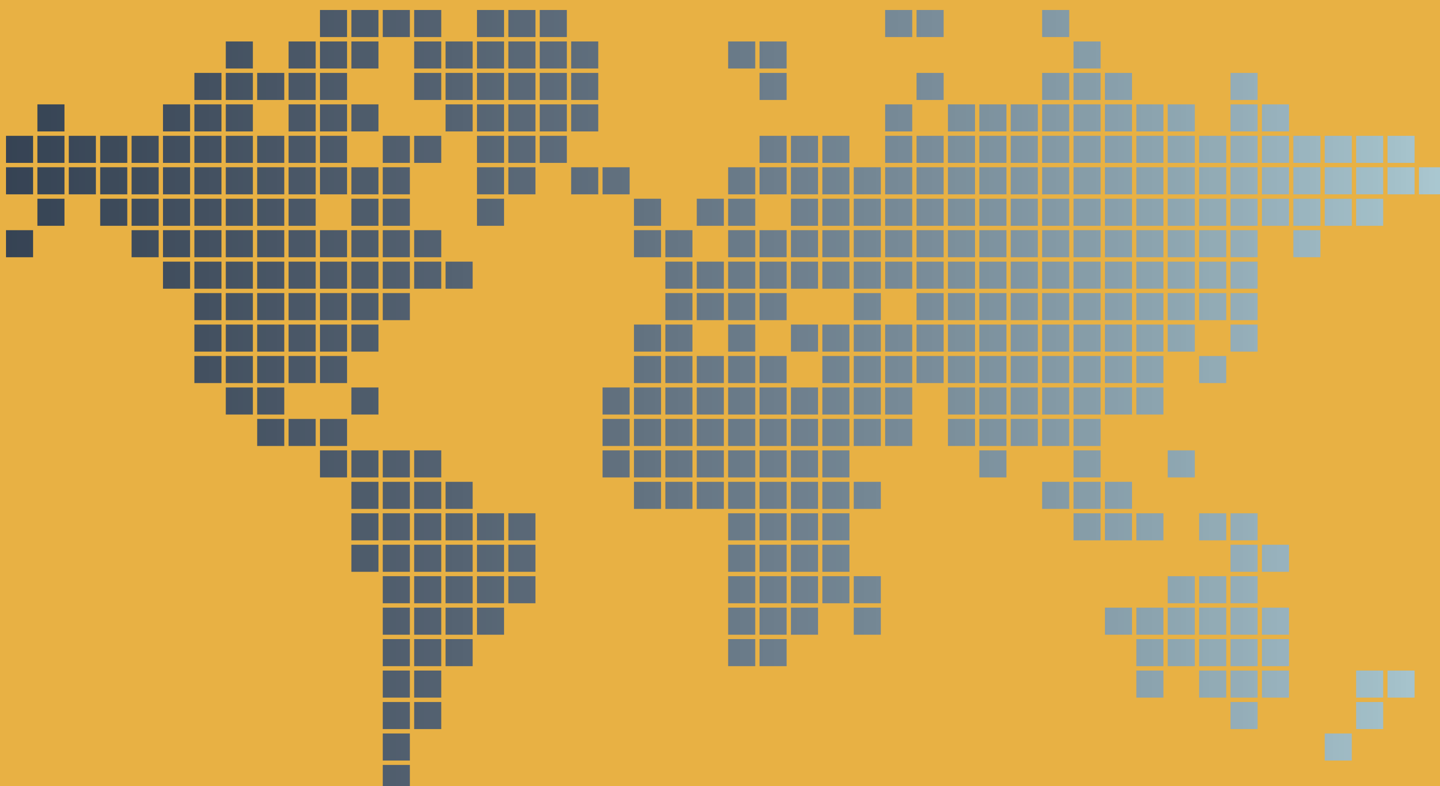
Global Limited Partners Survey

Investors' Views of Private Equity in Emerging Markets

2017



EMPEA

About EMPEA

EMPEA is the global industry association for private capital in emerging markets. We are an independent non-profit organization with over 300 member firms, comprising institutional investors, fund managers and industry advisors, who together manage more than US$1 trillion of assets and have offices in more than 100 countries across the globe. Our members share EMPEA's belief that private capital is a highly suited investment strategy in emerging markets, delivering attractive long-term investment returns and promoting the sustainable growth of companies and economies. We support our members through global authoritative intelligence, conferences, networking, education and advocacy.

Editor
Jeff Schlapinski, *Director, Research*

Lead Contributor
Rae Winborn, *Senior Research Analyst*

Contributors
Robert W. van Zwieten, *President & Chief Executive Officer*
Brady Jewett, *Senior Research Analyst*
Luke Moderhack, *Senior Research Analyst*
Isabelle Diop, *Research Analyst*
Kevin Horvath, *Research Analyst*

Production Assistance
Zelnar Zingale, LLC

EMPEA's Board of Directors

EMPEA

2600 Virginia Avenue NW • Suite 500 • Washington, DC 20037 USA
Phone: +1.202.333.8171 • Fax: +1.202.333.3162 • Web: empea.org

To learn more about EMPEA, or to request a membership application, please send an email to info@empea.net.

2017 Global Limited Partners Survey Executive Summary

The 13th annual edition of EMPEA's *Global Limited Partners Survey* features the views of 127 representatives from 106 limited partners (LPs) on the emerging markets private equity (EM PE) asset class. This study aims to provide the industry with a better understanding of how LPs' plans and strategies for investing are evolving, how they are accessing the asset class, what challenges they face in managing their portfolios, what their return expectations are and which geographies and sectors they view as attractive.

The institutions participating in the 2017 survey comprise public and private pension funds, family offices, endowments, foundations, banks, asset managers, insurance companies, government agencies, sovereign wealth funds, development finance institutions (DFIs), funds of funds and private markets advisors. These institutions are based in 34 different countries and collectively represent global PE assets under management (AUM) of approximately US$480 billion and total AUM of US$6.6 trillion. Additional details regarding survey respondents are available on page 16.

Key findings from the 2017 *Global Limited Partners Survey* include:

- Despite year-on-year declines in EM PE fundraising and investment activity in 2016, the majority of LP respondents* do not anticipate a drop in the dollar level of their new commitments to EM PE over the next two years. However, 25% of respondents* plan to decrease the proportion of their total PE allocation targeting emerging markets—up from 13% of LPs in the 2016 survey—suggesting that for some institutions, EM PE allocations may not be keeping pace with rising allocations to PE globally.

- More than half of LP respondents expect to form fewer than five new EM PE fund manager relationships in the next three years—in line with a global trend toward capital concentration and relationship consolidation. DFIs expect to form the most relationships, with 84% of respondents expecting to form five or more new relationships and 26% expecting 11 or more. Operational expertise in target sectors is the most important factor for LPs when evaluating new EM PE fund managers, with 61% of survey respondents considering operational expertise as very important.

- Two-thirds of LPs currently seek co-investment opportunities with EM PE funds, and over half expect to increase co-investment activities with EM PE funds over the next two years. While fewer LPs (43%) currently seek direct investment opportunities in EM-based companies, 35% plan to increase their direct, non-intermediated exposure over the next two years.

- India has endured dramatic swings in investor sentiment over the last decade, but the country now ranks as the most attractive emerging market for GP investment over the next 12 months, followed by Southeast Asia and Latin America (excl. Brazil), respectively. India ranked as low as ninth (out of ten) in the survey's market attractiveness rankings as recently as 2013. Of the 10 EM geographies included in the survey, the highest proportion of respondents (9%) plan to *begin* investing in Latin America (excl. Brazil) over the two years.

- Following a record year for investments, health care ranks as the most attractive sector in which to build exposure via EM PE for the second consecutive edition of the survey. Consumer goods and services, which accounted for the highest share of disclosed capital invested and deal count in emerging markets in 2016, follows health care in terms of sector attractiveness.

- Currency volatility and the lack of distributions from EM funds top investors' list of macro and fundamental portfolio concerns, followed by political risk in emerging markets. LPs were most likely to cite the stability of teams and personnel at investee GPs as a concern among institutional issues.

- Despite lingering investor concerns over distributions from EM PE funds, just 14% of respondents expect to sell EM PE fund interests in the secondary market over the next 12 months, while 26% expect to buy secondary EM PE fund interests over the same horizon. Of those who do expect to sell fund positions, 46% indicate that their EM PE fund positions are underperforming and unlikely to recover in the future, while 38% cite a change in investment policy or target allocation to EM PE as a reason for selling.

- EM PE portfolio performance has met or exceeded expectations for 69% of LPs surveyed. Return expectations globally continue to moderate: 43% of LPs expect returns of 16% or greater from 2016-vintage EM PE funds, down from 54% of LPs in last year's survey. For 2016-vintage developed markets-focused funds, just 17% of LPs expect returns of 16% or greater, compared to 27% the year prior. Respondents continue to expect the highest PE returns globally from funds focused on Emerging Asia and Latin America.

*Excludes institutions with EM-only mandates, including DFIs, EM-focused funds of funds and others legally mandated to invest in emerging markets.

