THE DEVELOPMENT OF A PRIVATE EQUITY STRATEGY

HSBC Private Bank

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“Les propos tenus dans ce document n’engagent que leur auteur”.
How can we develop the Private Equity investment strategy?
Thanks

I would like to especially thank Mr Guers and Ms Vandermersch, coordinator from HSBC Private Banking for their welcome and integration. They helped me to gain more experience and go further with my research. Thanks to all the members of HSBC Private Banking and Asset Management for their information, cooperation in our work and achievements.

I would also like to give special recognition to Mr Sadecki, head of Axess Finances (financial planning company) and Mr Archer, head of HSBC Private Banking France who gave me the passion for private equity and capital investment activities since 2010.
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Abstract

The Business School I have been involved in, ESPEME from the EDHEC Group, taught me a lot about business administration and management. A large program opened on the international supported me to evolve and get curious about all economy. Throughout the internship I have had the opportunity to follow the practical application of what I have learned and developed a special interest for finance.

After a brief experience in the banking performance analysis, my two last missions followed this trend. Driven by the curiosity and the envy to learn more, I worked with a Private Equity investor. He transmitted me his concern about those investments. We also worked together through some interesting projects that will be exposed in the thesis.

One year after, I was involved in HSBC Private Bank in Paris for wealth management activities, performance analysis and reporting. Through our work, conferences and interviews, I comfort my idea to dig deeper in the subject. It was the occasion for me to consult professionals and get more information about Private Equity.

This thesis will deal with private equity, capital investment and venture capital. The goal is to develop a thesis based on theories and examples. It describes and analyses a real private equity investment strategy.
**Introduction**

In a changing economic world with uncertainty on public markets, decrease in stock exchange incomes and tax pressure causes difficulties when investing money. Lack of trust appeared helped by famous financial scandals. When people never save or take care of their money, the demand for alternative investments solutions is increasing.

We will mainly focus our study on one asset class, full of hope and development capacities.

Born in the United States and driven by the “American dream”, Private Equity activity has been developing a lot over the last decades. Entrepreneurs founding start-ups, raising funds with investors’ help and generating huge profits made it well known. Threatened by the last recession, it still recovers better and faster than most of other assets. Professionals are working on the subject to understand it better and project its development opportunities.

The Private Equity investment is referring to a capital given to a non-listed company. Typically, the Private Equity fund will provide money to a targeted company, contributing to its development, expansion and maturity. This process requires experience, knowledge and curiosity from the investor. A professional link is built between the targeted business and the supporter, not only investing capital but also advices and operational management. There are different activities linked to this sector as Venture Capital, Capital investment and Ethic investments that will be detailed in the thesis.

Private Equity is a large activity involving big actors as institutions or governments and also smaller entities as cooperatives or independent investors. Geographically, businesses all over the world require funds for their expansion. If Wall Street managed a lot of deals, Private Equity and Venture Capital investments find interests in emerging countries in Pacific Asia, Latin America, Africa and Eastern Europe.

It came to our mind to share an overview on global economy and especially on financial markets for two years. It is a good starting point to understand the environment and its stakes. By approaching PE first with the theory, we will analyse the private equity market with main actors, consumers, products and areas. A quantitative survey will sum up keys of the market in figures, charts and analysis.
Overall, the goal of this work is to show speculation and aggressive management in stock exchange is not a solution. Examples will be exposed with proven successes for the investor but also for the investee. Entrepreneurs, businesses and companies can provide brilliant solutions. They are also increasing their value thanks to creativity, production and development.

Thus, chapters will be dedicated to the importance of the relation between investor and investee. And this will be one of the explanations for performance. A win-win relation is appreciated when both parts are ready to operate in an optimal environment. Private Equity is finding his strength on supporting local development, business sustainability, professional achievements respecting ethics and ecology. At the same time, both parts can enjoy capital gains.

Through our work, we will try to understand how future drivers of growth could be supported by Private Equity. Investors can develop a strategy with PE and Venture Capital in their portfolio. Money retained in saving accounts can be invested, supporting growth because returns on investments from Private Equity transactions have been, on average, higher than those observed in public markets. Even if this activity is handling more risk, at first sight, one of the thesis’s aims is to find origins of this outperformance.

As the demand for alternative sources of investments and diversification is increasing, we concentrate on the influence of Private Equity in a portfolio performance. Is it adding a value to the portfolio? Is it relevant to own such shares in a pool of assets? It will be important to clarify those points.

According to lot of professionals, academic studies and testimonials, we estimate Private Equity will be one of the most attractive asset classes for investment in the next ten years. We use all our sources and what will be developed in the thesis to look for new opportunities. Also, we wonder how Private Equity will interact with its environment in the next years, what will be the main changes and how will look like the market in the future.

A real interest for ethic venture capital is shared through the thesis. And the most surprising is the performance of these investments. Concrete examples will probably help us to consider responsible Private Equity investments as beneficial and profitable. Cases from my professional experience are shared.
From the typical leverage buyout in United States, until the early stage venture capital in a Sri Lankan farm, the choice is wide. But not wise.

Finally, it is also important to detail our study with theories and examples. We will debunk a few clichés, bringing elements of answer and opening the debate about this subjects and its future.
Part I: Motivations for a Private Equity Investment

« Actual financial markets situation is not meeting properly investor’s expectations. Secured assets are not as yielded as before and volatility impacts risk taken. Moreover, tax burden and stock exchange image do not makes it easier. Through this part we estimate how Private Equity can represent an alternative investment. A significant interest is given due to its outperformance, help for smaller companies and growth. After a 2012 and 2013’s financial market's overview, we will analyse characteristics of PE such as motivation to invest in PE, strategies, investment performance. At the end of the part, a quantitative survey will sum up activity’s weight in the economy. »
Chapter 1: Justification for Private Equity interest

I - 2012 and 2013 financial markets overview

In order to approach our reflexion about Private Equity and develop an investment strategy, it is important to underline actual investment environment and economic context. A sum up for 2012 and 2013 financial markets is a nice starting point to understand world’s economy dynamics. From the 1987 crash, financial markets knew a prosperous period. Euphoria on the dot-com bubble, high technologies industries, automotive industry, health, and globalization drove growth.

Stocks had a lot of volatility. Inflation was higher than GDP and growing by roughly 3% per year. Security investments were paid with decent yield. At the same time, risk was paying more often. Investors had a real freedom in their medium choice due to a relative tax policy.

Also, this period experienced less scandals, compared to what we are living nowadays.

Market’s freedom and lack of control have driven to dramatic situations. The failure of investment houses overexposed to complex securities (CDO’s – Collaterized Debt Obligations and MBS’s – Mortagged-Backed Securities) that felt due to the collapse of the real-estate bubble caused to mistrust. Actors are confronted to a strictly limited environment. Economic agents are acting under regulations, concretely representing an administrative and tax burden.

Those events impact financial markets and may delay a real recovery. In order to understand the environment we are studying, we will focus on the evolution of financial markets last year and 2013.

2012 seems to be a better year for financial markets than 2011. With the global economy slowdown, volatility in financial markets and the European debt crisis, 2011 has been a difficult year both for investors and fund managers. Results are higher than expected, economic perspectives are stable. Previsions of world growth are lowered for 2012 and 2013. Two explications can be discussed. First of all, actions of central banks permitted to lower non-risk assets income. This created an important income research, which benefited company bonds and then equities. Also, signs of solidarity inside Euro area contributed to reduce yield gap on peripheral debt and banking assets.

Equities are representing roughly 25% of total assets. Bonds brought a significant contribution to performance. Representing 40% of total assets, they are being mainly invested in company bonds. They are penalised in 2011 but looked for again this year.
Emerging markets equities income was not as high as expected at the beginning of the year. But liquidity abundance from central banks is predicting a recovering for equities and currencies in the short term.

At the end of the year, assets growth seems to be flat, markets being worry about the Euro area crisis and effects of the tax cliff. Economic growth will probably fluctuate around 1%. About China, its growth could be adjusted downwards according to difficulty to manage credit dynamism. Positions on equities are reduced.

The Table number 1, 2012 and 2013 market’s outlook is showing indexes’ evolution in 2011 and 2012.

After this overview, we can sum up this year as Mr Philip Poole, asset manager at HSBC assimilates it: “2012 has been a rollercoaster ride for investors”. The Chart number 1 illustrates this citation.

Now we can continue our analysis with the 2013 overview.

The beginning of 2013 seems similar to the 2012 second semester. Politic, economic and social difficulties in Southern European countries can impact equities and peripheral spreads. Hopefully, Central bank supports the dynamic. At the same time, bullish trend in risky assets are reassuring.

Growth in United States is awaited, driven by real estate, automotive industry and employment. Economy is looking more attractive and robust than the last years. Overall, economic data from United States are showing that the tax measures will not prevent a progressive recovering. News from USA is giving back trust in markets: Obama’s speech about debt reduction and a better minimum wage are announcing trust back. Thus, USD against Japanese YEN is performing (more than 15% between January and April). Figures of employment in United States are influencing Federal Reserve to reduce its buying program expenses. Germany is not reacting in the same way; quality of jobs has not been recognized, saying they were not considered as long term agreements. American 10 years’ interest rate (government) reached a lower point (1.63). It is highly expected to grow up.
Japan’s answer is to go for an inflation situation. Japanese central bank is lowering their currency. The actual debt on GDP ratio is high, they want to lower it. Effects will be direct: by the end of April, Japanese economy explodes: the gross domestic product grew 0.9% in the three months to March compared to the previous quarter. It is actually going out of the “lost decades”. We still have to take into account Japanese’s drop in the middle of May.

Due to low rates and low income on security investments, risky assets are helping markets to recover.

Regarding sectors and geography, growth has been generalized even if American equities knew the best increase.

