



Global private equity watch

Striving for growth –
a return to entrepreneurship
2012

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Striving for growth – a return to entrepreneurship

Passion. Persistence. Opportunity. ... Value creation. Business transformation.

A new paradigm of “entrepreneurship” seems to be emerging. And private equity (PE) firms are part of the force driving that change.

Although entrepreneurs operate across a highly diverse range of sectors and regions of the world, we have found that they share a number of common behaviors and characteristics. Subsequent research conducted by Ernst & Young, which included a survey of 685 entrepreneurs and in-depth interviews with winners of the Ernst & Young Entrepreneur Of The Year® program, has helped us formalize our view into a solid model of the makeup of the entrepreneur.

Looking back at the PE industry over the last decade, we would argue that the firms thriving today are those that have embraced the entrepreneurial culture and have evolved to thrive in a new world order. It is the industry's reputation for innovation and creativity that has propelled PE forward as it drives value creation and business transformation in the companies it owns.

While the PE model has already demonstrated its resilience in the face of adversity, there is no doubt that success in today's market will require firms to adapt even further. PE needs to identify and capture the most promising growth prospects. Capitalizing on opportunities in turbulent times requires agility and entrepreneurial management – the attributes that made PE so successful in the early years. And the most successful PE funds are demonstrating that they still have these in abundance as they find ways to thrive and expand.

Yet at the same time, PE must pay heed to the increased requirements of stakeholders, such as limited partners and regulators – creating the need for professionalized firms with sophisticated systems and procedures. The last decade has seen a drive toward institutionalization as PE has moved into the mainstream. The PE winners will be those that optimize their firms' new culture to ensure that they can spot new opportunities for growth and investment.

As the experience of 2011 has clearly shown, global economic volatility has become the new normal. The year 2012 and beyond will likely be characterized by a continuation of volatility as the global economy struggles with weak fundamentals. With a highly flexible model, PE is ideally suited to this environment, and the industry is already evolving to capitalize on future opportunity. To be successful, PE firms need to be bold and look beyond the obvious by seeking out new markets and new sources of capital and identifying the most promising businesses in the sectors that will underpin economic growth. Those that strike the right balance between recapturing the entrepreneurial approach adopted by PE's pioneers and managing their firms and stakeholders effectively will be tomorrow's winners.



Jeff Bunder, Global Private Equity Leader, Ernst & Young

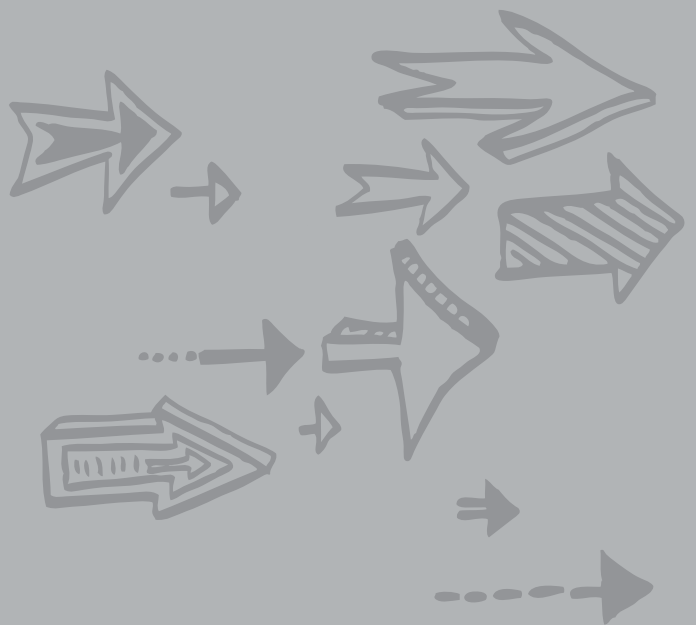
Driving an entrepreneurial spirit

PE firms to succeed in today's turbulent times and beyond

Tenacity, focus, ability to spot new opportunities where others see disruption, determination to succeed, resilience, ability to learn from experience, discipline. These attributes are the essence of what makes an entrepreneur – their core behaviors. They are also at the heart of the new paradigm for PE.

To succeed in today's turbulent times and beyond, firms will need to find ways to drive these entrepreneurial behaviors across the enterprise:

- Have drive, tenacity and persistence
- Seek out niches and market gaps
- Build an ecosystem of finance, people and know-how
- Live what you believe: build success culture and values
- Be a nonconformist and a team player
- Be the architect of your own vision: passionate and focused



The DNA of the entrepreneur model



“Throughout its history, private equity has demonstrated its entrepreneurial spirit. It has survived several downturns and has proved it can sustain through cycles. The current volatility will require it to show still more drive and tenacity, finding opportunity where others see only disorder.”

Maria Pinelli, Ernst & Young Global Vice-Chair, Strategic Growth Markets

An opportunistic mindset

There is no doubt that PE is adapting well to what has become a more volatile and demanding environment. PE’s most successful firms are proving themselves to be far from the financial engineers they are often characterized to be. Instead, they are demonstrating their entrepreneurial credentials: they are looking for the right opportunities in an uncertain environment, moving into new markets, finding innovative ways of financing deals, seeking out new investment and capital sources, identifying new paths to growth for portfolio companies and taking calculated risks while also maintaining discipline and focus.

The resilience and adaptability of the PE model has come clearly into focus in recent years. Faced with the challenges of a difficult deal-making environment, low growth in developed markets and an increasingly selective and diverse LP base, the entrepreneurship that resides in the industry’s best performers has shone through in three key areas: targeting new growth opportunities, responding with agility to and anticipating the shifting needs of LPs and identifying the sectors and niches with the potential to far outstrip a low-growth environment.

Acceptance of risk and potential failure

PE’s attitude toward risk is central to its underlying business model. It is this very acceptance of risk that has seen PE challenged in the media over recent months. PE investors look for undervalued and underperforming companies, growth companies and even distressed companies – which seek capital that is otherwise difficult to obtain – but have tremendous opportunity for growth and improvement. While some investments have not performed successfully, overall PE returns continue to outperform the public markets.

PE is responsible for the growth of scores of companies, leading many to successful initial public offerings (IPOs) and selling many others to corporate buyers or other PE buyers – for additional growth opportunities. The industry’s focus on building value has been validated and, as such, continues to attract investors to the asset class.



The behaviors around the core

Supporting the appetite for risk and the ability to spot opportunities are the set of core behaviors that drive entrepreneurs. The pioneers of PE founded a new type of investing 30-odd years ago – one that continues to support other entrepreneurs, value creation and growth. They may not all have demonstrated entrepreneurial traits throughout the entire time, but many have taken those qualities to heart and now are exhibiting them.

Drive, tenacity and persistence

Pulling through a global recession

PE firms have spent the last three years adapting to a new paradigm defined by sustained volatility coexisting with robust fund-raising, acquisition and divestiture activity. They quickly adapted to the challenges before them and created new opportunities to add value on behalf of their investors – by entering new markets and aggressively employing new strategies of managing their portfolio companies. Some – the largest firms – have even expanded and diversified into new businesses.

Perhaps most importantly though, they have maintained a laser focus on operational improvements and a commitment to navigating the companies they own through the global recession. PE firms capitalized on attractive terms to refinance portfolio company debt, positioning them for long-term stability – and averting what many thought would be the downfall of the industry.

PE firms continue to be in a growth mode, doing what they do best – finding ways to execute in an ever-changing environment, and adapting to conditions to create and maximize value.

Focus on organic growth to drive returns

One key shift made by PE investors over the last decade has been a greater focus on organic revenue growth in portfolio companies. Add-on acquisitions continue to remain an important feature of the PE investment thesis, with sponsors working to ensure that portfolio companies are in a position to buy the right targets by providing further equity capital, helping them to raise debt and optimizing their capital structures. However, organic revenue growth has become the most important driver of returns.

Our latest value creation studies in the US and Europe have found that, since the onset of the recession, EBITDA growth has risen in importance as a driver of PE's value creation compared with pre-crisis years, with organic revenue growth accounting for the largest portion, that of which is 46% of EBITDA growth in Europe and 40% in the US.

The results of the Capital Confidence Barometer (CCB) reinforce the overall picture of PE employing a laser-sharp focus on adding value. By far the largest use for excess cash in portfolio companies was organic growth, according to respondents. The survey also found that new product offerings and entering new geographic or products markets were the greatest sources of value creation in portfolio companies.



Seek out niches and market gaps

New capital sources, new asset classes

PE has also been quick to identify a shift in capital flows. While most existing LPs remain supportive of PE, firms have recognized that to continue growing, they must tap new capital sources. The industry's most successful players have built out extensive investor relations capabilities to connect with investors across the world, particularly those in Asia and the Middle East. The rise of the RMB-denominated funds is just one example of how this is playing out as firms seek not only to invest in the rapidly expanding Chinese market but also gain access to a set of local investors who are actively searching for PE investment opportunities.

As their investor bases grow, some of the larger firms are taking the opportunity to expand their business to offer LPs a wide variety of investment strategies and asset classes. They have extended into new areas, such as hedge funds, real estate and distressed debt evolving into multi-asset managers. This is true not only of firms in the more established markets, but also in Asia Pacific. Our latest outlook for the region found that 64% of respondents felt that local firms were following the lead of their Western counterparts in adding new offerings to the traditional PE model.

PE continues to view the public markets as an opportunity for funding and liquidity. The Carlyle Group and Oaktree Capital Management have announced their plans to become publicly-listed, joining firms such as KKR, Apollo Global Management and The Blackstone Group.

The move takes the archetypal entrepreneurial approach in transforming a series of challenges into positive advantage. The creation of public currency helps them attract and retain top talent and offers a possible exit route for retiring founders, thereby resolving some of the succession issues these firms face while also providing a source of permanent capital supporting the effort to build out additional business lines and also possibly safeguarding firms from economic turbulence and the challenging fund-raising environment.

"Local firms are realizing the vast potential of a number of growing alternative asset classes in Asia Pacific and are casting a wider net in order to capture institutional investor demand."

Michael Buxton, Ernst & Young
Private Equity Leader, Asia Pacific

Unconventional financing

At the same time, debt financing for PE deals is more difficult, particularly in Europe. As we observe in early 2012, it is becoming clear that credit is available for high-quality assets, though this varies market-to-market. However, even as credit has turned away from high tide, PE is demonstrating its determination to sign high-quality deals by seeking out less obvious sources of debt finance. Faced with a lack of appetite in Europe, Apollo Group turned to the US high-yield bond markets last year when it acquired Belgian chemical business Taminco in late 2011 for €1.1 billion.

And, in classic entrepreneurial style, some of the larger groups have spotted an opportunity. They have established or acquired debt capabilities. In early 2012, CVC boosted its debt arm with the acquisition of a majority stake in US credit manager Apidos Capital Management to form CVC Credit Partners. KKR Capital Markets' support for its private equity arm in buying UK safety harness manufacturer Capital Safety Group for US\$1.12 billion in late 2011 underscores how PE's adaptability is ensuring that it can thrive even in hostile conditions.

PE is also proving itself to be highly entrepreneurial in the way that it structures deals and manages its portfolio. Our analysis shows that the equity component in buyouts has increased over recent years from less than a third to around 40%. And, in the emerging markets, there is even willingness to put in 100% equity for the right deal. Consequently, PE has increased its focus on driving fundamental changes to the businesses it backs, moving profit growth rather than financial engineering to the top of the agenda as a way to offset the drag on returns.



"PE is facing difficult credit conditions, but it is still finding ways of doing deals. Tapping the high yield bond markets has been one route, but we're also seeing firms being highly creative by establishing their own debt funds."

Sachin Date, Ernst & Young Private Equity Leader, Europe, the Middle East & Africa

Smaller funds, opportunistic strategies

Many of the largest PE players have downsized their latest funds to adapt to an environment of smaller commitments from LPs and a more hands-on strategy of targeting smaller, growth assets. None of the funds closed in 2011 was greater than US\$7 billion and many of the funds currently on the road are targeting smaller funds than their predecessors.

In addition, many of the larger players have taken the proactive step of raising funds that target specific regions or strategies. The Carlyle Group exemplifies this trend. The firm has separate funds dedicated to buyouts in regions such as Europe, the US, South America, Asia and Japan as well as specific funds for global financial services and European technology. This approach not only provides LPs with expanded alternatives for their allocations, but also enables GPs to take an opportunistic approach that places them at the forefront of regional and sector developments.

"The strong yen, low interest rates and a shrinking domestic market mean that a number of Japanese companies are aggressively looking to expand overseas. However, they are unable to establish an appropriate level of governance in a target company in order to control the existing management. Private equity firms can foresee opportunities here by co-investing with Japanese companies and assisting them with establishing an appropriate level of governance."

Satoshi Sekine, Ernst & Young Japan Private Equity Leader

PE devising new strategies and digging deep for new deals

In 2011, the number of large deals declined, while the middle market held its ground. This reflects the fact that many sponsors are now looking at smaller, platform deals with highly promising growth prospects. This is in part a response to challenging debt markets, as some of these situations permitted sponsors to complete investments on an all-equity basis. But it's also evidence of PE looking beyond traditional deal sources and seeking out new opportunities.