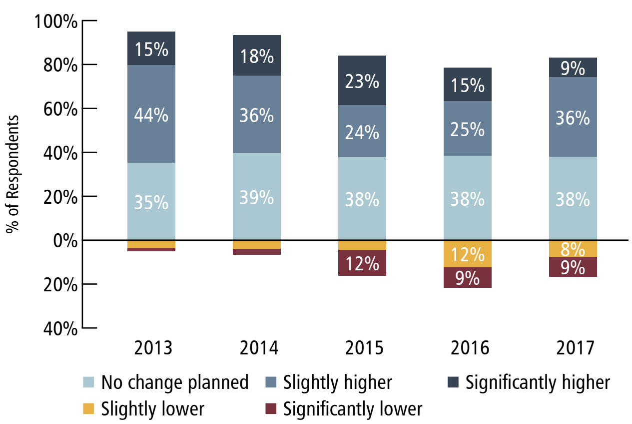
Dollar Level of New Commitments to EM PE Set to Rise, but More LPs Are Lowering Overall Allocation Levels

Despite year-on-year declines in EM PE fundraising and investment activity in 2016, the majority of LP respondents from EMPEA's 2017 *Global Limited Partners Survey*—excluding investors with EM-only mandates—anticipate maintaining or increasing the pace of their commitments to the asset class. While 38% of respondents plan to maintain the dollar level of EM PE commitments, in line with the previous three surveys, 45% of respondents expect to increase commitments compared to 40% in the 2016 LP Survey. Furthermore, the percentage of respondents planning to decrease the dollar level of EM PE commitments also dropped from 22% in 2016 to 17% in 2017.

For respondents indicating plans to increase the dollar level of new EM PE commitments or plans to begin investing in EM PE, a majority of respondents cite exposure to high-growth economies (61%) and greater geographic diversification (52%) as reasons for the change. More than a third of respondents also indicate that they expect EM PE to deliver high returns relative to other EM investment opportunities.

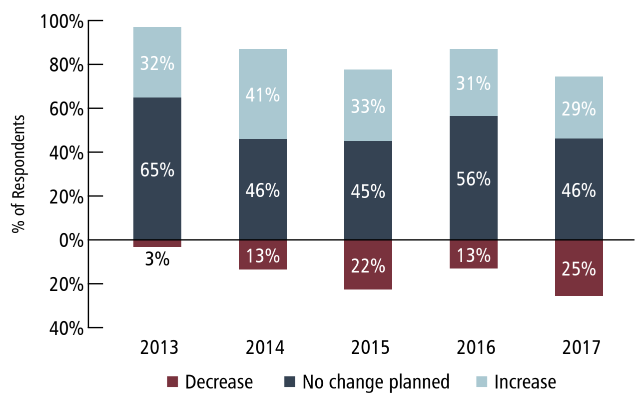
In contrast, among institutions planning to decrease the value of their new EM PE commitments, 55% indicate that EM PE returns have not met expectations, while 45% indicate that their institution has already met its portfolio goals for EM PE. Political instability and currency volatility tie as the third most-cited reason for declines in new EM PE commitments.

Exhibit 1: Anticipated Level of New Commitments to EM PE Funds Over the Next Two Years, 2013-2017*



*Excludes investors with EM-only mandates.

Exhibit 2: LPs' Planned Changes to Proportion of Total PE Allocation Targeted at EM PE Over the Next Two Years, 2013–2017*



*Excludes investors with EM-only mandates.

Exhibit 3: LPs' Reasons for Increasing or Decreasing Commitments to EM PE Funds Over the Next Two Years*

Rank	Top Reasons for Beginning/Increasing	% of Respondents
1	We are seeking increased exposure to high-growth economies	61%
2	We are seeking greater geographic diversification in our portfolio	52%
3	We expect EM PE to deliver high returns relative to other EM investment opportunities	36%

Rank	Top Reasons for Decreasing	% of Respondents
1	Returns have not met expectations	55%
2	We have met our portfolio goals for EM PE for now	45%
3=	Political instability is causing uncertainty over the future investment climate in emerging markets	36%
3=	Currency volatility	36%

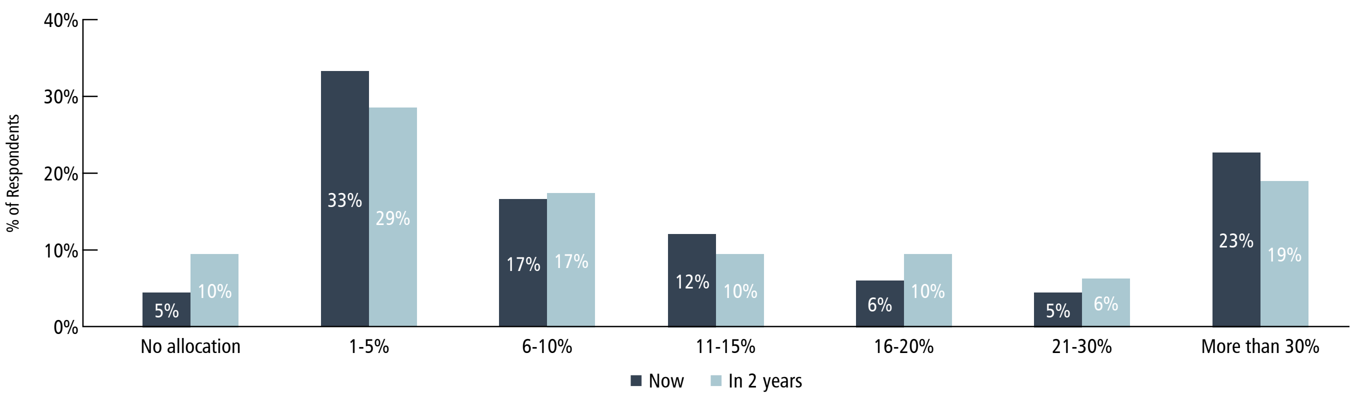
*Excludes investors with EM-only mandates.

A majority of investors plan to maintain or increase the proportion of their PE allocation targeted at emerging markets over the next two years. However, 25% of respondents plan to decrease the EM proportion of their global PE allocation, up from 13% of LPs in the 2016 survey. The contrast between stable or rising dollar commitment levels and falling EM allocations suggests that, at least for some institutions, EM PE commitment levels may not be keeping pace with a more rapid buildup in exposure to PE in developed markets.

Survey respondents with US$10 billion or more in global PE assets appear most likely to increase their EM PE allocation levels. In contrast, none of the survey respondents with PE assets under US$100 million plan to increase the proportion of their PE allocation directed at emerging markets. Given the time and resources cited by some LPs as necessary to invest in emerging markets (see page 12), this discrepancy between relatively small and large LPs is not surprising.

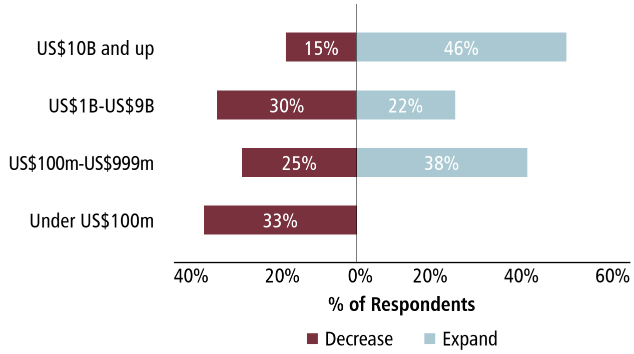
The EM PE experience levels of surveyed institutions also appear to be a determining factor in whether or not LPs plan to increase allocation levels. LPs with more than 10 years of experience investing in EM PE are more likely to increase the proportion of their PE allocation targeting emerging markets.

Exhibit 4: LPs' Proportion of Total PE Allocation Targeted at EM PE*



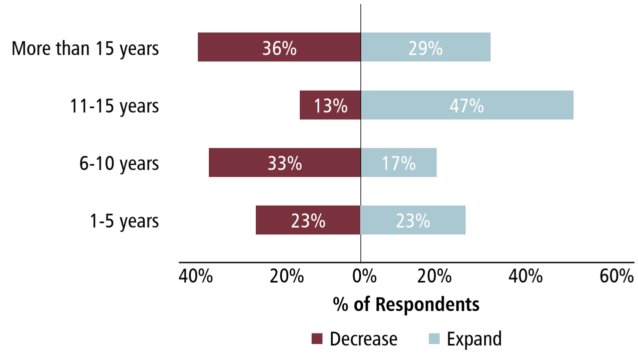
*Excludes investors with EM-only mandates.

Exhibit 5: LPs' Planned Changes to Proportion of Total PE Allocation Targeted at EM PE Over the Next Two Years – By PE Assets*



*Excludes investors with EM-only mandates.

Exhibit 6: LPs' Planned Changes to Proportion of Total PE Allocation Targeted at EM PE Over the Next Two Years – By EM PE Experience*



*Excludes investors with EM-only mandates.

LPs Opting for Fewer New GP Relationships for EM PE in Coming Years, Expanding Co-investing and Direct Investing Programs

More than half of LP respondents expect to form fewer than five new EM PE fund manager relationships in the next three years. DFIs expect to form the most relationships, with 84% of respondents expecting to form five or more new relationships and 26% expecting 11 or more. Conversely, excluding investors with EM-only mandates, 71% of institutions expect to form five or fewer new EM PE fund manager relationships. Pension funds may have deep pockets—the median pension fund respondent's AUM is US$44 billion—but 75% of respondents plan to cultivate fewer than five new EM PE fund manager relationships as they opt for fewer, deeper relationships through which they can deploy more capital.

