



 private**equity**wire

# Global Private Equity 2019: The Year Ahead

A Private Equity Wire special report

In association with





## Introduction...

Last year proved to be another significant step forward for private equity, which continues to show little sign of fatigue among institutional allocators. A survey that we ran with Intralinks last summer – **The LP Blueprint 2018** – found that one quarter of LPs said that they planned to increase their allocation by 10 per cent or more; moreover, four out of 10 LPs said their preferred

manager size were those running USD100 million to USD1 billion in AUM, which is encouraging news for the global mid-market players.

In Europe, deal volume reached an all-time annual record of 2,230 last year, while deal value reached an 11-year high of EUR199 billion, according to *Aberdeen Standard Investments'* Q4 2018 Private Equity Barometer, produced in collaboration with Unquote.

From a fundraising perspective, the larger players dominated, with several mega funds coming to market. In Europe, PAI Partners did a EUR5 billion raise, Triton Partners targeted EUR3 billion for its fifth flagship fund, while Inflexion Private Equity Partners LLP, secured GBP1.25 billion for the Inflexion Buyout Fund V. Still, overall fundraising levels contracted in 2018, falling 25 per cent from USD566 billion in 2017 to USD426 billion according to Preqin, but I think it is fair to say that with more than USD1 trillion in dry powder, PE groups have enjoyed substantial fundraising success over the last few years.

As I write this introduction, the spectre of Brexit looms ever larger. This is creating huge uncertainty in the market. Last year, the UK and France saw good traction in their respective mid-markets but there are some who believe the UK deal market, in particular, will soften in 2019. Factor in a China economic slowdown, problems in South America, and the threat of an escalating US/China trade war and it could make for a more challenging macro environment in 2019; how will this impact corporate earnings and valuation multiples over the near term? What will deal flow look like in 2019 and what fundraising and fee trends might we see? How are managers thinking about the marketplace? These questions will be answered in the following pages.

I extend my sincere gratitude to each and every manager who gave their respective house views on the outlook for the year ahead. I hope you find it an insightful compendium, and a useful steer on how some of the industry's leading PE groups view today's marketplace.

*James Williams, Managing Editor, Private Equity Wire*

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## Chapter 1

# Macro / Geopolitical Outlook

“Corporates are likely to be more selective when it comes to cross-border M&A in jurisdictions where there is uncertainty over trade agreements.”

**Jon Edirmanasinghe,**  
Cavendish Corporate Finance

## How do you think the global economic environment will impact private equity investors in 2019?



### TIM HAMES

#### Director General, BVCA

Macro-economic and macro-political conditions are likely to be an “amber light” for the sector in 2019. Deals will be done and funds will be raised and exits made but perhaps at a slower pace than the past three years. This may not be a bad development.



### ALAN GIDDINS

#### Managing Partner and Head of Private Equity, 3i Group

Looking forward, whilst we see challenges in the macro economy and the political backdrop, we stay absolutely aligned to our core focus of growing mid-market businesses internationally across our four chosen sectors: business & technology services, industrial, healthcare and consumer. We also see significant value opportunities through our platform assets where we see the opportunity to make transformational bolt-on acquisitions. We did that in 2018 in Aspen Pumps, Royal Saunders and Group Ponroy Sante.

While 2019 will undoubtedly be an interesting and potentially very challenging year, we enter it with huge confidence that we will continue to see interesting investment opportunities.