For Europe, we cannot talk about an increase while MSCI EMU scores 1.97% during first two months. Industrial production is decreasing and Greece obtained a 3.2 billion EUR’s help. Worries are coming supported by situation of Italy and Cyprus. Political crisis in Italy have driven borrowing costs to rise markedly since February. Investors have weakened the euro currency against others as dollar or Japanese yen. In Cyprus, devaluation of Greek public debt bonds mainly owned by Cyprus banks, lack of capitalisation and unhealthy stocks created a crisis. Stockholders are being impacted and banks will need re-capitalization. Saving accounts over 100,000 Euros are targeted. Tax regime threats are not helping the zone for a steady upswing.

Despite those events, German economy is stabilizing and United Kingdom is showing the best yields’ remuneration. Some sectors of equities are performing the market really well: health (Essilor, Sanofi), automotive industry (VW, GM), technologies and communications (Samsung, Fugro, Fresenius, Teleperf, Ubisoft) and industry as EADS.

By May 2013, systemic risk is disappearing. European Central Bank wants to encourage access to loans and shareholding for small and middle-sized businesses in peripheral countries. Rates are going lower by the end of March (Spain: 4.1% in May compared to 7% in July 2012, Italia: 3.9% in May against 6% in July 2012). Fitch will review its quotation on Greece from CCC to B-. Portugal reached its emission objectives up to 92% in May. Key rate adjustments are expected.

But Mario Monti considers that it is too early for a money market relaxation.

For emerging markets, MSCI EM is just positive for two main reasons: weakness of natural resources and doubts about China. Local Chinese market is getting mature, going from an exporting
country to a consuming one. The country is encouraging accesses to loans to increase Chinese consumption and internal demand. Authorities are already announcing an inflation control. At the same time, government is defining three objectives: have a higher GDP than USA, have a GDP representing 80% of Euro area’s GDP, and five times the Japanese one in 2025. Analyses are showing that growth support will be enhanced by commercial, real estate and energy sectors.

Rates are fluctuating between 0 and 1%. A tight increase in rates has been compensated by a spread contraction. Emerging markets bonds are being more attractive than developed. The reason comes from lower rates and an increase in capital. Inflationary risk will certainly be avoided by central banks but needs to be monitored. Equities, local bonds and currencies are asset classes to conserve or reinforce for their potential performance. Economic environment is profitable for emerging markets: debt on GDP ratio is averaging 36% and deficit is about 2, 5%. For developed it is respectively 65 and 7%. Areas as South-East Asia, South America, Russia, Eastern Europe, Turkey and Africa are offering opportunities of growth. Industrial production is encouraging employment and credit access.

After two good starting months, in March emerging markets’ growth is stabilizing. But the impact of bad news in Europe is encouraging investors to support growth in emerging markets. Inflation is being stable for the period, with no drop or increase to anticipate, except for Brazil, which hiked its interest rate by 0.5 points at the end of May.

Natural resources as gold knew a sharp decrease due to a macroeconomic event. The sold of trackers by institutional investors created a decrease on markets. From 1700 USD/oz in April until 1400 in May, the quotation recovered directly after a massive purchasing campaign from China and India. This is a way for them to diversify their cash balances, too dependent on currencies. China is also purchasing fewer currencies than before.

Bonds knew a “boom market” in the early eighties. In 1980, bond rates were around 18%. They are now on a slowly decreasing period with a 2% rate. Equities which are being late in stock exchange and with a potential growth represent a nice investment. Absolute value of equity and treasury funds is corresponding with indexes. Alternative investments in equities, corporate assets and cash with diversification are bringing the best risk/income ratio. Moreover, risky assets are preferred due to a systemic risk expected to increase. The Table number 1 is showing indexes’ evolution for 2012 and 2013 until June.
In the first months on 2013, stock exchange was showing an outperformance compared to the related economic environment. Those elements let us think it is an optimal period for an equity strategy investment, increasing shares allocation in a portfolio. 
(Source: Internal HSBC).

II – Hints for Private Equity investments

After those overviews, we can see that financial markets are providing a source of income and possibilities. But the part of risk, unknown situations and changing environment are real. And private investors are being less and less interested in financial markets. Two main factors have been influencing the capacity of financial markets to perform properly. Tax law management and few actors’ behaviour and monopolies influenced strongly the prosperity of the market.

The clash is actually coming from the 2008 subprime mortgage crisis. Finance, trade and speculation on unsecured loans drove to a collapsing point. When everybody put the blame on financial firms, government was feeling independent from the crisis. The lack of control was difficult to handle for private investors. Institution’s power was questioned due to missing regulations.

Abuses as Goldman Sachs created a worldwide echo. Speculation on food staples, as wheat, maize, coffee and sugar through commodity funds strongly impacted the sector. Traders’ reputation is at the lowest.

Global reputation has changed about financial markets. The fact people can lose their capital in a stock exchange investment, speculation on financial markets and its consequences sharply affected markets reputation and trust. The lack of moral and ethics is having consequences.

To increase their income and limit inflation, governments are implementing more taxes. Tax pressure can be seen in France for example. Government turnovers, lack of income, crisis’ impact tax law regulations. There is nothing worse than changing tax laws. Visibility is threatened; investors are lost in their predictions and anticipations for wealth management.

Capital gains on stocks or bonds are different from countries. Currently 50% of realized capital gains are taxed in Canada; while Bulgaria is exempted on equity instruments traded on regulatory
markets within the European Union. Tax heavens as Belize, Bahamas, Isle of Man, Jersey, Singapore, Jamaica, Cayman Islands and others do not tax capital gains. But some others countries, involved in public markets are proceeding with a tax on capital gains.

The example of France shows that a significant part of gains coming from sold shares or bonds is taken. And what’s more after the 2013 financial law. Before this law, all capital gains from securities and social rights for independent investors were taxed to a 34.5% rate (19% rate plus 15.5% of social security charges). After the implementation of the law, dividends, interests and gains will be taxed according to the income tax scale, just beneath.

For United States, capital gains are taxed at a 15% tax rate for individuals making in the $36.250 to $400.000 range. Above this bracket, singles will pay 20% of their earnings. The same is implemented for couples earning over $450.000.

The table in the appendix number 3 is showing tax regime scale. It is underlining lack of attractiveness due to tax barriers on capital gains. This aspect may be considered with the performance of stock exchange classical investments.

Traditional asset classes are not always able to offer profit, stability and diversification investors are looking for. More and more experienced investors are going toward alternative investment solutions. Among those available nowadays, Private Equity or capital investment showed its ability to provide high profits. It is considered as an essential component for a diversified portfolio, as shares, bonds, structured products, monetary assets and others. Allocate a part of a portfolio with Private Equity can optimise its management, and develop a juicy and long term investment strategy.

Forecasts for the next years of Mr Poole, Mr Hubert and also shared by some economists and professional of the sector are converging. Private equity is expected to be the most profitable asset class in the next ten years. Capacity of development and world demand for private equity investments, infrastructure partnerships, and venture capitals is considerable.

And it is more than understandable. The economic recession and new dynamics have led employees and managers to create their own business and be independent. The feeling of being his own boss was shared by plenty of people. It was the moment to do it.
Figures of unemployment after the 2008’s clash drove people to find alternative sources of income. Number of entrepreneurs grew up drastically while demand for services, buildings, engineering, health care and energy is missing human and financial capital.

The Chart number 2 is showing the profitable assets chart in the next years, meeting Mr Poole’s studies and believes.

Throughout this chart and documents, we tend to wonder about to consider Private Equity as a strategy for wealth management and investments... The following characteristics of private equity justify its use.

First of all, it is exploiting market imperfections. This is the principal source of income. Private Equity is certainly looking for sectors or companies that are not present on public markets. When an opportunity appears, it is directly considered as a priority for investment. Time of reaction from actors is very short. As Mr Haguet says, teacher at EDHEC Business School, “if a note is on the floor, it is probably a fake. If it has been a real one, it would have already been gone”. The reaction of public trade is faster than private equity’s one. The information being private, number of actors and analysts is limited. Market imperfections that cannot be seen by public trade are by PE funds. The point of view is more flexible and wider; PE funds can eventually invest with entrepreneurs, small caps, bigger companies, cooperatives and others. The goal is to enjoy a lack in the market to ensure return on investment. It depends on actors’ ability to find businesses with a growth potential. This drives us to the next point.

Furthermore, the strength of PE is to trust in small and medium-sized enterprises’ (SME) growth potential. Public trade also invests in small caps using specialized funds, but in smaller proportions. A small, flexible and dynamic company has an interesting capacity to increase its activities and income than a bigger and mature entity. The aim is to take advantage of this increasing period by financing the business from its beginning until its maturity.

And the two ideas are linked. The synergy is creating an added value: a SME exploiting market imperfections is a profitability source. Because of its time of reaction, appetite for gain, information effectiveness and position, SMEs are one of the main supports of growth. They are more flexible.

Last but not least, Private Equity has a low correlation with other assets. Non-quotation on public trade, different sizes, presence in emerging sectors and high risk driving to an exigent selection can explain this de-correlation. PE companies come from a mix of current and stale company
valuations, and thus are not accurate measures of the true change in value of the portfolio. The advantage will be useful in recession or crisis periods. PE investments will not be necessarily drawing down as other assets will do. The independence acquired by PE is comforting investors in their support to growth. This can also be an attractive way to diversify its portfolio to lower the risk. This topic will be discussed in the performance survey part.

**Chapter 2: The Private equity market survey**

**I – Theory approach**

To begin it is important to debunk a few clichés. To introduce our theoretical approach, we can discuss four misconceptions of Private Equity:

- **It is a win-lose game.** Most of the time, the activity beneficiates from both parts. Concretely, the performance of funds raised will satisfy the investor and participate to the development of the business. Those companies will be more able to perform in a concurrency environment. They will also invest monopoly markets, which will beneficiate from the final customer;

- **Valuation of the business is the only criteria.** One does not simply invest in a business regarding its purchasing value and possible exit value. Important criteria as debt/income or income/gross margin ratios, working capital requirements are determinant. Over financial aspects, operational management, company’s integrity, human resource, networks and market analysis are relevant;

- **The taking of the business by PE or VC means entrepreneurs will lose control of their company.** Generally, the management team is willing to stay to run the business. Employment agreements are also negotiable between the parts;

- **“Sharks” are only interested in the exit and forgets ethics.** If some actors are overly concentrated in huge profits at all costs, ethics are a performance source. They are driving investment policies where there is a great need for development. Private Equity encourages responsible investments and tries to be beneficial for each actor. Operational management help is also providing a future prosperity for the business, after the sale.