PE is also increasingly seeking to partner with strategic buyers on the basis that these can provide additional capital and resources, expertise in a given market and a means of risk mitigation to achieve mutually beneficial outcomes. This approach has the potential benefit of reducing competition from strategic buyers.

There is also evidence that corporates continue to restructure their businesses turning to spin-offs or divestitures of non-core assets. PE was active in this space in 2011 and the same is expected for 2012.

PE firms are finding opportunity in the face of volatility and adversity. PE faces a challenging landscape of increased competition for deals, lower debt availability and the prospect of low growth in the developed economies. All of these are long-term challenges, and they have the potential to negatively affect the outcome of PE deals. However, with true entrepreneurial vigor, PE firms are devising strategies that not only mitigate some of these issues, but also in many cases take advantage of them.

Their quest for growth is also prompting firms to delve deeper into the market for new deal sources. The most successful PE operators are pursuing strategies to identify proprietary deal flow.

Tapping emerging markets

The move toward emerging markets is further evidence of this determination to find new deal sources and opportunities. Over the last few years, PE has extended well beyond its traditional markets into fast-growth economies such as India, China and Brazil in an attempt to capitalize on the emerging middle class in these geographies. These have proved highly successful markets for many PE firms, which have tapped these regions for new investments as well as expanded existing portfolio companies there.



“PE is demonstrating that it doesn’t need to do mega-deals to be successful. Many firms are moving to smaller deals, putting in more equity and aligning themselves with entrepreneurs to drive growth.”

**Philip Bass, Ernst & Young Private Equity
Global Markets Leader**

However, even these markets have become more established. International and local firms now compete for deals in these markets, and competition for deals has increased significantly. Meanwhile, there are also signs of a slowdown in the breakneck GDP growth some of these countries have witnessed over recent years. The World Bank recently revised its 2012 growth forecasts for China, Brazil and India downward.

Even so, these countries will continue to grow strongly compared with developed markets, and they still hold plenty of promise for PE. JPMorgan and Blackstone have acquired stakes in local Brazilian managers, and firms such as TPG, Blackstone, Carlyle and Morgan Stanley either have raised or are raising RMB – denominated funds as a means of accessing local capital and investment opportunities. In addition, there are many cities beyond the well-trodden path of the capitals in which strong PE investment potential resides.

PE pioneers will go beyond BRICs

But it is possible that PE firms with the vision to tap into the world’s frontier markets will reap the best rewards. Markets such as Turkey, Indonesia, Vietnam, Africa (see pages 8-9), Colombia, Chile, Mexico and Peru all exhibit similar trends to the BRICs. They have young, growing populations with increasing disposable incomes. Consumer culture is taking hold in these countries, and economic growth is rapid. Yet valuations remain more moderate and competition more limited than the more established growth markets.

Meanwhile, in recognition of the important role foreign investors such as private equity firms can have on their development, governments are also increasing regulatory oversight and improving legislative frameworks to improve shareholder protection. As a result, many of these countries are attracting PE’s most entrepreneurial firms seeking risk-adjusted returns.

Gaining access to these newer markets and finding investments in second-tier cities in countries such as China, India and Brazil will be challenging. Intermediary networks and legal and due diligence capabilities are in their early stages of development, for example. Lack of governance, clarity in the rule of business law, foreign currency and talent identification represent complex hurdles to being a successful investor. Achieving success will require a heavy dose of pioneering spirit, backed up by local talent and sophisticated management processes to ensure that risks are appropriately managed.

Yet the PE model has adapted in the past. Sponsors have proven that they can deploy a variety of different strategies for success, from building local teams through to harnessing local knowledge and contacts via partnerships. TPG’s recent share swap with local Indonesian fund manager Northstar Pacific is one example of how international firms are broadening their global reach. CVC’s partnership with government-linked Johor Corporation to bid and potentially acquire Malaysia’s KFC Holdings and its parent QSR Brands for US\$1.6 billion was also announced at the end of last year and is another such example.

“Bigger PE firms are increasingly competing with the growing force of local firms in the BRICs, and competition is intensifying. PE is therefore looking further afield to frontier markets that benefit from similar dynamics and where valuations are more moderate. Yet the industry has learned from the past that it cannot successfully invest from afar, so it is putting people into the local markets or finding new ways of accessing local contacts and knowledge through partnerships and collaboration.”

**Jeffrey Bunder, Ernst & Young Global
Private Equity Leader**

Africa

In recent years, Africa has stepped into the limelight to become the new emerging market participant. It has long been a continent with significant promise, but issues such as corruption, conflict and economic crises have, until recently, overshadowed the economic fundamentals. However, the last few years have seen a broad range of reforms in the region, with improvements in infrastructure and initiatives aimed at regional integration ushering in new avenues of commerce and a push for greater transparency and accountability.

These developments, coupled with highly favorable demographic and economic trends, mean that the continent is now ready for significant investment. PE has for many years seen the opportunities the continent has to offer, with a number of funds established there for more than a decade. And the industry can point to a number of high-profile success stories, such as that of Celtel International, which grew from a small national telecoms operator to one of the region's biggest companies under PE ownership.

Recent times have witnessed a new wave of PE activity as Africa's untapped potential has prompted interest among GPs and LPs. In 2007, sub-Saharan Africa accounted for 3% of emerging market fund-raising; by 2010, this had doubled to 6%. Strong growth prospects, particularly in contrast to those in developed markets, are attracting PE capital. GDP growth across Africa is expected to

average 5% over the next 10 years, with many countries, such as Ghana, Ethiopia and Uganda, projected to exceed 7% GDP growth per year. PE's penetration in the region also remains low – representing just 0.11% in sub-Saharan Africa – which translates into less competition for deals and substantial opportunity for growth.

Investment values on the rise

South Africa remains the region's largest PE market in Africa and has attracted the most PE investment over the last two years, but opportunities beyond its borders are starting to attract more investment. The value of investments in sub-Saharan Africa increased by 38% in H1 2011 compared with US\$1.7 billion in the same period in 2010 despite a fall in the volume of deals from 25 to 21, according to figures from the Emerging Markets Private Equity Association (EMPEA).

The range of deals available to PE investors is also expanding as the region's economies diversify away from their reliance on extractive industries. Financial services, technology, telecoms, agriculture, consumer products and infrastructure investments all figure prominently in the sectors attractive to PE in Africa today.

Selected deals in Africa, 2010 and 2011				
Announced Date	Company	Deal value (US\$m)	Country	Firm
3 Oct 11	Tracker Network Ltd	\$434	South Africa	Actis Capital LLP, RMB Ventures Ltd
19 Sep 11	Eaton Towers	\$150	Ghana	Capital International, Inc
30 Aug 11	Universal Industries Corporation Ltd	\$184	South Africa	Ethos Private Equity Ltd
6 Jan 11	InterSwitch Ltd	\$110	Nigeria	Helios Investment Partners LLP, Adlevo Capital Managers LLC
11 Sep 11	Rift Valley Railways	\$110	Kenya	Citadel Capital, African Agriculture Fund, IFC
26 Oct 11	IHS Nigeria plc	\$52	Nigeria	Emerging Capital Partners – ECP, Investec Africa, Frontier Private Equity Fund LP
12 Jan 10	Seven Energy Nigeria Ltd (Minority%)	\$48	Nigeria	Capital International Inc; Standard Chartered Private Equity
13 Jul 11	Denny Mushrooms Ltd	\$38	South Africa	RMB Ventures
27 Jul 10	Mediterranean Smart Cards Co	\$30	Egypt	Actis Capital LLP
14 Mar 11	Metago International Holdings	\$11	South Africa	3i Group plc
8 Mar 10	C & I Leasing plc	\$10	Nigeria	Aureos Capital Ltd

Source: Dealogic, Thomson ONE, Bloomberg.com



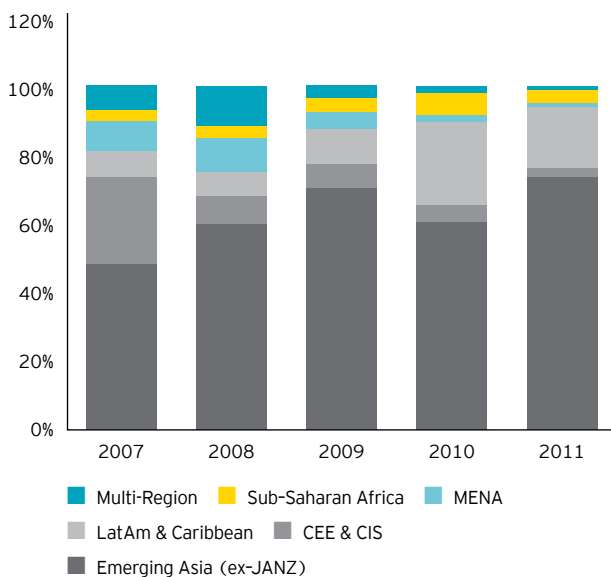
PE's penetration in the region remains low – representing just 0.11% in sub-Saharan Africa – which translates into low levels of competition for deals and substantial scope for growth.

Exits still to emerge

While some firms have been operating on the continent for many years, the latest wave of PE investment is still too recent for exit figures to be meaningful. This is particularly the case, given that many investments have been made in longer-term infrastructure projects and assets.

Nonetheless, exit alternatives are developing in Africa. While corporates are still by far the most common buyers of PE assets, accounting for 95% of exits in the region, Africa's capital markets are growing in importance in countries such as South Africa, Ghana and Nigeria. PE firms have also tapped Euronext Paris and other global exchanges for realizations. Indeed, a recent Collier Capital/EMPEA survey found that just 14% of participants felt that exit challenges were sufficient for them to reduce their likelihood of investing in Africa.

Africa fund-raising versus other key emerging markets



Source: EMPEA Industry Statistics, Q3 2011 release

Fund-raising up as new players enter the market

Historically, fund-raising for the region has been largely concentrated on funds targeting South Africa. But the last five years have seen a higher proportion of capital directed towards sub-Saharan Africa's frontier markets. Through Q3 2011, African PE funds outside South Africa were set to raise more than US\$1.7 billion for the whole year, with South African funds representing just 10% of the total amount raised for sub-Saharan Africa. The US\$1.7 billion was also a 13% increase on 2010 figures.

New funds are emerging to join the established players such as Kingdom Zephyr, Ethos and African Capital Alliance. At the same time, large international players such as The Carlyle Group are raising funds for Africa, joining the established global emerging markets players like Actis. The PE landscape is diversifying to offer financing to businesses in every stage of development.



Build an ecosystem of finance, people and know-how

Making investments in the back office

A professionalized back office was one of three key areas we identified in our report last year that would define the winners of tomorrow. And indeed, today we find the industry at a critical point of maturity as many firms are making significant decisions about their long-term operating infrastructure. As the firms evolve, there is a growing need for IT infrastructure in order to capture information requested by investors, regulators, auditors and other key stakeholders. FATCA, Form PF, the AIFM Directive and ILPA are just some of the drivers leading to this growing need. PE firms are improving their processes and systems as part of a cohesive and coordinated framework to provide internal and client-facing advantages. To create competitive advantages in deal-making, portfolio analysis and investor reporting, firms are looking to introduce strategic changes to how data and information are gathered and managed.

The modern objective of this evolved operating model is to respond to the increasing demands of the organization for timely and relevant information and to the increasing requests of stakeholders, as well as to support the expanding business lines. Those firms that demonstrate a robust and well-coordinated operating infrastructure will be more likely to attract funds in a challenging fund-raising environment.

It's important to note these investments are significant. With few standardized software packages in the market that can integrate the data required for accounting, CRM, portfolio management, investor reporting and other key functions, the industry's existing systems and tools for these functions have developed separately. This has given rise to a sector of vendors and service providers that will look to develop solutions to address the need for a more strategic approach to information management – further supporting entrepreneurship.

PE harnessing talent and driving through change

Initiatives such as the faithful, routine and constant use of 100-day plans – living, ongoing 100-day plans – to implement key improvements and the strengthening of firms' capabilities through hiring operating partners with top-quality sector credentials have become an integral part of PE's value-add story over the last few years. In many cases, these operating partners are corporate executives who are also helping to source and diligence new deals, in addition to providing operational support or acting as chairman of the board. In our recent CCB for PE, we found that since the crisis, nearly 70% of PE firms globally had increased the use of operating partners and 64% made more use of internal portfolio support teams to add incremental value to investee companies. We have seen this trend continue to expand resources focused on driving additional value in the portfolio – bringing both functional and strategic expertise to enhance performance.

Identifying the right sectors

Another way in which PE is demonstrating its impressive agility and adaptability in the face of these challenges is by increasing focus and expertise in the sectors it views as offering the greatest potential. Rather than taking a general approach to investing, many PE firms are focused on sectors and that display highly attractive fundamentals and spend significant time and effort searching for and understanding niches within them that play to PE's focus on growth and driving through business change. Some key sectors in which PE sees opportunity include oil and gas, health care and technology (see page 11-12).

