The Globalization Of Private Equity

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The History And Evolution Of Private Equity

- Early Days -- Venture Capital
  - 1960s - small funds, mostly U.S. based
  - Unique compensation scheme
    - 1% fee and 20% of profits
  - Relatively small investor base
    - High net worth families and individuals
    - Insurance companies
- Private equity was initially limited to a firm’s own country
  - The first VC funds in Silicon Valley (1960’s), thought of themselves as local businesses
The History And Evolution of Private Equity
*Early Days In The 1970s*

- “Bootstrap” deals, mostly in the US
- Novel concept
- Early investors
  - Banks, Insurance companies, high net worth families & individuals
- Late 1970s
  - Private equity funds tended to focus only on U.S. deals
  - First funds typically used venture capital model
- At this point, the globalization really began, with LPs beginning to invest with local private equity firms in other countries
The History And Evolution of Private Equity

*Development in the 1980s*

- “Leveraged buyouts"
- Returns were extremely high; Few competitors
- High-yield financing spurred many investments—some unfriendly
- Public companies taken private
- Pension funds allowed to invest, became biggest source of capital
- A number of U.S.-based firms began investing outside the U.S.
  - Why? Less competition, American hubris, “grass is greener” concept
The History And Evolution of Private Equity

Expansion in the 1990s

- “Management buyouts”
  - Mostly friendly transactions
- Accepted as safety valve
  - Able to make companies--and economies--more efficient
- Gigantic expansion of lender base
  - Banks and specialized lending vehicles
- Explosion of investor base
  - High net worth families and individuals
  - International investors
  - Corporate pension funds
  - Global banks
- Expansion to Europe, Asia and Latin America
Private Equity Moves Into Europe

- Early investors, 1970s and 80s
  - Warburg, Advent, JP Morgan, AIG, Patricof
- Dedicated funds
  - Carlyle, Hicks Muse, KKR, Bain
- Global funds
  - Blackstone, TPG, Clayton Dubilier, Apollo, Lee
- Now all of major U.S. firms are active in Europe
- Significant portion of money for European firms comes from outside of Europe (mostly in the U.S.)
Private Equity Moves Into Asia

- Initially more resistant to private equity than Europe
- Private equity typically took on a venture capital or non-controlling-stake form - this remains true in many areas
- Early firms were either local or larger organizations with other primary businesses (HSBC, Prudential)
- The 1997 Currency Crisis provided need for capital; more American & European firms became involved
  - Carlyle
  - JP Morgan
  - Newbridge
  - Warburg Pincus
  - CVC
Private Equity Moves Into Japan

- Extremely resistant to foreign capital and foreign presence
- 1970s - 90s nearly all private equity investing was local (Japanese banks or brokerage companies)
- Shinsei Bank transaction
  - Ripplewood Holdings acquired the company in 1999, made $2.3 billion in 2003 IPO
  - Helped to usher in a period of significant foreign private equity activity in the country
- Early 2000s - independent Japanese firms arose; Ripplewood, Carlyle, Warburg, Morgan
Private Equity Moves Into Latin America

- Local private equity investing in 1970s - 90s
- In the 1990s outside firms began investing
  - Newbridge
  - Morgan
  - Advent
  - Barings
  - Hicks Muse
- Bust of 2000 scared many investors and firms away
- More firms became interested in Brazil in late 2000s
The History And Evolution Of Private Equity

Spectacular Growth In the 2000s

Global Deal Value
($ in billions)

2Q 07 Value: $315 billion

Source: Thomson Reuters, October 2010
Note: Represents sponsor-entry transactions
The History And Evolution Of Private Equity
Spectacular Growth In the 2000s

Global Private Equity Fundraising
($ in billions)

Source: Preqin, October 2010
The Impact Of The Great Recession

- Completed deal activity fell by nearly 95%
- Average deal size fell by 60%; large deals virtually disappeared
- Fundraising activity fell 77%
- Distributions to LPs fell 93%

Sources: Thomson Reuters, October 2010; S&P Leveraged Commentary Data, as of October 2010; Preqin, October 2010; Thomson Venture Economics, as of October 2010
The Impact Of The Great Recession

Global Deal Value ($ in billions)

2Q '07 - 1Q '09: Declined 95%

Source: Thomson Reuters, October 2010
Note: Represents sponsor-entry transactions
The Impact Of The Great Recession