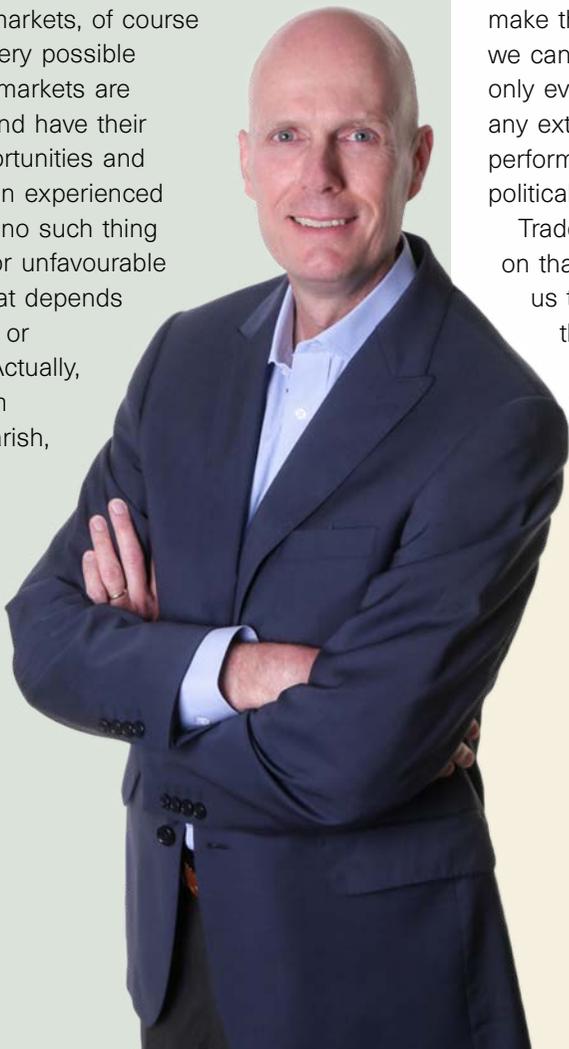
### TRISTAN NAGLER

#### UK Managing Director, Aurelius Equity Opportunities

Given that private equity is diversified across many different strategies and markets, it's difficult to speak on behalf of the entire sector. However, what is clear, is that the current economic climate is causing an uncertain and volatile environment for many businesses. Such conditions create an interesting investment landscape for Aurelius, particularly in the carve-out space, as corporations look to rationalise their strategies and divest of non-core or struggling assets. For us this economic environment should therefore be a time of opportunity, rather than threat.

**KARSTEN LANGER****Partner, The Riverside Company Europe**

As a private equity investor we don't invest based on GDP figures or any kind of macro forecast or political event. At Riverside, we invest in micro opportunities, in small companies that have the potential to grow internationally. We take a close look at their respective markets, of course – and plan for every possible scenario. These markets are all very special and have their own unique opportunities and challenges. For an experienced investor, there is no such thing as a favourable or unfavourable macro climate that depends on a few metrics or political events. Actually, when mainstream finance goes bearish, it has proven to be very good times for private equity.



## What effect might the US/China trade war and ongoing Brexit uncertainty have on the way you think about investment opportunities?

**TRISTAN NAGLER****UK Managing Director,  
Aurelius Equity Opportunities**

We buy companies that are imperfect and work hard to make them as sustainable and robust for the future as we can. When considering any new opportunity, we not only evaluate the business' operational model but also any external challenges that may impact a company's performance, which often relate to macroeconomic or political developments.

Trade tariffs or the implications of Brexit do feature on that list of considerations, because they require us to think about a range of issues including the implications of changing foreign exchange exposure or access to labour. However, they



are just two in a long list of things we have to consider when assessing investment opportunities.

## How might market conditions impact the structure of deals and transactions being made in 2019?

**TIM HAMES****Director General, BVCA**

The forces behind the evolving structure of funds and deals are largely internal to the industry itself, namely its expansion and increasing complexity. The external impact of economics and politics here should be modest.





### **JON EDIRMANASINGHE**

#### **Partner, Cavendish Corporate Finance**

Coming off some very strong years, there is likely to be a dip in M&A activity in early 2019 as several vendors and buyers await more clarity on a number of political and economic fronts. In terms of private equity transactions that do take place, the prevailing uncertainty and market conditions are likely to result in lower leverage multiples than in recent years in order to weather any potential storms.

Corporates are likely to be more selective when it comes to cross-border M&A in jurisdictions where there is uncertainty over trade agreements. Pricing for transactions is likely to remain close to record highs as demand for good assets currently appears to be outweighing supply. In recent weeks, we have heard several private equity investors and strategic buyers say they are looking for more deal flow.



### **SCOTT HENDON**

#### **Leader of BDO's National Private Equity Practice**

I think globally there is a bit of concern that global growth will decelerate given the amount of uncertainty that exists around the Chinese economy. Any PE funds with ties to international manufacturing and distribution might be impacted by reduced deal flow in my view. From what I've heard, some PE managers feel they will need to proceed cautiously in 2019.

As more indicators point to a potential downturn soon, there will be an increased focus over the next year on investments in sectors that fulfil constant, irreplaceable consumer needs.

Even this early in 2019 I've seen a lot of new funds launch. What could slow up fund raising activity - if you look at returns on private equity versus public markets, they are still higher, which should support continued capital inflows into private equity this year, even though there is this market uncertainty. The demand for PE among institutional investors is still driven by returns being better than those in public equities, and this is further supported by the higher volatility we saw in the stock markets at the end of 2018.





### **HENRY H. MCVEY**

#### **Head of Global Macro & Asset Allocation, KKR**

In our humble opinion, the game has changed. Specifically, we see four major influences that require a different approach to asset allocation in 2019:

- 1) A notable shift from monetary policy to fiscal is under way;
- 2) Technology, while still an incredibly powerful agent of change in the global economy, now faces more valuation and regulatory headwinds than in the past;
- 3) Tightening liquidity conditions amidst higher real rates are macro headwinds that must now be considered; and
- 4) The rise of geopolitical uncertainty warrants a higher risk premium than in the past.

