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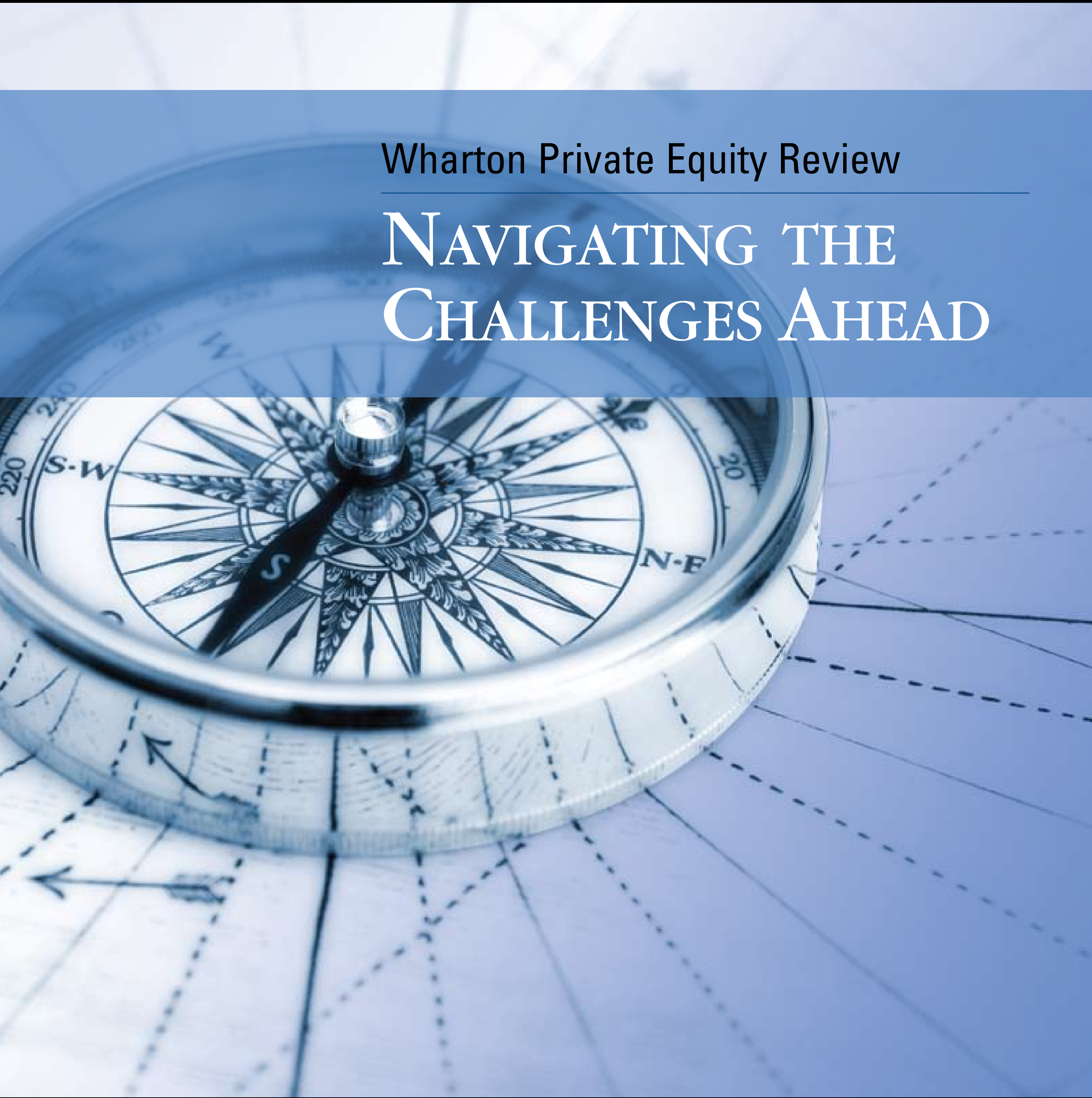

Wharton Private Equity Review

NAVIGATING THE CHALLENGES AHEAD

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Wharton Private Equity Review

Navigating the Challenges Ahead

Private equity (PE) firms will see unprecedented challenges over the next few years, given the depth and duration of the current financial crisis. In this special report, produced in cooperation with the Wharton Private Equity Club, Knowledge@Wharton looks at how markets are shifting and what participants can expect in the coming months. One example: Deals that settled for just 15% in equity a couple of years ago now require 35% to 40%, and up to 75% for some smaller buyouts. Going forward, a "wall" of refinancing due in 2012 will challenge the survival of many portfolio companies — and PE firms as well. Also included in this report are a roundtable discussion on the secondaries industry (the buying and selling of pre-existing PE commitments) and an interview with Dalip Pathak of Warburg Pincus and Bridgepoint Capital's Alastair Gibbons on the prospects for PE in India and China.

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Private Equity Secondary Funds: Are They Players or Opportunistic Investors?

Investment managers involved in the private equity (PE) secondaries industry — the buying and selling of existing PE commitments — see distressed sellers continuing to act as a source of growth through 2009 and 2010. In an interview with members of the Wharton Private Equity Club, three senior members of firms that focus on these transactions predicted the role of secondaries will grow over the medium and long term as they provide a solid source of short-term liquidity, allow larger PE positions to change hands and make it easier for investors to adjust their PE portfolios.

India and China Offer Attractive Private Equity Opportunities, but Without Majority Control

Strong fundamentals in China and India continue to offer some highly attractive opportunities for prudent private equity investors. But successful PE investments require careful planning and a regional presence in order to identify lucrative opportunities and better understand potential competitive threats to Western companies. To learn more about private equity investment in these countries, members of Wharton's Private Equity Club recently interviewed Dalip Pathak of Warburg Pincus and Alastair Gibbons of Bridgepoint Capital about their views on the best investing practices in today's transformed environment.

The Coming 'Wall' of Refinancings: A Trial for Private Equity Firms — and Their Portfolio Companies

Private equity faces significant challenges as credit markets try to absorb maturing debt from large leveraged buyouts. Panelists at the 2009 Wharton Private Equity & Venture Capital Conference, "Multiplicity Without Rhythm: Investing in Chaotic Markets," said financial sponsors are scrambling to prepare for the refinancings that will start coming onto markets in 2012.

According to panelists who took part in a discussion titled, "Leveraged Buyouts: Strategies in Times of Turmoil," firms are focusing hard on portfolio company operations, exploring new positions in the capital structure and considering strategic, synergistic transactions.

> "Today, we have no credit market. . . . Life has changed."
>
> Jack Daly, managing director of Goldman Sachs' principal investment area

Jack Daly, managing director of Goldman Sachs' principal investment area, put the crisis in historical perspective, noting that 2007 and 2008 represent sharply different markets. In 2007, the market was robust, with easy access to credit, liberal loan covenants, and the possibility of a $100 billion buyout. By the end of 2008, everything was different. "Today, we have no credit market," he said. "Life has changed." Buyout multiples have dropped, and deal volume is down 75% since 2007.