Global Private Equity Fundraising
($ in billions)

Source: Preqin, October 2010
Dire Predictions Made During The Great Recession

- Many large portfolio bankruptcies would arise
- Large employee layoffs would occur in those bankrupt companies
- Major private equity firms would implode
- Private equity industry would shrink dramatically
- Major LPs would default on commitments and abandon the asset class
- Major LPs would sell their fund commitments on the secondary markets—flooding that market
What Really Happened

- Comparatively few bankruptcies occurred
  - None of the top 20 largest buyouts went bankrupt
- No major private equity firm imploded; relatively few shrank in size
- Layoffs tended to be less in PE-backed companies than in non-PE companies
- Relatively few institutional LPs defaulted; none appear to have abandoned the asset class
- Major LPs sold comparatively few of their private equity commitments
- Secondary markets did not see the level of anticipated activity

Source: Private Equity & Growth Capital Council, May 2010; Cogent Partners, January 2010
Increased Private Equity Deal Flow

- New deal activity has increased from 2009 lows

Global Private Equity Transaction Value
($ in billions)

Q1 09: $17
Q2 09: $18
Q3 09: $36
Q4 09: $50
Q1 10: $63
Q2 10: $45
Q3 10: $71

Source: Thomson Reuters, 10/10
Avenues For Exit Have Improved

- IPOs & other avenues of exit are available again

US IPO Market Volume
(Number of IPO Filings)

- Q1 09: 2
- Q2 09: 12
- Q3 09: 20
- Q4 09: 35
- Q1 10: 27
- Q2 10: 40
- Q3 10: 32

Source: PricewaterhouseCoopers, 10/10

Global PE Transaction Exits
($ in billions)

- Q1 09: $6
- Q2 09: $22
- Q3 09: $27
- Q4 09: $33
- Q1 10: $38
- Q2 10: $61
- Q3 10: $60

Source: Dealogic, as of 10/28/10
The Other Result Of The Great Recession… Increased Emphasis on Emerging Markets

- By and large, the global financial crisis had a less severe impact on foreign markets, particularly the largest
  - China
  - Brazil
  - India
- As a result, private equity firms began to shift their focus to these markets
  - New fundraising efforts
  - Advent of local currency funds (RMB funds in China)
  - More investing in foreign markets
The Globalization Of The Industry

- This trend is evident in the overall allocation of PE deals
  - In 1995, 22% of deal volume was in the U.S. or UK
  - By 2009, this figure had risen to 56%

1995 Allocation by Target Nationality

- Non-US or UK Deals: 22%
- US or UK Deals: 78%

2009 Allocation by Target Nationality

- Non-US or UK Deals: 56%
- US or UK Deals: 44%

Sources: Dealogic, Sponsor Analytics, data for sponsor-entry transactions, accessed October 28, 2010
Note: Allocation percentages referenced above based on aggregate deal value of completed transactions in the periods presented above
The Carlyle Group

- One of the largest global alternative asset managers with more than $97 billion in AUM committed to 77 funds

**Private Equity**
- Largest, most established segment
- Buyout & Growth Equity
- Most diversified global buyout operation in the industry with 27 offices
- 23 global funds with $65 billion in AUM

**Credit Alternatives**
- Invests in bank loans, leveraged finance bonds, distressed assets, and mezzanine
- Global reach with offices in New York, Washington D.C., Los Angeles and London

**Real Estate**
- Invests in offices, hotels, retail, residential, multi-residential, & senior living properties, as well as, securitized mortgage products
- Single asset focus
- Local market expertise

Note: As of September 30, 2010.
The Carlyle Group - International Presence

North America:
- Offices: 5
- Funds:
  - Buyouts
  - Growth Capital
  - Energy & Power
  - Real Estate
  - Structured Credit
  - Mezzanine
  - Distressed Situations
  - Infrastructure

Europe:
- Offices: 9
- Funds:
  - Buyouts
  - Growth Capital
  - Real Estate
  - Structured Credit
  - Mezzanine
  - Distressed Situations