If there is one thing that became increasingly apparent during the fourth quarter of 2018, it was the inconsistencies in value that now are appearing across capital structures and asset classes. For example, Liquid Credit has sold off much more than some of the opportunities we are seeing in Private Credit, and as such, there is a capital structure arbitrage/opportunity that now exists for exible capital to step in and buy into potentially “hung” new issue paper as well as unloved trading positions in Liquid Credit and Structured Products.

We are also seeing some “good company, bad capital structure” opportunities emerge, particularly outside of the US.

As a result, we now hold a large overweight to Actively Managed Opportunistic Credit, and we have again increased our position in Special Situations/Distressed this year. Meanwhile, in Asia it appears to us that growth in the Public Equity Markets is trading substantially cheaper than Private Growth opportunities. In our view, private investment opportunities in Growth will need to ‘catch-down’ to the rest of the public markets in 2019.

*(Reproduced with permission from KKR’s **INSIGHTS, Global Macro Trends** report, January 2019)*

## **How might analytics tools improve portfolio risk analysis and performance in a more volatile market?**

### **MAURO PFISTER**

#### **Managing Director, Capital Dynamics**

Increased market volatility generally affects the interim valuations of privately held assets and typically results in less acquisitions and exit activity. Those two effects combined may lead private equity fund investors to adjust their commitment activity. However, our research has shown that a consistent long-term planning and investment pace is optimal in terms of risk and return. In developing its sophisticated cash flow and NAV simulation tools, Capital Dynamics made sure they take increased market volatility periods into account. Consequently, our and our clients’ investment activity, which is driven by those models, would not be affected by more volatility in the market.





## Chapter 2

# Fundraising Trends

“*Smart money will be looking for cycle-tested managers, proven cross-border reach and a technology edge.*”

**Andrew Bentley, Campbell Lutyens**

## How do you view the fund raising environment for global private equity in 2019?



**PAUL BOYNTON**  
**CEO, Old Mutual Alternative Investments**

In the current global context of increasing amounts of capital chasing fewer attractive deals, and driving down returns in traditional markets, Limited Partners (LPs) are increasingly looking to new markets to achieve their return objectives – and Africa can offer this.

In 2019 we will continue to see an uptick in investor enquiries looking to benefit from the key macro trends which are expected to underpin positive GDP growth across the continent. Foremost amongst these are rapid urbanisation and the expanding middle class (Africa is urbanising at a rate of 24 million people a year, more than twice the rate of urbanisation occurring in either India or China).

The African Private Equity and Venture Capital Association's (AVCA) fifth annual Limited Partner Survey for 2018, which examines global investor views and expectations about private equity in Africa, revealed that the majority of LPs (76 per cent) plan to increase or maintain their allocation to African PE over the next three years. The data provides a clear indication that LPs are confident and optimistic about the continued attractiveness of African PE.

In 2019, African pension funds will have a growing role to play as an additional pool of capital. In 2018, OMAI was able to attract increasing amounts of investor interest from Africa-based LPs and we expect this to continue into 2019 as their assets grow (around 20% per annum in some African countries).

The outlook for 2019 and beyond is positive, with strong indications of sustained confidence in the African PE industry.



**ANDREW BENTLEY**  
**Partner, Campbell Lutyens**

We expect a consolidating but nonetheless strong year in private equity with most investor programmes continuing to commit capital but not perhaps seeking to grow their programmes in the way they have done in recent years. Partly, this is due to a balancing out of distributions versus drawdowns in the latter part of 2018.

We expect most capital will be applied to servicing re-up requests from LP's core existing managers, with new relationships being harder to consummate versus 2017 and 2018. Smart money will be looking for cycle-tested managers, proven cross-border reach and a technology edge.

## Which fund categories are most likely to appeal to investors in 2019?



### DAVID ARCAUZ

#### CIO (Europe), Flexstone Partners

For sophisticated investors, the small and mid-market sectors will remain a focus in 2019 on a global basis. This space offers the opportunity for consistent outperformance in different phases of the economic cycle. Managers tend to pay lower entry multiples than the larger funds and they can use their operating partners and skills to grow and fix the businesses.

While the spread of mid-market returns is wider than for larger funds, the ability to pick the best funds and gain access can lead to significant outperformance. Since we are at the later stages of an economic expansion, managers with the ability to implement operational improvements without using higher levels of financial leverage should continue to be a focus for private equity investors.

In addition, given the concern of record high valuations, investors are increasingly seeking opportunities to create value at lower multiples, even if the initial platform investment is higher, by making add on acquisitions and use operational skills to integrate and build the platform.