He pointed to an analysis by Ned Davis Research of the ratio of credit to GDP over the last 100 years. Over most of that time, the figure ranged from 140% to 160%, but it spiked to 265% before the Great Depression. It rose to the highest levels ever, more than 300%, approaching the current downturn. Returning to more natural levels will require high savings rates, inflation, or a massive markdown of bad debt, he said.

In the boom years from 2005 to 2007, private equity deals were completed with as little as 15% equity, leaving leveraged portions at a higher rate than in the 1980s and 1990s. Since the economic meltdown that began in late 2007, 35% to 40% equity has been required. For smaller buyouts, Daly stated, the equity requirement is 50% to 75%.

According to Garrett Moran, senior managing director at the Blackstone Group, the economy is experiencing "the mother of all recessions," and that the stock market [early in 2009] is effectively saying that the financial sector is bankrupt. He noted that during the last big wave of private equity financing, hedge funds were flush and found it easy to leverage syndicated products. In 2006, financial sector market capitalizations had doubled from just a few years earlier. Looking forward three or four years, he said, the industry will have decreased dramatically, with hedge funds no longer leveraging deals with 90% debt levels. "All these companies will have to refinance into a much smaller market. So we're going to see a world of distress."

Questions about Viability

Moran referred to a "wall" of private equity bank financing that will mature in 2012 and 2013. Because of this, private equity firms must increase cash margins. Blackstone has been meeting with its portfolio company management teams and scrutinizing projections for 2009 and 2010. In order to conserve cash, some managers are closing plants and trying to sell assets, he said, but asset sales are difficult in the current environment. Blackstone is questioning whether business models and assumptions are viable even after significant cost cuts. Moran added that companies are "skinnying down," taking a strategic look at their models. If a portfolio company's model requires cash early on to meet the promise of opportunity later, "you have to get rid of it."

Operational team meetings are being set to devise 100-day plans focusing on issues such as supply-chain management and sales programs. "Basically, management teams are being told to 'bar the door. Take more severe actions,'" said Moran. One course of action, for example, is to ramp up outsourcing.

Private equity firms, Moran predicted, will experience a "slow-motion" period over the next three to four years in which firms can restructure, buy back portfolio company debt, or take other operational steps "to be all set to have handsome returns when the refinancing hits." Some companies are approaching private equity firms about partnerships, he added, noting that Blackstone created a partnership with Bain Capital and NBC Universal to take control of the Weather Channel, with NBC as the operating partner. "When the dust settles, there will be more private equity going into corporate partnerships than corporate money going into private equity firms."

Peter J. Clare, managing director at the Carlyle Group, predicted that credit markets would remain expensive for close to two years, suggesting it would take at least that long for the banking system to get its bad assets off the books and recapitalize.

Relationships Mean Less

Buddy Gumina, a partner in Apax Partners, said the changing credit picture would have a major impact on private equity portfolio companies. In the last few years, as the economy boomed, banks were eager to lend. If a borrower had a problem, the bank would fall back on relationships and cooperate with management as it worked through the difficulty. Now, he said, relationships no longer rule. "In today's market, the reasonableness is often gone and (lenders) are instructed to push as hard as possible to extract as much value as they can."

Private equity firms are on the defensive. Gumina said that while the firm once spent much of its time on deal generation, the emphasis now is on operations. "We have clearly shifted in a very, very organized way within the firm. We are looking at each portfolio company and questioning the business model, the cash flows, and the ability to survive."

Gumina said Apax is preparing more than ever to take advantage of potential consolidation or investments from strategic buyers or investors, especially because it expects economic conditions to remain murky for the next 18 months. "We would rather do something today and shore up the capital structure than wait until later when there are fewer options. From a limited partner standpoint, they are looking for us to be thoughtful and creative."

Returns are going to matter a great deal in the near future, he added, because when it is time to raise money again, limited partners will want to see how well private equity firms managed their portfolio companies during the recession. "One solution could be capital injections and also being very operationally involved in the businesses."

Daly said he, too, is concerned about the large amount of private equity debt due to mature. "It's unclear to me how we're going to end up dealing with that in 2012, 2013 and 2014. It sounds like a long way away but it's going to be here soon," he warned.

Sharply Lower Prices

Gumina noted that all is not "doom and gloom" in the private equity market. While buyers would like to see higher prices to help complete exit transactions, he said, at the same time prices are sharply lower for those interested in strategic acquisitions.

Regarding the risk-return ratio, Clare added, the debt market represents one of the best investment options. He suggested thinking about this market as two buckets. One is the debt of healthy companies returning 15% to 25%. The other is the debt of distressed companies that could be purchased to gain control of the business or drive it into a restructuring. Such an approach will become increasingly popular, he said, though it is still early in the process. A lack of covenants and other mechanisms that would trigger default sooner are delaying inevitable restructurings. "Given the maturities, this is going to continue for four or five years at a minimum. We're in the top of the first inning in terms of restructuring and distressed-debt opportunities."

Forced divestitures will also provide opportunity, he said. Major companies under pressure, such as AIG and Citigroup, will need to unload desirable businesses. "It will take a while for buyer and seller expectations to line up." However, "the companies that become available to us will be at valuations that are more attractive."

Moderator Curt Cornwell, a partner in transaction services at PricewaterhouseCoopers, asked the panelists which industries were particularly interesting for distressed investing.

Gumina pointed to the retail sector. He said his firm is looking at retail opportunities even though the industry was "banged up" by extremely weak [Christmas] holiday spending. "We have to be creative. There are no straightforward LBOs to be done, but there are ways we can come in to shore up the capital structure or help buy a competitor and achieve synergy. It's an area where having a good understanding of the space will matter."

Gumina said his firm wasn't seeing much opportunity in the health care sector, though it is considered a defensive investment. The sharp decline in consumer spending has extended to elective procedures. Uncertainty over the future of the industry under the Obama administration also makes health care less attractive, at least in the near term. Longer-term, he added, both retail and health care will provide opportunities for creative, smart strategies because they are undergoing dramatic change and because, in past recessions, the price to acquire competitors has declined.

Cornwell asked speakers about how federal government efforts to revive the economy through the Troubled Asset Relief Program (TARP) and other stimulus programs would affect private equity. According to Clare, TARP was a good step forward, but he said confidence would be critical in restoring economic growth. "We have to stop the massive fear and panic. Massive bank failure creates fear and panic, and that's where we were headed. The TARP may not have been the most efficient way to go about it, but those big bold steps had to be taken."

TARP and financial stimulus programs would provide opportunities for private equity to recapitalize and revamp the nation's financial structure, he added. "I don't think the government can afford to do it by itself and will need to create a structure that allows private capital to come in and build up an equity base for financial institutions." He noted, however, that the process of restructuring and selling off bad assets had not even started. "It's a bit early to jump in, and there's no reward to being early."