Larger firms are expanding around the concept of specific pools of capital for sector opportunities, while others are honing their investment focus to concentrate on industries set on a growth path. This approach not only answers LPs' desire for more direct exposure to specific sectors, but also assists firms in their bid to create competitive advantages in deal origination and value creation strategies to capture growth.



The sector view

Oil and gas

This sector has moved up the PE agenda over the last five years as fundamentals for oil and gas have demonstrated strong returns. The rise in commodity consumption from emerging markets has driven much of this demand, resulting in higher oil prices. Strong oil prices, coupled with steadily growing consumption, mean that the oil and gas sector will require heavy investment to ensure that existing extraction sites are tapped to the maximum possible and that oil and gas fields in new and increasingly remote locations are discovered and developed. New technologies are enabling increased output as well as extraction from wells that were historically either impossible to access or prohibitively expensive to drill.

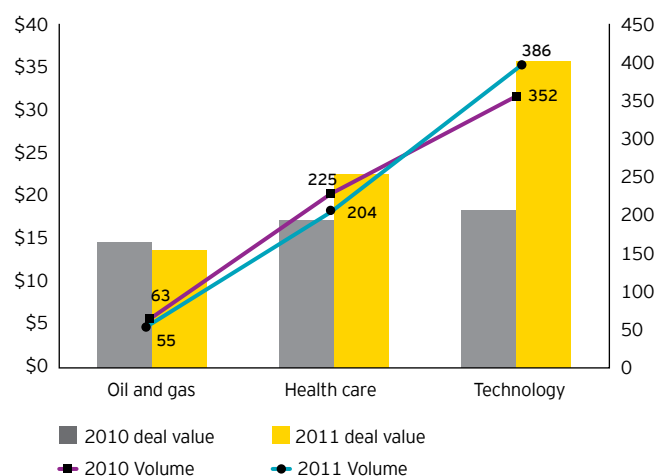
Opportunities will arise in the primary areas of the sector, particularly for specialist oil and gas funds. Generalist PE funds seeking oil and gas exposure will, for the most part, focus on investing in the suppliers and service providers to the industry, which requires less technical analysis.

Major finds in regions such as Brazil and off the coast of West Africa are drawing more attention to the emerging markets. Indeed, in Brazil, the country's oil giant, Petrobras, has said it will invest a staggering US\$225 billion over the next five years.

Additional areas for investment will be in oil and gas technology, businesses that can improve the efficiency of oil and gas extraction and enhance environmental management techniques – the latter of which has increased in importance since the Gulf of Mexico oil spill.

In 2011, PE activity in this sector was roughly in line with 2010 levels in the US by value and volume. We expect investment levels to be strong in 2012 and beyond, as there is ample capital available and the fundamentals of the sector remain intact. Deals will also emerge from strategic sources, as the results from our CCB found that 37% of oil and gas companies will look to make divestments in 2012.

US PE sector breakout (in US\$ billions)



Source: Dealogic Jan 2012

Health care

Historically, health care has had a fundamentally strong track record for PE returns, driven by a number of trends, including medical innovation, cost containment, consolidation and outsourcing, among several other themes. Over the past decade, global health care spending has increased steadily as new treatments have emerged, demographics have shifted and increased demand for solutions in emerging markets has driven demand, with health care expenditures outpacing the rate of inflation.

Federal and state budgets have come under pressure over the last several years. This dynamic, coupled with health care reform, presents PE with a great deal of investment potential, as growth companies are looking to capitalize on the opportunity to improve productivity by enhancing efficiency and setting up and designing platforms that enhance patient access. These companies will be seeking capital, which can be differentiated by having industry-leading operational executives, industry knowledge and well-developed networks in the sector.



The sector view (cont.)

In addition, the pharmaceutical sector continues to evaluate, restructure and streamline operations across drug discovery, clinical development and commercialization to offset the reduction in new blockbuster drugs. The mega-deals over the last few years will create divestiture opportunities in redundant product categories and tangential businesses that no longer fit the companies' models. Finally, the industry may continue to outsource many of its non-core activities, offering PE opportunities in areas such as contract manufacturing, telehealth, patient trial management services and laboratory services, among other attractive subsectors.

PE is well positioned to offer the strategic capital that many of these companies require. Firms are working with organizations to provide value by exploring opportunities for scale, diversification and convergence. PE is assisting in the sector's dynamic evolution. For example, we are seeing provider organizations being sold to managed care payors. The fundamentals of the global health care market will remain a strong attraction, and so we predict a continued growth for 2012 and beyond.

Technology

As technology plays an ever-increasing role across most sectors and technology companies increase in maturity, PE's interest (as opposed to venture capital) has expanded. The sector now boasts thousands of companies that are well-suited to the buyout model: many are highly cash generative, profitable and operate in niches with growth potential that far outstrips that of the wider economy.

A key attraction is the fact that major technology corporations, such as Google, Microsoft and SAP, are actively seeking new technologies that enhance their offerings or move them into new markets. They will often pay a significant premium for businesses they see as vital to their development and give them first-mover advantage in new areas. In addition, many large

139% – the increase in the value of PE investments in the technology sector.

technology companies have built up significant cash balances enabling them to make acquisitions. Our global CCB found that 45% of technology companies were planning acquisitions in 2012.

PE is ideally placed to transform young technology businesses in fast-growth niches into professional companies that are highly attractive to strategic buyers. Indeed, it is often in this area that PE has made some of its most stellar returns.

Technology companies will need to grow into spaces such as wireless, mobility and phone technology, cloud computing and social networking to stay ahead of the game providing much of the opportunity for PE to supply these solutions.

In line with the technology industry's development, PE is refining its strategy for investing in the sector. Players are increasingly focusing on hardware or software and are specializing in particular subsectors within those broad categories.

We are expecting an increase in deal activity in the technology space for 2012, particularly as many targets look to raise capital from alternative sources. In China, PE investments in the technology space are gathering pace. The value of PE investments in the sector rose by 139% from US\$1.7 billion in 2010 to US\$4.1 billion in 2011. In Q4 2011 alone, there were 40 PE investments in technology, including the largest deal of the quarter – the US\$1.6 billion investment by a consortium including Silver Lake and Temasek Holdings in Alibaba Group.



Live what you believe: build success culture and values

PE working closely with LPs to adapt to their changing needs

As PE extends its reach to source new opportunities, the industry is also paying close attention to its investors. Since the onset of the crisis, fund-raising has been more of a challenge. Fund-raising figures declined in 2011 from the previous year and are well below the 2008 peak. This trend reflects the limited partners' more rigorous fund manager selection processes, less capital available for new commitments as distributions have materialized more slowly than anticipated and a desire to reduce the number of GP relationships they manage.

Yet LP needs have changed in other ways, too. In recent years, they have become more strategic in the deployment of their PE allocations. Previously, allocations to PE might have entailed selecting managers at the upper, the middle and the lower ends of the fund size spectrum, with some regard to geography, LPs now require increasing granularity over their asset allocation decisions as they seek to manage their investments and risk more effectively, with some even targeting specific sub-asset allocations.

PE has responded to these trends in pragmatic and entrepreneurial fashion, with the result that LP allocations to PE are set to continue increasing over the medium to long term.

Investors view PE as a vital means of achieving strong risk-adjusted returns. Over the last five years, allocations by most major investment types have trended higher. Average allocations by pension funds increased from 4% to 5% and those by endowments rose from 8% to 12%. These proportions could rise further as increased public market volatility and a continuing low interest environment impact LPs' overall returns in other asset classes.

Proactive engagement with LPs

GPs have also become more focused on ensuring adequate alignment of interest with their LPs. More than 240 GPs have endorsed the ILPA principles which have issued a series of guidelines to help frame discussions with GPs around fund terms and conditions. In addition, GPs are increasing their reporting and transparency to LPs.

Yet there has not been a wholesale shift in terms. Instead, in recognition of the partnership between LPs and GPs that is the foundation of PE, sponsors have proactively engaged with investors and sought to meet their individual needs. As LP portfolio management has increased in its sophistication, GPs are developing alternative ways to work with their larger LPs, including providing more co-investment rights. Some are also establishing separate accounts for LPs, which provide large investors with more control over their committed capital. Partnerships such as those agreed between The Blackstone Group and the New Jersey Division of Investment and KKR and the Teacher Retirement System of Texas are two such examples.

These developments demonstrate both the staying power of the industry and how adaptable the PE model can be as they address the needs of the LPs. They help investors boost returns through direct exposure and offer them more control over their investments. They also provide additional capital to GPs at a time of lower credit availability and offer an alternative to club deals, which can be difficult to execute successfully.

Nonconformist and a team player

In uncertain economic times, when capital is scarce, PE has a significant role to play. The industry often steps up as the sole source of capital in times of need, as we have discussed. Often, PE firms take contrarian viewpoints and invest in the face of negative growth trends. This is the specialty of turnaround firms like Sun Capital. BankUnited is a good example of this too. The Blackstone Group, The Carlyle Group, Wilbur Ross & Co., and others bought BankUnited from the FDIC in 2008. After three years of work, it is now one of the most profitable banks in the US and went public in 2011. This is representative of an entrepreneurial mindset that has become more mainstream as the PE industry has matured – part of a secular trend underway before the recession, but that has rapidly accelerated over the last few years.

Finally, be the architect of your own vision: passionate and focused

PE's entrepreneurial style will be vital to its success

The PE model has proven itself resilient and highly adaptable in difficult times. In partnership with top quality management teams, PE has strengthened portfolio companies' balance sheets and directed fundamental changes to ensure that businesses were focused on key growth opportunities. It has managed relationships with investors effectively and adapted to ensure that their increasingly complex needs are met. PE has expanded its reach to source the best and most exciting growth prospects both in traditional and new markets. And it is improving its internal management systems to ensure that it is complying with the rising tide of regulatory requests from key stakeholders and managing risk appropriately.

It has achieved this through a passion for what it does and laser focus – the dogged determination to improve businesses and the ability to spot new opportunities that are the hallmarks of entrepreneurial endeavor. Not all firms have managed to recapture this spirit. We have witnessed some weaker players struggle to

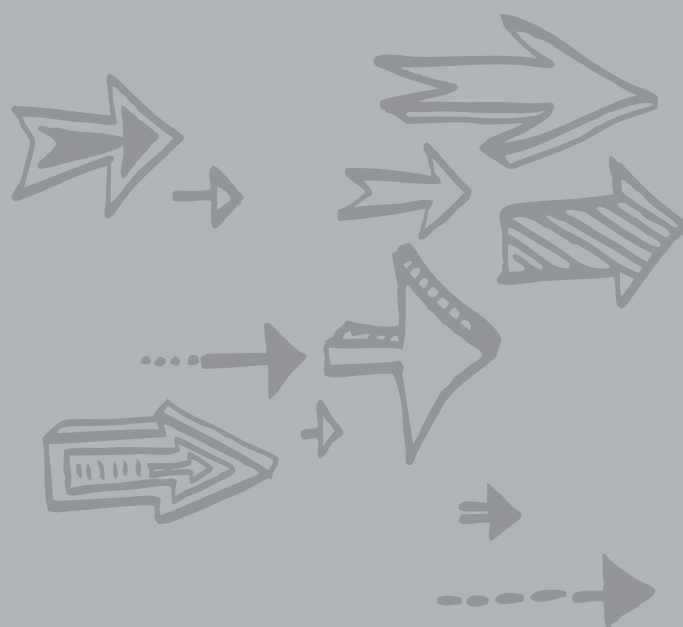
adapt to the shifting tides, and we will undoubtedly see more swept away. In last year's report, we said that 2011 would be the start of a process from which PE winners would emerge. Today's bifurcated fund-raising market, in which successful firms are raising at or above target over the period of a few months while others struggle or fail altogether, is evidence of the changing landscape.

Economies undergoing change or shock require entrepreneurs to find new avenues for growth and transform business failure into success. We are in such a period now, and the best PE firms have shown themselves more than equal to these tasks. PE and its investors benefit from this, but so does the economy at large. The instability of the capital markets over recent times has proved more than ever that PE is an essential part of the funding ecosystem. PE directs capital to the world's most promising companies and, together with highly talented management teams, shapes them to become market and global leaders, creating wealth, jobs and further opportunity. PE's entrepreneurial nature will ensure that it continues to grow, but it will also mean that it will play an integral role in elevating the world's economic growth prospects.



