example, has suffered continued and significant devaluation in 2018.

Despite a more benign global growth environment, emerging markets economies have faced significant headwinds in recent months, including rising oil prices, higher yields in the US, dollar appreciation, trade tensions, and geopolitical challenges. The near-term outlook for real GDP growth in emerging markets outside of Asia therefore remains relatively modest, with **Russia, South Africa, Brazil**, and **Mexico** all expected to deliver real GDP growth of between 1.5% and 2.5% in 2018.

Private markets fundraising in these regions has been relatively weak since 2014 as managers have taken time to invest the funds raised in the prior cycle. Investment activity increased 10% year-on-year through June as emerging markets managers were able to price deals with more confidence. A more stable market environment and increased investment activity could lead to a stronger fundraising environment for emerging markets funds for the balance of 2018.

(**Sources:** IMF World Economic Outlook, July 2018; EMPEA)

DIRECT CO-INVESTMENTS

Direct co-investment activity continued to expand in the first half of 2018, with an ample supply of dry powder, favorable debt markets, and strong global economic momentum all serving as key catalysts. Global private equity acquisition value totaled $204 billion during the first half of 2018, up 48% over the same period in 2017 and mostly driven by robust activity in the US and Asian markets. Deal activity in Europe grew at a more modest year-on-year rate of 9% in the first half of the year, reaching total deal value of $41 billion, influenced by ongoing investor concerns around Brexit and other geopolitical risks. Add-on transactions continued to grow in prevalence, representing 66% of total US buyout activity during the second quarter alone, as private equity sponsors sought to create value and consolidate fragmented industries. Leveraged buyout multiples fell from 10.6x EBITDA in 2017 to 9.8x through June, which if sustained through the remainder of 2018 would mark the first full year since 2014 of sub-10.0x multiples. Leverage multiples on middle-market leveraged buyouts remained largely consistent with 2017 readings at approximately 5.5x

EBITDA, with interest rate spreads only slightly higher than 2017 levels. While global fundraising was lower than the historical highs of 2017, dry powder remained at record levels of nearly $1.8 trillion through June, which is expected to continue driving strong deal activity. Investors will have to balance the attractive tailwinds created by strong global economic momentum, an attractive debt financing environment, and recent US tax reform against the risks posed by ongoing geopolitical uncertainty and trade uncertainty, as well as concerns around the late stage of the economic cycle.

(**Sources:** Financial Times (data sourced from Thomson Reuters); Axios Pro Rata (data source from LCD); LCD Middle Market Review; Deal Street Asia; PwC)

SECONDARIES

Supported by relatively calm public markets and sustained global economic growth, the first half of 2018 produced new record levels of **secondary market** transaction volume and GP-led activity. We are cautiously optimistic that the growth in GP-led deals and other complex transaction types will continue to generate attractive investment opportunities over the remainder of the year.

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Through June, transaction volume had reached new heights of $27 billion in value, up from $22 billion in the first half of 2017. More GPs than ever before are engaged in the GP-led market and are pursuing an expanding list of transaction types. Through June, GP-led transactions accounted for 25% of overall volume, or $7 billion in value. On the LP side, market activity remained strong with a cross-section of institutions accessing the secondary market as a proactive portfolio management tool. Pricing remained similar to the first half of 2017, with average high bids of 93% of NAV on all strategies. Buyout portfolios were strong with average high bids of 98% of NAV, followed by venture portfolios with average high bids of 85% of NAV. Lastly, GPs on the primary side of the business are currently seeking to raise $830 billion of capital after having raised more than $2 trillion over the past five years. These newer pools of capital represent the future inventory for the secondary market and should help support continued strong market growth going forward.

(**Sources:** Greenhill Secondary Market Trends & Outlook, July 2018; Preqin)