A second opportunity will come in remaking the financial sector itself, Clare predicted. "Restructuring the industry will create opportunities for new business models that people have not thought of yet and put private equity capital behind new financial businesses."

Continuing Defaults by Private Equity Portfolio Companies Transform the Middle Market

At the peak of the private equity boom, the largest leveraged buyouts ballooned in value and captured headlines. Traditional middle-market deals also grew at a robust pace, but with less fanfare. Now that the market has turned, both sectors are challenged.

Panelists at the 2009 Wharton Private Equity & Venture Capital Conference, "Multiplicity Without Rhythm: Investing in Chaotic Markets," said opportunities, or "gems," are nonetheless still available for investors in midsize deals if they approach transactions creatively and consider taking new and innovative positions in companies' capital structures.

Private equity professionals discussed credit market conditions, deal flow and fund-raising in the middle market in a session titled, "Finding Gems Under Rocks: How to Drive Value Going Forward in Middle Markets." The middle market was defined as private equity funds with capital commitments of $250 million to $5 billion and transactions with a total enterprise value of $100 million to $2 billion.

The discussion focused on constraints in the credit market and strategies to restructure financing and operations within portfolio companies to protect investments. Michael DeFlorio, senior managing director at Harvest Partners, began by characterizing the economy as not equal to the Great Depression, "but if there's such a thing as a lower-case depression then we're in one." With the possibility of 10% unemployment and a dramatically changed banking environment, he said, companies need to avoid Chapter 11 bankruptcy because they may not find debtor-in-possession (DIP) financing to exit. "Traditional sources of DIP financing are husbanding capital and reserving it for companies they really want to be in, not DIP situations."

According to Robert Long, managing director at Allied Capital, the sick economy's underlying causes — similar to other recessionary cycles — boil down to a lack of confidence among consumers and investors who are readjusting to new realities following a bullish 25 years. "The unwinding of all that leverage has to take place, and we have the situation where you are constantly marking down the existing assets as waves of liquidation keep coming."

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>
> Robert Long, managing director at Allied Capital

When the liquidity pressure subsides, he said, markets will have created a bottom. Default rates will be a key indicator, though they tend to lag, not lead. He predicted default rates would rise to 10% or even higher in the next 12 months. "We are looking at liquidations subsiding this year, and when you see liquidations stop, that's when new capital will come in in new forms." Seller financing remains viable, he added, because sellers are happy to take some capital — instead of none — to get a deal done.

Bankruptcy's Changing Face

In connection with default rates, said Jeff Feinberg, managing director at Alvarez & Marsal, the traditional Chapter 11 bankruptcy case has changed because of the lack of DIP financing. "Turnarounds in the court are done. It's going to be out of court and it's going to be expensive and it's going to have to be funded by equity because the banks aren't going to be there for you." The fear is tremendous that if a company enters bankruptcy, it will wind up in liquidation because of difficulty in finding deal participants, he noted. "It's shocking, but really telling as to the nature of what's happening today."

According to Feinberg, the new focus on out-of-court restructuring requires balancing severe cost cuts with the possibility that the cuts kill off the chance to "live another day." He predicted that consumers will not provide a revenue runway for turnarounds, as they have after past downturns. "The pressure on the process is significant. Private equity shops can't go to their lenders. They have to go back into their own pocket and double down. It's a very difficult situation."

Reginald L. Jones III, managing partner at Greenbriar Equity Group, noted that while the federal government has provided about $2 trillion to financial markets, including through its Troubled Asset Relief Program (TARP), attempts to revive the economy through such credit injections had not yet paid off as today's tight market conditions continue. "My suspicion is that the TARP has been given out in large chunks to institutions that will use it to replenish their balance sheets. I would say I haven't seen any evidence that TARP is having a positive impact."

Jones cited a Boston Consulting Group study that forecast that 20% to 40% of private equity firms would go out of business because of the economic crisis. As a result of falling asset prices elsewhere in the financial system, many limited partners are now overexposed to private equity, he said. They will want to reduce their commitment to the sector to bring wounded portfolios into better balance. "I do believe there will be a shakeout in the sector."

Three Forces Shaping Markets

Peggy Koenig, managing partner at Abry Partners, pointed to three aspects of the credit environment that will shape private equity investment. First is that hedge funds' forced selling will continue to erode markets. Second, lenders haven't recognized the true value of the debt on their balance sheets, with many still valuing impaired credit at par. Third, lenders and troubled portfolio companies haven't begun to work out their problems. "Everyone is pessimistic and will continue to be in 2009 and 2010 as all this continues to unfold."

G. Daniel O'Donnell, chair of the Private Equity Group at the global law firm Dechert LLP and the panel's moderator, said that as credit markets began to fall apart in 2007, analysts predicted that mega-deals would dry up, but that mezzanine funds and other third-party lenders would step in, allowing mid-market transactions to continue. Data from 2008 indicates that didn't happen. O'Donnell asked why.

When the correction began in August 2007, Koenig explained, private equity players were offered several opportunities from institutions unable to syndicate their transactions. The companies weren't really attractive, she said, and the pricing wasn't good enough to motivate mezzanine funds. That is changing, she added, and the debt backlog is being whittled down. "Now what we're seeing is a lot more attractive companies coming into the market, and we are able to receive very attractive pricing." In addition to good prices, she said, Abry Partners is able to move up in the capital structure while still targeting returns of 20%.

O'Donnell also asked whether a trend among private equity firms to buy more debt in companies in which they already have a position is a fix to the problem, or just a fad. DeFlorio said he thinks the strategy is a fad that seems attractive because senior debt is trading at 60 to 80 cents on the dollar. Firms might be willing to buy additional debt because they feel a company remains a good investment, he added, but doing so amounts to doubling down on a bet. "If your equity is underwater and you are now buying debt, you don't want to be wrong twice."

O'Donnell further asked about attitudes among limited partners toward changing the traditional structuring of middle-market deals. "Do you worry about limited partners accusing you of, in effect, creating strategy drift?" he asked.

According to DeFlorio, the existing opportunities lie in distressed companies' senior debt. If a firm holds onto the notion that the role of middle-market private equity is to come in at the bottom of the capital structure, "You're not going to be very busy. Or," he continued, "middle-market firms can choose to find attractive risk-return opportunities and play different parts of the capital structure in a creative way to put money to work."

What Style Drift?

DeFlorio stated that his firm had talked to limited partners and that no clear consensus had emerged on whether they are concerned about style drift in taking on debt. They have made it clear, however, that they want the firm to "stick to its knitting" in the types of businesses it invests in.

On one hand, Jones said, limited partners pay the firm to manage money because they believe it is smart and capable and, if it makes a mistake, it will be fired. However, he said, market conditions transcend concerns about style drift. Many limited partners have experienced massive declines in their portfolios' public-equity portions and are now overweight in private equity. To make a cash call to seize on a chance to buy a great company at a good price, limited partners would have to sell equities in companies at distressed prices.