2011 Private equity year in review

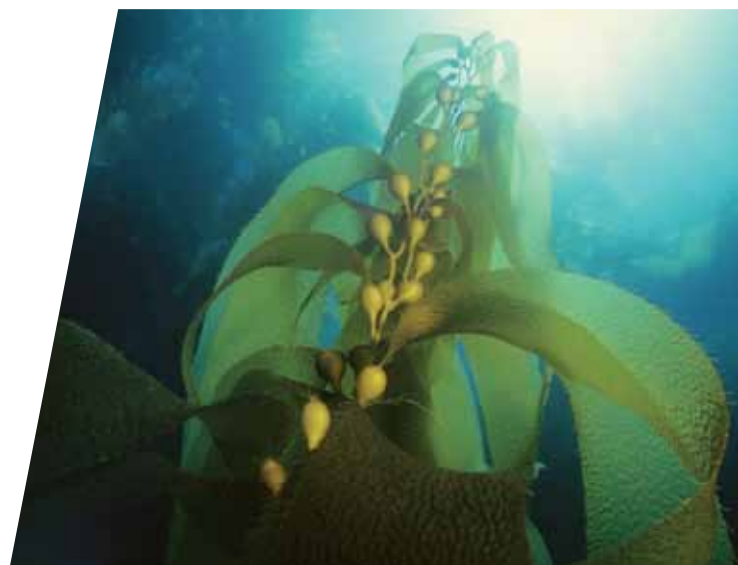
A tale of two halves



The first half of 2011 saw PE continue the emergence that began in 2010 from one of the most challenging periods in modern times. As the economic outlook improved, PE took advantage of improving market conditions and increased confidence to make new investments and exit some of its most promising companies. In particular, PE was able to capitalize on appetite for new issues to raise capital for portfolio companies and achieve much-needed liquidity for investors via IPOs.

However, the second half of 2011 was characterized by growing concerns over the economy as the sovereign debt crisis picked up velocity in Europe, the US suffered a downgrade by ratings agency S&P and, toward the end of the year, Asia's growth rate slowed. The result was, inevitably, a tailing off of new investments, particularly at the larger end of the deal spectrum, and a shuddering halt to the IPO market. The health of the global economy affects investors much more dramatically than in the past, resulting in a more rapid curtailment of deal activity.

Overall, investments and fund-raising closed the year down on 2010 figures, while exit numbers remained stable. Even despite these challenging conditions, PE continued to work closely with existing portfolio companies to generate value and position more mature investments for exit, while also paying close attention to its own business development through expanding its reach by geography and asset class. PE found new opportunities in the face of a down market.



Key PE statistics at a glance					
	2007	2008	2009	2010	2011
PE funds closed	1,029	970	584	522	477
Committed capital	US\$609.6b	US\$624.9b	US\$281.4b	US\$245.9b	US\$229.8b
Announced PE deals	3,231	2,653	1,796	2,158	2,190
Announced PE deal value	US\$731.4b	US\$219.1b	US\$137.9b	US\$235.1b	US\$217.6b
Average PE deal equity component	30.87%	38.85%	45.51%	41.37%	37.95%
PE-backed M&A exits	US\$302.8b	US\$141.4b	US\$70.1b	US\$225.1b	US\$219.7b
PE-backed IPOs	US\$58.1b	US\$8.8b	US\$17.1b	US\$37.1b	US\$38.8b

Source: Preqin, through 31 December 2011; Dealogic – includes sponsored entry and exit deals, and PE-backed IPOs – through 31 December 2011; S&P LCD, January 2012 release.

US\$31.4 billion raised through
IPOs by 70 PE-backed companies
in H1 2011



Activity reduces as economic and credit conditions deteriorate

After a strong start to the year, PE investment activity declined overall in 2011. PE sponsors announced deals valued at US\$217.6 billion in 2011, a 7% decline from the US\$235.1 billion announced in 2010. Activity was spread across 2,190 transactions, up slightly from the 2,158 recorded in 2010.

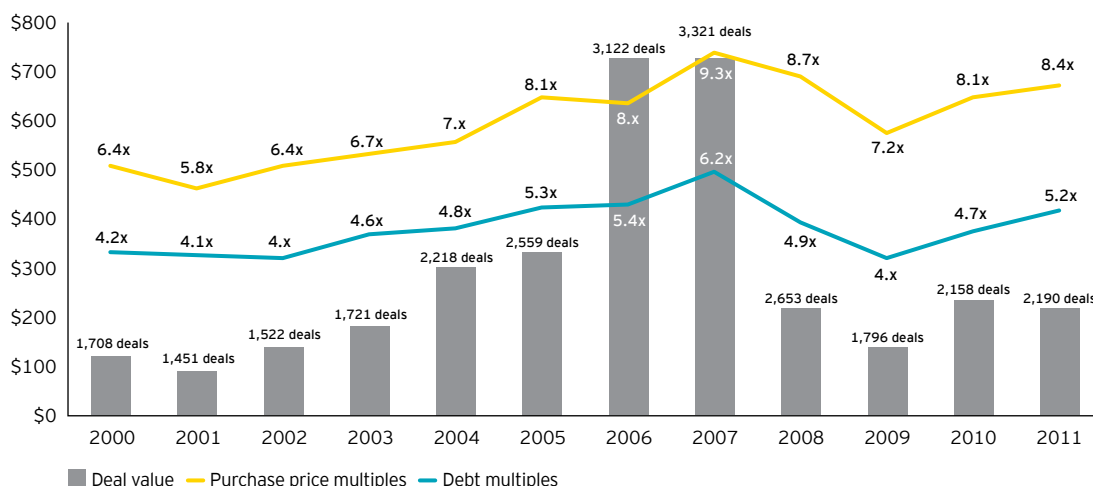
This pattern mirrors the rise and fall observed in the global M&A market. Deal volume showed an increase of 5.7% to 43,972 deals on 2010 figures, although this was driven largely by positive sentiment in the first half of the year. Activity slowed significantly in the second half of 2011, when the aggregate value of global M&A fell 12.7% on H1 figures and volume decreased by 6.4% as uncertainty spread through the world's economy and acquirors postponed plans for new deals.

Yet despite the decline in PE activity, valuations moved higher in 2011 as the operating environment for most companies normalized. Over 2011, the average purchase price multiple was 8.4 times EBITDA, up from 8.1 times in 2010. Leverage was also up over the year, although this was driven mainly by the availability of financing in the first half of the year. Debt multiples in 2011 averaged 5.2 times EBITDA, up from 4.7 times in 2010. It is worth noting that both multiples in 2011 were higher than those seen in pre-peak periods.

PE activity peaked in the second quarter of 2011. However, from Q3 onward, activity declined as concerns mounted over Europe's debt crisis, the US experienced an S&P downgrade and credit financing availability evaporated.

Q4 was the slowest quarter for new investments since the first quarter of 2010, with 480 deals announced at a value of US\$37.6 billion. Unsurprisingly, given the impact of the European sovereign debt crisis, the drop-off in activity was largely driven by a slowdown in the EMEA region, which saw deal value decline 34.7% in Q3. By contrast, the Americas remained broadly stable through 2011 in terms of deal value, while the Asia Pacific region saw a modest increase in value in Q4 compared with the previous two quarters.

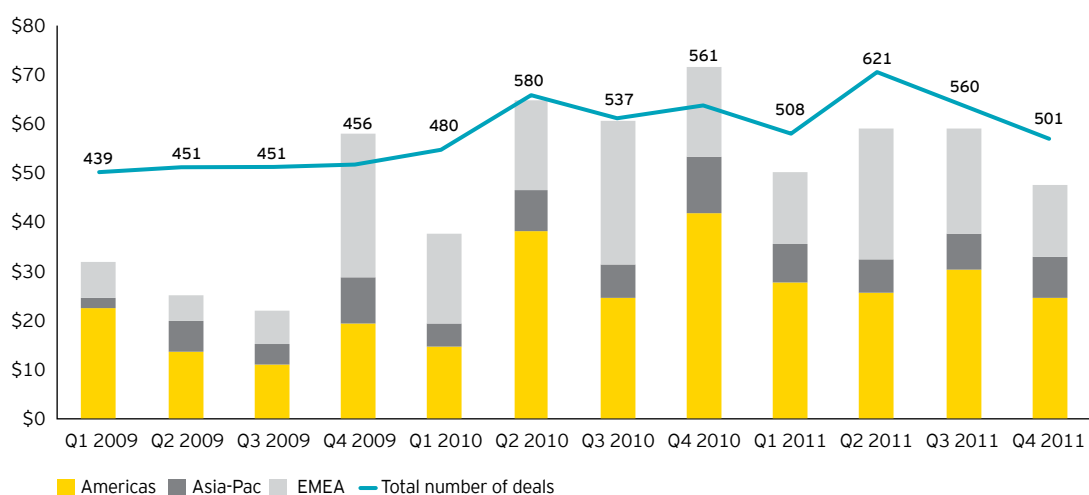
PE acquisitions and valuations 2000-2011 (in US\$ billions)



Source: Dealogic through 31 December 2011 – includes sponsor-backed acquisitions; excludes repurchases, spin-offs, split-offs and add-ons; S&P LCD, January 2012 release. Purchase price multiple calculated using average purchase price divided by adjusted EBITDA. Debt multiples calculated using average debt-to-adjusted EBITDA ratio for leveraged buyout (LBO) transactions for companies with EBITDA greater than US\$500m.



Quarterly PE acquisitions by region 2008-2011 (in US\$ billions)



Source: Dealogic – includes sponsor-backed acquisitions; excludes repurchases and add-ons. Regional breakdown based on location of target headquarters.

Top deals announced in 2011				
Announced	Target	PE Buyer	Deal value (US\$b)	Target industry
1 Mar 11	Centro Properties Group (US assets)	Blackstone Group	\$9.0	Real estate/property
23 Nov 11	Samson Investment Co	Natural Gas Partners, Crestview Partners LLC, KKR & Co.	\$7.2	Oil & gas
13 Jul 11	Kinetic Concepts Inc	Apax Partners	\$6.3	Health care
3 Oct 11	Pharmaceutical Product Development Inc – PPD	Carlyle Group, Hellman & Friedman	\$3.9	Health care
23 Jun 11	Securitas Direct Sverige AB	Hellman & Friedman, Bain Capital Partners	\$3.4	Professional services
21 Oct 11	Skylark Co Ltd	Bain Capital Partners	\$3.4	Dining & lodging
4 Aug 11	Emdeon Inc	Blackstone Group	\$3.1	Computers & electronics
27 Apr 11	SAVVIS Inc	Welsh Carson Anderson & Stowe	\$3.1	Computers & electronics
31 May 11	SPIE SA	Clayton Dubilier & Rice, AXA Private Equity	\$3.0	Construction/building
14 Feb 11	Emergency Medical Services Corp	Clayton Dubilier & Rice	\$3.0	Transportation

Source: Dealogic – includes sponsor-backed acquisitions announced 1 January 2011-31 December 2011



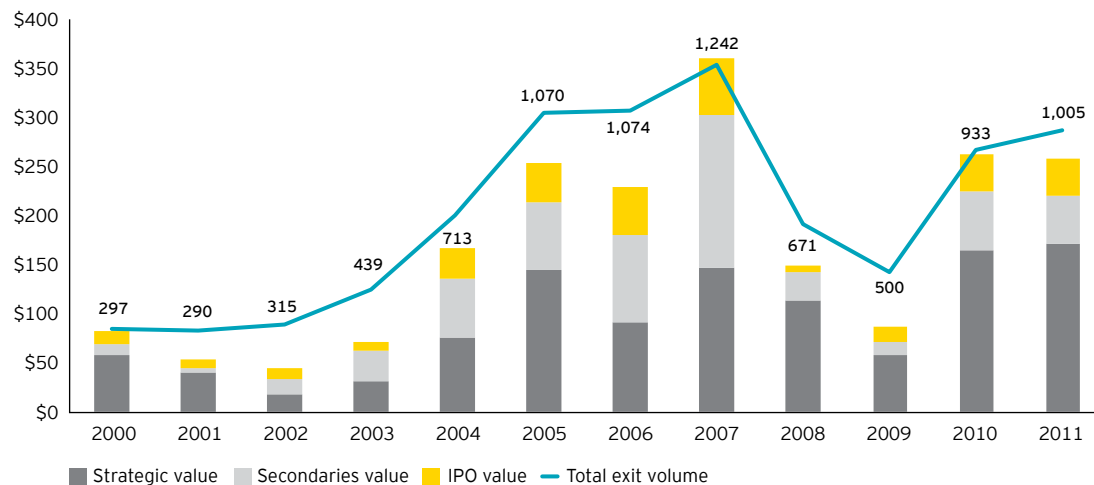
The lack of available credit in the second half of 2011 led to an inevitable 18.5% decline in the overall number of large deals announced in 2011 (those over US\$1 billion). But perhaps surprisingly, the largest 10 deals of 2011 were evenly spread across the year, with 5 in the first half and 5 in large transactions.

The Blackstone Group's US\$9.0 billion acquisition of a portfolio of 600 shopping malls from Australia's Centro Properties was the largest deal of 2011. It was also one of the largest real estate deals since the onset of the recession in 2008.

The second-largest deal took place in November, even as credit markets hit a trough. A consortium comprising KKR, Natural Gas Partners and Crestview Partners acquired Samson Investment Co. for US\$7.2 billion. The buyout is to be financed with a US\$2.35 billion asset-based revolving loan, a US\$2.25 billion bridge-to-high-yield bond facility, and US\$3.5 billion of equity.

Other notable deals include July's buyout of Kinetic Concepts by a consortium led by Apax Partners for US\$6.3 billion, the US\$3.9 billion acquisition of Pharmaceutical Product Development by Hellman & Friedman and The Carlyle Group, both in the health care space, and the US\$3.4 billion transaction to buy Securitas Direct by Hellman & Friedman and Bain Capital Partners.