Operational expertise in target sectors is the most important factor for LPs when evaluating an EM PE fund manager, with 61% of survey respondents considering operational expertise very important. Buyout strategies, which have grown in prominence in select emerging markets in recent years, arguably require deeper sector expertise than minority growth transactions, suggesting LPs' focus on operational skills at the GP level will only increase in years to come. The length of the working relationship among senior members of the GP team, which survey respondents viewed as the most important manager selection factor in the 2016 survey, was cited as very important by 55% of LPs (see page 12 for more on LP concerns regarding stability).

Exhibit 7: How Many New EM PE Fund Manager Relationships Do You Expect to Form in the Next 3 Years?

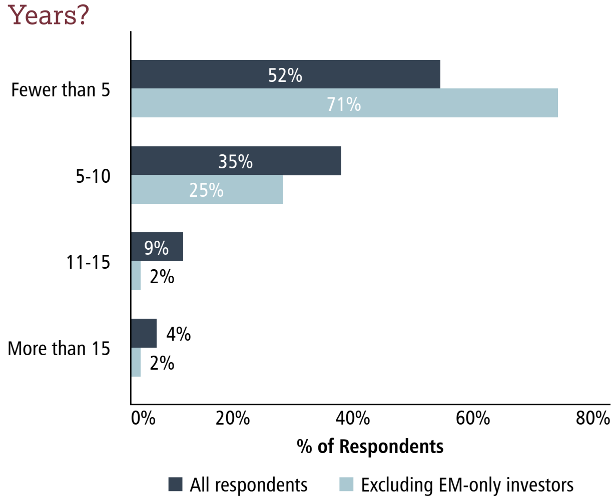


Exhibit 8: Would You Consider a Follow-on EM PE Fund Commitment Based Primarily on a GP's Local Currency Performance?

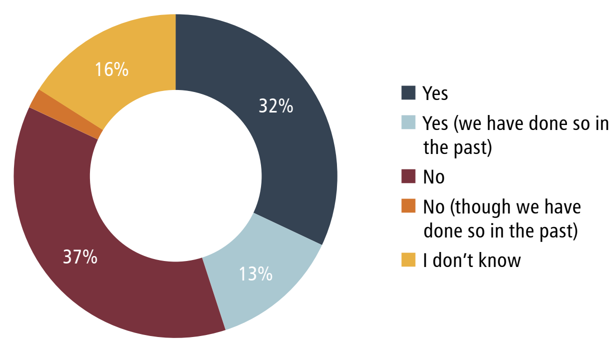
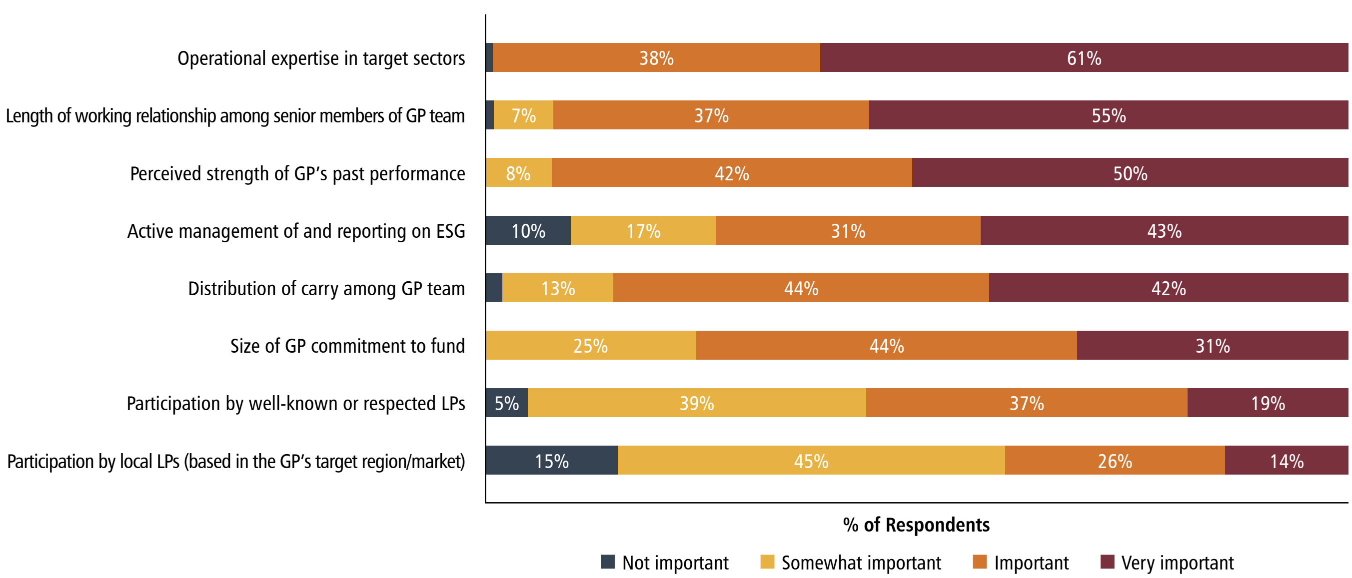


Exhibit 9: Important Factors in Evaluating an EM PE Fund Manager

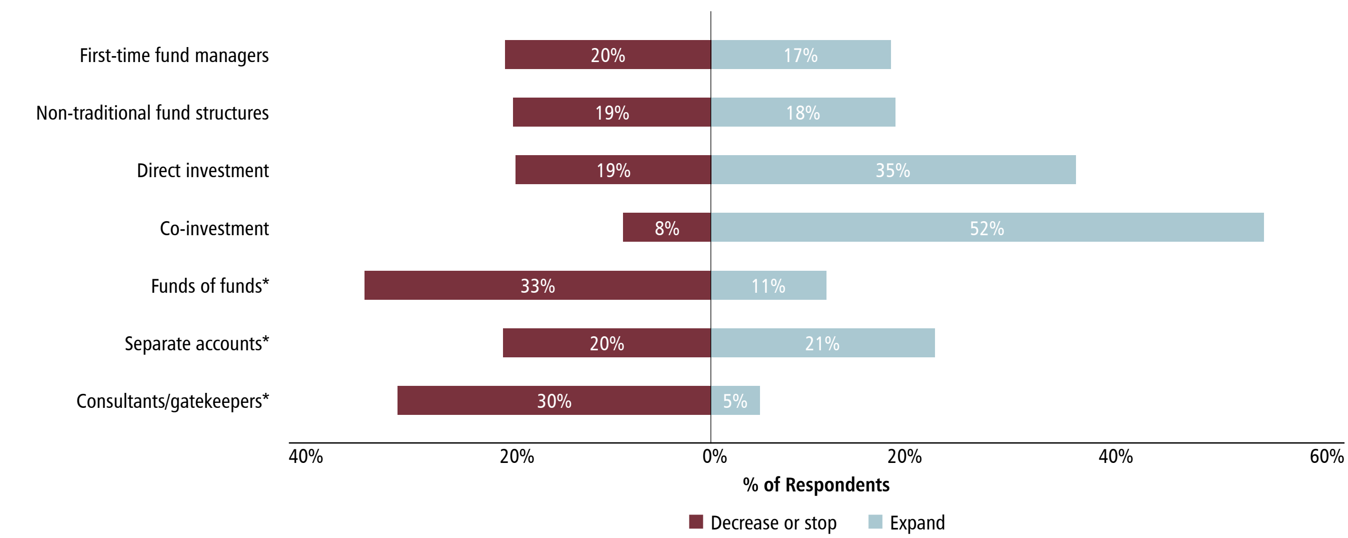


Half of survey respondents consider the strength of a GP's past performance as a very important factor in fund manager evaluation. However, the currency volatility experienced by many emerging markets in recent years has the potential to negatively distort many EM-focused fund managers' track records. On this front, nearly half of respondents (45%) indicate that they would consider a follow-on EM PE fund commitment based primarily on a GP's local currency performance, while 39% state that they would not.

LPs' means of accessing individual EM PE investment opportunities appear to be rapidly evolving, with more and more desiring additional flexibility and choice, as well as looking for ways to reduce fee drag. More than two-thirds of LPs surveyed seek co-investments with EM PE funds, and 52% of respondents plan to increase their exposure to co-investment opportunities over the next two years. A sizeable number of respondents, at least in some cases, forgo fund managers altogether, with 43% of respondents seeking direct investment opportunities in EM-based companies and 35% looking to increase this direct exposure in the future.