"There's a question around the value proposition we offer to limited partners," he conceded. He said private equity firms are on the spot because if they don't invest in anything, two years from now their limited partners will wonder why they are paying the firm to do nothing. "If you want to be a true partner," Jones said, private equity firms need to provide limited partners with transparency and detailed explanations.

O'Donnell asked about the impact of so-called covenant light financing, or loans without traditional levers, such as working capital requirements, that can signal danger before a company slips into deep trouble. This type of financing was popular during the private equity boom years, and O'Donnell wondered whether it would delay the downturn's effects because lenders may have no indication that they should be working with a troubled borrower until it is in full default.

Feinberg agreed that a lack of covenants may make problem private equity deals worse in the long run. "We're all paying the price now."

The business model of large leveraged buyout funds, which was to buy companies and then leverage the deal eight to one, is dead, Long stated. Middle-market funds have been less reliant on financial engineering than large LBO funds and are better prepared to create value in portfolio companies through operations. Middle-market private equity owners, he added, are better positioned than mega-funds to take a central role in the future "trajectory" of the companies they hold.

'True Turnaround Specialists' Are Poised to Survive in Today's Challenging Private Equity Market

As the economy erodes and bankruptcies rise, private equity is turning away from traditional leveraged deals and toward investment in distressed companies, according to speakers at the 2009 Wharton Private Equity & Venture Capital Conference, "Multiplicity Without Rhythm: Investing in Chaotic Markets."

Private equity specialists in distressed businesses, speaking on a panel titled, "From Vultures to Saviors: How Distressed Investing Is Helping to Shape Tomorrow's Economy," said they expect a tidal wave of private equity deals made in 2006 and 2007 to go bad in the next few years. Given the number of opportunities and the lack of bankruptcy credit, many restructurings will occur outside of bankruptcy court and could result in swift liquidation. Kyle Cruz, managing director at Centerbridge Partners, explained that during the private equity boom, many deals were structured with loose covenants and too much debt.

> The volume of impending credit defaults will make lenders more inclined to restructure deals outside of the bankruptcy courts.
>
> John Caple, a principal at Bayside Capital

John Caple, a principal at Bayside Capital, said the volume of impending credit defaults will make lenders more inclined to restructure deals outside of the bankruptcy courts, if only because it would be impossible to work through all of the court system's cases in a reasonable time frame. He said that if a lender has 20 companies in a distressed situation and 10 are making some payment, the bank may ask the private equity sponsors of those companies to put more into the deal rather than pursue the company in court. "It might not be the right thing to do," he said, "but it is the right thing to do given everything else they have to do."

Panel moderator David Gerson, a partner at the global law firm Morgan Lewis, asked how distressed deals differ from traditional private equity transactions that are based on leverage and the promise of unlocking value through operational expertise.

Michael Psaros, managing director at KPS Capital Partners, pointed out that cash usually isn't available to leverage in distressed situations. Most of the companies that his firm looks at have managers who are "catastrophic failures" and need to be replaced with new leadership, or a chief restructuring officer, to begin to create value. "That's our world," said Psaros, who added that after 20 years in the corporate restructuring field he had never seen so few true competitors in the business. "That's because it is hard. It is as different from the traditional LBO model as you can imagine."

Cruz pointed out another reason why distressed transactions are often more difficult to structure: A company's debt is frequently controlled by many parties that may have their own agendas, and distressed times can place more pressure on agenda differences. For example, lenders holding the primary debt may be more inclined to hold out for a better price than those who took on debt in the secondary market and are looking for a quick way to monetize their investment.

'Top Lines Getting Crushed'

Gerson asked how the panelists begin to think about valuation, given that prices have been dropping "like a sharp knife." Cruz acknowledged that valuations are challenging because it is unclear where the market bottom is, and it is increasingly difficult to forecast the future.

Psaros agreed that the biggest problem facing the industry in 2009 and 2010 will be falling demand. He described how a senior debt lender invited his firm to look at a deal for an RV manufacturer. The company produced 1,000 units in 2008 but had no orders backlogged for the first quarter of 2009. "What keeps me up at night?" he asked. "It's this whole 'catching a falling-knife' concept. We're seeing top lines getting crushed like I've never seen before." No matter how much a private equity firm paid for a company, he said, or how the deal is structured or how well the company is run, with revenue declines like those at the RV company, it is impossible to make money for investors.

Another problem, according to Michael Fieldstone, a principal at Sun Capital Partners, is that vendors are no longer as willing to prop up their customers. For the last 18 months, he said, many companies have taken it for granted that vendors would extend generous credit terms to keep their own products flowing. As credit markets weakened and financial firms pulled back, eroding balance sheets prevented companies from continuing to provide cheap credit to customers. The liquidation of Circuit City, he said, is an example of a company that went under quickly primarily because vendors stopped supporting the business.

The panelists stressed that in today's environment, with little or no leverage available, a buyout's success depends on operational basics. According to Caple, obvious, easy-to-correct problems must be present to justify keeping a company afloat. "In distressed situations, you are finding businesses that are wildly under-promising and spending money in really silly ways."

Existing management is more likely to be replaced in a distressed situation than in a typical buyout deal where the company has positive earnings. Psaros said that before his firm takes on a distressed asset, it often installs a chief restructuring officer to ensure that honest and competent management is in place. He said his firm pulls from a network of individuals it can rely on for the job. KPS has a small, in-house "best practices" group, but appoints managers on a case-by-case basis. Fieldstone said his firm, too, has a pool of experienced former corporate executives that it draws on when a new management team is necessary. "This is a tough business. It's not for the fainthearted. This is complicated, and even more complicated with the liquidity crisis."

Psaros notes how, in many cases, a management change can drastically alter a company's prospects. "Sometimes all we have to do is change out a CEO and everybody below him just blossoms. On the other hand, we have literally had to fire everybody down to the shop floor level. Those two extremes are fascinating." He warned against buying into stereotypes about the management style of turnaround specialists. "Most people assume that the successful manager of a turnaround is a high-testosterone, chest-pounding professional. We have seen individuals with that kind of personality be successful, but we have also seen bookish, cerebral and methodical managers be equally successful. There's really no pattern." The key to managing a turnaround, he said, is to develop a plan and stick to it day by day, to ratchet up expectations. "Big-picture professionals have no place in a turnaround."

Obstacles to Exits

Even if a company can be restructured successfully, private equity firms face enormous obstacles in exiting investments today, the panelists said. Caple explained that in private equity's boom years, investors could exit deals in just a couple of years. Now the time frame is more likely to be five years. "So we will see very few exits in the near future," he said, referring to deals completed shortly before the credit crunch. "The market to sell businesses is nonexistent."

In the beginning of 2008, Fieldstone noted, buyers from India, China and other Asian nations did allow for some private equity exits, but that was because the dollar was weak. Now, with a stronger dollar, at least for the moment, even that exit door is closed.