### RICHARD HOPE

#### Managing Director, Hamilton Lane

Last year we received approximately 900 PPMs globally. The amount of capital raised in Europe alone was approximately EUR160 billion.

On average, we see around 30 per cent of capital (following exits) coming back into the market, which is a huge amount of money. We see these exits happening but equally we see a huge clamour on the GP to buy deals. That requires real discipline: how much are you willing to pay? How high will you go to complete a new deal? That's the big challenge. When we do due diligence with managers, this is one of the areas we spend a lot of time discussing. What is the GP's investment angle?

## Chapter 3

# Deal Trends

**“** *We expect to see the continuation of strong pricing trends in 2019, resulting largely from the combination of surplus dry powder and cheap debt financing. However, there is anecdotal evidence of an increasing number of sale processes not reaching expected valuation levels, perhaps due to some nervousness over the economic outlook.”*

**Steve O'Hare, Equistone Partners Europe**

## How do you see market valuations playing out in 2019? In particular in Europe?



**CARL HARING**  
**Managing Director & Head of UK, BLX & Nordics, HIG Capital**

Valuations will be coming down. US macro will be tougher, although rate rises will be slower than people expect. The UK outlook is negative and the reforms in Germany and France aren't progressing quickly enough. Equity markets have already started the correction. Deals will continue to be meaningfully leveraged as funds are struggling to keep returns high.

**MORTEN HUMMELMOSE**  
**Partner, EQT Partners**

Rising interest rates and decreasing public market valuations might put some pressure on private market valuations, but given the amount of dry powder under management, we believe that the impact on valuations will be modest.



**JAN JOHAN KUHL**  
**Managing Partner, Polaris**

Valuations should be more sensible in 2019, driven by lower stock market valuations and the ongoing fears over the likelihood of a recession.

We are hearing that investment banks are spending a lot of time with clients, managing their expectations on valuations, rather than expecting to see the multiples we had a year or two ago. Processes are therefore also

taking longer, as vendors are not always ready to accept that, to reduce their expectations and take a lower price.



**STEVE O'HARE**  
**UK Country Head, Equistone Partners Europe**

We expect to see the continuation of strong pricing trends in 2019, resulting largely from the combination of surplus dry powder and cheap debt financing. However, there is anecdotal evidence of an increasing number of sale processes not reaching expected valuation levels, perhaps due to some nervousness over the economic outlook.

In a high-valuation environment, there will be understandable concern as to whether the quality of the business justifies the valuation. Notwithstanding this, we believe it is possible to make good-value, sensible investments in such an environment, be that through off-market deal processes, embracing investments with a greater degree of complexity and looking for consolidation opportunities.

**KARSTEN LANGER**  
**Partner, The Riverside Company Europe**

Great companies will always command relatively high multiples, but rising interest rates and any prolonged macroeconomic weakness will likely moderate prices. Private equity – like equity markets in general – has enjoyed a long bull market, and there are signs this may reverse or flatten out in the coming years. So asset selection, finding those companies that can sustain growth and maintain value through a period of lower economic growth, will become more important. Having said this, it remains a seller's market for right now, and significant liquidity is sustaining valuations for strong companies.



## What are your thoughts on deal flow for global private equity in 2019?



### **MORTEN HUMMELMOSE**

**Partner, EQT Partners**

We would expect deal volumes to be slightly down versus 2017 and 2018, which were record years. We expect public valuations and rising interest rates to put moderate pressure on the multiples buyers are willing to pay, which will likely result in a lower volume of deals as some sellers with lofty 2018 valuation expectations choose to hold on to their assets.



### **JAN JOHAN KUHL**

**Managing Partner, Polaris**

Overall, I expect deal activity to reduce. We have had some very strong years recently, and now we are starting to see that deal processes are dragging, and things are taking a longer time. But 2018 was a peak year, so we will still have a good level of activity overall.

We may also see a split in the market. One thing that has gone away in recent years has been a focus on quality – some lukewarm deals might have slipped through the net. People are returning to that focus on quality.



### **STEVE O'HARE**

**UK Country Head,  
Equistone Partners Europe**

There has been a lot of discussion about the effect that macroeconomic and political developments may have on deal flow in 2019, particularly in the European market. In the UK, I think we can expect a further moderate dip in the number of private equity-backed deals in the first part of the year, as the ongoing uncertainty around Brexit continues to impact the market.

Despite this however, I am optimistic that deal activity in the mid-market will remain active as we continue to see a wealth of attractive growth businesses in the markets in which Equistone invests including France, Germany and the UK.