Exits by type 2000-2010 (in US\$ billions)



Source: Dealogic – includes sponsor-backed exits, excludes repurchases and add-ons for M&A, through 31 December 2011

"In Japan, competition for deals has been increasing from both cash-rich corporates and PE firms with ample dry powder to spend. Despite the economic challenges, valuations have remained high."

**Satoshi Sekine, Ernst & Young Japan
Private Equity Leader**

Strong exit activity for most of 2011

After a growing momentum in 2010, PE sought to take advantage of improved market conditions by exiting investees through much of 2011. PE firms exited 1,005 investments valued at US\$258.5 billion in 2011, exceeding on a volume basis the 933 exits in 2010, but slightly trailing in value.

Sales to strategic investors had by far the strongest showing, as in 2010. Sponsors realized US\$170.4 billion through sales to trade buyers in 2011, followed by US\$49.3 billion to other PE players and US\$38.8 billion in 119 initial public offerings.

The majority of PE-backed IPO activity occurred in the first half of 2011, when investor appetite for new issues was strong. Indeed, in H1 2011, 70 companies raised US\$31.4 billion through IPO, putting PE on track for its best year on record. However, global IPO activity slowed sharply in the second half of the year as economic conditions in Europe deteriorated and corporate governance concerns surfaced in Asia. Between July and December 2011, PE-backed companies raised just US\$7.4 billion on the public markets, a drop of 77% on H1's values and the lowest value since 2009.

Looking forward to the rest of 2012, the outlook for PE-backed IPOs is heavily dependent on external factors such as the stabilization of Europe, improved growth prospects for the US and increased investor confidence in Asia. With improved operating results at many PE portfolio companies and an aging portfolio, many sponsors are watching closely for signs of the IPO window reopening and have been working diligently to prepare their portfolio companies for a public equity exit. There are currently more than 95 companies in active registration to go public, which in the aggregate could raise more than US\$21 billion.

The exit pipeline for outright sales also remains full, as sponsors have readied their companies with an eye toward distributing much anticipated capital to LPs. However, even though they have high levels of capital at their disposal, buyers are highly selective. They are most interested in companies with strong revenue growth potential – an area that our research highlights has become a key area of focus in PE's value creation story. The signs are that this should stand PE in good stead as market trends demonstrate that acquirors are willing to pay a premium for businesses that exhibit this characteristic.

Top five PE-backed IPOs: 2011

Pricing date	Issuer	Sponsor	Proceeds (US\$b)	Industry
9 Mar 11	HCA Holdings	Bain Capital, KKR & Co., North Cove Partners	\$4,354	Health care
10 Feb 11	Kinder Morgan	Carlyle/Riverstone Global Energy & Power, The Carlyle Group, Goldman Sachs Capital Partners, Highstar Capital	\$3,294	Energy
25 Jan 11	Nielsen Holdings	Thomas H. Lee Partners, The Carlyle Group, The Blackstone Group, Alpinvest Partners, Hellman & Friedman, KKR & Co.	\$1,889	Media
13 Apr 11	Arcos Dorados	Capital International, DLJ Merchant Banking Partners	\$1,437	Retail
23 May 11	Yandex NV	Baring Vostok Capital Partners	\$1,435	Technology

Top five PE exits by M&A: 2011

Announced	Company	Sponsor	Deal value (US\$b)	Industry
19 May 11	Nycomed SCA SICAR	DLJ Merchant Banking Partners, Nordic Capital Svenska AB, Avista Capital Partners	\$13,682	Health care
13 May 11	Nomura Land & Building	JAFco Co Ltd.	\$10,972	Real estate
10 May 11	Skype	Silver Lake Partners LP	\$8,500	Technology
21 Mar 11	Kabel Baden-Wuerttemberg GmbH	EQT Partners AB	\$4,482	Telecommunications
21 Feb 11	Seven Media Group	KKR & Co.	\$4,144	Telecommunications

Source: Dealogic – through 30 September 2011



Fund-raising remains a challenge but the best firms attract capital

While acquisitions and exits have recovered from their recessionary troughs, PE fund-raising has remained challenging. Through the end of 2011, 477 funds raised US\$229.8 billion, a decline of 6.6% on the US\$245.9 billion raised in 2010 and far below the 2008 peak of US\$625 billion.

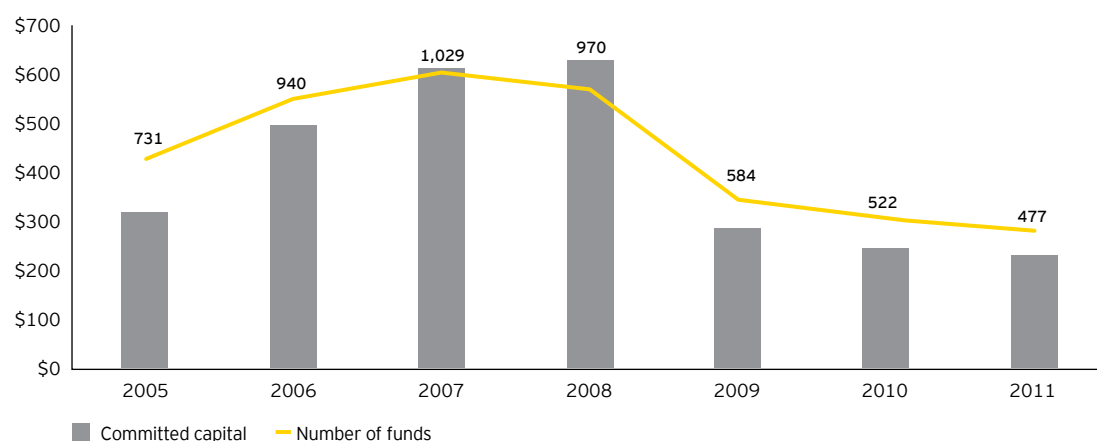
LPs have become increasingly selective in the funds to which they commit. They are seeking funds with top quartile returns, a lengthy track record and a core team of best-in-class deal professionals who have worked together for a period of time. Other key characteristics include excellent operational capabilities, highly-organized back offices that enable effective communication, strategies that capitalize on volatile market conditions and, in many cases industry or geographic expertise.

In some cases, LPs are also seeking increasing granularity over their asset allocation decisions, including looking at smaller, more specialized funds, and considering target allocations for sub-asset classes.

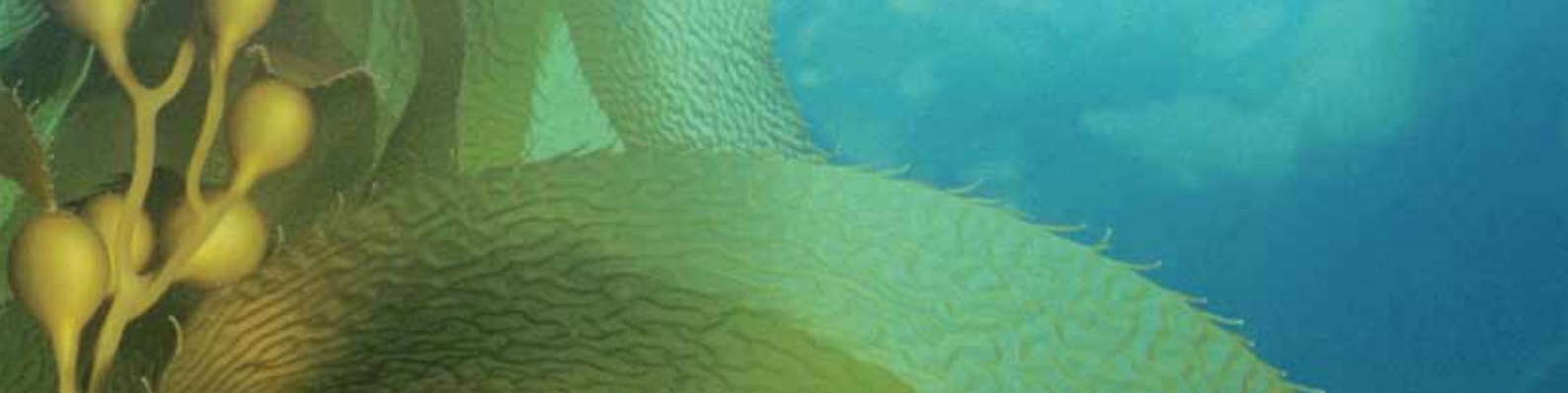
The largest fund to close in 2011 was EQT Partners VI, which raised a total of US\$6.5 billion in investor commitments. Other significant closes were Berkshire Partners' eighth fund, which closed at US\$4.5 billion, Oaktree Capital Management's European special situations fund, Centerbridge Capital Partners second fund, Montagu Private Equity's fourth fund and Golder Thoma Cressey Rauner's fifth PE fund. Many of the largest funds, such as EQT, Berkshire and Montagu, exceeded their targets, attesting to the appetite among LPs for the funds that registered top performance.

The very largest funds continue to be raised for established markets. However, emerging markets-focused funds are now appearing with greater regularity in the top 25 as local and international investors increase their exposure to the world's fast-growing economies. Examples in 2011 included China's Hony Capital, Brazil's BTG Pactual and Pátria Investimentos and Africa-focused Helios, which collectively raised US\$5.2 billion.

PE fund-raising 2005-present (in US\$ billions)



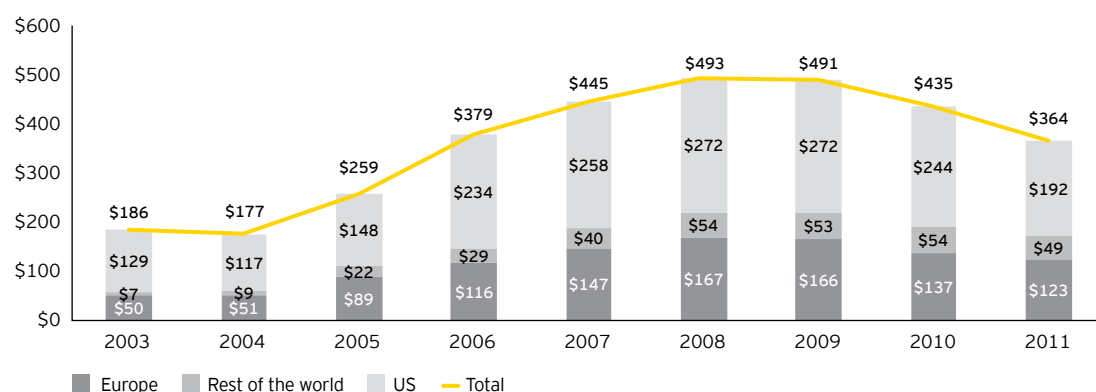
Source: Preqin – includes all investment styles except venture and venture-related, including but not limited to: buyouts, real estate, infrastructure, distressed, fund-of-funds, secondary funds, balanced funds and mezzanine. Funds listed by date of final close through 31 December 2011.



Top buyout funds				
Close date	Fund	Target (US\$b)	Closed (US\$b)	Geographic focus
14 Oct 11	EQT VI	\$6.0	\$6.5	Austria, Germany, Switzerland, Nordic
20 Jul 11	Berkshire Fund VIII	\$4.0	\$4.5	North America
1 Aug 11	Centerbridge Capital Partners II	\$3.8	\$4.4	US
1 Dec 11	OCM European Principal Opportunities Fund III	\$4.2	\$4.0	Europe
20 Apr 11	Montagu IV	\$2.8	\$3.7	Europe
22 Feb 11	Golder Thoma Cressey Rauner X	\$3.0	\$3.3	US
15 Jun 11	Pamplona Capital Partners III	N/A	\$2.9	North America, Europe
21 Oct 11	Summit Partners Growth Equity Fund VIII	\$2.5	\$2.7	North America, Europe
31 Jan 11	Gores Capital Partners III	\$1.5	\$2.1	North America, Europe
1 Jun 11	KSL Capital Partners III	\$1.5	\$2.0	North America

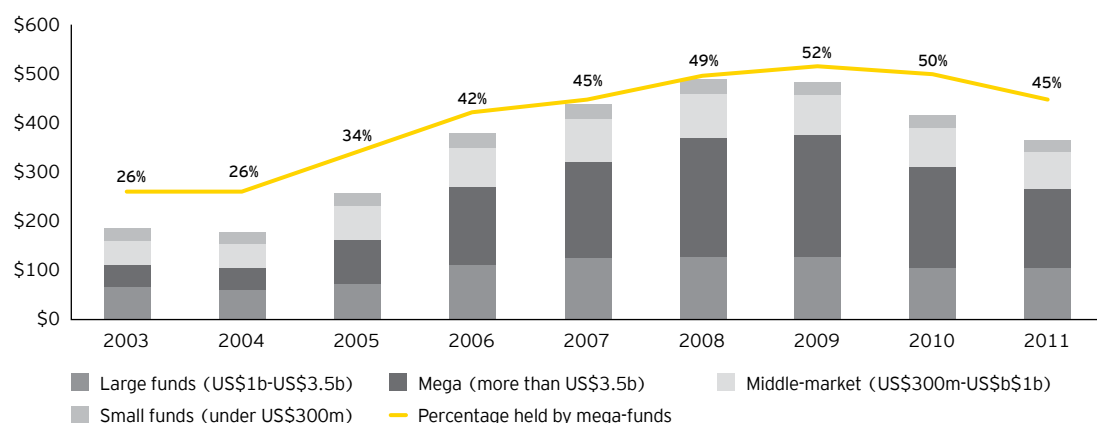
Source: Preqin through 31 December 2011

Buyout firms' dry powder by region 2003-2011 (in US\$ billions)



Source: Preqin, December 2011; ROW and emerging markets includes Latin America, Africa, Australia and Asia Pacific regions

Buyout firms' dry powder by fund size 2003-2011



Source: Preqin, December 2011; ROW and emerging markets includes Latin America, Africa, Australia and Asia-Pacific regions

Fund-raising accounts have receded over the last few years, largely due to the very large mega-funds raised in 2006 and 2007. Many firms simply did not need to raise new funds – as investment activity hit the brakes in late 2008. And PE continues to deploy this “dry powder”. In December 2011, buyout firms had US\$364.6 billion in unspent commitments. More than US\$192.1 billion of this resides with funds targeting the US, US\$123.4 billion for Europe, the Middle East and Africa and US\$49.1 billion for Asia and other emerging markets.