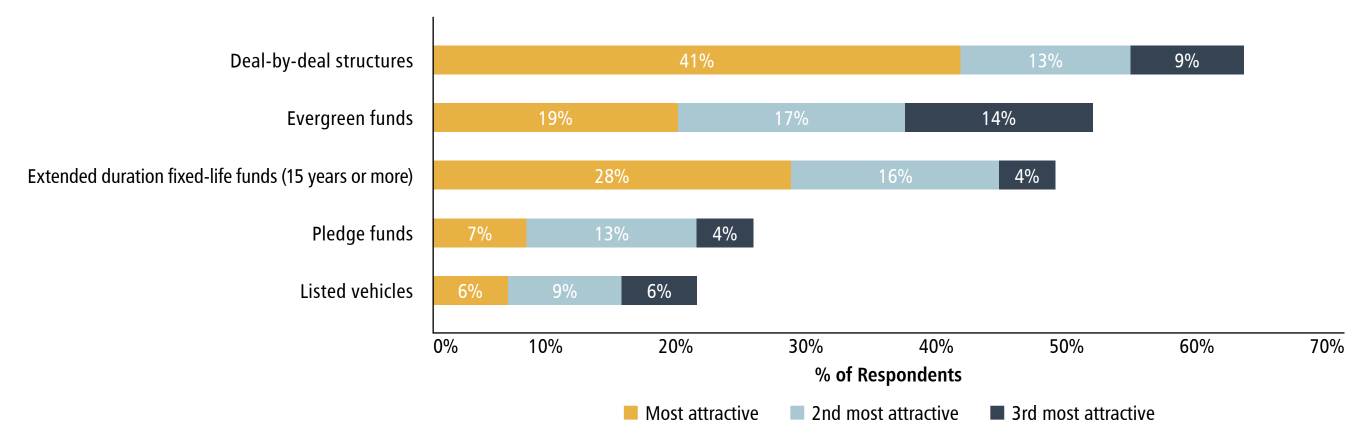
In addition to the increased emphasis on co-investing and direct investing, GP-led alternatives to the traditional fund model have become a mainstay in industry conversations. However, fewer LPs (18%) plan to increase their exposure to alternative structures in the next two years. Nearly two-thirds of respondents list deal-by-deal structures among their top-three most attractive options, with evergreen and extended-duration fixed-life funds following behind at 51% and 48%, respectively. If they take hold within the industry, longer-dated or evergreen funds may reduce pressure on fund managers to exit successful, profit-generating businesses and projects within a predefined timeframe.

Exhibit 10: LPs' Planned Changes to Their Means of Accessing EM PE Investment Opportunities Over the Next Two Years



*Excludes funds of funds and private markets advisors.

Exhibit 11: Attractiveness of Alternatives to the Traditional Fund Model



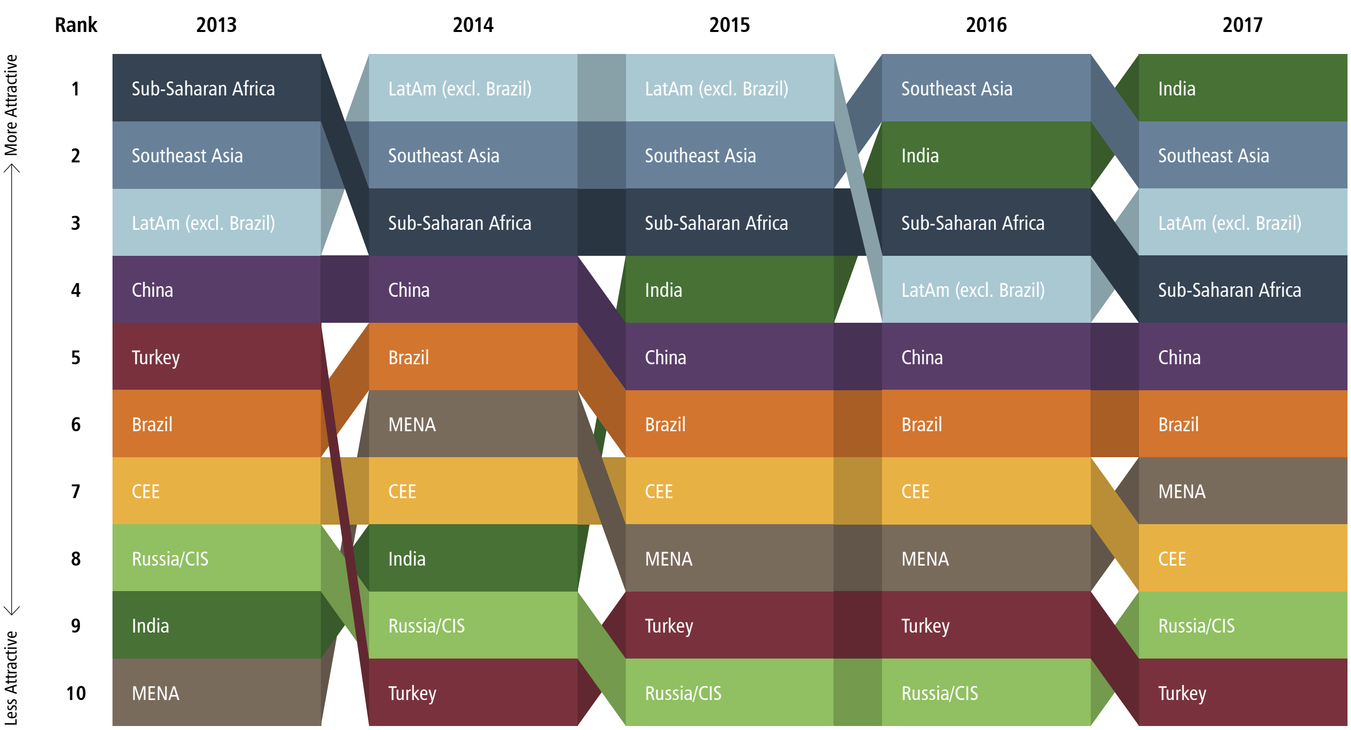
India Climbs to First Place in Market Attractiveness Ranking

The top three most attractive emerging markets for GP investment over the next 12 months have changed from the 2016 survey. After steadily climbing in the survey's attractiveness ranking over the past three years, India has finally secured the top spot as the most attractive emerging market for GP investment in 2017, with Southeast Asia falling to second place. Fundraising totals have reflected current LP sentiment: GPs raised US$4.7 billion and US$3.7 billion for India-focused private capital vehicles in 2015 and 2016, respectively—the highest annual totals since 2008.

Latin America (excl. Brazil) overtook Sub-Saharan Africa for third place in the attractiveness ranking after a steep drop from first to fourth place in 2016. This modest increase in ranking mirrors positive developments in the region. In 2016, disclosed private capital invested in Mexico nearly doubled 2015's total, and GPs completed 18 deals in Argentina, a record high.

Movement was limited further down in the rankings. China and Brazil both maintained their 2016 positions at fifth and sixth, respectively, while the Middle East and Central & Eastern Europe swapped places at seventh and eighth. Turkey fell below Russia/CIS into the tenth and last spot in the table, despite fund managers raising US$824 million for Turkey-focused funds in 2016, the highest total since 2012 when GPs collected US$2.0 billion. While the majority of survey respondents currently consider the market unattractive, Turkey's fundraising traction over the last year suggests a subset of investors retain confidence in the market's ability to deliver long-term returns.

Exhibit 12: The Attractiveness of Emerging Markets for GP Investment Over the Next 12 Months – LP Views



> "Latin America could become a great place to invest given company prices and recent market performance."
>
> *–DFI*

> "India is currently growing at more than 6%. Sound fundamentals, a reforming government and a strong entrepreneurial start-up environment are all factors that make the country attractive."
>
> *–Foundation*

LPs Most Likely to Expand Commitments in India and Southeast Asia

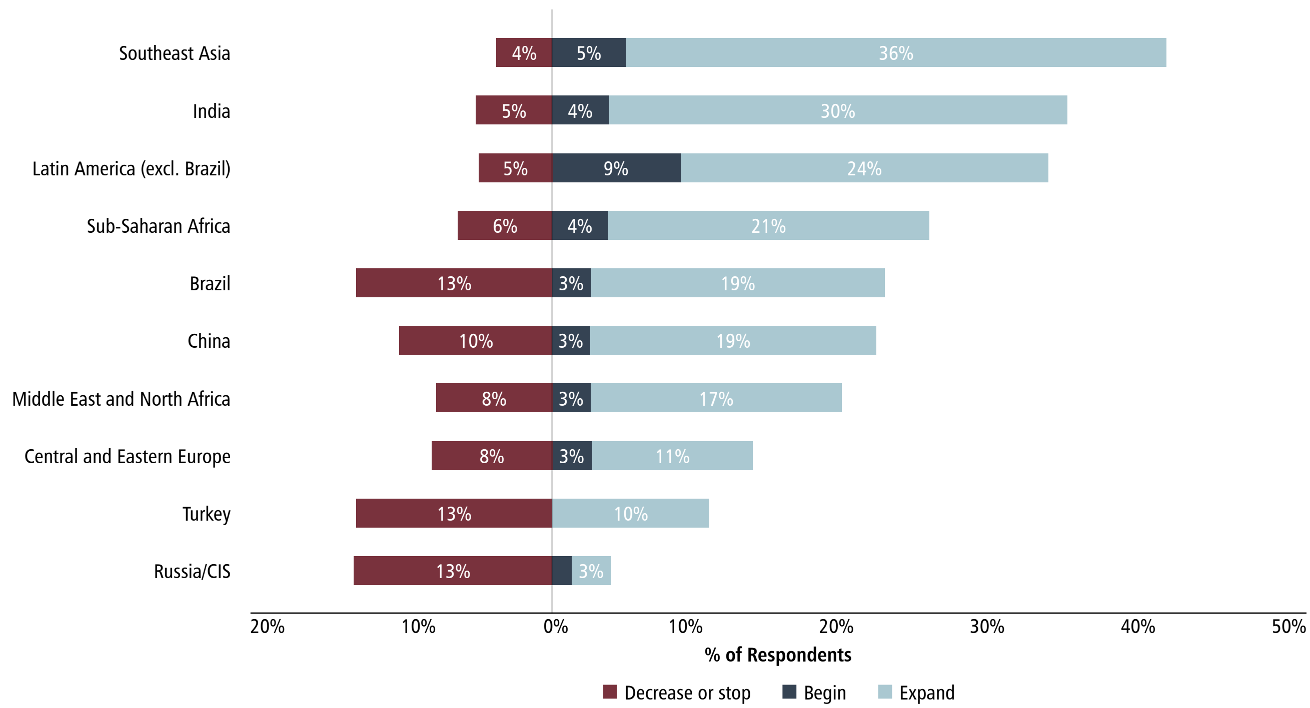
LPs' investment plans for emerging markets over the next two years closely follow each region or country's place in the market attractiveness ranking. For the second year in a row, the highest percentage of survey respondents plan to begin or expand investing in Southeast Asia and India. Furthermore, only 4% and 5% of respondents plan to decrease or stop investing these two markets, respectively. Yet a note of caution is called for. Though fundraising for India has increased in the past two years, fundraising totals for Southeast Asia-focused vehicles historically have not reflected investors' bullish plans and, with the exception of the VC segment, the region remains hampered by a limited number of established fund managers exclusively dedicated to Southeast Asian markets (see page 8). Together, these factors suggest LPs may be turning to larger pan-Asian GPs to access Southeast Asian opportunities.

