INSIGHTS:
PRIVATE EQUITY
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iCapital NETWORK

# PRIVATE MARKET INVESTING FLOURISHES IN EUROPE AND ASIA

Buyouts outside the U.S. account for a growing percentage of global deal flow.

Today's global private capital industry originated in the United States in the 1970s and gained momentum during the 1980s. The industry subsequently spread to Europe and Asia, and now exceeds $7 trillion in assets under management,[1] more than double the total of a decade ago. This momentum is expected to continue into the foreseeable future, lifted by non-U.S. markets, primarily Europe and Asia, which on a combined basis, account for a growing portion of total global buyout deal value.[2]

## A MISMATCH BETWEEN ASIA'S GROWING ECONOMIES AND ITS LESS-DEVELOPED CAPITAL MARKET

Asia is forecasted to be a major driver of private equity (PE) opportunities, due to the region's favorable underlying fundamentals, dynamic economies, and higher growth rates compared with other parts of the world. The region currently represents approximately 30% of the global economy and more than 50% of global growth,[3] which is fueled by a rising middle class with greater disposable income. However, local capital has not kept pace with Asia's growth rate, and it is anticipated that the region will incur a private capital supply and demand imbalance.

Financing for local companies is primarily led by regional banks that are often bureaucratic in their operations and favor large, traditional businesses with tangible assets. Similarly, equity markets are not as accessible to smaller companies with shorter operating histories and bond markets are extremely underdeveloped. As a result, Asian companies are receptive to local and foreign investment to support their fast-growing and maturing economies.

The growth in private equity in the Asia-Pacific region has been strong over the past decade. The region accounted for approximately 10% of global PE dollars raised in 2009, a figure that increased over subsequent years and eventually peaked at one-third of the global PE fundraise in 2018.

Yet despite this impressive growth, private equity remains under-penetrated in Asia relative to the U.S. and Europe. In the U.S., private equity investment as a percentage of GDP is 1.4% on a three-year average.[4] The European Union ranks second at 1.0% and the majority of Asian countries are generally well below 1%.[5]

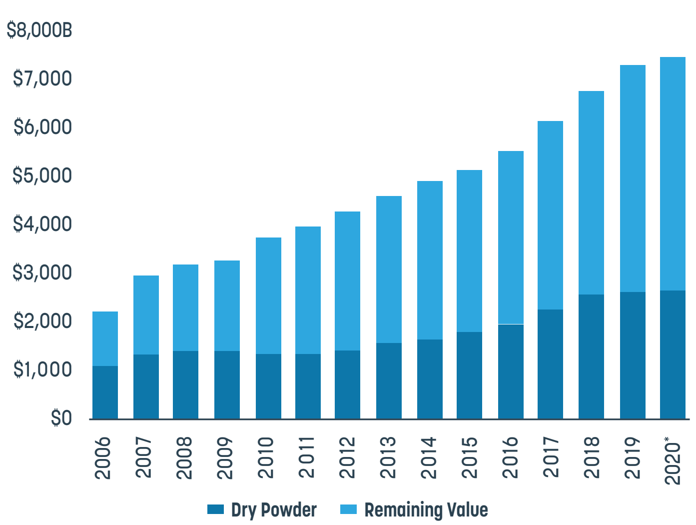
Asia's market opportunity set is generally bifurcated between companies building their brands domestically and those seeking to create or expand an international presence. Both types of companies are well suited for PE partnerships, which can provide the necessary capital and expertise to grow and expand these companies. However, each type of investment will attract different types of private equity investors.

Companies seeking international expansion prefer to partner with global private equity firms that can provide a global network and a physical presence in the target regions or countries for such expansion. Typically, companies seeking to grow outside of their local markets are larger companies with a well-established local presence.