### **SCOTT HENDON**

#### **Leader of BDO's National Private Equity Practice**

There is some caution on manufacturing and distribution. I think the healthcare and technology sectors will continue to be quite strong. One of the factors that managers need to monitor in 2019 is the cost of debt. When interest rates rise and the cost of debt climbs higher, it could have some negative impact on pricing and cause valuation multiples to fall.

The threat of a market correction does make people more cautious. Managers will have to continue to remain diligent they are not over-paying for companies, which may, in the event of a downturn, take longer to improve the EBITDA and make operational improvements.

In this market environment, some mid-market PE funds might look to put a number of smaller deals together, which have lower multiples, in an attempt to get a residual benefit with an overall higher multiple (than might be possible by doing one or two bigger deals). It could be one way for them to generate a higher return, while remaining cautious that they are not overpaying for deals.



### **PAUL BOYNTON**

#### **CEO, Old Mutual Alternative Investments**

In 2018, investor sentiment, deal flow and pipeline visibility improved (for African private equity) driven by factors such as higher than expected GDP growth in some regions, recovery of the oil price in Nigeria, political leadership changes in South Africa and improved foreign exchange liquidity. Certainly, it's a rosier picture than a few years ago when the global economy slowed, affecting Africa's major economies. The improvements are encouraging and reflect Africa's status as the world's fastest urbanising continent.

Looking forward, we expect to see more deal flow in the African infrastructure space. It's an exciting area for us. We're also particularly optimistic about the general environment in South Africa, which has been quite tight over the last few years because of the political and economic situation. It's early days but we believe that the situation is more prospective from a deal point of view. In fact, the whole continent has recovered from the commodity slump to a certain extent and we're expecting more of Africa's cylinders to be firing over the next year. There's a lot of opportunity for us and the PE industry in Africa.

## Which industry sectors do you expect to focus on, broadly, based on valuation multiples?



**ELIAS KOROSIS**  
Partner, Hermes GPE

There are lots of themes. The time for growth investing is attractive and a lot of success has taken place growing companies across Europe. The more success stories you have, the more that follow. Fintech is a good space, Europe has been on the front foot and has an edge in terms of payment system innovation. Healthcare is another interesting area. France is a very strong market. A third sector we like is sustainability, including resource efficiency (which used to be captured under 'cleantech'). This is a sector Europe continues to be a global leader in. So with respect to these three sectors - fintech/digital, healthcare and sustainability - we think Europe has a very interesting set of themes to pursue and build global champions.



**MORTEN HUMMELMOSE**  
Partner, EQT Partners

At this point in the cycle, we are focused on industries that are non-cyclical in nature such as healthcare and certain areas of technology and business services.

**ODED LEVY**  
Co-founder and Managing Partner,  
Blue Ox Healthcare Partners

As the market keeps adapting value-based care and individualism, we are witnessing a long-term cycle shift in how care is delivered and financed in the US.

The adaptation of technologies that are imported for the high-tech sector underscore the extent to which the healthcare sector is experiencing a transformation. Precision Medicine is now tailored to individual diagnostic, and new life science diagnostics and therapeutics are aided by the availability of data and machine learning adaptation. And, that's just the beginning; we are continuing to see new healthcare innovation - that improves care and lowers cost of delivery - coming to market and ready for deployment.

As we head into 2019, the only obstacle we're really seeing is the growing trend toward high deductible policies, which are putting strains on hospitals and providers while at the same time causing patients to struggle with high out-of-pocket expenses.

Looking ahead, we expect to see more consolidation in providers and managed care, which means more buyouts by pharmaceutical and big biotech companies as well as acquisitions of technology-enabled platforms by buyouts and strategic acquirers. While LBOs may very well decrease due to higher fund costs and concerns regarding the economy, we believe acquisitions of growth companies will continue at a robust pace.



**JAN JOHAN KUHL**  
**Managing Partner, Polaris**

There is likely to be an increase in take-private transactions driven by lower public market valuations, whereas private companies are priced somewhat higher relatively speaking.

We also have a view that growth companies and companies that “tick all boxes” are perhaps overpriced, while companies that are showing lower growth but are in need of revitalisation are underpriced and might offer good value.

People often say it is better to overpay for a good company, but we don't tend to agree. If you are paying 14x on the way into a deal, you might only get 10x at exit. In this case you need to create a huge amount of value in the investment period to generate returns for investors. In our view pricing discipline is critical and that will become more evident if we now are on our way into a period of multiple contraction.

### **ANTOINE PAPIERNIK**

#### **Managing Partner and President, Sofinnova Capital**

The healthcare and biotech sector has really gone from scratch when there was no biotech industry to speak of in Europe 20 to 25 years ago, to one where there are now hundreds of established companies that are now competing on the world stage.