Smaller markets, rather than large BRIC countries, appear most likely to attract new investors. Among respondents who plan to begin investing in a new region or country, Latin America (excl. Brazil) leads all other markets, followed by Southeast Asia.

Relative to the 2016 survey, only Brazil changed its comparative standing among all markets concerning LPs' future investment plans, jumping from seventh to fifth place. However, while 22% of LPs plan to begin investing or expand their commitments in Brazil, 13% plan to decrease or stop investing. Given the country's slow economic recovery, this mixed view among respondents may reflect lingering uncertainty regarding its near-term suitability for putting capital to work.

China garnered the largest share of survey respondents (35%) who plan to maintain the current level of their investments. Coupled with the country's continued substantial share of EM investment activity—26% of disclosed capital invested in 2016—it is evident the country has served as the first destination in emerging markets for many LPs as they have built global PE programs.

Exhibit 13: LPs' Planned Changes to Their EM PE Investment Strategy Over the Next Two Years



Political Risk and Currency Risk Most Likely to Deter LPs in CEE & CIS and Latin America, Respectively

While political and currency risk remain top of mind for most investors—in seven of the ten EM geographies included in the survey, LPs cite political and currency risk as the most likely deterrent to investing—these factors appear more prohibitive in some markets than others. Brazil and Latin America (excl. Brazil) received the largest share of respondents deterred by currency risk (53% and 48%, respectively), while Russia/CIS and Turkey received the highest percentage for political risk (78%). More than half of respondents also cited political risk as a deterrent in the Middle East and North Africa and Sub-Saharan Africa.

China and India stand out from other emerging markets in that competitive pressure and high entry valuations contribute to keeping some investors away. China also received the highest percentage of respondents citing challenging regulatory and tax issues as a deterrent to investing, reflecting ongoing policy interventions that have had an impact on the industry. While China and India fight off a reputation as oversaturated, many investors in Southeast Asia remain challenged by the perceived limited scale of the opportunity and dearth of established fund managers, which may be problematic given the increased number of investors who want to enter the region. Southeast Asia is not alone in this regard, as LPs also cited these factors for MENA and Sub-Saharan Africa.

More respondents cited historical performance and weak exit environments as deterrents to investing in India than for all other markets (with the exception of Central & Eastern Europe for performance). However, given India's top ranking in terms of market attractiveness and strong fundraising record in 2015 and 2016, it is clear that many LPs are ready to give the market a second chance.

Exhibit 14: Factors Likely to Deter LPs from Investing in Individual Emerging Markets/Regions Within the Next Two Years*

	Already at recommended exposure	Historical performance	Limited number of established fund managers	Oversupply of funds (too competitive)	Scale of opportunity to invest is too small	Entry valuations are too high	Weak exit environments	Challenging regulatory/tax issues	Prefer exposure via other asset classes	Political risk	Currency risk
China	29%	11%	7%	18%	2%	13%	20%	31%	13%	27%	20%
India	17%	20%	9%	20%	3%	11%	29%	17%	20%	11%	20%
Southeast Asia	7%	14%	32%	7%	25%	7%	21%	7%	21%	18%	29%
Russia/CIS	7%	18%	17%	2%	10%	2%	17%	18%	12%	78%	37%
Turkey	2%	14%	16%	-	14%	2%	10%	6%	14%	78%	42%
Central and Eastern Europe	9%	20%	24%	2%	20%	4%	20%	16%	20%	42%	24%
Brazil	19%	19%	17%	11%	11%	8%	22%	22%	14%	42%	53%
Latin America (excl. Brazil)	19%	16%	23%	-	19%	3%	19%	19%	16%	32%	48%
Middle East and North Africa	10%	15%	25%	5%	23%	5%	18%	15%	10%	58%	35%
Sub-Saharan Africa	13%	15%	26%	3%	21%	3%	18%	10%	8%	51%	44%

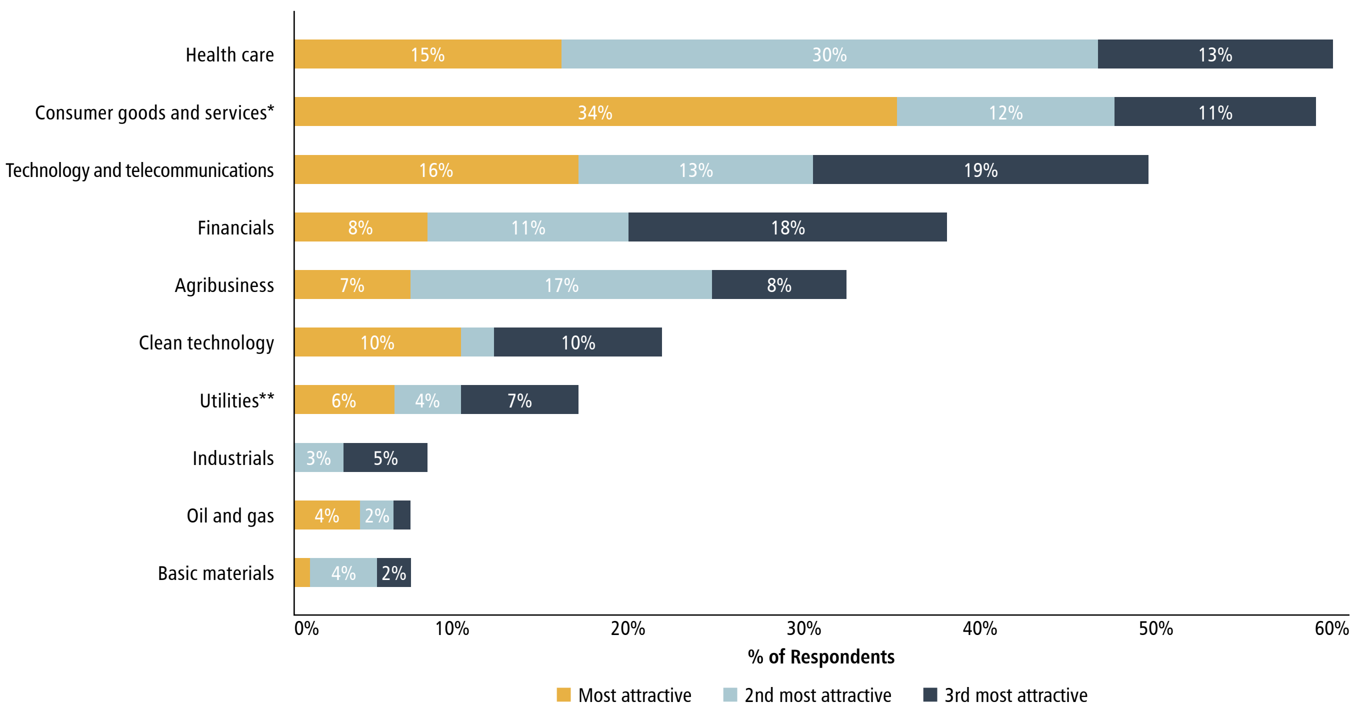
*Indicates percentage of respondents answering for each region/market.

LPs Continue to Find Health Care, Consumer Goods and Services Most Attractive

For the second consecutive year, LPs found health care and consumer goods and services to be the most attractive sectors in which to invest via EM PE in 2017. Health care ranked the highest, with 59% of respondents ranking health care as a one of the top three most attractive sectors. As explored in EMPEA's *Special Report: Private Equity and Health Care in Emerging Markets*, despite strong company valuations in the sector, the structural gap between health care supply and demand in many emerging markets could translate into significant opportunities for investors for decades to come. Health care deal activity has already risen substantially: fund managers completed 123 health care deals across emerging markets in 2016, the highest number of investments in the sector since EMPEA began reporting on investment activity in 2008.

While health care attracted the most top-three designations overall, a slightly higher percentage (34%) ranked consumer goods and services as the most attractive sector. According to EMPEA's *Industry Statistics*, consumer goods and services also consistently attracts the largest share of capital invested in emerging markets, with total capital invested reaching a record-high of US$14 billion in 2015, though it fell to US$8.4 billion in 2016.

Exhibit 15: Most Attractive Sectors in Which to Build Exposure via EM PE



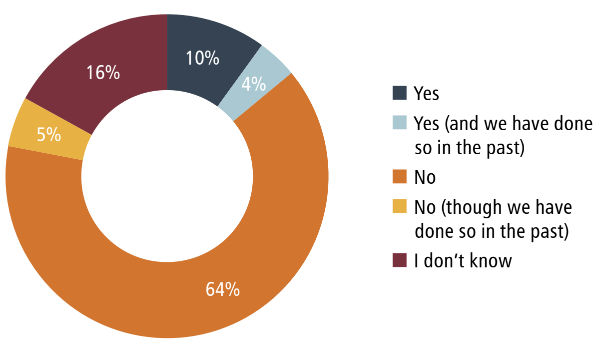
*Includes retail/e-commerce. **Includes water and electric power.

