Q1 2018 GLOBAL PRIVATE EQUITY UPDATE

2017 in Review

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Introduction

Private equity had a solid year globally in 2017. With significant capital to invest, and multiple types of financial investors looking to invest (from PE sponsors, family offices, pension plans, and the like), there was no shortage of investors looking for opportunities. However, high valuations, combined with a finite number of appropriate investment opportunities, meant that traditional LBO auction activity was generally mixed. As a result, financial investors spent time thinking "outside of the box" in terms of how to put capital to work.

With that backdrop, we look back on 2017 in terms of market activity, trends and developments across the U.S., Europe and Asia, and look ahead to 2018.

	United States	Europe	Asia
Overall deal market activity	PE deal activity generally solid, with limited quality targets and strong competition among buyers. Buyouts remain the main transaction type in the market, but sponsors are increasingly looking at other types of transactions to put capital to work.	Despite uncertain start to year, caused mainly by political uncertainty in Eurozone and ongoing developments surrounding Brexit, confidence in deal market has grown and activity has picked up, particularly in Eurozone and Nordics, with overall private equity buyout activity reaching its highest value and deal count since the financial crisis.	Like in U.S., PE deal activity generally solid, with limited quality targets and strong competition among buyers. Buyouts increasing but remain a relatively thin slice of overall market. Large Asia-based sponsors (many of whom have raised US$3+ billion funds) increasingly looking outside of Asia for deals.
Industries most active	Activity robust across many industries, including industrials, business services, financial services, healthcare, TMT and consumer.	Robust activity across many industries, with the highest levels reported in industrials and chemicals, consumer, energy, construction and	Consumer-related sectors are most active, including healthcare, financial services, education and TMT.

	United States	Europe	Asia
		financial services.	
Valuations	Valuations remain very high, especially for well-run companies in the upper middle market and large buyout areas. This remains a significant challenge for sponsors and continues to put pressure on returns. In addition to multiples being high, there is significant focus on the calculation of EBITDA, as sellers look to extract as much value as possible from buyers.	Competition for quality assets has become even more intense when compared to previous years, with EBITDA exit multiples continuing to move up on most competitive auctions. Buy-out sizes have increased as sponsors have started looking at larger targets and take-private deals.	Abundant dry powder, cheap debt financing and a relative scarcity of quality assets has resulted in strong competition among buyers and higher valuations.
Auction activity	Auctions are still the most prevalent process for deal activity. However, given high valuations and seller friendly deal terms, sponsors are spending more time on proprietary or alternative deals.	As in U.S., auctions are still the most prevalent process for deal activity but for same reasons, sponsors have begun focusing more efforts on proprietary or alternative deals.	Auctions are prevalent, particularly for larger deals and control deals of any size.
Auction dynamics	Auctions remain highly competitive. To be successful in an auction, a sponsor has to be prepared to sign a deal within days from the final bid date (if not on the same day as the final bid date, after pre-negotiating the purchase agreement). Pre-emptive bids are very common and proprietary deals often evolve into competitive auctions. Continuing to see rising participation in auctions by non-traditional PE players, such as sovereign wealth funds, pension plans and family offices. Sovereign wealth funds and pension plans that used to be co-investors or 50/50 partners are leading deals.	As in U.S., auctions remain highly competitive and sponsors must be prepared to sign deals quickly, with pre-emptive bids being common. Similar to U.S., we are continuing to see rising participation in European auctions by non-traditional PE players, such as sovereign wealth funds, government pension plans and family offices, many of whom have lower costs of capital. Sovereign wealth funds and pension plans are leading deals.	Auctions are highly competitive. Sponsors may attempt to pre-empt the process by pro-actively offering transaction insurance, full-equity backstop and limited conditionality and post-closing liability for the seller. Participants in auction process remain traditional PE players – typically do not include family offices, sovereign wealth funds and pension plans, who are more likely to participate in deals as co-investors.
Trends in purchase agreements	Purchase agreement terms remain very seller friendly. Generally, deals are structured as “walk away” or “public style” with no or very limited indemnification (in	As in U.S., purchase agreement terms remain very seller friendly. Accordingly, buyers generally accept relatively aggressive seller	Like in U.S., purchase agreement terms remain very seller friendly. Starting to see deals structured as “walk away” or “public style” with