According to Cruz, the private equity market is in the early stages of the distress cycle after an explosion of buyouts that peaked in the summer of 2007. Activity fell to more rational levels in 2008, then ceased in mid-September of 2008, when Lehman Brothers filed for bankruptcy. "In this kind of macro-environment, by fall and for the next 12 to 24 months, you will see increasing true-distressed situations at companies that are coming back to lenders seeking relief," Cruz said. "We've seen some, but there is a lot more to come."

Karl Beinkampen, managing director at Morgan Stanley Alternative Investment Partners, predicted a bifurcation in the distressed market. He suggested that some buyers could handle deals for midsize firms when they run into trouble, but it isn't clear who would step in to take over the large companies that went private in the boom years and that may fail to meet loan covenants in 2012 and 2013.

The sharp economic downturn and tight credit markets are likely to lead to increased asset sales under Section 363 of the U.S. Bankruptcy Code. The panelists outlined strategies for acquiring distressed assets through bankruptcy. Sometimes it is best to take a "toehold" position in firms through debt to have more say in the firm's disposition, Caple said. Other times, it is best to stay on the sideline, especially as valuations fall fast. Psaros recommended basing strategy on the distressed company's capital structure. It is easier to do an out-of-court deal for a company with only one or two major lenders, he said. "If they have widely syndicated credit it is much harder to get together to do something out of court, especially in the environment today."

At the heart of the problem are the artificially high levels of credit and consumption in the last 24 months. "Much of what we have been using for historic reference was fundamentally flawed," Cruz noted. "We all wish we had a crystal ball, but all we can do is be extra conservative and wait."

While the downturn is likely to generate "extraordinary opportunity," private equity firms that, early in the crisis, stepped into purchasing corporate debt at "low valuations" in the secondary market "got killed" as valuations kept on falling, Caple said. It is hard for a private equity firm to go back into this market if it has been burned recently. "How do you step in and say, 'Now is the time.' I think it is, but it's a tough thing to say."

The industry's tone, added Psaros, has changed dramatically with the disappearance of young "cowboys" working at hedge funds who rushed in and bought companies or their debt with little due diligence and loads of leverage. "It was nuts what happened in 2006, 2007 and early 2008 with these hedge funds."

Longer Investment Horizons

Gerson asked the panelists to describe the future of private equity finance. Caple responded that future deals will be all-equity transactions with an investment horizon of five to eight years, not the recently common three to five years. Psaros added that debtor-in-possession financing now lasts only six months with an up-front fee, and sometimes an additional exit fee, which he said is a recent development.

Gerson wondered whether difficulty arranging debtor-in-possession financing to carry companies until they can restructure would result in increasing "fire sale" liquidations, while Caple pointed out that, despite the economic downturn's severity, lenders are not forcing as many companies into bankruptcy as might be expected because they know debtor-in-possession financing is hard to arrange. "Many banks are being extraordinarily patient now. It's better for them to hang out and hope it gets better." Even if the economy recovered in two to three years, he said, the distress cycle will take five to seven years to complete given the financial markets' weakness.

According to Fieldstone, the economic collapse may be good in the long run because it can clean out the overcapacity and inefficiencies that had been generated, "like a forest fire that needs to happen." Investors have to be especially careful about selecting companies this year and next, he added, but good companies should survive and reap big returns when the economy recovers because there is significant investment capital on the sideline.

"I'd be hard-pressed to say I'm excited about the recession," Beinkampen said. But in a Darwinian view, today's business climate will winnow out less-focused private equity firms, leaving greater opportunity for those that survive. "Private equity won't disappear because of the restructuring," he noted. "But there's going to be a lot fewer folks overall, and that will be good for the buyout business." ●

Private Equity Secondary Funds: Are They Players or Opportunistic Investors?

Over the last 10 years, the private equity secondaries industry has grown from a few investors looking to acquire existing stakes in private equity funds from other fund investors to becoming a full-fledged asset class. Proven returns and a flood of potential buying opportunities have driven much of this trend. As a result of significant recent fund-raising, secondary funds now have more than $30 billion in "dry powder" available to provide liquidity to an otherwise distressed alternative investment community.

As a result of significant recent fund-raising, secondary funds now have more than $30 billion in "dry powder" available. . .

But so far, the secondary players have largely held back. So what will it take to unleash this capital? And will heightened secondary investment activity — and more liquidity — revitalize the dried-up private equity industry? Three senior members of leading secondaries firms discussed these questions — and how they view the opportunities today — with members of the Wharton Private Equity Club (WPEC).

***Sebastien Burdel** is an investment principal at Coller Capital. Since joining Coller Capital in 2003, Burdel has completed many transactions and contributed to the firm's growing U.S. presence. Prior to joining Coller, he worked in corporate M&A at General Electric and handled direct buyouts at GE Equity. He is part of the team responsible for investing Coller International Partners IV and V.*

***Wouter Moerel** is a partner in the secondaries team at AlpInvest Partners. Moerel joined the firm in 2005 from The Carlyle Group, where he was a principal responsible for telecom and media-sector investments. Previously, he worked as vice president and director at JPMorgan and Lehman Brothers. He heads the European arm of the secondaries team at AlpInvest Partners.*

***Peter Wilson** is a managing director at HarbourVest Partners. He joined HarbourVest's London-based subsidiary in 1996, focusing on secondary investments in Europe and European venture partnerships. Prior to joining HarbourVest, Wilson worked for the European Bank for Reconstruction and Development and the Monitor Group. Wilson now heads the European secondaries effort at HarbourVest.*

An edited transcript of the discussion follows:

WPEC: Could you describe the growth and rationale for secondaries as an asset class?

Sebastien Burdel: Secondary transactions are a natural consequence of any large pool of primary investments. The illiquid nature of the private equity (PE) asset class, where limited partners (LPs) are locked in for up to 12 years, makes PE secondaries a valuable exit option. The formation of the secondaries market, which did not exist 20 years ago, created the ability for fund investors to sell their stakes and realize liquidity, increasing the efficiency of capital allocation and boosting the attractiveness of private equity as an asset class.

Beyond simple access to liquidity, the PE secondaries market has become an important portfolio management tool for investors. LPs sell PE interests for many reasons, some of which include re-allocation of capital and human resources, changes in investment strategy, regulatory or accounting changes or M&A activity. In fact, surveyed LPs rank portfolio management ahead of liquidity needs as the key reason why they would sell in the secondary market. Rapid growth in secondary fund-raising and deal flow has been driven by the more than $2 trillion raised by PE funds in the primary market over the past eight years. Despite the recent growth, our market is still a young one: In 2008, the secondaries market reached an estimated $90 billion of cumulative funds raised, still a tiny fraction of the overall PE market.