Asia:
- Offices: 8
- Funds:
  - Buyouts
  - Growth Capital
  - Real Estate

Middle East/North Africa:
- Offices: 4
- Fund:
  - Buyouts

South America:
- Office: 1
- Fund:
  - Buyouts

Note: As of June 30, 2010.
## Expanding to a Global Network

<table>
<thead>
<tr>
<th>Region</th>
<th>Office Year</th>
<th>Fund Year</th>
<th>Professionals</th>
<th>Funds</th>
<th>AUM</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Europe</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>2000</td>
<td>2003</td>
<td>22</td>
<td>2</td>
<td>$1.9 billion</td>
</tr>
<tr>
<td>Middle East</td>
<td>2005</td>
<td>2009</td>
<td>10</td>
<td>3</td>
<td>$500 million</td>
</tr>
<tr>
<td>South America</td>
<td>2007</td>
<td>2009</td>
<td>7</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Asia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>2000</td>
<td>2007</td>
<td>74</td>
<td>3</td>
<td></td>
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<td>74</td>
<td>3</td>
<td></td>
</tr>
</tbody>
</table>

Note: As of September 30, 2010; Inclusive of corporate deals only.
The Globalization of Carlyle

- Carlyle’s allocation to foreign markets has increased dramatically
  - From 12% in 1998 to 54% for new equity investments

1998 Allocation by Target Nation

- US Deals: 88%
- Non-US: 12%

2010 YTD Allocation by Target Region

- US Deals: 46%
- Non-US Deals: 54%

Sources: Carlyle internal data; all equity invested in new corporate transactions as of September 30, 2010
Managing A Global Firm

- Operating globally presents numerous challenges which general partners must face
  - Cultural differences
  - Different regulatory environments and tax laws
  - Ensuring consistency of products
  - Maintaining strong back-office
  - Different competitive landscape

- However, it also provides unique opportunities
  - Access to markets with strong economic growth
  - Markets with potentially less competition
  - Provides scale and diversity, both of which have become increasingly valuable
What It Takes To Be Successful In Foreign Markets

- Hire locals
- Understand local regulations and customs
- Have patience
- Become part of local business fabric, structure
- Recognize returns may not reward risk (relative to US)
- Enhance their due diligence
- Invest with track-record-proven firms
Managing Diverse Investment Environments

- Deals—and the factors which impact them—vary based on geography

<table>
<thead>
<tr>
<th>Developed Markets</th>
<th>Factor</th>
<th>Emerging Markets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Various</td>
<td>Type of Investment</td>
<td>Varies, primarily minority equity stakes</td>
</tr>
<tr>
<td>Common</td>
<td>Control</td>
<td>Rare</td>
</tr>
<tr>
<td>Commonly Used</td>
<td>Leverage</td>
<td>Rarely Used</td>
</tr>
<tr>
<td>Vary; 3-5 years normal</td>
<td>Holding Periods</td>
<td>Typically longer</td>
</tr>
<tr>
<td>Traditional</td>
<td>Exit Routes</td>
<td>Less Traditional</td>
</tr>
</tbody>
</table>
Emerging Market Example: China

- Due to its robust economic profile, China has become the most popular private equity market in the world.
- However, there are numerous factors which GPs must take into account when investing in this market:
  - Central government approval required for FDI projects greater than $300 million.
  - Investment in some industries restricted to local currency (RMB) or by citizens only.
  - Very rarely control investments; typically minority stake transactions & PIPE structures.

Experience In This Particular Market Is A Vital Component of a Successful Investment.
Carlyle’s Experience In China

- Long history of investing in the country
  - First deal in 2000; 41 dedicated investment professionals
  - 50 transactions to date totaling more than $3 billion in equity

- Three fund families that invest in China
  - Recent launch of two RMB-denominated funds

Carlyle’s Key Differentiators

- Several investments to bolster nutritional infrastructure
- Strong reputation for adding value to portfolio companies
- CAP committed $688 million to China deals in 2009-10

Representative China Investments\(^{(1)}\)

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*Note: As of June 30, 2010*
Key Challenges Facing Global Firms

1. Managing regulation - determining rules of the game
2. Managing growth in emerging markets
3. Effectively navigating the emerging competitive landscape
4. Avoiding constraints on foreign capital in emerging markets
5. Managing new and emergent sources of capital (sovereign wealth; private wealth)
6. Improving interaction with governments & other stakeholders
7. Continuing to generate real cash returns at appealing levels
8. Considering profit maximization in conjunction with other issues
9. Improving the industry’s image
10. Coping with fact that the industry’s activities are no longer “private”