There is a lot more demand for PE funds than there is supply from venture money in Europe, which is not the case in the US where there are a lot of dollars chasing deals in the VC space and valuations have gone up a lot; the size of the funding rounds has gone up dramatically. In Europe's early stage space, the valuation tension is not yet there. We see it coming, partly because we see US and Chinese who are suffering from high valuations, coming here thinking that Europe is cheaper and on the other side of the valuation spectrum.

There is still a buyer's advantage here in Europe. The work we have to put in is to ensure that when it comes to selling, you're not still at that European discount but are selling at a premium to the US: basically, our aim is to buy at discount in Europe and sell at a premium in the US. That's the theory.



## Chapter 4

# Secondaries & Co-Investing

“*Co-investing is a way to calibrate investors’ private investment exposure by investing in specific, individual opportunities. It allows investors to express their portfolio views in what can be a very distinctive way.*

*Overall, I believe we could easily see USD100 billion-plus in co-investment deals this year.”*

**Andrea Auerbach, Cambridge Associates**

## Will the co-investment trend we've seen over recent years continue in 2019 and if not, what might subdue investor interest?



**ANDREA AUERBACH**  
**Global Head of Private Investments,**  
**Cambridge Associates**

We saw approximately USD30 billion of co-invest opportunities last year but given that we don't see all the deal flow, you could double that figure to USD60 billion. There are several vectors that we believe will continue to keep co-invest opportunities at this level, or greater, in 2019.

There are two interesting elements, in particular. One is the performance of private investments overall continues to drive investor interest.

Allocations continue to increase into private investing and within that space, co-investing has become a substantive, complementary strategy. It is usually offered on a low fee, low carry basis compared to investing in a commingled fund. One of the reasons we believe managers

are offering it more than they ever have is because it has become harder to generate returns. As more capital flows in to the PE space, and returns are getting harder to generate, managers are thinking how best to help their investors earn 'old school' returns, without having to make changes to their fee structure.

Returns are under pressure everywhere and private equity is not immune to that pressure. GPs who can see pressure on returns have to do one of two things: either be better at investing in the face of increased capital and competition, or create a better return profile for their investors by lowering the cost to invest in some way. By not charging 2/20 for co-investment opportunities, it benefits the returns to investors.

The second vector is the investors themselves. At Cambridge Associates we invest on behalf of our clients, we've done nearly USD500 million of co-investment over the last couple of years and what I would say is LPs need to find a better way to make a return. I do think the low return environment has generated movement on the GP side to offer co-investment to create a better return profile, while on the LP side, those who have the ability to do so, are actively seeking out their own direct investment and co-investment opportunities to generate a better return.

Co-investing is a way to calibrate investors' private investment exposure by investing in specific, individual opportunities. It allows investors to express their portfolio views in what can be a very distinctive way.

Overall, I believe we could easily see USD100 billion-plus in co-investment deals this year.



**ERIK WONG**  
**Principal in Pantheon's Global**  
**Co-investment Team**

Notwithstanding the public market volatility at the end of 2018, the fundamentals of co-investment activities remain strong as we move into 2019. The robust fundraising by PE managers over the past few years provides significant "dry powder" to support the current level of deal activity, and LPs continue to use co-investments to optimise capital deployment, GP relationships and the overall economics of their private equity programmes.

While co-investment is expected to follow the overall buyout market environment should there be significant dislocation in leverage market or a global economic downturn, its role as a core strategy in private equity investments will remain intact in my view.



### **JAN JOHAN KUHL**

#### **Managing Partner, Polaris**

The trend for co-investment will continue, but there is a risk if certain deals start to underperform. GPs often look to co-investment to manage their risk, either because they are drifting on strategy or because they consider an asset to be higher risk. If there is an economic downturn, co-invest deals could therefore be worse hit, which might dampen returns and reduce appetite. In addition some LPs might find them short in resources to handle critical investment – a task historically “outsourced” to GPs.



### **DR STEFAN BEIL**

#### **Managing Partner, Sobera Capital GmbH**

Dry powder levels in the PE markets are still very high. Co-investing directly alongside funds allows PE investors bringing more money to work with moderate management attention. Signs for an economic downturn increase which is likely to result in lower PE performance. Co-investing allows for cherry picking and usually also lower fees and carry thereby buffering such potential performance risk to some extent.



### **SCOTT HENDON**

#### **Leader of BDO's National Private Equity Practice**

Club deals will see a strong resurgence: Loaded with dry powder and faced with inflated valuations that put good opportunities out of reach, club deals represent an opportunity for private equity funds to engage in bigger deals and utilise down capital.

I think GP/LP relationships will continue to strengthen through the exploration of co-investing opportunities in 2019, given the amount of capital that investors are likely to continue allocating into the space.