On the other hand, companies focused on domestic markets could offer faster organic revenue growth rates and may have the option to either partner with global firms that have a strong local presence or local private equity firms. Overall, investors in Asia may benefit from faster growth rates than are available in developed markets, which can drive investment returns. An additional attraction of Asian markets is that they are less prone to financial engineering,

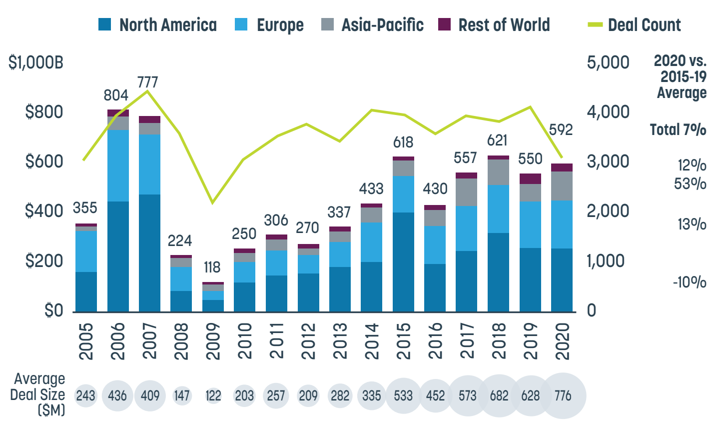
**Exhibit 1: Global private capital's trajectory is trending up**

Private capital AUM



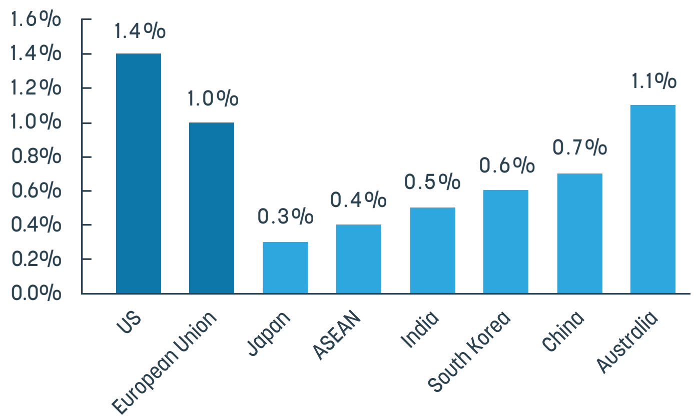

Source: PitchBook I Geography: Global. * As of June 30, 2020.

Global buyout deal value




Notes: Includes add-ons; excludes loan-to-own transactions and acquisitions of bankrupt assets; based on announcement date; includes announced deals that arae completed or pending, with data subject to change; geography based on target's location; average deal size calculated using deals with disclosed value only. Source: Dealogic.

**Exhibit 2: Private equity has room for growth in Europe and Asia**
Private equity investment as a percent of real GDP
Three-year average, 2017-2019



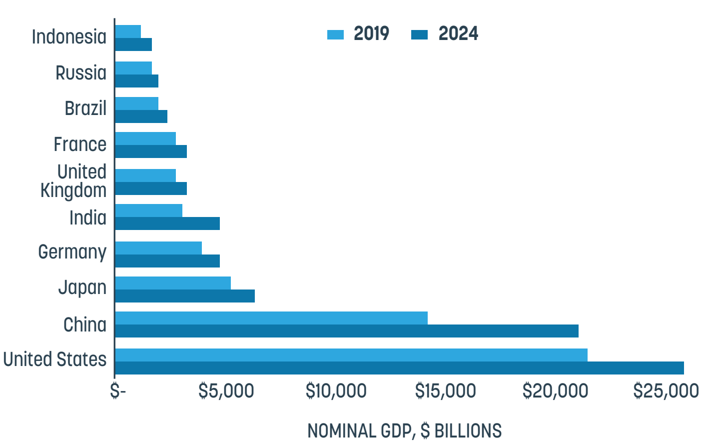

Note: United States (US); Association of South East Asian Nations (ASEAN)
Sources: UBS, Dealogic, The Economist Intelligence Unit; Data as of December 2019.

due to less developed capital markets and banking infrastructure. As a result, they can offer the potential for better unlevered returns.