Peter Wilson: Secondaries typically comprise three transaction types. First, traditional deals involve the transfer of LP interests in a given private equity fund from an existing LP to a new investor who, for an agreed price, assumes ownership of the selling LP's capital account value and assumes the remaining unfunded obligations from the seller LP. Second, synthetic secondaries, or secondary directs, involve creating a new partnership to purchase a portfolio of direct investments, using an incumbent or new general partner (GP, manager) contracted to oversee and ultimately sell the assets in the partnership. Finally, structured transactions involve the formation of special purpose vehicle(s) to establish a unique legal framework/structure that helps accomplish the goal(s) of a particular seller in closing a transaction. In this type of deal, assets may include LP interests or a portfolio of companies, or both.

Wouter Moerel: The developments outlined by Pete and Sebastien are generally in line with our views. We tend to see two trends in the secondaries market: a fundamental market growth driven by a growing primary private equity market and a larger proportion of LPs actively managing /selling their portfolio (the base growth); and periods of extraordinary growth during which LPs are actively selling their private equity investments as a result of financial distress, liquidity needs, reorganizations, refocus of strategy, etc. (the systemic shocks). We believe that we are currently in the middle of a period of extreme systemic shock which has flooded the market, and will continue to do so over the next 12 to 24 months, with secondary transactions. Thereafter, we expect a return to the base growth of the secondaries market.

WPEC: Is now a good time for secondary firms to deploy capital?

Moerel: As a result of an increase in distressed sales in the current market environment, pricing has come down and return expectations on transactions have gone up. This provides for an attractive market to deploy capital over the next 12 to 24 months. On the other hand, it is challenging to price secondaries transactions today, as the economic outlook is uncertain, the real impact on company performance is unknown, and underlying fund valuations keep declining. This has led to a large bid-ask spread between buyers and sellers. AlpInvest Partners estimates that only 20% of transactions which came to market in the second half of 2008 actually closed.

Burdel: Given the lack of visibility in the broader economy and the effects of the economic downturn on PE portfolios, many secondary buyers have taken a cautious approach to deploying capital. We have continued to make selective investments in the current market and expect the pace to pick up as the year progresses.

Wilson: Given current market conditions, we are seeing a further increase in deal flow volume, but share the view that the level of closed transactions is a fraction of the total opportunity set. Critical to success is structuring transactions that can provide sufficient downside protection while still approaching seller pricing expectations — not an easy mix.

WPEC: If holding back is the right strategy, what are factors that will need to change for you to start deploying capital again? When do you think this tipping point will happen?

Wilson: It's obviously important not to be pressured to invest, particularly in current market conditions. However, "holding back" is not, we believe, the correct approach, as one cannot remove oneself entirely from the market with the intention of re-entering at a later stage. We are actively pursuing opportunities, evident from the recent Tenaya Capital (the former Lehman Brothers Venture Capital team) transaction, as we feel it is paramount to stay involved in the deal flow. What slows the pace of closed transactions is that there remain divergences between sellers' expectations and buyer pricing. This is the principal reason so few deals are closing at present. Once this valuation gap narrows, we will see a greater number of firms transacting. In terms of timing, no one can actually predict an exact turn of the market. We could, however, infer a busier second half of the year on the back of Q1 and Q2 '09 financials, as people gain visibility on the trading outlook for 2009.

Moerel: AlpInvest Partners believes that the following events need to take place before the standstill in the market can unlock: the uncertainties in the economic environment need to subside somewhat (i.e., no more events such as Lehman, AIG, etc.); it must become clear what the impact of the financial crisis on the real economy can be (i.e., revenues and margins are no longer "falling off a cliff"); net asset values of the underlying funds/portfolio companies need to stabilize (i.e., reflect the true value of companies today based on their current trading and future opportunities/threats); and sellers need to have realistic pricing expectations (i.e., reflecting future value rather than historic valuations). We believe that the market could unlock in 3Q/4Q '09.

Burdel: The volume of secondary transactions being closed at the moment is low because of wide bid-ask spreads. Asset valuation adjustments will certainly be necessary to ease this blockage, and these are already under way. But I believe the real trigger for greater activity in the secondary market will be the resumption of investment by primary market GPs. When this happens, capital calls to LPs will resume, which in its turn will dramatically increase their need for liquidity, as missing a capital call would ultimately lead to complete forfeiture of already invested capital in the partnership.

WPEC: When purchasing LP interests in today's market, how do you gain comfort around uncertainties such as falling valuations, the constantly changing economic outlook, and unstable or collapsing private equity firms? Moreover, how do you assign value to assets when general partners themselves are uncertain about the outlook of their portfolio companies?

Moerel: In light of all the uncertainties listed above, we have become very selective in pursuing transactions. First, we focus even more on quality assets and managers that we know well, i.e. with whom AlpInvest Partners has long-standing relationships through our fund investment program. Second, we concentrate our efforts on acquiring funds/portfolio companies which focus on industries less prone to big economic shocks, such as food, health care, telecoms and the like. Third, we have significantly increased our due diligence requirements, trying to better understand current trading, industry outlook, leverage structures and covenant risks, etc. Finally, we have increased our return requirements. This leads to fewer transactions completed, realistic investment base cases and lower purchase prices.

Wilson: As a firm we have been historically conservative in arriving at performance assumptions and exit valuations. Specifically, we have increased the minimum return threshold that we require from transactions given the current market outlook. That said, our due diligence requirements have remained constant. Only once we have a comprehensive view of a portfolio, its exit prospects, and hence our entry pricing will we deploy capital. The other key factor for us is experience. The 10 most senior investment professionals on our secondaries team have worked together for more than 11 years on average. Institutional memory, as well as experience in designing creative structures, is a critical factor in allowing us to transact in this challenging environment.

Burdel: It is true that the distribution of potential PE investment outcomes has widened. For many buyout investments made in the last three years, it's easy to envisage a scenario where the equity gets wiped out. That's a new reality. On the other hand, venture capital has always had more variable outcomes. As an experienced investor across all stages of investment, we are well used to evaluating a wide range of scenarios. In today's difficult climate, investment judgment will be key, of course, but it always is. Buying poor-quality assets or buying good assets at the wrong valuations was just as risky during the boom years. As we will see, it is not only primary market GPs who will have burned fingers from the PE bull run.

WPEC: What types of secondary transactions are attractive to you right now? Which will be your initial focus?

Burdel: We actively look at a broad spectrum of investment opportunities from single LP positions to large portfolio deals, as well as complex direct or structured deals. Some transaction types have disappeared from the current market. Structured deals that involve third-party debt financing are essentially no longer an option. Stapled secondaries (i.e., acquisition of a secondary position in a fund combined with a primary commitment to a new fund of the same general partner) have vanished from the market.

Moerel: Today, the deal flow is tremendous, leading to significant choice and selection. As mentioned above, we focus on assets we know well, managed by relationship GPs and with attractive return characteristics. In today's market, it is possible to acquire attractive diversified portfolios at realistic prices. However, we tend to pick and choose specific fund interests which meet our requirements rather than bid for entire portfolios, specifically when these include assets that are less attractive to us. We continue to pursue more complex transactions, such as stapled secondaries, secondary direct transactions and more structured transactions, if such transactions meet our requirements and offer attractive returns.