## What are the main risks and opportunities to PE secondaries over the next 12 months?



**RUDY SCARPA**  
Partner and Co-Head of Global Secondaries,  
Pantheon

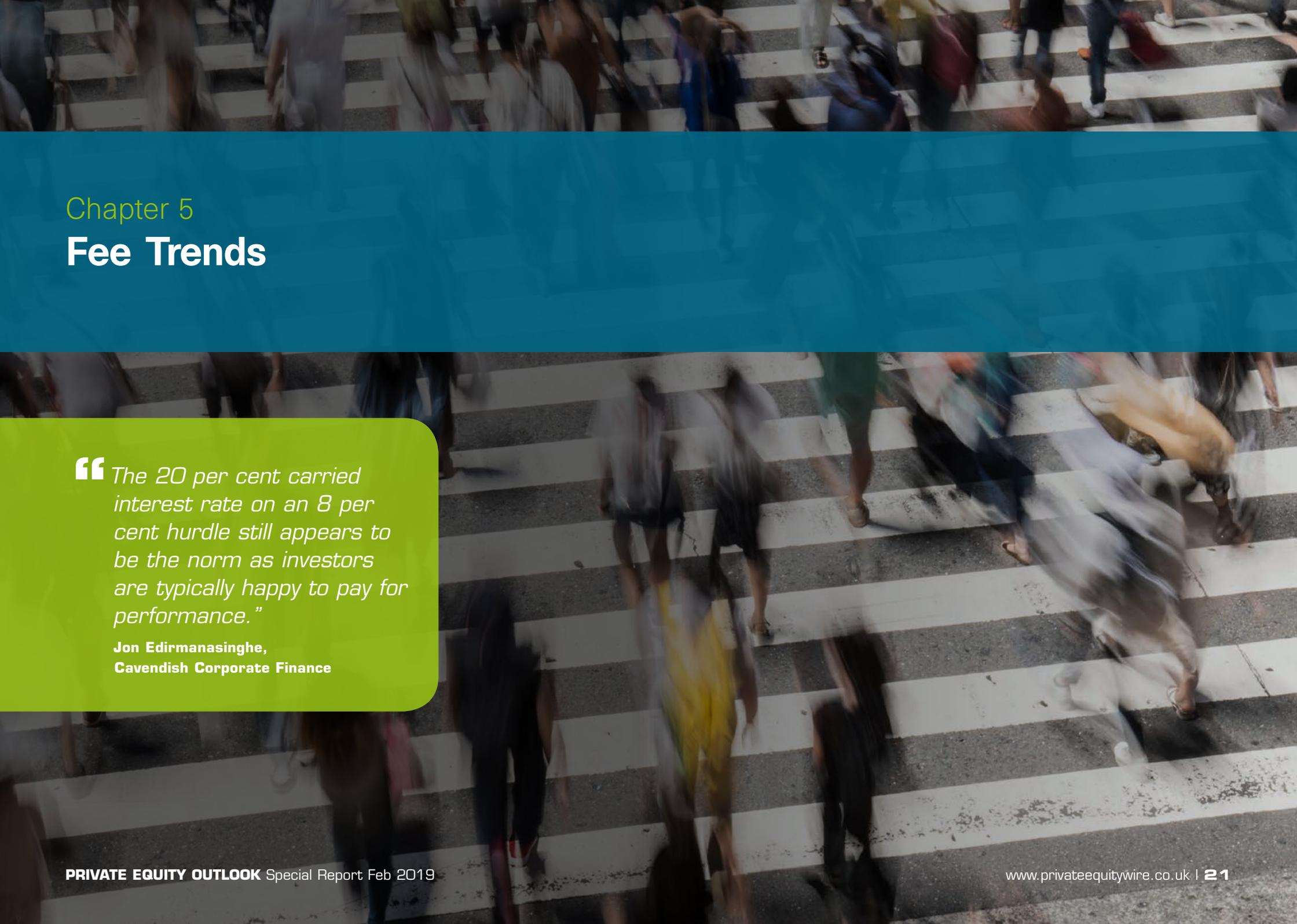
We expect secondary deal flow to continue to grow driven by not only larger institutional investors, including pension plans, rationalising their private equity relationships and fund of funds increasingly using the secondary market as a portfolio management tool, but also a larger number of General Partner-led transactions. GPs have become much more active in creatively exploring ways to provide liquidity for their limited partners in myriad ways, including fund level tender offers and recaps, portfolio sales and even single company sales to secondary buyers.



**MAURO PFISTER**  
Managing Director, Capital Dynamics

Given the stage of the business cycle and generally frothy valuations, PE secondary buyers may be tempted to “reach” for lower quality and riskier assets (recaps, concentrated deals, geography, etc). Also, a secondary buyer may struggle to properly price slowing growth (Italy, Germany), the effects of Brexit, monetary policy changes and other factors given the uncertainty of economic development.