Private equity funds are financial intermediary investing in companies’ capital. It takes the investors’ capital and invests it directly in portfolio companies. This differentiates Private Equity funds activities from angel investors and private investment companies. They are using their own
capital. A Private Equity fund only invests in private equity companies. Companies cannot be traded on a public exchange once investments are made.

A private equity fund is generally specialised in financing starting up companies. Conditions of the operation are being more adapted and comfortable for the private company. Banks need to consolidate their secured assets (with Basel III, they may own more than 8% of the money they are lending). Restrictions and regulations are limiting these investments. Abuses from the past have gone too far. Concretely, to expect a loan from banks, a start-up business needs to show guarantees. Independence and acceptance of a Private Equity fund are higher than classical banks are. They are also able to take more risk.

But private equity funds and investors also find an interest in periods of companies’ cycle. Start ups depends on projections on market and business and track record analysis. This is also the step were the higher risk is taken. That is why more mature companies are being financed. They certainly bring less income but provide security value and a lower risk. The remuneration of PE funds is coming from management fees and carried interest.

Company’s cycle life can be summed up as follows: Early stage, expansion, LBO, maturity and distressed stage. Each one is linked to the maturity of the targeted business. It is then impacting the investment strategy. We will discuss in detail this matter further in the paragraph.

A typical private equity firm is a partnership or limited liability corporation. Three main companies are leading the market: KKR (Kohlberg Kravis Roberts), Carlyle, and Blackstone. Starting with a modest balance sheet and an entrepreneurial network, they are now big asset management firms.

Two main subclasses for Private Equity are Venture Capital and leveraged buyout.

Venture Capitals are specialized in high growth, risky placements, and start-up firms in various sectors. Venture capital partnerships make investments in young private companies. They know a great success in emerging markets due to development opportunities. At the same time, start-ups are building up in developed countries linked to the independence phenomenon we discuss previously.

In a leveraged buyout, a specialized investment firm is acquiring a company’s majority control with an outside debt. A financial leverage is used to increase the initial investment. Often, LBOs companies use equity from limited partners. At the same time, to raise a higher return and to have access to more companies-for a wider freedom-they borrow the majority of their needs from banks. LBOs are targeting different companies:
- Firms with a stable profit in mature markets without strong investment needs (their treasury can repay the loan);
- Companies with a development potential;
- Companies under difficulties which attained their limits by a lack of financial or human resources.

For a middle sized company bought, an LBO operation can simplify a family succession and provide enough capital for its development.

For independent investors, there are different ways to approach private equity.

They can buy participation in PE funds as FCPR of FCPI in France for example. These investments vehicles provide tax law advantages (tax cuts, exemption from tax on wealth), and delegates the risk to the fund manager. Thanks to their experience and knowledge of the market, a real advantage is to be considered in acquiring such participation. Integrate this product in a portfolio seems to be beneficial: a higher income than a direct equity and a lower tax rate. Moreover, purchasing more than one participation can bring more stability to this asset class. The investment risk is lowered.

This is due to the fact that in Private Equity risk of capital and liquidity are the two main negative points. So, any method reducing risk or lack of liquidity is to be considered.

The other way is to create or purchase an independent investment, risk investment or venture capital company. As business angels do, an investor can enjoy a wider freedom and a personal strategy. Characteristics of these companies are really linked to the manager. Centres of interests and ability for risk are defining fund’s philosophy.

Business angels can invest in their companies’ network. And also in companies that are showing the best income for the risk taken.

There are different ways for a company to be invested by Private Equity; equity, debt and voting right. Those variables bring more freedom and choices in investors’ strategy. Depending on the nature of their participation through the company, the strategy investors are willing to apply can be different.

This activity is providing a consequent support to companies. It is an additional way of financing and developing businesses. PE can be considered as a solution to meet entrepreneurs and uniformed investors. In the optimal configuration, it is driving to a win win relation. Investors’ goal is to
maximise financial returns. The investor is regaining his capital and interests, while the private company can develop and invest its activities.

PE is evolving with its environment. For inventors, the solution is to increase their capital. A capital they are not using directly. Independents with consequent capital want a higher income than the deposit interest. Developing entrepreneurs and companies need loans banks cannot allow them to.

Private equity actually financed more than 10 000 companies in France, during the last ten years. Most of them are small of medium-size entities. It is a source of employment for Private Equity and venture capital funds, and also in the start-up networking (another proof of the win-win relationship).

We will see further that Private Equity firms apply financial, governance, and operational engineering. The following example of ARD (American Research and Development Corporation) and others will prove those characteristics are a source of success.

II – Practical approach

The reference country for capital investments and private equity is United States. After the Second World War, business men are worry about lack of financial entrepreneurs. They could have sustained technologic companies coming from military programs. An American senator, Ralph Flanders declares in June 1946 to the American Senate: “United States prosperity depends highly on financial support given to this small percentage of new ideas which offer an increase in production and employment, and a better quality of life for American people.” He further decided to create with influencing personalities the American Research & Development Corporation (ARD), with a capital of 3.4 million USD. In 1960 the ARD is listed on the stock exchange. Throughout hundreds of technological businesses ARD invested in, biggest success comes from Digital equipment. For a core holding of 70,000 USD in 1957, the increase in value is around 6,000 times in 1972. Specialists believe the key of the success comes from the philosophic idea of ARD. It is not only limited to raise capital and invest. It is also providing strategic and practical advises to companies they are investing in. “Men and ideas are our assets. Their analysis and evaluation are our problems.”
ARD’s success with the French CEO Georges F. Doriot inspires Rockefeller, Trask and Whitney. In 1960, numerous capital investment companies are created. Over the decade, the average profitability is 26% per year.

Support given to non-technological companies, which are not equally profitable, is driven by Small Business Investment Companies (SBIC), settled by the government in 1958. They are working as partnerships with banks and private companies. Banks are offering them budget credits to invest in capital and equities, company’s debt or securities.

According to a study of David Birch in 1979, 82% of new jobs are created by companies with less than 100 employees between 1969 and 1976. After this year, Silicon Valley will begin to attract venture capital companies.

For Private Equity sector in the French market, previsions are pessimistic. Finance activities are affected by the crisis’s environment. Lack of dynamism from French economy is dumping market’s liquidity. No change is waited in the short term. Fluidity is based in majority on trading between capital investment companies. Worries on stock exchange and research of security are driving, in general, investors to wait and put their money in saving accounts.

Moreover, French government is not helping for its development. Strong mutations, especially regarding tax law politics, are threatening the activity. FCP and FIP (principal investment vehicles for private equity investment in France) are threatened by the new finance law. On the one hand, the upper limit of tax loopholes in 10,000 Euros by tax household will have a strong influence on collect, which already slow down in 2011 and 2012. On the other hand, the upper limit of the deductibility of interests on loans for companies will affect potential candidates for capital transmission. If the debt on shareholder’s equity ratio is up to 1, loans interests will not be deductible. LBO’s operations will be less interesting. Last but not least, tax on carried interest will impact the entire sector. Carried interest will be considered as a wage, and then touched by social taxes.

Professionals came with the idea “France is a market to be avoided”, according the article Private Equity industry frowns from France by Anne-Sylvaine Chassany in the Financial Times, referring to the industry’s biggest annual gathering, Super Return. The reason given is the fear from the tax measures.
However, the activity is showing an honourable capitalisation, supporting growth and development for more than 10,000 companies. The most dynamic area is Rhône-Alpes and all the south-east. Siparex, a famous French capital investment company we will study after, borne in Lyon.

Those dynamics will probably drive the sector to a consolidation. Reactions from main actors are expected. Partnerships and networking are for example helping middle-size companies. Sharing knowledge between those companies to concurrence main actors as Axa Private Equity, Equistore Partners Europe, Eurazeo, LBO France, PAI Partners will be a development opportunity.

After our definition of Private Equity, characteristics, an overview of the market, hints on development opportunities, we can sum up our analysis into one conclusion:

- PE has additional risks to those of listed equities. The role of PE funds is to bet on entrepreneurs and start-ups growth, using leveraged buyouts to have a stronger participation in the business. Thanks to their analysis and experience, they are trusting in this volatility to raise income. And this from the early stage until asset backed. This is linked to the income and risk relation. To increase profit margin, an investor needs to accept a higher part of risk. The risks can be identified and mitigated, to capture higher return.

- Risk is concentrated in execution: a selection of right PE Fund Manager is the key. Average returns of Private Equity is not always higher than public markets: Cambridge Associates U.S. Private Equity Index outperformed S&P 500 Index (as we will see in the quantitative survey) last year. Meanwhile, some Private Equity funds more than doubled their average investments. Newbridge Asia III L.P. by 4,3 times, WLR Recovery fund multiplied by 3,6 times its average investment, T3 Partners II, L.P. by 3,2 times, Tower Brook Investors I, L.P. by 2,9 times, Polish Enterprise Fund VI, L.P. by 2,8 times.

- Private Equity has an important role in a portfolio: this risk can be qualified with the low correlation of Private Equity. The potential to lower overall portfolio volatility, thereby helping manage risk; and the potential for downside protection during varying market conditions. In growth period, PE can perform independently from other equities and provide high income. Furthermore, in recessions, it is a way to equilibrate a portfolio, due to its low correlation with other assets.
To debunk a few clichés, some risks must to be considered when investing in Private Equity. Limited marketability and transferability on the one hand, illiquidity on the other hand are the two main negative points. A Private Equity investment is locked-up of 10 or more years. The money invested needs to be independent from the treasury. The investor is consent this money cannot be used for another invest, until its maturity.