Wilson: As stated above, it is critical to remain opportunistic and creative in getting deals done. This requires a broader range of analytical skills than in previous cycles, and we will look to bring those talents to bear in completing more structured deals in the next 12 to 18 months.

WPEC: How do you think the secondaries industry will change given the large amounts of dry powder available and the expected large fund-raisings in the near future?

Wilson: Notwithstanding the amount of dry powder available and prospective fund-raisings, our experience in 2008 — and our estimates for 2009-2011 — is that there will be meaningfully more secondary assets available for sale than capital available to purchase them. This structural imbalance serves as a foundation stone for the potentially lucrative returns that the best secondary firms should be able to deliver to investors in the future.

Burdel: Secondaries will play a key role in helping the private equity market adjust to new economic realities, just as private equity itself will be an essential component in the recovery of the overall business landscape. The current environment is exacerbating investors' need for flexibility and liquidity, since many LPs are heavily committed, distributions have been reduced to a trickle, and holding periods for PE investments are getting longer. These dynamics mean that secondaries opportunity will easily accommodate the capital currently available in the market.

Moerel: Although I agree with Pete and Sebastien that there is a "buyer's market," at least for the next 12 to 24 months, we should all draw lessons from the 2006-2008 buyout fund-raising and buyout excesses. Specifically, being one of the few bright spots in the private equity market today, investment discipline, adherence to target returns and due diligence are more important in secondaries transactions than ever. Inevitably, the secondaries market is and will keep attracting new players. Experience, counterparty trust and relentless focus on quality will improve the position of players like AlpInvest even further.

WPEC: Where do you see returns of the secondaries industry going both in the short and long term?

Burdel: Some secondaries funds of recent vintages will show significantly lower returns than their investors expected because they were invested at the top of the market. In other words, they will have participated too strongly in the buyout bubble. Secondaries' managers who retain investor confidence and are, therefore, able to continue raising money will find attractive opportunities over the next few years.

Moerel: Pricing in the secondaries market is somewhat dynamic over time: It is dependent on supply vs. demand, economic outlook and levels of seller distress. In 2008, we have seen a significant recalibration of these three factors, leading to increased risk and hence a need for higher returns. Today, buyers are seeking returns approximately 25% to 35% higher than 12 months ago for similar transactions. More complex transactions generally command higher returns. We believe that as long as the supply-demand imbalance and macroeconomic uncertainties continue to exist, which we project for at least another 18 to 24 months, these return targets will continue. Thereafter, we expect a gradual decline to the historic returns.

Wilson: Returns for deals completed in the last two years will inevitably see lower IRRs given longer duration and likely reduced exit multiples on asset sales. However, these deals could still generate money multiples at relatively attractive levels. Looking over the next two to three years, we believe that the return profile for secondary players should be excellent, given the confluence of attractive forces that characterize the current market.

WPEC: What do you see as the future role of secondaries in the private equity market?

Moerel: AlpInvest Partners continues to see a long-term potential for the secondaries market, beyond the expected growth in 2009 and 2010, which will be largely driven by distressed sellers (i.e., banks, endowments, family offices, listed private equity vehicles). Fundamentally, the secondaries market grows as a result of more commitments in the primary private equity market and increased acceptance of secondaries as a tool to provide investors in private equity funds with liquidity (i.e., a larger percentage of funds trades every year). We expect both these elements to provide for continued growth post-2010. Large systemic shocks such as the current financial crisis will continue to provide for periods of peak growth and tremendous opportunities for secondaries funds.

Wilson: The principal role of secondaries in the market is to provide short-term liquidity. The creation of a secondary market in which larger positions can change hands and where vendor LPs can adjust their weighting to the asset class will be the main benefits from the evolution of secondaries as an asset class. Moreover, as mentioned above, secondaries firms will play a significant part in the further restructuring of the buyout industry, similar to the role they played with the VC industry.

Burdel: Investors have committed a huge amount of money to PE in the last few years — some $2 trillion since 2002 — and they remain strongly committed to PE as an asset class. However, new economic realities mean that changes are required to PE portfolios. It's not only a matter of each portfolio's liquidity profile, but also of its asset allocation by geography, investment stage and even manager quality. The secondary market will allow LPs to manage all these factors far more quickly and proactively than they otherwise could, which will be important for maximizing overall portfolio returns. By offering liquidity solutions for highly illiquid assets, secondaries are improving the attractiveness of PE as an investable asset class.

India and China Offer Attractive Private Equity Opportunities, but Without Majority Control

Despite the recent wave of corporate scandals, severe declines in local stock markets from their peaks and a challenging regulatory environment, strong fundamentals in China and India continue to offer some highly attractive potential opportunities for prudent private equity (PE) investors.

But to succeed, PE investments must be carefully planned and fully supported with a regional presence able to identify attractive opportunities and understand emerging competitive threats to Western companies. To learn more about PE investment in this region, members of Wharton's Private Equity Club (WPEC) recently interviewed Dalip Pathak of Warburg Pincus and Alastair Gibbons of Bridgepoint Capital about their views on PE investing in today's transformed environment. Dalip Pathak heads Warburg Pincus' London office and is responsible for the firm's investment activities in Europe and India. Pathak is also a member of the Advisory Council of the Emerging Markets Private Equity Association in Washington, D.C. Alastair Gibbons is a partner at Bridgepoint Capital. He led Bridgepoint's United Kingdom business until 2001 and then its German business until 2006. He now focuses on Bridgepoint's business development and cross-border investments.

An edited transcript of the interview appears below.

WPEC: Following the recent scandals in emerging markets, such as Satyam in India, have PE firms re-evaluated their approaches to developing markets?

Dalip Pathak: The Satyam scandal in India is obviously very unfortunate. It was shocking both in terms of the fraud committed and equally in the length of time it took for the situation to be detected. It was also one of India's companies which was more exposed to international business and capital markets; hence, one would have expected higher standards of corporate behavior. This occurrence has obviously made investors more cautious and will make them more demanding in terms of transparency, which in any case is good.

> The country [India] has seen huge improvements in both capital markets regulation and in corporate governance.
>
> Dalip Pathak, Warburg Pincus' London office

However, one should remember that Satyam is not representative of Indian companies at large. With regard to India, since the opening of the economy in 1991, the country has seen huge improvements in both capital markets regulation and in corporate governance. In fact, based on my 10 years' experience in the Far East and six years' experience in Europe, I am convinced that the top-tier companies in India pursue high standards of corporate governance, judged by international benchmarks. Even some medium-size companies in India compare favorably with similar companies in industrialized countries. The reason for this is very simple: Medium-size companies in

India need to access capital markets because of the traditional shortage of private capital, whereas in other parts of the world, similar size companies are often privately or bank-funded and can get away with being less transparent.