A combination of lower LP commitments, the more difficult investment climate and the shift toward more specialist strategies, has resulted in smaller fund sizes. In 2008, the average fund closed with US\$644 million in commitments, whereas the average fund size in 2010 and 2011 decreased to approximately US\$470-US\$480 million.

Mega-funds' market share has, as a percentage of the total, therefore shrunk. Funds with more than US\$3.5 billion in commitments accounted for approximately 45% of global dry powder, declining from the 52% registered at the market peak. However, many of the mega funds are beginning their fund-raising efforts in 2012 and 2013, so we may still see another shift.

The fund-raising market is becoming increasingly competitive. There are currently more than 1,200 PE funds on the road, seeking an aggregate US\$643 billion in LP commitments. This includes the latest funds from some of the industry's largest firms.

US\$49.1 billion available for investment in Asia and other emerging markets.



Emerging markets

As growth has decelerated in developed markets, it has continued to surge in the world's emerging economies. Indeed, emerging markets will continue to drive global growth far into the future as economic development continues at a rapid pace. The trends of increasing and young populations, a rising middle class with rapidly growing disposable incomes, a need for dramatically improved infrastructure, deregulation of key industries and improving legislative frameworks are converging to attract high levels of local and foreign investment to emerging markets.

These fundamentals mean that over the next three decades, emerging markets are expected to grow at more than twice the rate of developed markets, with the growth in many emerging markets far outpacing the average.

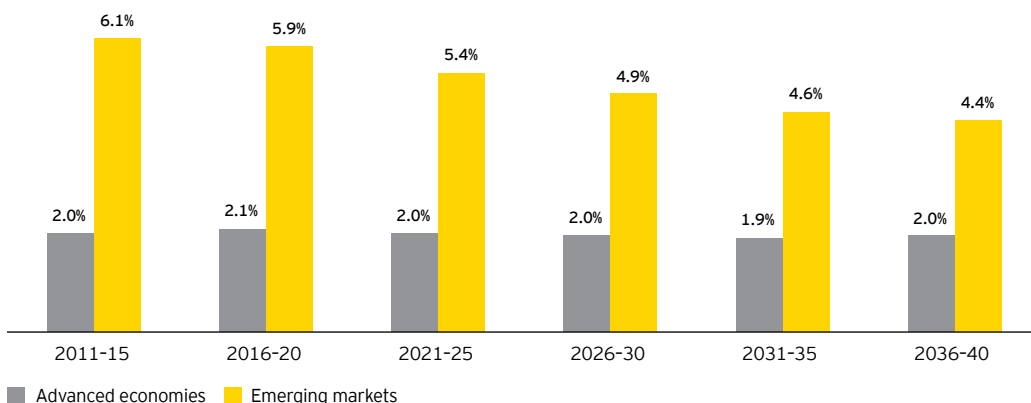
Having expanded in many of these markets a number of years ago, PE continues to be attracted by the high growth potential that these economies offer. In 2011, firms strengthened capabilities in the key BRIC markets and beyond into the frontier markets, which exhibit many of the same fundamentals.

While global fund-raising figures were down from 2010 levels, they were on an upward trend in 2011 for emerging markets. Through the third quarter of 2011, emerging markets-focused funds had raised an aggregate US\$32.2 billion, on pace to more than double last year's total. Much of the increase was attributable to Emerging Asia funds, which are set to increase fund-raising by 120% over 2010 figures.

LP appetite for exposure to emerging markets continues to expand. A recent survey by EMPEA and Collier Capital found that LPs already active in emerging markets investing are planning to increase the proportion of their PE allocations targeted to emerging markets from the current range of between 11% and 15% to 16% and 20% over the next two years alone.

US\$32.2 billion – funds raised through Q3 2011 for emerging markets-focused funds.

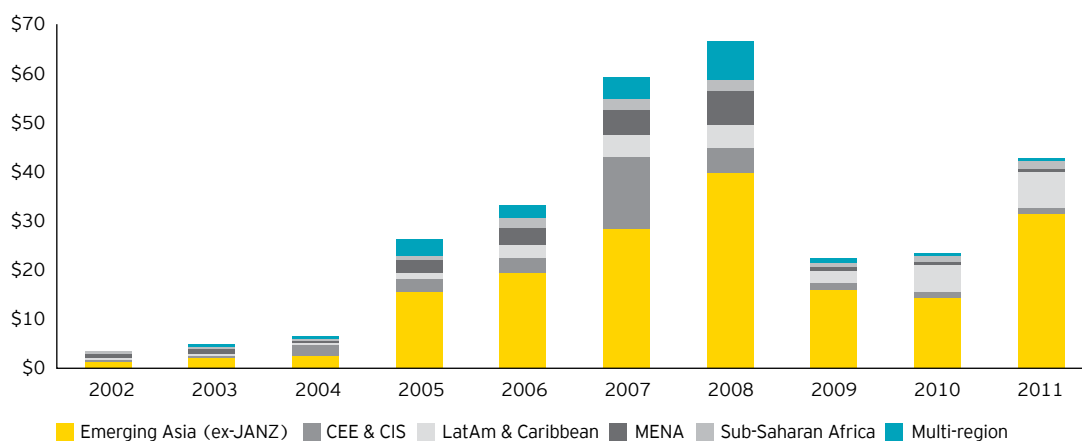
Long-term projected GDP growth for emerging markets relative to developed economies



Source: Global Insight, EMPEA

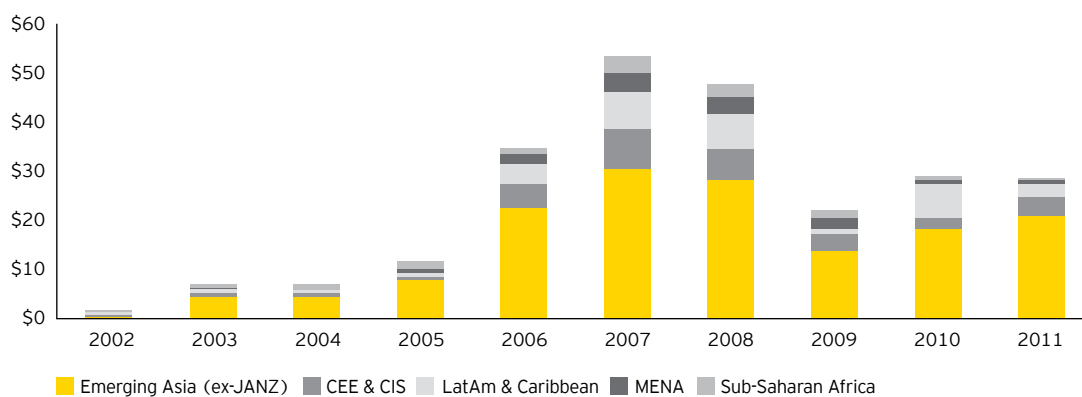


Emerging markets fund-raising 2002 – Q3 2011 (annualized, in US\$ billions)



Source: EMPEA/Collier Capital Emerging Markets Private Equity Survey 2011

Emerging markets investments 2001-2011 (in US\$ billions)

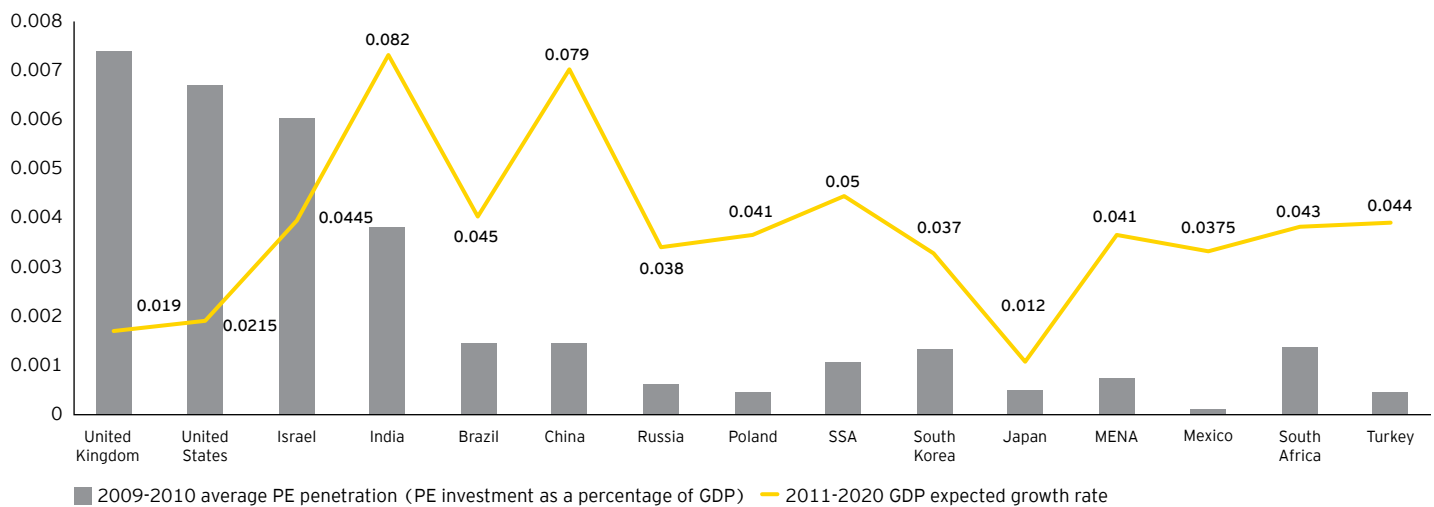


Source: EMPEA/Collier Capital Emerging Markets Private Equity Survey 2011

As capital continued to flow to emerging markets-focused funds, investment pace also remained brisk in 2011. Through the end of the third quarter, emerging markets had attracted US\$22.5 billion of PE investment, on track to at least match the US\$28.9 billion of deals announced in 2010. Focus remained on the BRICs in 2011: these accounted for 80% of PE investment totals in emerging markets.

Even though GDP growth slowed in Brazil and China at the end of the year, there is plenty of room for growth in PE activity in emerging markets. Even though deal and fund-raising figures have risen sharply over the last decade, PE penetration remains low in most emerging markets. China and Brazil have been particular areas of focus for PE in the last few years as the industry is becoming an important part of these countries' investment landscape. Notwithstanding this, PE accounted for just 0.14% of China's GDP and 0.15% of Brazil's. By comparison, the figures for the US and UK are 0.67% and 0.74%, respectively.

Average PE investment as a percentage of GDP and expected GDP growth rate (2011-2020)



Source: EMPEA, Global Insight



Recent vintage funds focused on the frontier markets					
Fund	Manager	Type	Fund size (US\$m)	Fund status	Location focus
Ethos Private Equity Fund VI	Ethos Private Equity	Buyout	750	Raising	South Africa, Africa
Hahn & Company I	Hahn & Company	Buyout	750	Closed	South Korea
Northstar Equity Partners III	Northstar Equity Partners	Buyout	820	Closed	Indonesia
Vogo 2	Vogo Investment	Buyout	500	Closed	South Korea
Mediterra Capital Partners I	Mediterra Capital	Buyout	360	First close	Turkey
Trifecta Fund I	Trifecta Capital Partners	Buyout	350	Raising	Eastern Europe

Source: Preqin, accessed on 15 February 2012

With an expected GDP growth rate of near 8% over the next decade, China represents a huge opportunity for PE growth. Yet there are others with similar potential, and many of these markets have less competition for high-quality assets than in China and Brazil, which have experienced rapidly rising valuations in some aspects of their markets.