According to our preliminary researches on different markets, we can estimate stakes for this activity. Private Equity is facing a difficult economic environment, moving to an increase in taxes and a lack of trust in global markets. Its performance compared to risk is to be considered in the following parts. If such an activity can provide revenue, and constitute an alternative strategy helping to diversify a portfolio, it is also not a miracle solution. Local development, participation to growth, ethic and responsible investments and a decent income are main goals PE is able to reach.

The question to consider Private Equity as an asset class will come in the third part.
Chapter 3: Quantitative survey

Investors are likely to maintain or slightly increase their allocation to Private Equity in 2013. Investors will keep this strategy for the next 18 months (Global Private Equity Barometer” study, Coller Capital, winter 2012). Buyout funds performance are outperforming public equity peer as the MSCI Europe. As 2012 was a better year than 2011, the outlook remains relatively positive (Chart number 3, Public and Private Equity performance).

Another interest for this asset class is its low volatility compared to public markets. As the chart below, volatility of buyout performance is around half MSCI’s one. Volatility over performance ratio is higher for public equities, showing that Private Equity can provide more revenue for a contained volatility (Chart number 4, Public and Private Equity volatility).

But it is a long term view as the graph shows below. Private equity’s efficiency is relevant after 3 years of investment. Venture Capital, which is mainly invested in small and middle-sized starting/early stage businesses, is requesting time for the development and maturity. Buyouts are based on developing companies which have a faster ability to bring incomes (Chart number 5, IRR compared to investment maturity).

The buyout activity suffered in 2011, especially in the final quarter of 2011. European deal-flows dropped by 24% in compared to the first two quarters.
United Kingdom and Ireland were really hit by this decrease in value and volume, value falling from €24 billion to less than €15 billion.
Meanwhile, volume of deals rose by two thirds in Germany-Austria-Switzerland region.

Most of deals were done in the middle market. We also underline the increasing interest for smaller companies and the abandonment of huge acquisitions (Chart number 6, Deal size for Private Equity between 2003 and 2012).

According to this chart showing allocation on emerging markets for Private Equity, we observe an interest for Latin American countries. PE funds are taking advantage from growth in those countries. That is why they increased their allocation with new commitments (Chart number 7, Emerging markets exposure). Those elements let us think Private Equity is able to represent an opportunity investment for the next years. A general upward trend of both volume and value is expected. Emerging markets charts is introducing our part focusing on this market. Small-sized
businesses are recognized in deals for their flexibility and performance. The study also underline future stakes: institutional actors increasing their allocation and a secondary market bringing more freedom in the activity.
Part II: Sources and opportunities for investing in Private Equity

« After the market overview and justification to consider Private Equity as a real alternative investment strategy, we will improve our study. At first sight, we will analyse real successful cases. The goal of this part is to work on elements and factors that drove to prosperity results.

Afterwards, two focuses will be made, by maturity of markets: one on developed markets and another one on emerging markets. These last ones are in the middle of the attentions due to their youth and growth. »
Chapter 1: Survey – Best supports, areas, sectors of investment. Concrete example

I - Best Private equity deals

In order to start our Private Equity survey’s overview, and after theory, we introduce some examples. Those ones have the potential to go down in history and illustrate the power of Private Equity. Even if the core of this study is not based on the biggest buyouts in value, we understand in further parts the business model. That could also be implemented with other philosophies.

Thanks to an article from the Business Insider, (The Biggest Private Equity Buyouts in History, April 2011); here are some relevant profitable buyouts.

Except for Dell’s buyout with a deal value of 24.4 billion USD which occurred this year, biggest Private Equity buyout in deal value are:

- RJR Nabisco. This is actually the biggest leveraged buyout operation. It created the reputation of KKR (Kohlberg, Kravis, Roberts & Co Ltd), with a 31.1 billion USD deal in value in 1989. Even if the financial success is not as high as expected, it will stay iconic with the publication of the book, “Barbarians At the Gate”.
- Energy future holdings. Also bought by KKR but also TPG and Goldman Sachs for roughly 45 billion USD, this company is a Dallas based electricity company. In 2007, the leverage is engaged.
- Hospital Corp. Of America. Around 3.8 billion USD were raised from 2006 to 2010. Buyers were Bain, KKR and Merrill Lynch. And a few years later, HCA went public again with the help of Private Equity buyers.

RJR Nabisco had issues due to tobacco measures, and did not drive to successful financial returns. Energy Future Holdings (TXU) has been described as “struggling” as of February 2013. HCA Private Equity’s operation was quite a success.

We can see from those examples that the value added is certainly beneficial, but can weaken a company or a market.

To a smaller scale, we can discuss the case of Private Equity operations in United Kingdom. The business model is the same, but a new dimension is added to the buyout. When advice and operational management is on equal footing with capital, result can be beneficial.
A nice example is coming from Minivator Company. This stair lift manufacturer underwent two buyouts: one in 2000, another one in 2004. Sales more than trebled in three years due to the first buyout. The second one came to further develop the company. As we saw before, a “shark” would only have been concentrated in the first one, taking his capital gain. But with the encouragement from Gresham’s investment in 2004, both parts worked on development for a management infrastructure to support rapid growth. “An open culture has been developed to support both customers and employees and this has helped make service quality one of the highest in the sector.” Money invested in research and development permitted a certain advantage to the company. Minivator continued its growth, employee number more than doubled, acquiring more market shares. The group have finally been sold to Handicare group of Norway for 42 million GBP. The operational support and “partnership” in the development to support growth led to a success. In the following of the thesis, we underline the importance of this aspect. Private Equity is not only an acquisition followed by a period of growth driving to an exit.

II - Representative Private Equity investments

In this part, two examples introduce the idea of a profitable transaction, for both parts, and not only in the financial way. We will first explain how HSBC launched a Private Equity activity in Pacific Asia. Then we will have a look closer to Europe with a French capital investment company, which knew a significant success because it is now listed on the public markets, Siparex.

HSBC launched a Private Equity activity in Asia. Main goals were to set a successful and experienced team to take advantage of growing Asian countries. As HSBC is already well established in the Private Equity business, it was an opportunity to take. A branch which operates independently under the HSBC Group umbrella could take quick decision and a streamlined decision making process. Enjoying long term equity partners, HSBC Private Equity Asia could provide to the entire group a portfolio management added value.

The Presence of HSBC in Asia (more than 900 branches and offices in Asia Pacific) is strength to develop this activity. Moreover, with its global presence, the group can serve client’s financing needs virtually anywhere in the world. The branch decided to focus on developing countries as China, South Korea, Southeast Asia and India. Fund investors are principally the HSBC Group, institutional and private investors from all around the world.
Active funds under management were approximately 2,520 million USD.
HSBC developed funds investing in both expansion capital and buyouts. On the first hand, expansion capital funds as The HSBC Asian Ventures Fund 3 Limited which were investing from 10 to 30 million USD in communication technology, semiconductors, software, internet services, consumer goods and services. Targeted investments were companies with experienced management, sustainable competitive position and a clearly defined exit strategy. On the other hand, buyout funds as The HSBC Private Equity Fund 6 L.P. were investing bigger amounts: from 40 to 150 million USD. Main sectors were consumer goods and services, technology media and telecoms and diversified industrial.
For both funds, holding period was up to 5 years.
HSBC succeed in its own bet thanks to two main characteristics, linked with HSBC’s philosophy. A rigorous investment process was expected, starting with preliminary discussions, reviews of businesses and markets, projections and risks until negotiations, due diligence and the investment. Furthermore, a post-investment support was provided. The group understood its knowledge, tools and experience as a financial institution would help its targets to reach their goals. After the investment, strategic and financial advices were given, as contacts with industry partners, corporate governance and human resources supports. All keys of success were combined in this strategy.

Some representative Private Equity investments can illustrate this overview.
- Acquisition of ordinary shares issued by a leading regional supermarket chain in China (Yonghui), 77.8 million USD;
- Acquisition of newly-issued shares in Sino-foreign joint venture company, one of the leading independent plantation and forestry companies in China (Heyang), 40.6 million USD;
- Buy-out of a delisted company on the Singapore Stock Exchange in March 2007. Activity is provision of electronics manufacturing services to OEMs, primarily in the telecommunications and medical sectors.

Other share, bond or buy-out operations were successful in sectors as call centres, manufacturing and apparel distribution, insurance products and endowments, software.

Venture investments also were a source of income and recognition for the group. Subscriptions and acquisitions for new and ordinary shares issued by high technologies companies (DelSolar with solar cells, Egis technology with software protection and fingerprint sensor, Jochu Technology with
design and production of metal bezels), food industry (Gourmet Master Co, with coffee and beverages in Taiwan and China), medical supplies and consumable products.

The branch continues actively to invest in this area with aggregate capital of approximately 3.5 billion USD. The branch’s network is developing, due to strong business and investments results. The HSBC Group is a substantial investor in the funds advised by HSBC Private Equity Asia.

After an outlook on most profitable Private Equity deals, most significant ones for developing countries as HSBC did, we can focus on best ethic investments. We found the idea to bring capital and advice to an entrepreneur or a company was source of win-win relation. Considering ethics in such an investment could certainly drive the business in its support to growth while respecting fundamental rights and everyone’s integrity. We will see with concrete examples that an ethic philosophy is not necessarily a barrier to growth. In fact it is the contrary.

We saw that small and middle sized businesses are playing a major role in economic growth. And Private Equity funds, such as capital investment or venture capital companies, encourage it. Emerging ideas can be implemented and shared through one good or service. If some of them are taking participation into businesses, some others are also developing stronger links with their “targets”.

We concentrate on a French example, Siparex. Now quoted on stock exchange, Siparex grew up from “nothing” except its human capital and point of view on Private Equity. Alain Borderie, writer of *financer les champions de demain* thinks this business is referring to the following quote: “French capital investment instead of English Private Equity”.

Siparex is one of the first capital investment French companies. It was created by Dominique Nouvellet (cofounder of the French capital investors Association) in Lyon in 1977. The characteristic of Siparex is its relation: ethic and performance. This business model has been exported in California, Russia, Italia, and other Mediterranean countries.