The capital markets impose higher standards of governance on these Indian listed companies. Furthermore, Indian capital markets regulation today is of a high standard. However, while the regulations per se are of a high standard, enforcement has the potential to improve further. Despite this, Satyam and other scandals have happened. But incidents such as Enron, Madoff and Parmalat prove that scandals of this sort happen not just in Asia. Rational and long-term investors should no more shy away from Asia as a whole and India in particular due to Satyam than they should from the U.S. due to Enron or Madoff. It is understandable if they are more cautious, and that is only appropriate. But the inability to put the situation in perspective will be unfortunate both for India and for investors.

WPEC: Given the dramatic decline in Asian stock markets and in GDP across the region, how have you adapted your investment strategy? Have valuations and management styles adjusted to those new levels of growth?

Pathak: The decline in Asian stock markets has been sharper than that in the U.S. or the UK. These markets are inherently more volatile because they are not broad and deep, and their perceived risk is higher. That said, even at the peak of the current crisis it has been difficult to identify high-quality companies in India which one would consider "cheap buys." Whilst GDP growth in Asia is currently lower than in the past, in countries such as India and China, growth rates are still substantially positive, unlike the GDP contraction that we see in Europe.

My suspicion is that the decline in valuations goes beyond a mere reflection of the earnings potential of the corporate sector in Asia. Liquidity has been sucked out of Asian markets due to redemption pressures in industrialized economies, and in most cases, this has penalized valuations disproportionately to the earnings potential or prospects of companies. From a capital markets (as opposed to an economic) perspective, emerging market equities have historically been more volatile than developed economies' markets because the marginal dollar (i.e., the dollar which drives near-term volatility) is typically "high-velocity" capital. That is, investors who are seeking "growth at reasonable value" will reallocate capital to emerging markets when reasonable values are not achievable in the developed markets, which is what happened in the late 1990s and in the mid 2000s.

As emerging markets begin to correct, this capital can go back home quite abruptly, leaving the emerging markets without a bid. This is a typical "flight" cycle. What happened this time around is that volatility in developed markets exceeded any precedent experience, resulting not just in risk capital going back home, but in its total capital destruction. So the redemption and margin wave that struck hedge funds and most high-beta capital after Lehman's bankruptcy had a much more dramatic effect than during prior cycles. In fact, these precipitous declines in emerging market equities took place *despite* the underlying and relatively favorable fundamental performance of the economies, financial system and individual companies in the respective markets.

A key question now, since developed markets are still in significant disarray, is whether emerging markets (especially China and India, which both have different, but very attractive underpinnings for growth) can develop more advanced sources of capital, perhaps even internally. This is important because liquidity from foreign flows might be slower to return this time, yet there is a significant need for non-domestic savings, at least in India, to support the high levels of growth in the recent past. Management teams were slow to recognize the oncoming economic tsunami that hit in 2008. For example, there was a sense in India that the country was somewhat immune from the world crisis. Furthermore, the severity of the global crisis was underestimated. However, by November 2008, most Indian businessmen had recognized that India would not go untouched, and subsequently have been quick to reduce costs or take other measures appropriate to the situation.

WPEC: Do you think there will be a distressed cycle in Asia that mirrors the U.S.? What factors limit PE firms' ability to execute LBOs [leveraged buyouts] in Asia, and how will those evolve?

Pathak: LBOs in much of Asia are rare events. The reasons for this, particularly in India, are fairly straightforward. Most Indian banks, relative to international banks, have small balance sheets. There are strict central bank regulations restricting how much Indian banks can lend to any one company, and this ultimately controls the amount of debt that any one company can have on its balance sheet, making the whole concept of LBOs in India quite alien. Furthermore, Indian companies are typically founder-family owned or controlled, and Indian families are disinclined to forego control for financial gain, even if the company is not performing well, or if they can achieve "super-normal" gains by divesting.

In Asia, this is very much a cultural factor, and unless this attitude changes, it will be difficult for LBOs to thrive. In addition, most of Asia does not have the kind of bankruptcy laws that exist in the U.S. For this and for other cultural reasons, you do not come across Indian banks foreclosing on companies or assets. They are more inclined to try and reach settlement with borrowers. If this were not the case, we would probably see the kind of disposals and distressed asset sales that we see in the West.

As Asian economies, including India, develop, we are likely to see the emergence of bankruptcy laws, more M&A and LBOs. In fact it is believed that there is a high likelihood that post the April-May 2009 elections in India, bankruptcy laws could well be introduced. This is desirable because the current regime of regulation permits poor governance and inefficient use of capital. Worse still, it punishes the performance of well-managed, high-quality companies by keeping inefficient companies alive supported by government banks or even private banks.

The promulgation of bankruptcy laws will create a market for M&A and restructurings which currently, though not non-existent, is quite small. In conclusion, I think it is fair to say that the secular trend is for Asian economies, particularly India and China, to grow at significantly higher rates than the U.S. or economies in Europe. The road will be bumpy on occasion, because development is not a neat process. However, it is this very growth, together with occasional discontinuities, that will continue to create unusual profit opportunities.

WPEC: How relevant are developing markets, such as India and China, to PE firms traditionally focused on Europe?

Alastair Gibbons: The developing markets are becoming more relevant to PE equity firms with a European investing focus. In evaluating potential deals or portfolio company performance in Europe, it is important to understand how value is impacted by competitive threats to European companies from these markets and also the opportunities that are available in India and China from improved commercial sourcing.

A secondary opportunity to develop sales channels in those countries is also relevant, albeit much more difficult to achieve in practice. In the future, we also expect more activity from Chinese and Indian companies looking to acquire businesses in Europe. Consequently, as we consider exit opportunities, we will increasingly extend our net to Asia for prospective acquirers. As a middle-market European firm, we do not envisage setting up a local team in these countries to compete with local private equity firms for local deals in the near term. However, for the reasons mentioned above, we are likely to establish representative offices to add value to our portfolio companies.

WPEC: How have Western PE firms needed to adapt their investment styles for the Asian markets? Which specific markets are most appealing and why?

Gibbons: Western PE firms have had to accept that acquisition of majority stakes providing outright control is extremely difficult to achieve and, hence, have had to shift their strategy to holding sizable minority stakes. The degree of control afforded is necessarily less and [therefore] more time is spent on goal alignment and relationship building with the majority shareholder. The PE markets today are largely growth-capital rather than buyout oriented, and less leverage is available to be structured into deals. [This means that] a higher proportion of target returns must come from growth in earnings, either revenue-driven or cost- and efficiency-improvement-driven.

Regarding specific attractive markets, China and India are both interesting as they offer enormous scale, strong long-term growth, burgeoning development of a sizable consumer-oriented middle class, low cost and an increasingly educated labor force. Furthermore, PE markets in these countries are still relatively nascent. They also present massive challenges, not least of which are weak corporate governance regimes, unreliable judicial systems and regulatory regimes, plus widespread corruption. Overlay on to that markedly different cultures and a language barrier (for China) as well as an inadequate supply of well-trained or experienced managers, and we conclude that market entry must be carefully planned and staged.

Wharton Private Equity Review

Navigating the Challenges Ahead

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