## UNLOCKING THE VALUE OF EUROPE'S MULTI-GENERATIONAL, FAMILY-OWNED BUSINESSES

There is also a sizable market opportunity within Europe, given that between 70% and 80% of companies there are owned and controlled by families.[6] Many of these family-owned enterprises span multiple generations and can benefit from partnering with PE managers to help institutionalize

**Exhibit 3: Countries with rising GDP are attractive to private capital providers**
Nominal GDP



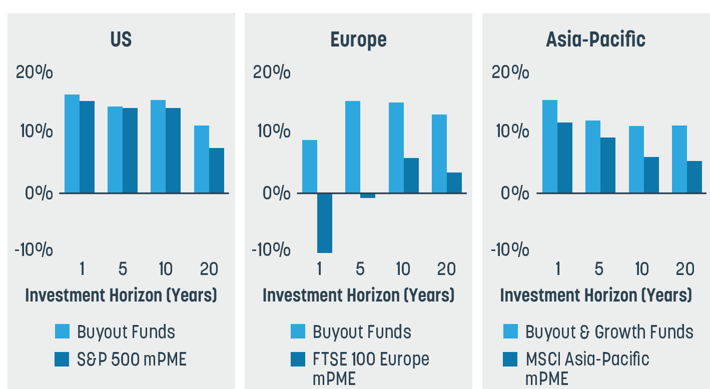

Source: The Carlyle Group, IMF WEO 2019. No assurance is given that these trends will continue or that the projected trends noted above will be realized. For illustrative purposes only.

their businesses in order to manage generational change and unlock growth potential. Moreover, many industries in Europe are more fragmented than in the U.S., which could present buy-and-build and consolidation opportunities.[7] Germany, the United Kingdom, and France account for a sizeable share of global GDP and are attractive markets for PE managers with a local presence.

## DIVERSIFICATION POTENTIAL FOR U.S. INVESTORS AND CORPORATE BUYERS

Private equity firms focused on Europe have outperformed their respective public indices over short- and long-term periods, and these returns have attracted investors who want to build geographically diversified portfolios and reap the benefits of global growth. One of the big reasons for this outperformance is the composition of local public equity markets that often have a higher exposure to slower-growing sectors such as consumer staples, financial services, and industrial sectors. By contrast, private equity firms provide financing to emerging and faster-growing sectors such as software, healthcare, and discretionary consumer spending in areas like education and personal care.

**Exhibit 4: Buyout funds outperform public stocks across multiple geographies**
End-to-end pooled net IRR



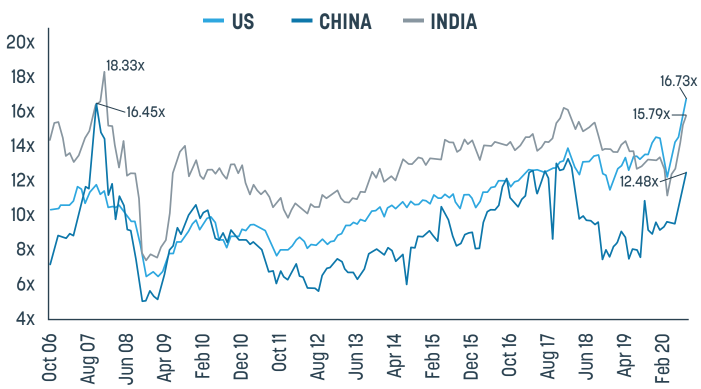

Notes: Data for US and Asia-Pacific calculated in US dollars; data for Europe calculated in euros; Europe includes developed economies only; Cambridge Associates Modified Public Market Equivalent (mPME) replicates private investment performance under public market conditions.
Source: Cambridge Associates, as of September 2020. For illustrative purposes only.