Some of the top frontier investment destinations include:

- Latin America – Colombia, Chile, Peru and Mexico
- Emerging Asia – Indonesia, Vietnam and Thailand
- Sub-Saharan Africa
- Middle East and North Africa
- Emerging Europe – Czech Republic, Hungary, Poland and Turkey

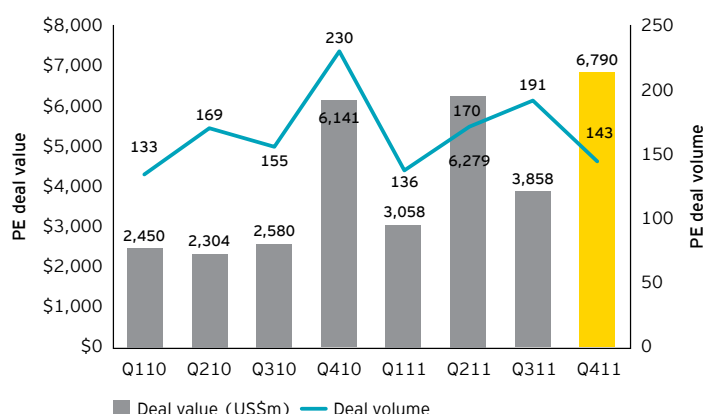
China

Momentum for deal-making in China continues amid global decline

PE activity in China continues to expand, with growth in PE deal activity supported by an active fund-raising environment and the availability of exit alternatives. Aggregate PE deal activity rose significantly in the fourth quarter of 2011, in sharp contrast to global trends. Moreover, despite valuation concerns founded in increasingly robust competition for deals among local and global PE firms, deal-making continued unabated, and the aggregate value of PE deals in 2011 rose to US\$20 billion – an increase of 48% as compared with 2010 figures. In 2011, there was a marginal decrease of 7% in PE deal volume with 640 deals, compared with 687 deals in 2010.

Unlike many emerging markets such as India in which PE deal activity is driven by global firms, China has a number of domestic firms that make up a sizable component of PE deals. Domestic PE firms led investments in 8 of the top 10 PE deals in China in Q411.

Quarterly PE deal activity in China, 2010-11 (US\$ millions)



Source: Thomson ONE, accessed 2 January 2012, and Ernst & Young research

Large deals gain momentum

The number and size of large PE deals (those with reported values of higher than US\$50 million) are increasing as Chinese companies continue to capitalize on the country's economic trajectory. Q4 2011 saw a total of 29 PE deals with values topping US\$50 million recorded, the highest quarterly number to date. On a yearly comparison, large PE deals also have increased in number significantly – by 50%, from 44 in 2010 to 66 in 2011.

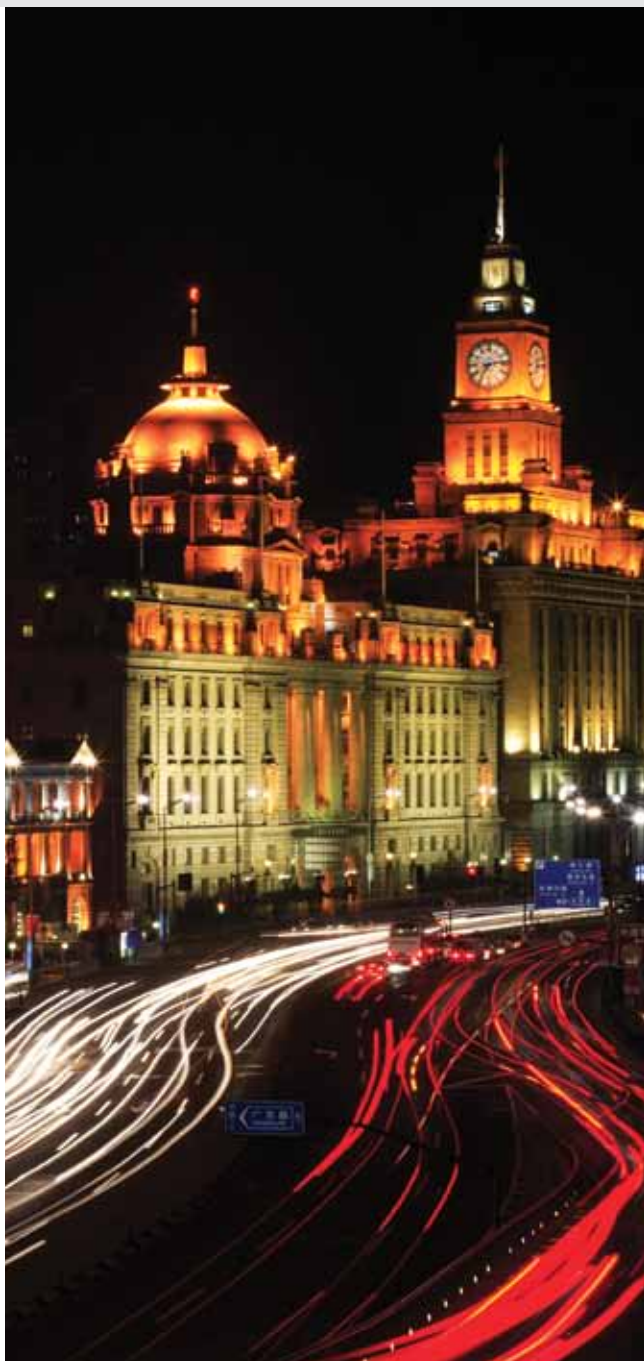
IPOs evaporate in H2

Consistent with global trends, PE-backed IPOs experienced a significant decline in the second half of the year. Just four PE-backed IPOs priced in H2 2011, compared with 33 in the second half of 2010. For the entire year, PE-backed IPOs declined by 60% in 2011, from 47 to 18. However, it is likely IPOs as an exit route will remain attractive to PE firms, with Hong Kong rated as one of the top global financial centers and China considered the world's largest IPO market.

Meanwhile, trade sale and secondary buyouts also declined in Q4 2011 to just 6, compared with 19 in Q4 2010. Over the whole of 2011, the number of exits by these routes fell from 50 in 2010 to 41. However, values were significantly up, rising from US\$4.3 billion to US\$8.8 billion as several large deals were orchestrated by PE, the largest of which was the US\$1.7 billion sale of Hsu Fu Chi by Baring Private Equity to Nestlé.

"Though relatively young in tenure, Asia Pacific private equity investors are gaining experience as well as accumulating investment capital. They could well break into global markets seeking their own diversification strategies."

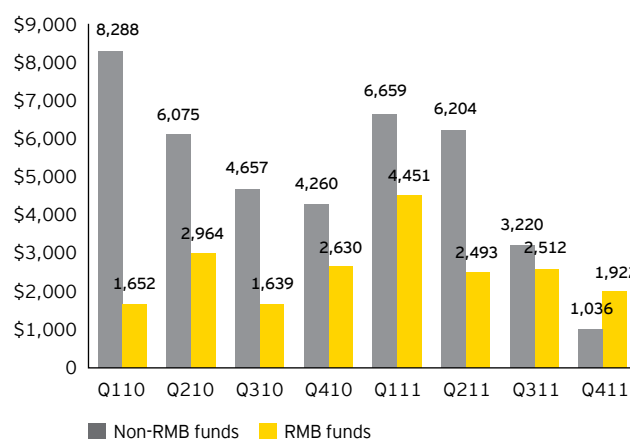
Michael Buxton, Ernst & Young Asia Pacific Private Equity Leader



Fund-raising down, but local investors on the up

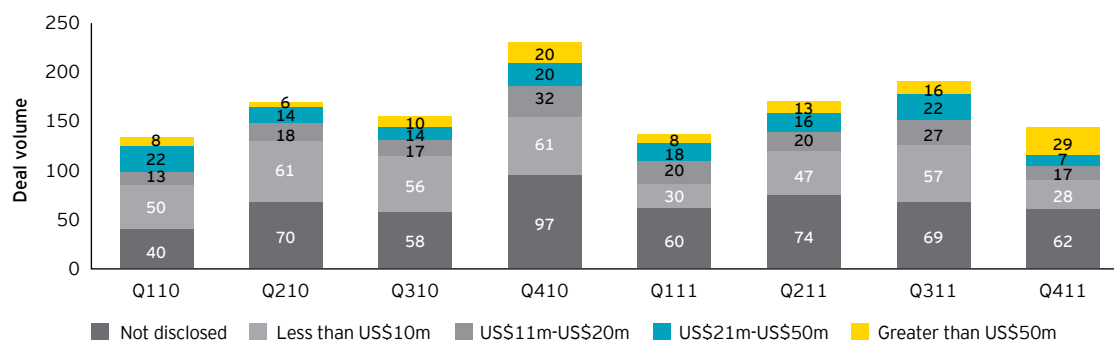
PE fund-raising in China declined by 11% from US\$32.1 billion in 2010 to US\$28.5 billion in 2011. The second half of 2011 witnessed new commitments totaling US\$8.6 billion, just half that of the first part of the year. However, LPs and GPs remain focused on the Asia Pacific region and China in particular as local currency PE funds continue to expand. Renminbi (RMB) funds experienced a 28% year-on-year increase in their aggregate value to US\$11.4 billion in 2011, indicating that local investor participation in Chinese PE is on the rise. The picture in China is clearly different from that in markets such as India where fund-raising is largely dominated by global PE funds.

PE fund-raising for China, 2010-11 (US\$ millions)



Source: Preqin, accessed 3 January 2012

Composite of PE deal volume by deal size

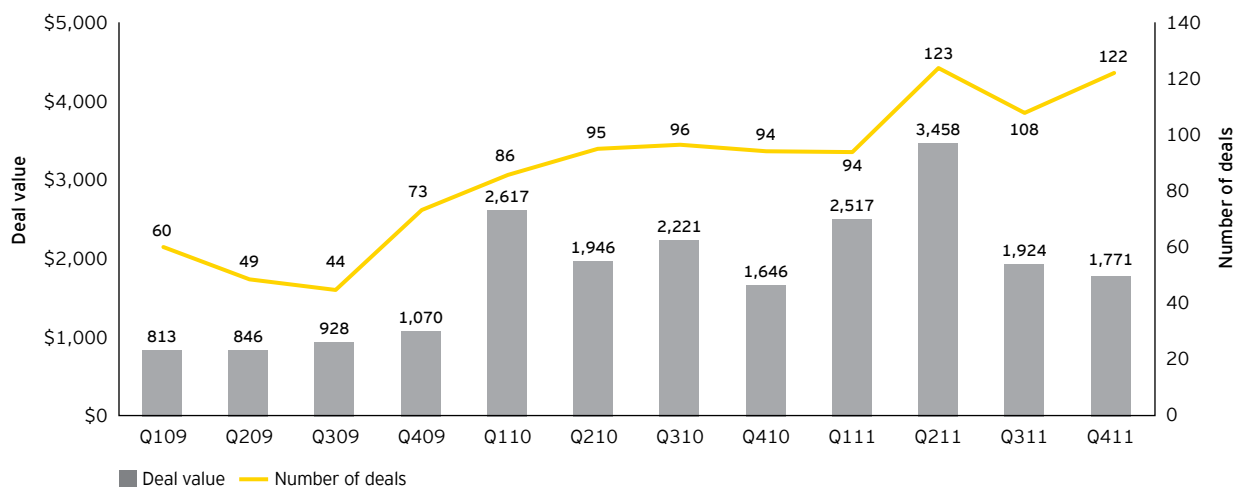


Source: Thomson ONE, accessed 2 January 2012, and Ernst & Young research

India

Smaller deals drive PE activity in India

Trend in PE investments (in US\$ millions)



Source: VCCEdge, Asian Venture Capital Journal (AVCJ) and Ernst & Young research.

Note: Deal value considers deals where values have been disclosed while the deal volumes consider all the deals announced in respective quarters.

2011 started on a high note, with deal buoyancy carried forward from late 2010. However, in line with global trends, the second half witnessed a steep decline in investment value compared with the first half. A notable difference, however, was the number of deals, which remained consistent throughout 2011. This was the result of an uptick in early-stage investments in 2011. Many VCs showed a strong interest in the start-up companies reflecting their confidence in the innovative ideas in play.

The total deal value in Q4 2011 declined 8% to US\$1.8 billion from US\$1.9 billion in the previous quarter. However, Q4 2011 registered a total of 122 PE deals, representing an increase of 13% compared with 108 deals during Q3 2011. The aggregate deal value in the current quarter is the lowest across 2011. However, a year-on-year comparison indicates 8% and 30% improvement in aggregate deal value and deal count, respectively, compared with Q4 2010. Unlike in China, where local firms tend to complete the largest deals, global PE firms continued to dominate the Indian market, with a showing of 9 in the top 10 deals by value in Q4 2011, mirroring the results seen in previous quarters. Firms such as Actis, Blackstone and Goldman Sachs were active in this segment.

Exits decline, led by lack of IPOs

PE-backed IPOs declined over 2011 in India, with just one PE-backed listing in the last quarter. There were 8 IPOs by PE in 2011, significantly down on the 27 seen in 2010. The amount raised through IPOs has also dropped from US\$4.3 billion to US\$1.2 billion – a 71% decline. This is a reflection of the uncertainty in Indian stock markets: the BSE Sensex fell nearly 25% in 2011 and was one of the world's worst performers. As a result, PE has delayed listing portfolio companies, but is ready to push the button when market conditions improve. There are 13 PE-backed companies that have filed for listing over the last two years on Indian exchanges.