Few LPs Plan to Sell EM PE Fund Interests in the Secondary Market

According to the EMPEA *Brief: Alternative Paths to Liquidity*, distributions from EM private equity and venture capital funds that were raised in the lead-up to the Global Financial Crisis and subsequent recovery years have lagged behind those from their peers in developed markets. Indeed, 56% of LP respondents indicate a lack of exit activity and fund distributions as a top three concern among macro and fundamental investment management concerns (see page 12).

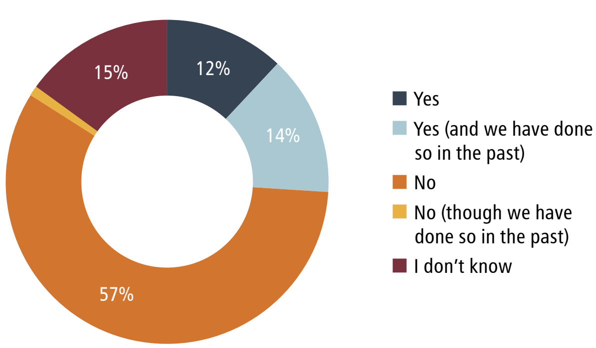
Thus, ostensibly, secondary transactions seem to hold the potential to provide needed liquidity for LPs. Yet when asked whether they were likely to sell EM PE fund interests in the secondary market over the next 12 months, just 14% of respondents indicate that they would. Moreover, this finding holds even when investors with EM-only mandates are excluded from the sample (16% of this subset plan to sell). Overall, only 10% of respondents had sold an EM PE fund interest in the past. Conversely, 26% of respondents are likely to buy fund interests in the secondary market, with 15% indicating that they had done so in the past.

Exhibit 16: Are You Likely to Sell EM PE Fund Interests in the Secondary Market Over the Next 12 Months?*



*Excludes dedicated secondaries investors.

Exhibit 17: Are You Likely to Buy EM PE Fund Interests in the Secondary Market Over the Next 12 Months?*



*Excludes dedicated secondaries investors.

> "Pricing is not attractive for sellers now. We would rather buy than sell."
>
> *–Fund of Funds*

> "Selling to the secondary market could be an option to further investigate."
>
> *–DFI*

> "Bid-ask spreads and information asymmetries make secondary markets unattractive to us. We would participate at the right price, but rarely see interesting offers."
>
> *–Foundation*

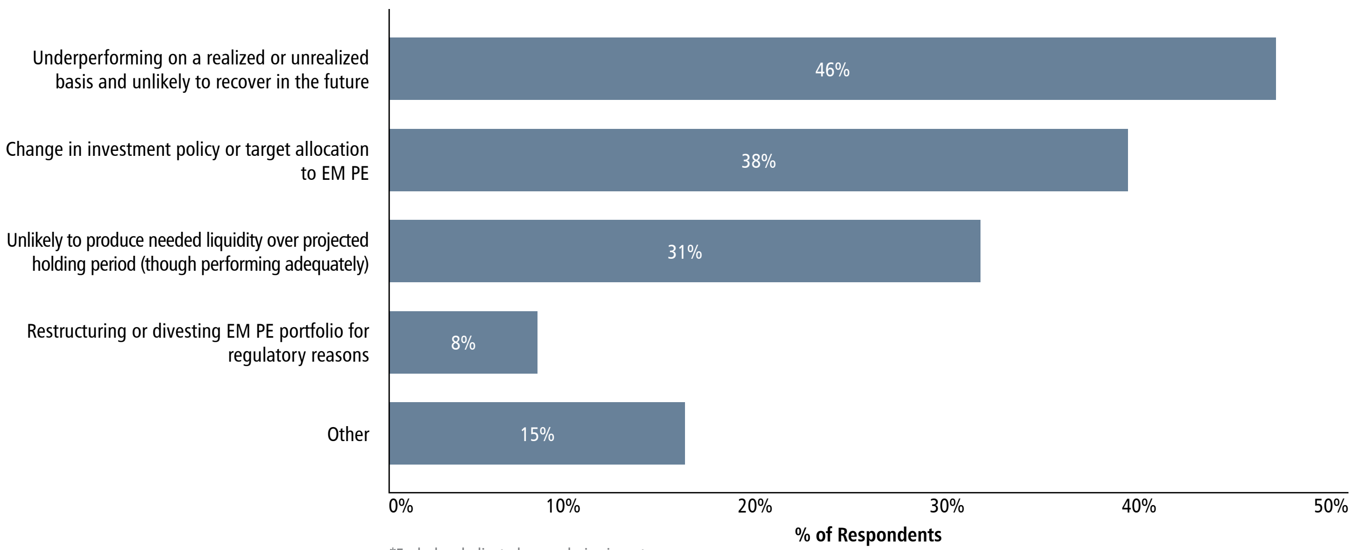
> "Buying secondaries can be a great way to reduce the J-curve of a new fund. Thus, we do look for opportunities to invest with players with whom we have already developed a working relationship."
>
> *–Fund of Funds*

> "While we rarely see secondaries and they are harder to evaluate, weaker EM currencies make EM funds more attractive in the secondary market."
>
> *–Multi-family Office*

While the findings do not afford any sweeping conclusions, they suggest most EM PE investors have not availed themselves of the secondary market, nor will they in the near future. Indeed, 70% of respondents are unlikely to sell fund interests on the secondary market, while 58% of respondents are unlikely to buy. When asked to comment further, several respondents pointed to pricing challenges, both for buyers and sellers. Furthermore, for respondents looking to sell their EM PE fund positions on the secondary market, 46% report that their funds were underperforming on a realized or unrealized basis and were unlikely to recover in the future. Such positions would be less likely to attract buyers without significant discounts to net asset value.

Alternatively, a number of respondents are likely to sell EM PE fund positions for reasons not necessarily linked to their fundamental performance on a total value basis. For instance, 38% of respondents indicate a change in investment policy or target allocation to EM PE as a reason to sell. Another 31% of respondents' fund positions are performing adequately but unlikely to produce the needed liquidity over their original projected holding period, motivating a sale.

Exhibit 18: Reasons for Selling EM PE Fund Positions on the Secondary Market*



*Excludes dedicated secondaries investors.

> "If liquidity and return (IRR) projections do not meet our return target, e.g. net 20% IRR, it may warrant consideration of sale."
>
> *–Fund of Funds*

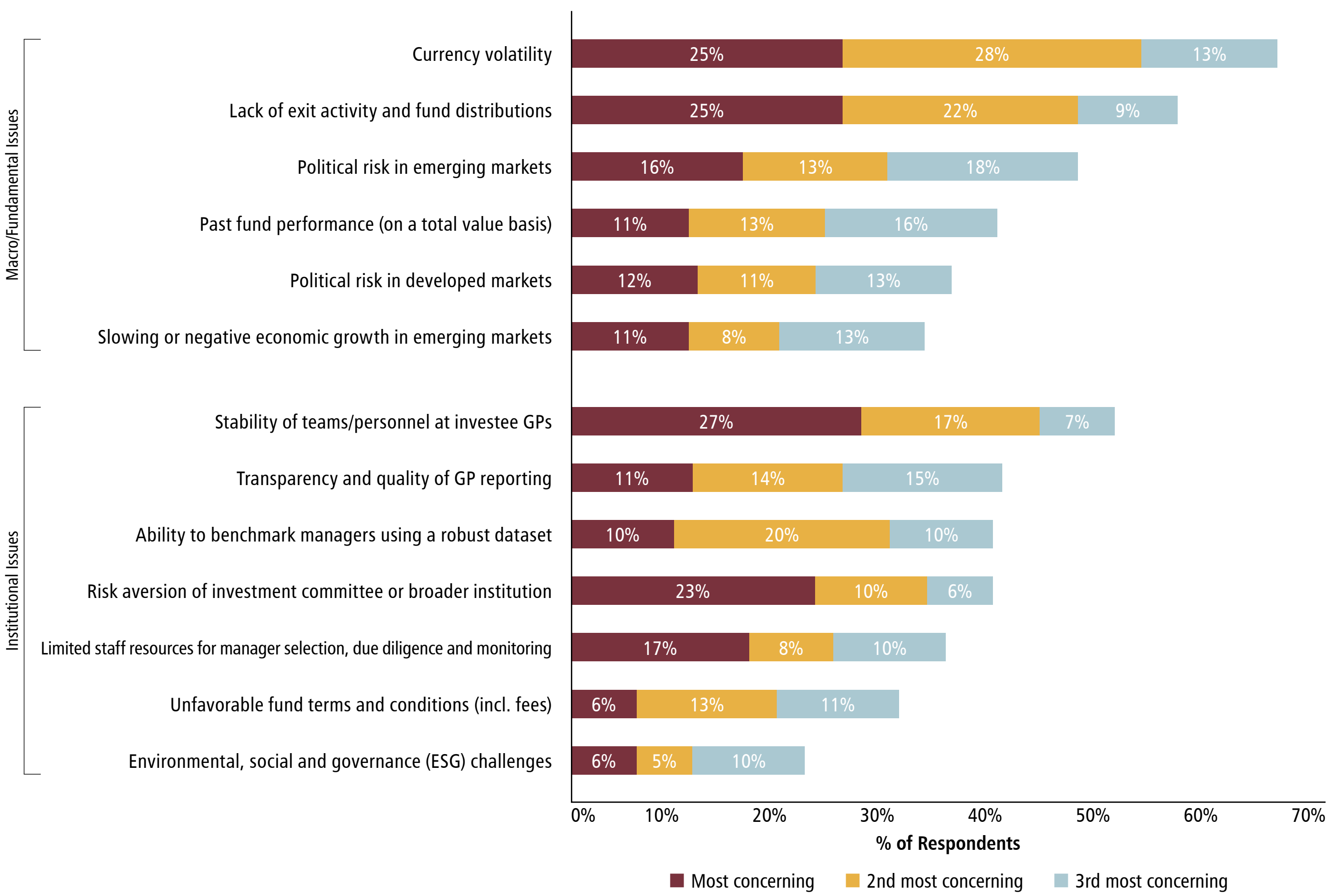
> "The PE team is going through portfolio concentration efforts around a smaller number of large managers. For this reason, legacy funds are being reviewed for sale."
>
> *–Pension Fund*