On the other hand, the current volatility creates opportunity for attractive deals and motivated sellers. Particularly the segment of smaller transactions can offer a secondary buyer more ability to creatively structure transactions, address downside risks and acquire assets outside an auction channel.



## Chapter 5

# Fee Trends

“The 20 per cent carried interest rate on an 8 per cent hurdle still appears to be the norm as investors are typically happy to pay for performance.”

**Jon Edirmanasinghe,**  
Cavendish Corporate Finance

## How will fee structures evolve in 2019?



### **JON EDIRMANASINGHE**

#### **Partner, Cavendish Corporate Finance**

The 2/20 per cent private equity model has been the norm for many years, however there continues to be a shift away from this. Increasing amounts of private equity funds and related fundraisings have led to competition and the need for some to deviate from the norm.

Funds have increasingly become more flexible with their structures, for example reducing the 2 per cent entirely or offering various discounts based on the amount of capital committed. The 2 per cent management fee appears to have come under more pressure, with capital commitment discounts or time-based step-downs now being offered by some funds.

The 20 per cent carried interest rate on an 8 per cent hurdle still appears to be the norm as investors are typically happy to pay for performance.

## How far do you think investors will push for further customisation on fees?



### **DAVID ARCAUZ**

#### **CIO (Europe), Flexstone Partners**

Regarding customisation, the market is bifurcated between the larger investors who are seeking to use their scale to create customised accounts and reduce fees and smaller investors, many of whom are the newer investors to the asset class such as high net worth individuals or family offices, that do not have the staff or access to the best investment opportunities and do not have the scale for customised accounts and fee negotiations.

However, investors do not only seek customised separate accounts to reduce fees as they are often seeking other dimensions such as tenor, liquidity, industry or geographic concentrations, scale, transparency, co-investments, or the ability to opt out of certain sectors or avoid/underweight for ESG or social impact reasons. Therefore, customised separate accounts are increasingly in demand even if fees are not reduced.

## Chapter 6

# Regulatory & ESG Trends

“ Sustainable and impact investing has become one of the fastest-growing areas of the investment world, and we expect this trend to continue in 2019. This growth is partly driven by the ongoing transfer of wealth to the younger generation, who seem to be particularly keen that their investments reflect their values.”

**Philip Newborough, Bridges Fund Management**

## What influence do you expect global regulations to play in 2019?



### **JAN JOHAN KUHL**

#### **Managing Partner, Polaris**

The Nordic FSAs are focusing on banks' exposure to private equity, which could impact gearing levels and reduce appetite in certain industries.

From a wider perspective, we have the European Parliament elections in May and 2019 will be an important year for both AIFMD and Solvency II. Further regulation could be negative for the private equity industry and might reduce appetite and limit access to capital.

## How do you see ESG factors playing a role in PE in 2019?

### **DR STEFAN BEIL**

#### **Managing Partner, Sobera Capital GmbH**

ESG awareness in the public and therefore in politics increases, ultimately resulting in more regulations effecting also the PE market. It is reasonable to assume that investments, which may just be "on the edge" of current ESG rules, may no longer be compliant in some years bearing the risk of negative impact on PE fund performance and/or fundraising success.

Therefore, PE managers will continue complying and carefully monitoring ESG rules development.



### **PHILIP NEWBOROUGH**

#### **CEO, Bridges Fund Management**

Sustainable and impact investing has become one of the fastest-growing areas of the investment world, and we expect this trend to continue in 2019. This growth is partly driven by the ongoing transfer of wealth to the younger generation, who seem to be particularly keen that their investments reflect their values. It's no longer about simply minimising portfolio risk, as some early forms of ESG investing were - it's about actively using capital to address the pressing social and environmental challenges we face, recognising that this can also be a source of financial value.

Fund managers are responding by developing new structures that can both meet this growing demand from investors and provide the kind of aligned capital that impact-driven organisations need. For instance, we recently launched a permanent capital vehicle (Bridges Evergreen) that can act as a long-term investment partner - while also delivering a competitive financial yield to investors (alongside measurable impact).

The biggest challenge this creates is maintaining impact integrity. As all these new entrants come along, often with their own ways of doing things, how do we make sure that everyone along the investment value chain is speaking the same language?

That's why we think the Impact Management Project, which we've been working on for the last couple of years as part of our broader field-building efforts, is such an important initiative. Over 2,000 of the world's leading investors and impact specialists have come together over the last couple of years to agree a globally-accepted framework for analysing, measuring and reporting on impact. This will make it so much easier to collaborate in pursuit of common goals.