Siparex means “Investment company in local middle-sized growing businesses”, “Société de participation dans les entreprises moyennes régionales en expansion” in French. This company is encouraging a long term view, rigorous ethic, transparency, strong relation with entrepreneurs, and a total independency.
Original founders are a lawyer, a strategy consultant, and a capital investment specialist, Dominique Nouvellet. Siparex’s members are experienced and coming from different sectors as banking, law, politic, juridical. The founder is also encouraging mid-time employment to enjoy this synergy.

Siparex’s capital is raising from 3 million of French currency to 50 million really soon. Dominique Nouvellet is also engaged to protect shareholders as those in public markets are protected. Siparex company is showing a rigorous and serious attitude:

- Selection process of targeted companies is exigent;
- Total independency from any majority interest of a shareholder;

Those decisions and dynamics encourage the French government to provide tax transparency. Company is exempted from corporation tax on yield and on capital gain on sale of subsidiaries. This relation between industrial actors, shareholders and the government will be beneficial to local development. Siparex will also contribute to legislation propositions in order to improve businesses development according to ethic rules.

Targeted companies by Siparex are industrial firms located close to Lyon and in the centre of France. Thanks to the globalization of the firm, it will find diversified shareholders but also diversified targets. New capitalists companies in Eastern Europe will represent goodwill to consider as an opportunity.

First subsidiaries outgoings are confirming company’s success: receipts of the first sold show an increase of 15 million French currencies. In addition, return is increasing company’s yield: for a nominal share of 100 FR, yield given is 7,85. In percentage of the net return, it represents a payout ratio over 60%.

The business model is attracting the opinion over French frontiers: Koweit State, *Cantrale Ormond Burrus* and SOGENER from Switzerland, *Mediocredito Centrale* from Italy and Société Générale de Belgique become shareholders. Those numerous partnerships will drive Siparex to create one with Fred Adler under a new juridical form: an investment fund. *Euro-America I* will help American high technologies companies to settle in France and help French companies to conquer the American market.

Investments gaining maturity will drive to a turnover. The gross margin obtained can be reintroduced in new subsidiaries. The sold of shares continues to provide a high yield. Siparex
associates are gaining more experience, their advices being part of the business strategy. Their network is also growing up and expanding abroad. Company’s activities and behaviour is driving it to the public markets: Siparex is quoted on the stock exchange in 1990 for 626 million FR. It represents an increase of more than 600% in seven years. Even if the price will know a slow decrease in 1991 due to the presence of non-quoted shares and its resistance on the public markets, the quotation will continue to grow up by 20% per year. Siparex will continue to invest strongly in regional businesses in France, especially in innovating small and middle sized companies: ionisation, medical apparel, food-processing industry. LBOs will become a main activity in 2000, characterized by a mix of shareholders’ equity and debt or with two main invests: Roche-Bobois and La Grande Récré.

Siparex celebrated its thirtieth birthday in 2008, with a total outgoing disinvestment of 404 million Euros for a total input of 286 million Euros, still managing LBOs, capital investments and venture capital funds.

We found interesting the idea to study a Euro area country, the French market.

**III - Focus on the French market**

Structure of Private Equity market in France is really specific. Regarding invested amounts, France is the first capital investment market in Europe, and the third in the world. According to the association of French investors for growth this activity is employing roughly 1.5 million people and involved more than 1,500 companies in 2012.

A hundred of actors are composing it. On the first hand, we can find big firms with assets over 1 billion EUR. According to the survey on Capital Investment driven by Xerfi 700, Axa Private Equity is the major one with more than 28 billion EUR of assets in 2012. Followed by FSI (19.7 billion EUR), BC Partners (16 billion EUR), 3i (14.4 billion EUR) and Cinven (10.1 billion EUR). International Private Equity brand is managing 6.2 billion EUR. On the other hand, smaller companies with less than 100 million EUR managed are found. Overall, most of actors in the Private Equity sector in France are supported or are subsidiaries of big groups (CM-CIC Finance, GIMV, and IdInvest Partners). FSI is a governmental entity. Presence of English Private Equity firms is limited; they are involved in few operations. But those ones are often form an important size.
Financial crisis and new regulations from Basel III impacted banks in limiting their exposition to this asset class. Investment subsidiaries are reorganized, some of them sold. In addition, fiscal pressure is growing up with the end of deductibility of interest from LBO operations. LBO represents 61% of the activity in France, it is perceived as the most profitable one. Moreover, as we saw before, the upper limit of tax loopholes in 10,000 Euros by tax household will reduce impact negatively investments in products as FCPI or FIP.

At the same time, French government is increasing its activities in this sector. The creation of FSI (In French, “Fonds Stratégiques d’Investissement”) in 2009 is showing interests of public actors into capital investment activities. The positive point is that FSI and the French government is promoting a sort of private-public partnership. In the public side, under the State’s control, it is acting in a “responsible interest”, investing in employment, innovation, education, international trade. A selective process is implemented for choosing investment targets. In the private side, FSI is holding shares in private companies specialized in capital investment activities: Ace Management (solutions for innovative companies in defence), Demeter Partners (eco-industries), and Emertec (long term and ecologic development).

Through all those tendencies, most of actors are considering responsible investments for their activity. For a reputation advantage and also for a financial performance (management with targets, follow-up, reporting, monitoring, due diligences...).

According to the Capital Investment survey in Xerfi 700, we can sum up three trends for the French market:

First, actors are isolated. Deals in France are made by French actors in general. No particular link is shared with foreign countries. And capital investment companies (even big) are counting few human resource affected to this activity. For example, Axa Private Equity, one of the world leaders involves 270 people. A positive reaction to this trend is the creation of the PEN (Private Equity Network). Its goal is to promote the internationalisation of both Private Equity firms and targeted companies. Thanks to this network, the French Activa Capital merged with Graphite Capital (UK), ECM (GER), and MCH (ESP). Those companies are LBO specialists and share the same vision for the activity. Probably this trend will open more and more opportunities abroad for European partnerships.

Second, meeting processes between entrepreneurs and investors needs to be improved. A lack of fluidity in transaction is researched. Palico and SecondaryNet are two exchanges platforms for Private Equity transactions. They are working as the meeting website, Meetic. In addition to usual
services offered by those websites, Palico for example is offering specialized services for companies as professional advices. SecondaryNet is more focused in secondary transactions. A follow-up is provided to investors during all the investment process. It is reacting to market inefficiency and supporting meeting between entrepreneurs and investors.

Third, reorganization is expected in the next years. Smaller actors will be vulnerable in recovering financial crisis, harder regulations, and lack of trust. French capital investment firms are fragile and their activity is decreasing. Limited partners will probably focus more in big actors to prevent from the incoming natural selection.

Last but not least, especially in France, lot of companies will be sold out. As we saw before, number of entrepreneurs will increase. We can think this market still have good years in front of it.
Chapter 2: Focus on developed markets

I - Overview

Born in United States early in the 20th century and then shared abroad, Private Equity has been a support to growth. As long as public markets and stock exchange played an important role in development for the biggest capitalized companies, PE focused on smaller companies, start-ups and entrepreneurs. Sharply helped with the idealistic “American dream”, it also contributed to build countries to the rank of developed.

In this part we will try to see to what extent developed markets are using Private Equity. We will work on how they encourage this activity, and also which are the stakes for such markets.

Some Private Equity investments outperformed public ones in a difficult economic environment. A proof that there are still opportunities in a slowly growing economy. Indeed, as we saw before some sectors were exploited thanks to a significant demand. Medical, high tech, buildings are highly selected for development projects. It is a sure way to confirm ones country added value. Moreover there is a certain guarantee to create income and make profit. The money involved and trust given to projects influenced in a positive way employment.

Research of optimisation, international concurrence and ecologic awareness is driving authorities to collect funds, open their capital and invest in sustainable development projects. Investors help governments to raise funds to realize those projects. It is giving a bigger impact on one investment. It can also give the opportunity for a country to manage more programs. And get a real advantage for its health conditions, GDP, economy, premises and infrastructures.

Authorities are agreeing with companies for projects of infrastructure (construction and maintenance). Classical loans are financing the project and in addition Infrastructure investor, operational partner and construction partner are shareholders of the project company. This last one is then managing the project with treasury provided, in agreement with governments or public institutions.

Despite Private Equity is providing high yield for investments in emerging markets, developed markets are a juicy target for infrastructure. We can find it in Europe and especially in United Kingdom, which is encouraging these type of invests. Most of funds are supporting projects of accommodation, health, transport, education, law and order and utilities. As a concrete example,
HSBC is taking participation in governments programs of development. It is one of the earliest players in the infrastructure investment market. It can be home office headquarters, hospitals, river crossing, factories, speed rail links. Through investment funds, HSBC Infrastructure is bringing capital to government for its projects.

By its core characteristics, Infrastructure is sharing similar aspects with Private Equity:

- Infrastructure is, as PE is, fitting with a long term investment strategy; long duration concessions needs to be undertook by managers;
- Also, low correlation to economic cycle and low volatility of cash flows can be explained by a high demography and an older population. Demand on accommodations, health or utilities are necessary for a sustainable development;
- Little correlation to market or economy cycles;
- Macroeconomic risks are hedged long term. Since the beginning, a high volatility and high profits on short term are not researched. The investment can accept a period of recession if the final income is positive. The long term perspective is looking above cyclic market’s reactions;
- There is a high quality counterparty with essential services. A physical impact can be observed, the project is concrete;
- Exposure to infrastructure can contribute to diversification in an investment portfolio, as classical Private Equity. Adding a new asset class to a portfolio is, according to diversification studies, lowering risk. Last but not least, the overall risk-return profile can be improved when yields are constant and risk contained.

If some characteristics of Infrastructure are similar to Private Equity, Infrastructure is differing from certain point as income/risk ratio.