Currency Risk, Team Stability Top List of Portfolio Management Concerns

Two-thirds of LP respondents list currency risk among their top-three macro and fundamental issues in managing their EM PE portfolios. Concern over lack of exit activity and fund distributions for EM PE followed close behind currency concerns, with 56% of respondents indicating exits were a top-three concern. Respondents were least likely to rate slowing or negative economic growth in emerging markets as a top macro/fundamental concern.

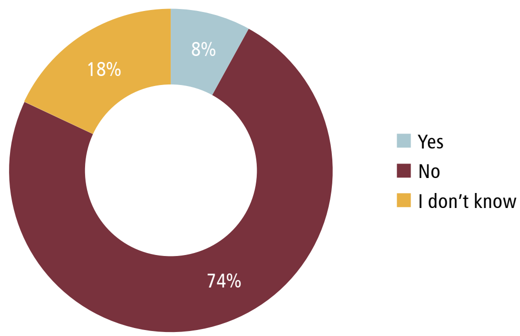
Respondents exhibited less uniformity of opinion regarding institutional or firm-level concerns—about which they were queried separately—than for macro/fundamental issues. However, 27% of respondents rated the stability of personnel at investee GPs as their most-concerning issue. As one respondent noted, significant personnel changes at a GP can render past performance obsolete when evaluating a follow-on commitment. The competition for talent among EM GPs and the formation of spinouts from successful franchises may be exacerbating this trend. (Please see page 13 for additional direct feedback on LP concerns.)

Exhibit 19: Issues That Pose the Greatest Concern for LPs' EM PE Portfolio Management, Ranked 1–3



While LPs may be highly concerned about currency volatility in managing their EM PE portfolios, most intend to stay the course: only 8% of respondents expect to delay EM PE commitments due to EM currency volatility, while 74% did not expect to delay commitments; the remainder of respondents were uncertain. Among respondents who do expect to delay their EM PE fund commitments due to currency volatility, two-thirds indicate that currency depreciation has subtracted value from their realized EM PE investments (see page 14).

Exhibit 20: Over the Next 12 Months, Do You Expect to Delay Your EM PE Commitments Due to EM Currency Volatility?



"Currency volatility has had the largest effect on our EM portfolio." *–Fund of Funds*

"EM funds are more difficult to evaluate and monitor. Funds need to have ESG activities in place to ensure sustainable investments." *–Pension Fund*

"Personnel changes affect the GP's ability to replicate past performance and generate alpha on a U.S. dollar basis." *–Fund of Funds*

"Risk aversion in our institution directly affects deployment pace and thus impacts diversification in our portfolio construction." *–DFI*

"Returns have been poor on a relative basis and certainly on a risk-adjusted basis. GPs tend to obscure performance, especially relative to other EM managers, so a robust benchmark would help eliminate the noise." *–Family Office*

"ESG standards are a fundamental part of our investment strategy, yet can be easily overlooked by GPs and are difficult for LPs to monitor, putting the investment objective at risk." *–DFI*

"Our biggest constraint in EM PE is finding high quality GPs of scale." *–Pension Fund*

"Our team is best suited to find, develop and manage direct investments instead of fund investments. The minimum investment sizes in funds restrict our potential to diversify. Most of our underlying investments, both direct and indirect, are greatly affected by EM currency volatility." *–Foundation*

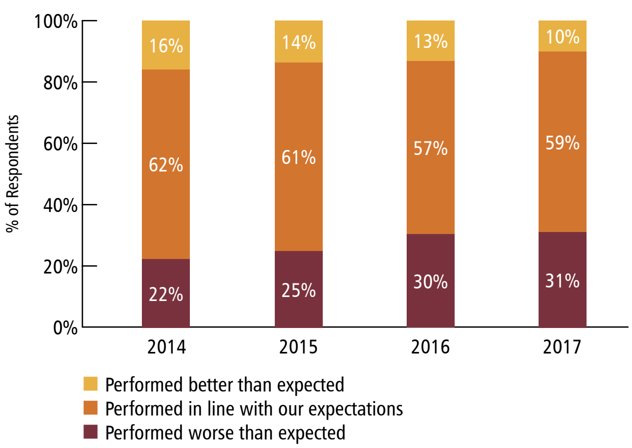
"Basically, I don't think one should dabble in emerging markets. Either one needs to build a proper program or avoid them. We have considered and invested in fund of funds-type products on a limited basis, but fee stacking is difficult to accept." *–Sovereign Wealth Fund*

Most LPs Still Satisfied with EM PE Performance, but Expectations for Both Emerging Markets and Developed Markets Continue to Decline

Over the past four years, LPs' satisfaction with the performance of their EM PE portfolios has gradually declined. Only 10% of respondents indicate that their portfolios have exceeded expectations, compared to 16% in 2014. Correspondingly, the percentage of respondents reporting worse than expected performance has increased from 22% in 2014 to 31% in 2017. Recent currency volatility in emerging markets is likely a large factor in decreasing satisfaction with EM PE returns. For EM PE investors of five years or more, currency depreciation has negatively impacted realized investments for 72% of respondents. In contrast, a mere 2% of respondents experienced added gains from changes in currency exchange rates.

Nevertheless, EM PE portfolio performance has met or exceed expectations for 70% of LP respondents. Return expectations for both emerging markets and developed markets have moderated substantially in recent years as investors continue to increase allocations to private equity globally. While 61% of survey respondents expected returns of 16% or greater from EM PE portfolios in the 2013 edition of the survey, just 43% now expect similar returns. For developed markets, the proportion of LPs expecting returns of 16% or greater has fallen to 17%.

Exhibit 21: EM PE Portfolio Performance Relative to Expectations, 2014-2017



Note: Exludes LPs that felt it was too soon to assess the performance of their portfolios.

Exhibit 22: Net Return Expectations of 16% or More for Developed Markets vs. Emerging Markets PE Portfolios, 2013-2017

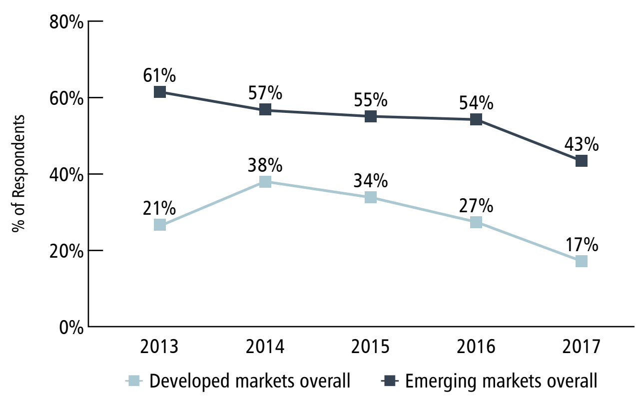
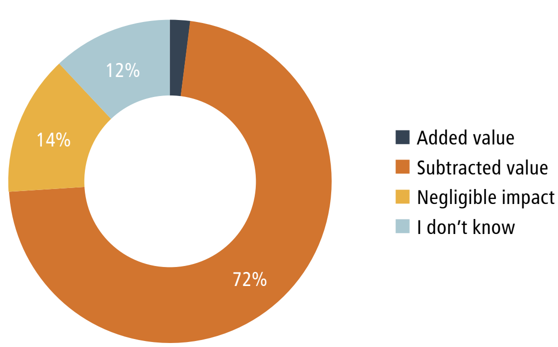


Exhibit 23: Currency Exchange Rate Impact on Realized Investments for EM PE Investors of 5+ Years