Exits on the open market, to trade and other PE firms also witnessed a sharp fall, with volumes dropping 37% on 2010 figures. This reflects the tougher market conditions in the final quarter of 2011 as global turbulence hit the Indian market. PE firms are working through these challenges though, exiting in tranches. One example was the US\$72 million sale of a 1% stake in Kotak Mahindra on the open market in October 2011 by Warburg Pincus, which recently completed the sale of an additional 2.4% stake for approximately US\$170 million in February 2012.



Global PE firms continue to dominate the Indian market, appearing in 9 of the top 10 deals by value in Q4 2011.



Fund-raising continues apace

However, the long-term attraction of the Indian market was demonstrated by the improvement in fund-raising toward the end of the year. Q4 2011 saw an increase in fund-raising to US\$800 million, up from US\$500 million recorded in the previous quarter. In addition, a further 17 PE and VC firms launched fund-raising processes in Q4, targeting an aggregate US\$7.5 billion. Recent times have seen some firms abandon fund-raising targeted at Indian investments, yet the signs are that firms with a proven track record of returning money to investors will be successful.

India-focused PE funds raised during Q4 2011

Name	Status	Focus sector	Fund size (US\$m)
ChrysCapital VI LLC	Raised	Sector-agnostic	225
Accel Partners	Raised	Sector-agnostic	155
Kotak Realty Fund	Raised	Real estate	100
IndoUS Venture Partners II	Raised	Sector-agnostic	98
Tano India Private Equity Fund II	Raised	Sector-agnostic	97
Aavishkaar India II	Raised	Sector-agnostic	62
CapitalNexus Partners – Next Orbit Ventures-Entrepreneurs Fund for professionals	Raised	Sector-agnostic	40
ICICI Ventures	Raised	Sector-agnostic	40

Source: Factiva, ISI Emerging Markets and Ernst & Young research

Latin America

Promising outlook with a rise in fund-raising

PE activity in Latin America continues to strengthen, with robust fund-raising, steady deal-making, and an improving exit market environment. In contrast to global trends, fund-raising for Latin America rose by 68%, from US\$8.3 billion in 2010 to US\$13.9 billion in 2011. Moreover, robust activity from local managers signifies an encouraging outlook for PE in the region, as they raised more than 75% of aggregate commitments garnered during the year.

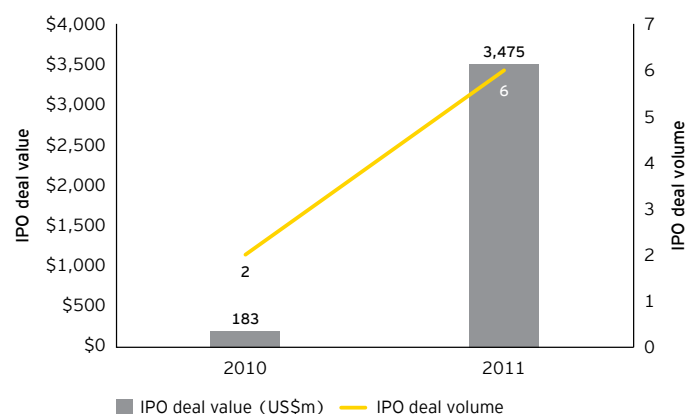
The number of PE deals remained flat in 2011 compared with the year before, with 72 announced investments. There was an absence of large deals during the year however, and aggregate deal value declined by 78%, to US\$2.0b. Factors behind the drop-off included a temporary shift in focus to fund-raising in 2011 for many funds, coupled with an absence of large assets coming to market during the year – while 2010 saw nine deals valued at more than US\$400m, 2011 saw no such deals.

Gains in exit activity expected to continue

While the PE exit market in Latin America is still evolving relative to China and India, it made significant improvements in 2011, with 6 PE-backed IPOs and 19 M&A exits, compared with 2 PE-backed IPOs and 14 M&A exits in 2010. Consistent with global trends, the majority of exit activity, including all six of the PE-backed IPOs, occurred in the first half the year.

If market conditions remain favorable, exit activity should see new highs in the coming year. Going forward, IPOs are likely to remain an important exit route for PE firms investing in Latin America.

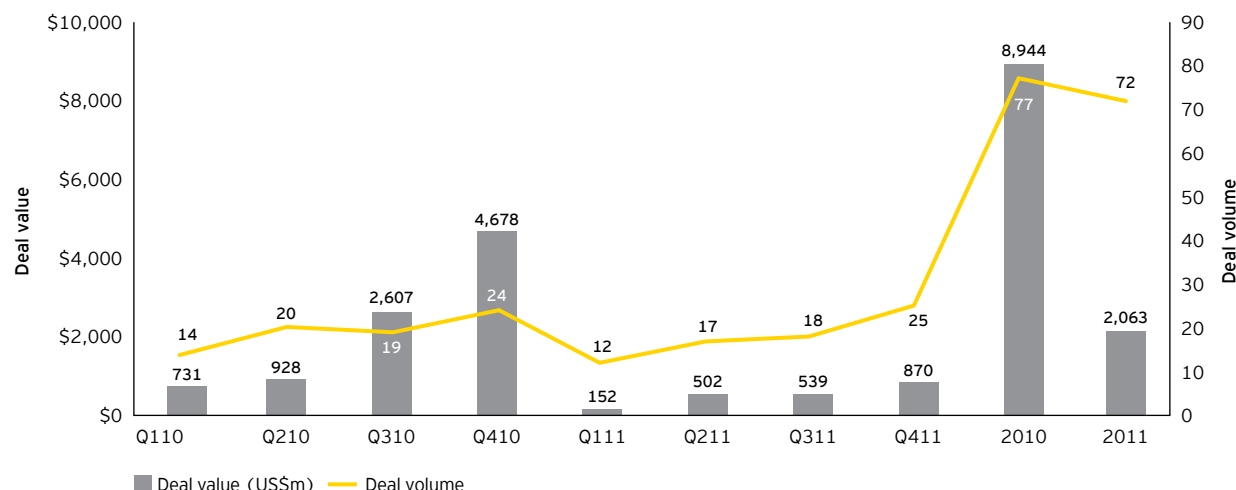
PE-backed IPOs, 2010-2011 (in US\$ millions)



Source: Dealogic, accessed 19 January 2012

Note: Above includes only PE-backed IPOs, not VC-backed IPOs.

Quarterly and yearly PE deal activity in Latin America, 2010-2011 (in US\$ millions)



Source: Thomson ONE, accessed 15 January 2012, and Ernst & Young research

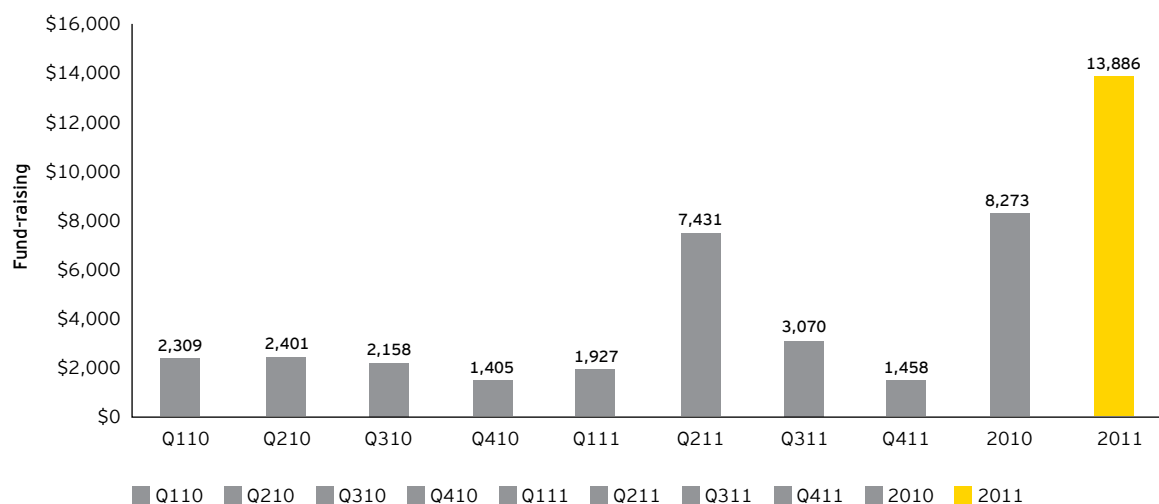


Encouraging outlook for fund-raising

Fund-raising for Latin America defied the sluggish rate of global fund-raising and rose by 68% in 2011 from US\$8.3 billion in 2010 to US\$13.9 billion. Interestingly, local managers accounted for more than 75% of the year's fund-raising (US\$10.9 billion) and represented the top five funds raised during the year. As in past years, the bulk of commitments targeted Brazil.

Much of the growth in fund-raising occurred in the first half of the year. Between July and December, fund-raising fell by nearly 50% compared with the first half of 2011. Fund-raising should quickly regain the momentum of the first half of 2011, as there are currently more than 80 funds on the road targeting an aggregate of US\$33.2b for Latin America.

PE fund-raising for Latin America, 2010-2011 (in US\$ millions)



Source: Preqin, accessed 17 January 2012

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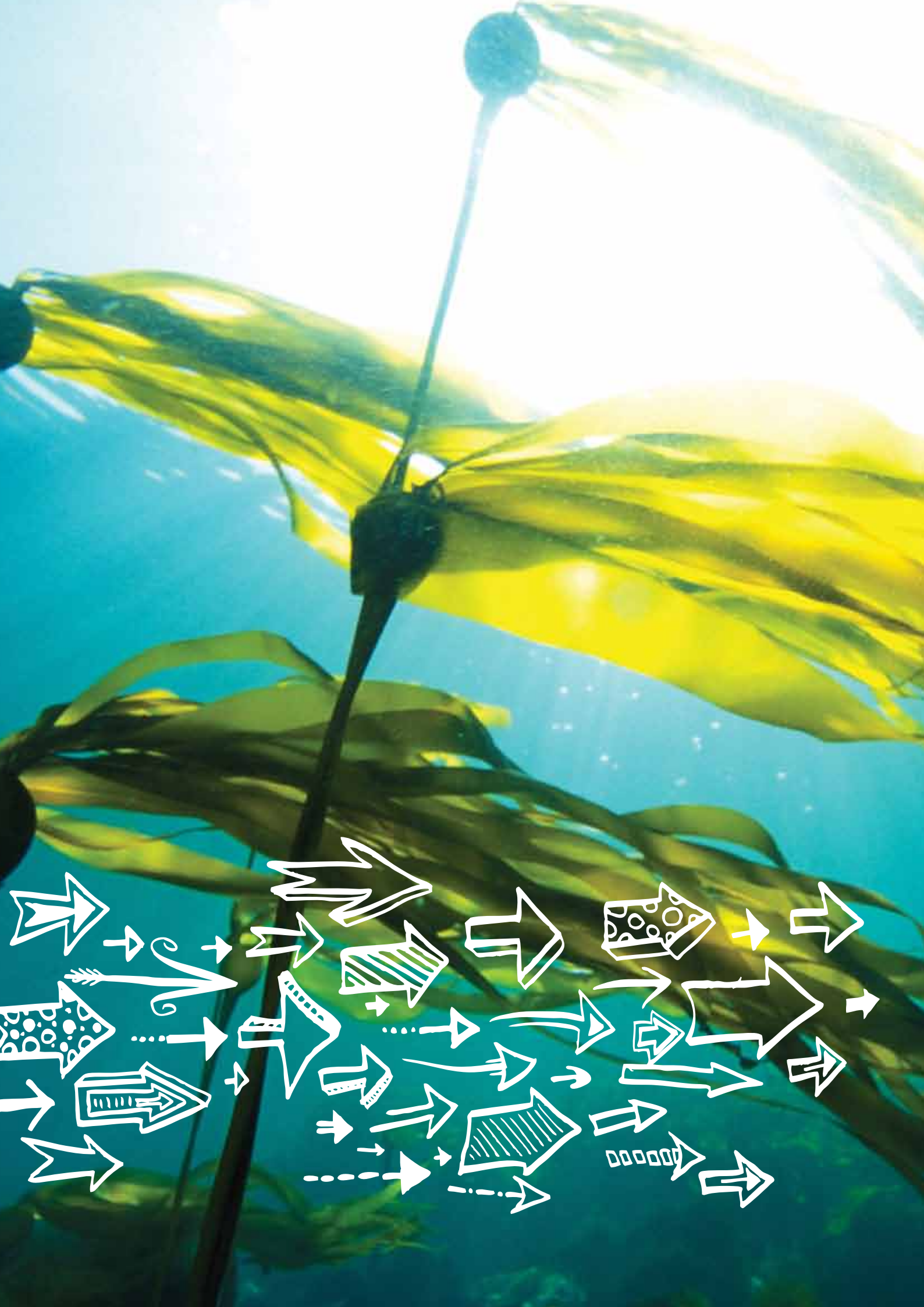
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