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Looking for the Bright Spots for Private Equity in 2014

The U.S., European, and Japanese economies continue to outperform expectations this year while many emerging market economies continue to disappoint. This is not a surprise because many emerging markets are heavily dependent on exports for growth, and international trade has not yet fully recovered from the effects of the “Great Recession.” Even though the major advanced economies have recovered, they are still performing below historic growth levels, which means their imports from emerging market economies are growing less rapidly. Nevertheless, there are many potential bright spots that could drive investment and growth to higher levels.

Change creates not only uncertainties but also opportunities. A large number of fundamental changes are impacting all asset classes, including private equity (PE). One of the most important is rapidly changing technology, which is affecting almost every aspect of life and society, including the roles of women and men. The resulting career path changes in the workplace and higher required education levels are a major effect. Mobile and easy access to advanced forms of almost all types of information is increasingly possible. Energy sources and usage, telecommunications, transportation, manufacturing, medicine and healthcare, commodities, agriculture and food, and an aging population are only a few of the global areas where change presents new opportunities. Private equity is at the forefront of this “competitive recreation” (not destruction) of our world.

As we can see in the market snapshot at the back of this issue, private equity continues to sort through these dynamic uncertainties to identify viable future trends and new ventures or company opportunities in which to invest as their fundraising and accumulation of “dry powder” continues to build.

This issue of *The Journal of Private Equity* explores some of these potential opportunities in terms of industry, management actions, and different areas of the world. David Haarmeyer, in the lead article, “Global Energy: The Private Equity Opportunity of the Century,” explores the PE and infrastructure opportunities and drivers across the oil, gas, and power sectors. He concludes that the opportunity is global, is unfolding in developing and developed countries, is reverberating across entire value chains, and is massive—a multi-decade, multi-trillion dollar endeavor.

Manu Sharma and Gunwant Singh Saini, in “Performance Indicators for Global Buyout and Global Growth Equity Funds,” examine the

leading macro signals of opportunities. They study the relationship between return on global buyout and global growth indices and returns for equity indices of major world economies as well as the U.S. GDP. They observe a clear pattern in terms of predictors of global buyout indices (U.S. and ex U.S.; U.S. only), global growth and buyout indices (U.S. and ex U.S.; U.S. only), whereas the results for the global growth index (U.S. and ex U.S.) suggest that for growth equity investments the returns are dependent more on the ability of PE investors to identify the lucrative investments rather than on such explanatory variables as the U.S. GDP, S&P 500, GSPSC, DAX, FTSE, or CAC 40.

Antonio Meles, Claudio Porzio, and Vincenzo Verdoliva in their article “Mala Tempora Currunt: How Do PE-Backed Firms React to Financial Crises?” investigate how private equity backing has influenced the operating performance of firms (primarily in terms of ROA and ROE) during the recent financial crises (2006–2010). Despite the fact that the recent financial crisis had a negative effect on the operating performance of both PE-backed and non-PE-backed firms, they find strong evidence that the former have a greater ability to withstand turbulent economic environments.

Paul Edwards and Robert Costa contribute “Evolving Business Information Systems (BIS) Usage in Asset-Intensive Industries: What to Look for as an Investor.” Business information systems solutions to asset-intensive industries, such as industrial/manufacturing, transportation/logistics, and energy, have a lot of allure for private equity and other investors these days. Companies in these industries have been slow relative to many others in adopting BIS solutions, but they are racing to catch up as they have had to fight harder for every bit of incremental profit. Once buyers do pick solutions, however, they tend not to change out often. As attractive as this kind of rising demand and brand loyalty may sound from an investment perspective, the solutions these companies are buying have changed markedly over the past several years.

Mark Nuijten and Marja Pronk, in “Financial Valuation Algorithm for the Assessment of the Future Sales of a New, Innovative Medicinal Product,” analyze new and emerging requirements by reimbursement authorities and payers and policy changes that are increasingly

going to determine the actual future sales and also the actual post-launch costs of new, innovative medicinal products. Because the future financial performance of a pharmaceutical company is directly related to the revenues of new products, an appropriate assessment of the potential sales forecast of the portfolio of forthcoming new products is an important predictor of the financial value of a pharmaceutical company. This article presents a financial valuation algorithm for the assessment of the futures sales of a new, innovative medicinal product based on current reimbursement policies and future business models for reimbursement.

Adrian Oberli examines the topic of “Private Equity in Emerging Markets: Drivers in Asia Compared with Developed Countries.” There are interesting structural differences in PE fundraising in Asia compared with developed markets. Exit opportunities and the amount of credit provided by the banking sector are found to be strong determinants of new funds raised. Unlike in developed markets, emerging markets are negatively affected by the amount of credit provided by the banking sector. Funding of transactions stands in direct competition with banks in these markets. Consequently, in emerging markets, PE transactions use less leverage.

Although we have often heard about PE opportunities in Asia, Gabriel Rosado Iturralde identifies the current situation in “Private Equity in Latin America.” Private equity is increasing its presence in emerging markets because developed countries have more barriers to entry because they are more crowded by funds looking for returns. However, with the new economic outlook and stability of the Latin America region, both politically and economically, countries have begun to show promising and sustainable growth, attracting the attention of several venture capital and private equity funds. Opportunities to invest in high-quality, private companies have increased, supported by socio-economic trends that have allowed millions of people to become part of the middle class, thus activating the economy and raising the quality of the enterprises. The author analyzes the private equity outlook and opportunities in the principal countries in Latin America.

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