- The low risk of an infrastructure investment is verified. Contractors are often public institutions or governments, with a low default risk. High quality counterparty is giving a competitive advantage to investors. Furthermore, all activities are concentrated in essential services as saw before. The accrual demand for those sectors is guaranteed.
- Risks are mitigated. They are passed down to subcontractors in their main part. As compensation, cash flows are sustainable and can be easily predicted. They are also correlated to inflation.
- Infrastructure is providing sustainable market positions. Number of projects proposed is inferior to those asked. It is setting a selection. Entry barriers are then limiting actors on the market.

From an investor’s point of view, which investments are providing low risks? Where is the concurrence’s impact?
The table number 2, Infrastructure category scale, is setting revenue volatility against investment risks with examples.

We can observe high revenues are observed where demand is more specific. Also, for diversified sectors a high concurrence will be seen on projects. Investments with lower risks are attracting more transaction debt in volume than high volatility programs. Healthcare for example is totalizing $55 million in 2008, education $30 and transport 35 while waste is roughly counting $7 million at the same date. In value, transportation assets represent the largest proportion of the global transaction by value (Chart number 8, Infrastructure risk scale).

Investors should determine which risk-return profile best suits their investment objectives. Two main strategies exist:
- Private Equity investments: are considered with a higher risk reward investment, returns being mostly shared through capital gains. As other PE investments, they are illiquid and required a successful exit. They are also medium term investments.
- Yield investments: are with less risk while providing high and stable yields. If the investor accepts to keep its money hold for a long time, listed vehicles are bringing liquidity.

According to chart number 9, Infrastructure market opportunities, market opportunities are concentrated in developed countries between transports, power and social. Even with a significant impact of the financial crisis, countries continued to develop infrastructures. First it was still a source of employment, and an international recognition. Spain kept developing its airport projects as Valencia’s one. Denmark... Also, the need of power is more and more verified (electric consummation between 2007 and 2012). Social needs have been high during this period, with peaks of unemployment. So this concentration of investments is still currently in the post-crisis period.

But if we actualize this chart regarding all we studied, and some future opportunities, circles may be seen to a bigger size:
- China with power, telecom and waste (to a longer term view);
- Africa and Medium Orient with telecoms and water sewage;
- Latin America with telecoms;
- All Asia pacific.

And some of them lowered:
- North America and Western Europe with transports, but higher in power;
- Western Europe in social.

According to our studies, we can underline some profitable markets to support growth:
- Electronics and technology high technologies (HSBC survey Specialists agree to consider electricity generation as the future main market);
- Consumer goods and services (Nutrition and Food, Outlet, Supports to demography (nurses, alimentation);
- Industrial and manufacturing (energy, productivity, international trade);
- Infrastructure.
II - Institutional investment opportunities

After a flat period with an uncertain economic environment and a decrease in assets profitability, institutions are more likely to unload their capital in Private Equities. Even if their pool of assets is spread between shares, bonds, monetary assets, structured products and others, the part dedicated to Private Equity is expected to increase. It is mainly due to lacks of income coming from bonds and money markets, the core capital of those entities. The “satellite” part, expected to provide more income but more volatile is invested between public and private equities.

The appetite of institutions for such investments is increasing. For instance, those entities are finding interests they cannot find through other asset classes. Net added value is important, especially when times are difficult. Early cash distribution (mainly in secondary market) is a positive point for the treasury management. Also, most profitable funds between 2000 and 2011 were in the 200-500 million EUR bracket, with an averaged net pooled interest rate since inception of 19%. Over this limit, funds are showing a lower performance. That means a Private Equity strategy is interesting for institutions, not expected to invest in expensive funds. Moreover, with the same amount of money invested in expensive funds (one billion USD for example) a better performance is appreciated but also a greater diversification (by vintage, geography, sector...).

Institutions have the possibility to increase incomes for those investments, and at the same time to manage the risk with a rigorous number of funds.

And the main positive aspect is the targeted geographical zone: Europe and North America. Most of deals will be located in those markets, certainly sustaining a tight recovery in the long term. According to the European Private Equity outlook for 2012 by IdInvest partners, 2012, they will remain regions of greatest interest for institutional investors. If China attracted significant investments over the past ten years, European institutions believe in their home market to recover. Political and financial instability is difficult for building a sustainable relationship. Nordic countries are attracting their interest, followed by Germany and United Kingdom.

Overall economic performance, with good GDP growth and effects on employment are interesting. But more likely to attract institutional investors, surveys demonstrate opportunities in Nordic markets:

- Lot of deals are coming to maturity, leaving possibilities to penetrate the market;
- Innovation and natural resources are comforting investors in country’s prosperity. Entrepreneurs are succeeding in those sectors;
- Public sector is ready to open to competition;
- Private Equity’s public image is positive in local markets.

All of the above let us think Nordic area can be a new target for institutional investors. Moreover, if fiscal adjustment plans and concrete moves towards fiscal union are implemented, Euro area could remain an overhang for investments.

Still considering Northern Europe countries as an investment target, UK is showing interesting figures. According to IBES, Datastream, data as of March 2013, UK has the best equity dividend yield. Followed by Europe ex UK and China. The attractiveness of shares is increasing. Proportion of profits shared with equity owners is high. Moreover, the ratio price to book on return on equity is the most attractive one with roughly 9 for UK compared to 25 for Latin America.

As of example, real estate and infrastructure projects are developing, driven by demand in building and housing sector. We saw in the last part attractiveness for infrastructure projects. In such markets, government is encouraging demography, education and health. Need in student and professional housing is opening possibilities for Private Equity investments. Moreover, the majority of migrants in those areas are educated or looking for education improvement. Student housings are expected to develop. Profitability of such investments is proved. Even banks are on track to finance building projects. But a Private Equity support could help construction companies to start the work.

Especially because return on investment is high and the operation is presenting a low risk. Capital gains can reimburse in two years the initial investment. As rents will continue to be perceived, yields can push up performance of a fund or a portfolio. Limited risk, high yield and long term investment is explaining attractiveness and competition for such transactions.

Last but not least, there is a natural tension between protecting capital and generating income. Alternative approaches have been taken to this problem. For institutions, they will probably extent duration in an effort to push up returns on a view that yields will probably remain low for the foreseeable future. Another strategy would be to “take the pain” by staying short on the curve to avoid locking into the risk that yields will rise sharply in the future. And institutional investors are considering alternative assets including debt, real estate, public and Private Equity.
Chapter 3: Focus on emerging markets

I – An example on how PE should be implemented

We saw Private Equity showed its proofs in developed markets. What about markets just expanding, eager to grow up and deal with the world, even overtake mature ones? Ambition, natural and human resources can meet research, high technologies and experience and needs for development. Annualized growth reaching roughly two figures is attracting capital and interests. Is that an opportunity for Private Equity to surf on the wave of growth?

Growth for China is about 7.9%, Brazil 3.9%, and Pacific-Asia roughly 4%. Those figures are putting on the sideline developed countries with their 1, or 0.5% of annualized growth. In countries where development potential is higher than developed ones, and where there is a lot to do, PE has a role to play. Especially because of the number of small businesses and entrepreneurs eager to enhance their growth is high. Even stock exchange observed and is still observing a steady increase for shares and bonds in China, Pacific Asia, Latin America and others.

Chart

With concrete examples we will try to develop an overview for Private Equity in emerging markets. Which sectors, type of businesses, maturity of investments and capital gains can be expected, how this activity can be implement in such markets.

Presence of emerging economies in a portfolio is redundant; it can concern equities and bonds of a company located in an emerging country, a company linked to emerging countries or market (but can be located in developed markets) and frontier markets. Frontier markets are considered as emerging of the emerging. Their development stage is a bit lower than in emerging markets, and the development capacity is higher. At the same time, the risk and country issues can affect the safety of the investment.

But it is important to deal with those markets, having high hopes and beneficial development goals. We can start our approach of Private Equity in emerging markets with examples. I had the opportunity to work with a financial planner in the south of France. Different from its dynamism and pragmatism, and supported by a rich network, he knew how to “swim with the current” when markets were favourable. But he also surprised me and convinced his network and followers to “swim against the tide”. And he came up with brilliant ideas.
His goal was not to speculate and expect growth, forgetting ethics and human values. He wanted to launch Private Equity investments in the Third World, from his own. He believed in projects that would help the local population, encourage them to learn techniques, implement them and develop their business in order to improve their living and working conditions. Also a big impact on the employment would be appreciated. Win-win relations were the goal. He also was rich from multinational experiences, which probably contributed to his open mind and wide vision.

By developing three main projects in Asia and Pacific Asia, Mr S. conducted surveys about the success of integration from a foreign investor.

First, emerging and frontier markets are known for having low GDP per inhabitants, due to an early starting economy. From a macroeconomic aspect, incomes generated by growth are concentrated on foreign investors, main industries and institutions, and governments. The entrepreneur trend is not the main driver for growth, as United States can have it. But we cannot deny the high demand and the need for small businesses or entrepreneurs in economy’s network. Opportunities for them in trade are huge because of an overall lack of concurrence.

Thus, emerging markets are investing in development, stocks, and infrastructures in lot of sectors. Banks are answering this demand by loans to government, institutions, and companies. But a genius way to encourage growth with money lending has been developed in such countries: micro credit. Muhammad Yunus first assessed it in Bangladesh, with the Grameen Bank. After implementations, micro credit represented a real hope for people to improve their revenues by launching or developing an activity. It also proved that women could access more easily to a freedom in their working choice. Most of the money borrowed has been invested in health and education and, also in poor areas.

Principal demand for microcredit is coming by far from Pacific Asia (roughly 70%), followed by Latin America and Africa.

Our researches help us to think a microcredit activity can be implemented in other countries. Sri Lankan government is highly encouraging foreign direct investments for its country. Most of micro credits are issued by financial corporations working as cooperatives. An acquisition in their capital, a partnership can be easily considered. Partnerships with banks are supported by Sri Lankan State (through the Board of Investment, with tax advantages, advices, premises).
The main strengths for this investment are the demand, investors’ protection, and high attraction for DFI supported by government. As China did and still does, low barriers and attractiveness for foreign investors are beneficial for developing countries. Capital, human and knowledge is provided to the host country, while a foreign company enjoys a dynamic market and comfortable taxes. Also to consider such investments, special precautions need to be taken. Solidity of juridical guaranties, risk of non-payment and corruption, can be weaknesses in frontier and emerging markets. That is why survey is necessary while introducing a new market. Those projects represent real opportunities for investors, and illustrates out theory on the diversification of a portfolio.