	United States	Europe	Asia
	some deals a limited escrow of 1% or less) to support R&W insurance. There is limited conditionality, and significant focus on speed and timing, impacting marketing period discussion on financing and any other aspects of the documents that impact timing (increasing use of “inside date” rather than marketing period). Locked box structures are still not that common (but talked about more often), with the traditional purchase price calculation still the preferred form. Although in private auctions have seen sellers be able to negotiate for fixed, per share purchase price like with a public company.	positions to get ahead in auctions, including shorter claim periods, lack of seller non-solicits, reduced scope of warranty cover and more extensive warranty limitations. There is also a key focus on deal certainty which has led to limited deal conditionality and, increasingly, buyers accepting reverse break fees (which were previously very rare in Europe). Unlike in the U.S., locked box structures remain the preferred approach for deals other than carve-outs. The use of R&W insurance (“warranty and indemnity” insurance in Europe) is common, with synthetic policies (with nominal seller liability caps as opposed to the more traditional warranty and indemnity insurance policies which have higher seller liability caps) becoming increasingly prevalent.	limited post-closing recourse against sellers and a sharp uptick in use of R&W (warranty and indemnity) insurance. Both locked box and traditional post-closing purchase price adjustment mechanism are common.
Status of debt financing markets	The debt financing markets remain strong, as high investor appetite, compared with a relatively limited supply of new issuances, has driven pricing downward and facilitated even more borrower-friendly documentary terms. In the new regulatory environment, industry observers anticipate a loosening of the government-driven leveraged lending guidelines, which will likely pave the way for more highly levered syndicated transactions.	2017 was a bumper year for leveraged loans, with European issuances growing 52% on the previous year – a post-crisis record. Continued low interest rates saw repricing of loans becoming a common feature of the market. 2018 has continued in a similar vein with a significant number of loans currently in syndication and with jumbo-sized financings becoming more common. We have also seen the increasing influence of alternative debt providers over the past few years and we expect they will continue to play an important	Markets generally liquid for the right credit. Tighter scrutiny on financings for outbound transactions from China. Trends vary widely depending on credit and jurisdiction.

	United States	Europe	Asia
		role in the next 12 months.	
Activity outside auctions	Sponsors are spending time on proprietary deals (which take longer to execute), more platform (or "buy-and-build") deals, carve-outs and minority investments. Sponsors continue to look at SPACs, as well as other asset classes (infrastructure, debt, special situations). Rollovers on exit are common.	As in U.S., sponsors are focusing more of their efforts on alternative deal types, such as proprietary transactions, different asset classes and "buy-and-build" platforms. In addition, rollovers on exit are also common.	Asia-based sponsors are looking at other asset classes (country-specific and special situations). Carve-out deals have been prevalent in China, Korea and Japan.
Fund-raising environment	The private equity fundraising market continued to be robust in 2017, with over $400 billion raised worldwide. While limited partners are seemingly concerned about the volume of dry powder and high valuations, we nonetheless expect the fundraising pace to continue to be impressive in 2018 given early indications and reporting of limited partner allocations.	Private equity fundraising hit an all-time high in 2017, with a number of firms raising their largest ever funds dedicated to PE.	A number of global and Asia-based funds have recently raised very large buyout funds in record time (e.g., KKR raised US$9.3 billion for its third Asia fund in 2017).
Other trends and developments in 2017	Starting to see more consortium deals among sponsors. As sponsors look for new angles, sponsors have looked to partner with strategics on some deals. Seeing some rollovers on exit (where exiting sponsors retain a minority stake). Tax reform enacted late in 2017 (see our blog for more information). R&W insurance remains a highly common tool.	Starting to see more consortium deals among sponsors. Increasing popularity of "buy-and-build strategies". Rollovers on exit remain common. Warranty and indemnity insurance remains a highly common tool.	Like in U.S., starting to see more consortium deals among sponsors. Sometimes see sponsors partnering with strategics. Increasing use of transaction insurance. Larger and more complicated buyout deals.
Overall outlook for 2018	More of the same – expect valuations to remain high, and overall deal activity to be similar to 2017. Time will tell how the new tax legislation will impact deal activity.	Expect market to be similar to 2017. Valuations are expected to remain high (and potentially grow). Uncertainty around Brexit will continue to be a factor in UK deals.	Expect valuations to remain high, and overall deal activity to be similar to, or stronger than, 2017. Expect continued global sourcing from Asia-based PE funds.

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