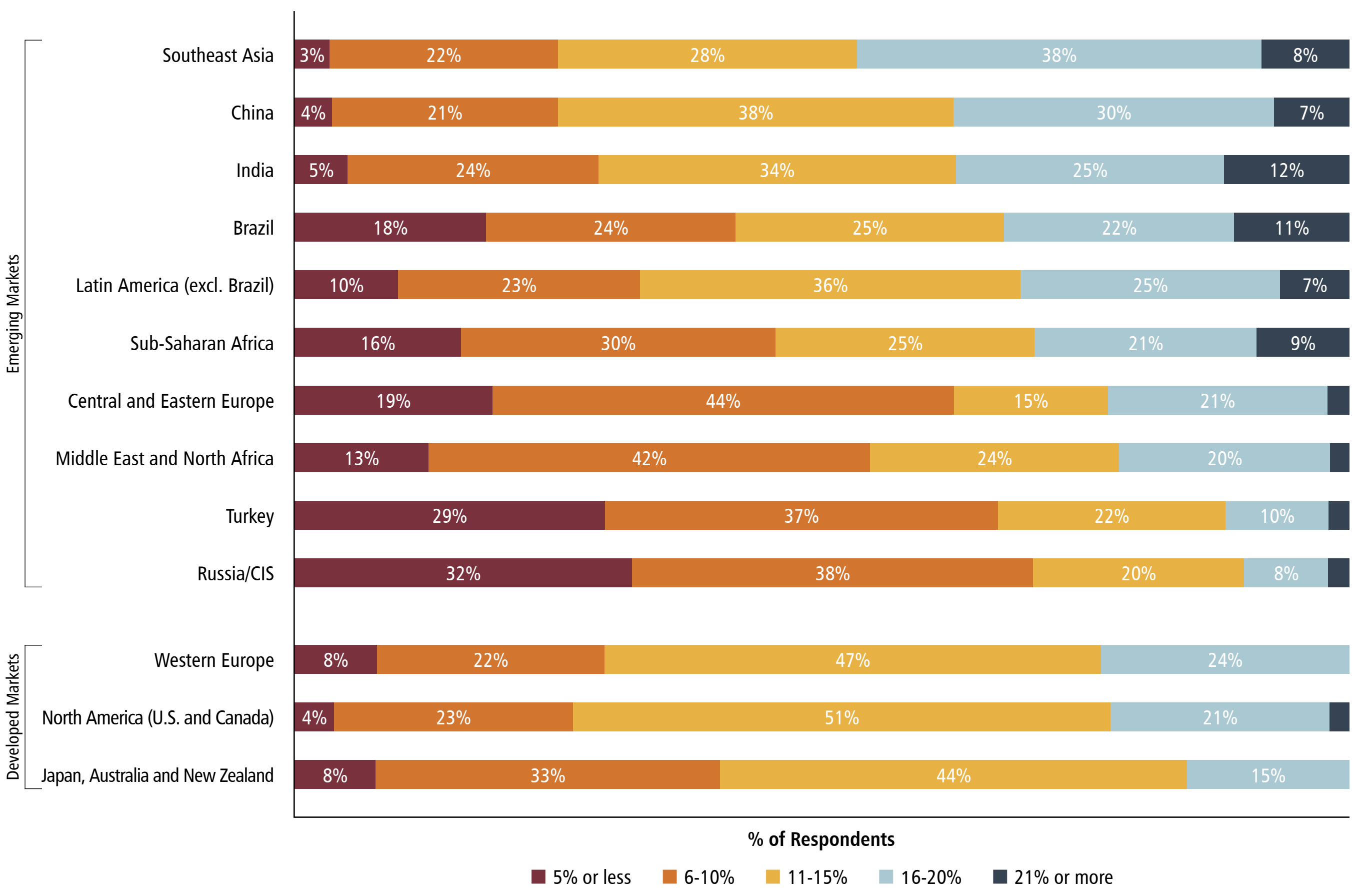


> "In our prior experience in emerging markets, performance was poor due to difficult exit environments and the lack of robust buyer's markets."
>
> *–Public Pension Fund*

In line with previous years, LPs are most bullish on Emerging Asia-focused funds. The highest percentage of respondents believe that 2016-vintage PE funds focused on Southeast Asia, China and India will deliver returns of 16% or more. Southeast Asia, which ranked the highest in terms of performance expectations, was also the only market that did not experience a decline in expectations, with 47% of respondents anticipating returns of 16% or more, equal to that in the 2016 survey.

Though less bullish than for Emerging Asia, more than a third of LPs expect returns of 16% or more for Brazil, Latin America (excl. Brazil) and Sub-Saharan Africa. In all of the aforementioned regions, the proportion of respondents with return expectations of 16% or greater exceeds that for developed markets. Across all other markets—Russia/CIS, Middle East and North Africa, Turkey and Central and Eastern Europe—more than half of respondents expect returns of 10% or less.

Exhibit 24: Distribution of Net Return Expectations from 2016-Vintage Funds



Respondent Profile and Survey Methodology

In February and March 2017, EMPEA surveyed 127 representatives from 106 different LP institutions headquartered across 34 countries—collectively representing more than US$480 billion in reported global PE assets under management and US$6.6 trillion in total AUM—to gather their views on the EM PE asset class. Respondents represent a diverse mix of institutions, including public and private pension funds, family offices, endowments, foundations, banks, asset managers, insurance companies, government agencies, corporations, development finance institutions, funds of funds and private market advisors. In cases where more than one respondent from the same institution took part in the survey, only one response was included for questions concerning an institution's current allocations and future investment plans. Just under 96% of institutions surveyed are currently invested in at least one EM PE fund, and 80% have been investing in EM PE funds for more than five years. EM PE constitutes approximately 22% of the current overall PE portfolio of the average surveyed institution (excluding development finance institutions, EM-focused funds of funds and others legally mandated to invest in emerging markets).

Exhibit 25: Respondents by Institution Type

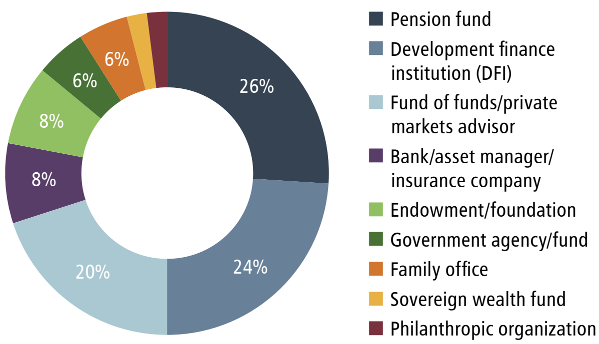


Exhibit 26: Respondents by Headquarter Region

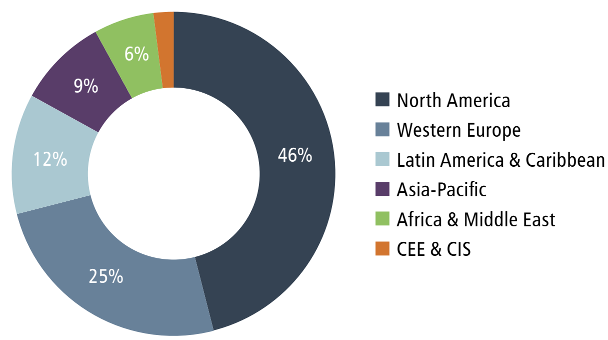
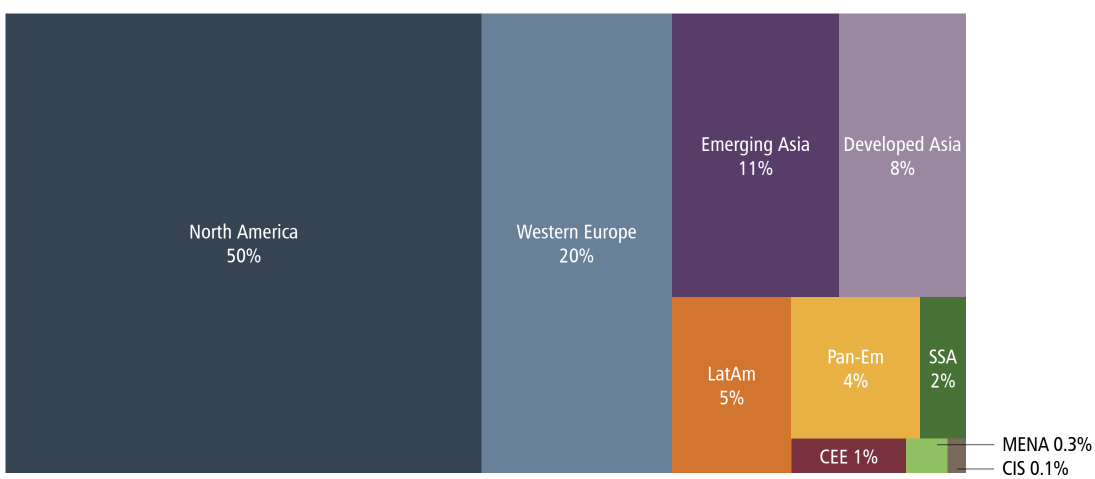


Exhibit 27: Disclosed Distribution of Current Committed Capital in Global PE Portfolio*



*Excludes investors with EM-only mandates.

Survey Definitions

Emerging markets ("EM") includes all countries outside of the United States, Canada, Western Europe, Israel, Japan, Australia and New Zealand.

Private equity ("PE") encompasses (leveraged) buyout, growth/expansion, venture capital and mezzanine investment strategies.

Emerging markets private equity ("EM PE") funds are PE funds that principally target investments in emerging markets.

Limited partners ("LPs") are investors in PE funds.

General partners ("GPs") are PE fund managers.

Development finance institutions ("DFIs") are independent, government-backed or multilateral financial institutions that promote private sector development in developing countries.

Note: In some exhibits, percentages may not sum due to rounding.

EMPEA
2600 Virginia Avenue NW • Suite 500 • Washington, DC 20037 USA
Phone: +1.202.333.8171 • Fax: +1.202.333.3162 • Web: empea.org