Second, development of infrastructure is determinant for a developing country. Mobility is a factor a country may take into account when developing. Time and money dedicated to transportation from the farm, factory, industry, company until the final consumer needs to be relative to the operation. That is why the importance of having infrastructures is important. Connexions between companies, consumers, institutions are supporting human and capital flows. It is a support to growth in general and also a target for investors. In India, roads and highways represent the second most attractive sector for the future, after power (Daycoindia, Importance of infrastructure on Indian economy, 2013).

I had the opportunity to work on a franchise project in Sri Lanka. The goal was to be a franchisee building small-sized car factories in the country. High dependence to Chinese and Indian market is encouraging an entry on the market. Developing a network of factories and dealing stores could answer to Sri Lanka’s automotive need and also to all the Pacific Asia. Indeed, the geographic position of the country is optimal to start an exportation activity.

The requirement to launch such a project is to have local partners knowing the market. An efficient network is necessary to implement those “handmade” investments. The opportunity is to consider. While most of vehicles are imported (mainly from China), it is a way to give more independence to Sri Lankan people. At the same time, low cost and price strategy from exporters are hard, concurrence is high. Labour cost is still higher than Bangladesh for example. A rigorous price management, business plan and experience in the sector could be appreciated to launch a project.

Bring knowledge and organization to small farms or plantations to meet local needs: excess exported. Low costs of entry: high dev possibility: low cost labour: many consumers, support of state (low barriers, low tax).
Those examples are showing how profitable could be private equity and venture capital investments while be beneficial for the investee and its environment. The last example is relevant – agriculture with coconuts.

On the first hand, a cheap amount can be invested and the business, here the farm, can be developed, producing more, opening to more consumers inside and outside the area. Benefits earned can easily attain 10% per year, the majority of the gross margin being invested in the business for its development. Short term capital gains as coupons or dividends are provided and long term revenues are expected to come.

On the other hand, this brings solutions for food abundance, employment, and local concurrence – with a dynamic effect on the market – knowledge, business’ experience, and many other advantages.

Our study makes us believe the development of such projects can help emerging markets to reach their position of prosperity, or, at least, to improve their conditions, and participate to growth and trade. They could also represent a solution of investment for portfolios, to diversify and revitalize them, being at the same time a long term share, and providing short term gains.

New challenges are opening overseas. Investors with a worldwide, profitable and responsible point of view are able to support beneficial growth. Especially with win-win relationships as seen above where every part is satisfied. Emerging to emerging transactions will become a huge market in the next decades.
II – Opportunities in emerging markets

The last paragraph was approaching the implementation of Private Equity in emerging markets with examples. After illustrating our theory believing this area is full of opportunities, we can study the market in its macroeconomic aspect.

Thus, we did not spoke about Africa before in our study. But this continent could certainly support and need Private Equity investments.
First of all, it is interesting by its geography. Africa is located between Europe, Western Asia and Middle East. And it is not that far from the American continent and Pacific Asia by boat. It is a positive point for exchanges and trade.
Second, labour force is an interesting factor for the development of an activity. People are able to work, for a reasonable wage.
Third, natural resources are giving an advantage to Africa for trade. In a world consuming more, needing energy, fuels, goods and precious stones, the continent can exploit the land’s wealth. Even if in reality, this is a source of conflicts and abuses.
Fourth, space is permitting geographical development without hard limitation constraints. Prices for real estate and lands can support a developing activity.

Developed groups are already located in Africa through subsidiaries and partners. The French group Total is exploiting around thirty offshore oil derricks in Gabon. Zara is located in the Maghreb region to produce its clothes for Europe. Smaller entrepreneurs are expanding their activity in exports or imports, or directly integrated in the market.

Stakes for Africa are clear: try to reach a higher independence rank and improve its inner living conditions. Dependence on humanitarian assistance was for sure a solution in the short term, but lowered a certain control in the long term. At the same time, money given for charity sometimes knew frauds and financial wrongdoing. It is a key risk for Private Equity investments too. They may be suffering from similar diseases.
And abuses of African possibilities are threatening the continent already. China, the giant energy consumer is literally draining resources to ensure sources of supply.

It is time for investors to bring knowledge, experience and capital in a continent where “everything is to be made”. So Africa is presenting a lot of opportunities. And governments are supporting this trend. As the round table, Economic commission for Africa, organized on the 8th of May 2013, is
expected to “highlight the potential of Private Equity as an alternative source of financing [...] and generating growth and jobs in the continent”, (ECA, WEF to discuss private equity, capital markets on Africa, APASENE, 4th May 2013).

Another region is attracting Private Equity and capital investment. Since 2010 statistics recorded a vitality showing attraction from financial investors for Chinese performances. Enthusiasm is explained by high return on investments, more freedom in leverage operations and growth. China is on the first place for all capital investment activities in Pacific Asia area with 9 billion USD invested for 20 billion USD leveraged.

Expansion for those areas is considerable. High progressions are seen on Private Equity supports, and opportunities. As we saw before, governments are aware Private Equity can steadily impact their level of growth, development and competitively.

Investors may also consider changes in the sector. Before, external investors mostly coming from developed countries (United States, Europe, Hong Kong, Singapore) were the source of capital investments. But nowadays, such activities are also directed by new funds as “renminbi” (RMB), leveraged by domestic capital and investing in China.

The country is more and more driven by domestic growth and activity. Changes are seen in origins of Private Equity and capital investment operations. Those elements are meeting our hypothesis of emerging to emerging operations as increasing over the next years.

As we will see in the last Chapter, The future of Private Equity, and according to our study above, environment for Private Equity is changing. In emerging markets, transaction control is more local, with emerging funds. If over the past few years, foreign investors owned control of funds, they are now in concurrence with domestic actors.

Challenge for the next years will be to take advantage of those new market rules. For example in China, partnerships allow foreign investors to manage RMB funds. In 2010, half of RMB’s investments were under a co-management of foreign and local funds. Again we meet our idea that the mix between country’s knowledge and occidental experience is a good synergy.

Moreover, in emerging markets Private Equity and venture capital is useful to remedy the insufficiencies of the banking system. An alternative way to finance private companies and entrepreneurs gives an important contribution. Credit accessibility allowed small companies to support growth and explore new markets.
Governance is also improved with the help of the operational management support given by investors and their tools: management reports, auditing, financial direction, respect of social rules.

To conclude our overview, we can expose emerging countries with 2013 GDP/inflation forecasts:

- Japan (0.7+/−0.2) and Asia pacific (China 8.1/3.2, India 6.5/7.6, Thailand 4.6/3.3);
- Latin America (from 3.5 to 4.5/from 3 to 5). Chile is showing the best ratio with 4.7/3.1 ratio.

**Economic Source Consensus**

And according to our studies and examples, main markets in emerging countries will be:

- Natural resources;
- Infrastructure and premises;
- Agriculture;
- Industry;
- Growing technologies;
- International trade.

Last but not least, it is important to debunk few clichés. Emerging markets performance can be questioned. First of all, inflation is a threat for this area. It can drive to higher rates and a decrease in the consummation. Second, ecologic disrespect and natural resource abuses can create conflicts. This can led to asset back and guaranty issues. Finally, studies also showed that once businesses are financed, they are not more able to access bank credits.
Part III: Does Private Equity can be considered as an asset class?

« Thanks to our work done on the last part: we can now ask how to meet a new idea with an investor. Our sources let us know that a special attention needs to be taken in the way to present.

We will first develop a study on how Private Equity was, is and will probably perform.

Second, we wonder on how to propose these investments to institutions and independent investors. The way to share the information and get the trust of investors will be delicate and need to be studied well. As it represent a considerable source of income.

On the other hand, a framework will be developed working on the future of Private Equity. Which will be the goals, incomes, stakes, and impact? »
Chapter 1: Performance and opportunities – survey in a portfolio

I – Approach and survey conditions

A normal wealth is held generally with 30% in real estate, 10-20% in alternative (art, cars, others) and the rest in banking accounts (half treasury and a half investments as shares, bonds). This profile is changing a lot from countries (French are known for their attractiveness for real estate, North Americans for shares and bonds) and also from macroeconomic situations. Low income on bonds, money markets and treasury funds are discouraging investors for those assets classes.

According to the repartition listed above, attentions are focused on shares, real estate, alternative investments (a high demand for art) and Private Equity. And inflows are following this trend; demand for equities increased and capacity for financing companies seems more real. So if we focus on the part of the wealth invested in financial markets, we can see a mutation from secured asset classes to risky and highly potential’s ones. As shown below, a portfolio point of view is adopted for our study.

Portfolios are built regarding the investor’s profile. We know that according to risk taken and income expectations, the management of a portfolio is really different. To define the philosophy of an investor, managers are enjoying lots of possibilities and configurations. In order to surf on economical conditions, a portfolio can allocate its money into different asset classes. As follows, we study three variables an investor can use for its diversification and protection against systematic risk.

First, portfolios are divided into different asset classes. They might include equities, bonds, money markets, diversified assets like UCITS (Undertaking for Collective Investment in Transferable Securities), structured products, general funds. The behaviour’s an investor will adopt according to the analysis of the market will define assets’ allocation. When inflation and growth are predicted to be negative, positions should be reinforced in bonds. When growth will start, equities will be a good support to benefit from companies’ profits. From financials, transports and technologies in the early bull stage, passing by capital goods and basic industry in the middle bull one, until precious metals and energy in the late bull/early bear period. In times when inflation is expected to increase, commodities and real estate are to reinforce. Then, if the predicted inflation is still high and if growth is decreasing, cash and money markets are the main asset class to bring a future income.
Secondly, geographic location has a significant influence on the portfolio’s identity and on its performance too. As we saw through our focuses on developed and emerging markets, Part II, Chapter 2 and 3, capital gains and risks are differing. With a hypothetic portfolio containing the same asset repartition (changing only from its geographic location), different performances will be observed. A pool of assets invested in Pacific Asia area will enjoy local growth, while one invested in Western Europe area will be more flat nowadays. Capital allocation between Europe, North America, Pacific Asia, Emerging areas and Global areas is defining portfolio’s performance. Those criteria needs to be well managed with the asset class described above.