It is also worth noting that while valuations have generally increased across all regions, some non-U.S. markets are still relatively cheap, suggesting that there are attractive opportunities in other parts of the world on a relative-value basis. For example, valuations in China and India – two countries that account for nearly 50% of global growth –

have moderated and are currently below valuation levels in the United States.[8, 9] In 2020, the European median EV/EBITDA multiple fell to a seven-year low of 10.7x, while U.S. valuations remained elevated.[10]

**Exhibit 5: Europe and Asia offer attractive valuations relative to the U.S.**

Trailing 12 months enterprise value / EBITDA




Source: The Carlyle Group, as of December 2020. For illustrative purposes only.

## POTENTIAL RISK FACTORS

While there are several benefits of global portfolio diversification, there are also potential risks associated with investing in PE funds outside of investors' home countries. PE investments in Asia, for example, may encounter geopolitical risk, particularly those in China given persistent tensions with the United States. Concern around antitrust laws imposed by the Chinese government is also a potential headwind. In Europe, family-owned business may lack appropriate governance.

Furthermore, investments are typically denominated in a country's local currency. As a result, investments in foreign companies may also be subject to foreign exchange risk which, depending on the currency, can lead to volatility. In addition, most foreign investments are minority positions, and even as an enterprise benefits from PE expertise, the owners may not be willing to fully cede control of their company or follow the strategic guidance of their PE sponsor. Lastly, the ability to exit investments is another risk given that exit markets are less mature, especially in Asia.

## APPROACHES TO INVESTING IN NON-U.S. PE: LOCAL VS. GLOBAL PE MANAGERS

PE has evolved into a global asset class with experienced, high-quality managers around the world. Investors who seek global PE exposure have their choice of global players and local fund sponsors that have an established history and track record of successfully executing an investment strategy. Global PE firms typically maintain on-the-ground teams in local markets that enable them to be close to their investments. Portfolio companies leverage these firms' global platforms and resources, as well as benefit from shared knowledge among team members.

Local players also present a practical option for investors because these managers can generally execute transactions at a faster pace, as decision makers are local and not reliant on global team members who may be located in different time zones. Furthermore, there is generally less bureaucracy within domestic PE players, which could simplify investment decision-making.

Investors based outside of the region may choose to partner with global firms investing in the region first due to lower perceived risk associated with global firms with longer histories of investing in global businesses.

> "Choosing experienced managers with strong track records and deep knowledge of local markets may help alleviate some of the risks."

## BOOSTING THE RETURN POTENTIAL OF GLOBAL PORTFOLIOS

There is a vast and growing PE opportunity set outside of the United States – supported by knowledgeable PE managers – that can help investors construct a geographically diversified private investment portfolio with strong return potential. Private equity investments in these regions have consistently outperformed local public markets, adding long-term value to globally diversified portfolios. For investors, choosing experienced managers with strong track records and deep knowledge of local markets may help alleviate some of the risks of investing in other countries.

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## END NOTES


1. Source: Pitchbook 2020 Annual Private Fund Strategies Report, February 2021.
2. Source: Bain Global Private Equity Report, March 2021.
3. Source: Economist Intelligence Unit Report (published as of May 2020); Emerging Asia represents ~29% of global GDP and ~51% of global growth (at current exchange rates).
4. Source: FEG, "Opportunities in Transition, An Overview of the Asian Private Equity Market," Q4 2020.
5. Source: FEG, "Opportunities in Transition, An Overview of the Asian Private Equity Market," Q4 2020.
6. Source: Austrian Institute for SME Research, "Overview of Family Business Relevant Issues. Study commissioned by the European Commission," 2008.
7. Source: Schroders, "Three drivers of European private equity growth for the next decade," October 2020.
8. Source: Economist Intelligence Unit Report (published as of May 2020); Carlyle analysis as of May 2020.
9. Source: Carlyle Asia Partners Growth II L.P. PPM.
10. Source: Pitchbook Q1 2021 Analyst Note: Exploring European Buyout Multiples.





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