Third, a pool of assets may be shared between different currencies. It can be to protect or exposed to different currencies, waiting for a value/devaluation depending or not on Central Banks’ decisions. Assets can be denominated in different currencies as Euro (EUR), United States Dollar (USD), Great Britain Pound (GBP), Switzerland franc (CHF), and others. It is a way to lower the currency exposure.

Other variables are impacting this performance as the size of business, the maturity of the investment, sectors, risk policy (bankruptcy, event driven).

Here again we underline the importance of assets diversification in a portfolio. The risk is lowered significantly (as we saw in the Part II, Chapter 2, I – Overview) while capital gains and incomes can be from different origins. Those variables are providing a protection against cyclical risk for the investor when allocated strategically.

The other aspect from a portfolio management study is to consider the state of mind of the investor. His ability to handle risk for a return will define the composition of its assets. The three main behaviours are Prudent, Equilibrated and Dynamic.

The first one may consist of equilibrium between asset classes. It often includes secured categories with low volatility, mainly located in developed markets. Usually, equities are not exceeding 20% of the pool of asset’s allocation, bonds and monetary assets are under 80%.

The second one is less passive than a prudent management, with the main part comforting a secured capital, but with a higher part dedicated to the performance research. Thus, equities’ weight should be reinforced up to 40%, while maximum for monetary markets and bonds is 60%.

The third profile is dynamic. This configuration is able to accept a higher part of risk in order to maximise income. Minimum allocation for equities is then 60% of the entire portfolio. The other 40% may be spread between bonds and monetary assets. A dynamic pool of assets is betting on a
higher volatility compared to the prudent and equilibrated, given by equities. A high dependence on management choices requires more precautions. Portfolio may be more able to perform with this repartition.

All of the above may contain currencies.

So, we underline a real interest for Private Equity as an asset class. This activity which showed high capital gains over the last decades, especially in North America, still has a development capacity. Because it can follow the trends and also support actors of new waves and dynamics, it is always a (model) for growth and development. And if PE can exist respecting ethics and environmental regulations, it is definitely to consider as an asset class.

To continue our overview about Private Equity’s performance, it is important to approach the survey with quantitative issue analysis. Difficulties about comparing Public and Private Equity performance exist, due to different operation schemes.

Even if most of professionals are recommending this class in portfolios, some studies are being less optimistic. The difficulty is about to compare returns on investments between public and private equities. How can we study in a rigorous way the performance of one compared to another? Because investments philosophies are different, companies are from different size and country, in various sectors. All the scale is changing.

Even returns are not provided in the same way. Public markets are more predictable, often offering stable coupons or dividends over the years.

The maturity of the business targeted is also different. Most of investments made in public markets are enjoying mature companies, blue ships. Private Equity can invest from the early stage until the asset backed.

That is why most of the studies realized global researches, estimating an annualized performance for public and private equity. For a prudent strategy in public markets, a prudent strategy in private equity is compared.

According to Kaplan and Schoar (2005), returns on Private Equity (earned net of fees) are lower than what can provide S&P’s 500 index. Their studies showed, with an average ratio of 93% to 97%, that an investor will earn more investing in S&P’s 500 index than in Private Equity. The outperformance justified by a high risk is less than the index. However, when fees are added back, returns of Private Equity outperform index’s ones.
The interest is then depending on fees. A performing fund manager will require high fees.

It is important to consider returns on investments differences between public equities and Private Equity. For some Private Equity funds, returns are auto-correlated. They are depending on past returns. It is bringing another difficulty to our study. But the amount of those companies is negligible, around 15%.

**II – Performance survey**

If Private Equity is known for its illiquidity, it is also able to provide considerable returns. We will study how it can be considered as an asset class in a portfolio.

Since 2000, Private Equity investments have outperformed public markets by 9% in Europe, and 5% in North America per annum (Source Bloomberg, NDDUE15 Index in EUR, NDDUNA Index in USD compared to the MSCI Regional Index). Those figures are still seen during the financial crisis. It is showing that Private Equity has strong defensive qualities and can contribute to an alternative investment strategy.

A study from Partners Group, *Understanding the Private Equity’s outperformance in difficult times*, January 2012, is wondering on the explanation of this higher performance. According to the survey, the excess of return observed between public and Private Equity is certainly not due to a higher risk. Their adjusted for auto-correlation chart is still showing a lower volatility compared to public equities. They are then wondering why PE is more profitable while not taking more risk.

First, the selection from managers to invest in high potential business models, promising entrepreneurs, and distressed companies with future opportunities and starting businesses is basically adding a value. Their experience, network and analysis’ sense permit them to expect more revenues than listed and pre-selected companies composing indexes. When looking for a new investment, they are considering:

- The company’s position on market, main competitors, entry barriers for new competitors;
- The management and technology’s stage;
- Stability and profitability of future cash-flows.

Trough those criteria, businesses need to represent a real opportunity. Because managers are selective in order to manage their risk. A “due diligence” is conducted several months before the
eventual transaction. During this period, the investor can understand to what extent the business is working. He has time to conduct surveys on the economic stability of the business, its opportunities of development.

Second, they are enjoying a highly qualified network, specialised by sectors and geographical regions. Entrepreneurs, board members, CEO’s are providing advises and experiences, contributing for a well built decision making process. Finally, Private Equity investors are working with the support of a real board of investment. From the Partners Group’s point of view, we call that an “unparalleled pipeline of deal opportunities”.

So, we see that compared to our previous announcements, we acknowledge performance of Private Equity is not only driven by a higher risk. A demanding selection process, a capacity to understand the business with a due diligence, a collaborative network and professional advices can explain this outperformance.

According to (Private Equity portfolio company performance through the recession from the The British Private Equity & Venture Capital Association (BVCA)), companies financed by private equity are outperforming listed companies. Before and during the recession, an average of 14% higher productivity and 5% higher return on assets are observed. Comparing private equity firms with listed and private companies on all the United Kingdom stock market, results of the study consider PE as more profitable and reliable companies. The table 3 is illustrating those observations. As we saw before, the difficulty to compare rigorously Public with Private Equity is limited through the BVCA’s study. The matching process is selecting companies from the same sector, as similar relative size and a logical maturity.

Most unexpected results from this study are that Private Equity portfolio companies will have higher development capacities and a lower risk of failure:

- The average failure. As the Table 3, Performance analysis and recession impact on PE-Backed Companies, is showing, insolvency was concerning more Private Equity Buyouts before 2007 than listed companies. However, insolvency failure rate started to be lower for those companies after this period (Table 4, Insolvency and failure rates). We have could have expected from listed companies to justify a fewer failure risk. Another sign Private Equity is able to perform in recession period.
- The financial leverage. Private Equity owners are actively helping targeted companies, involved in the management and optimisation of performance. The investment capacity is variable and can reach peaks. Investors are more able to support a company they know well, trust, understand the environment and believe in growth. The amount assigned is relatively high compared to the size of the business.

Regarding PE, as showed before, this outperformance is explained by proactive management and a real involvement from actors. An ability to finance the firm in case of economic downturns and a real consciousness from actors is shared. This responsible behaviour has indirect positive effects on businesses. According to a Partners Group study, *Understanding the Private Equity's outperformance in difficult times*, January 2012, approximately 25% of value creation is due to operational improvement measures. The fact to act bone fide for the good of the company is also a variable for a Private Equity investment.

As we will see in the last chapter, the future of Private Equity, the secondary market brought a solution for the lack of liquidity. Competitive pricing, process efficiencies and use of secured financial tools are already encouraging secondary market transactions. An investor engaged with PE shares can easily change his positions if he needs his capital, or if he is interested in other investments.

Thus, this market is efficient and competitive. At first sight, a steady increase in new entrants was seen. Also, around 20 billion USD is held in fund structures for secondary investments. This is without taking into account fund of funds and large institutional investors. More strategic and promising investments can be found.

This freedom provided by significant number of actors on the market is more profitable. From the performance point of view, net added values are more frequent.

According to what we saw, two philosophies can be followed.

The first one is considering Private Equity introduction with a long term management. The initial investment driving to a maturity, with a consideration of the capital and advices brought to the business. The idea is to keep the PE share until the end. For example, investments seen in Part II, chapter 2, I - An example on how PE should be implemented, are illustrating this philosophy.

The second one is approaching PE from another point of view. With the help of the secondary markets, liquidity default is mainly avoided. Market risk is also decreasing due to the ability to re
allocate assets. But the advising activity and personal interest in one business is not as high as in the long term asset held strategy. But it does not mean this one is not considering ethics as one of its imperatives.

The idea came to change our vision. We were concentrating inside a Private Equity portfolio. We can also concentrate on how Private Equity performance is influencing overall portfolio performance. How PE held as an asset class is providing dynamism and return inside a global portfolio containing equities, bonds, money markets, UCITS (Undertaking for Collective Investment in Transferable Securities), structured products and more.

Chapter 2: Obtain trust from investors

We can suppose Private Equity is not well known from independents or companies. Indeed in Europe where investments are made in real estate and stock exchange. North America knew a real activity with good examples as Dell Inc or Heinz. Hedge funds are also active in this sector but suffer in Europe for a lack of recognition. Around 15% of stock capitalization is Socially Responsible investments in United States.

In France, ISR (Socially Responsible Investments) was launched for employee savings. In a responsible development philosophy, those products had a time before knowing a real interest. Helped by the economic context, independents are more and more aware to social and environmental risks.

We saw in the first part that a real demand exists for Private Equity. Low capital gains and uncertainty on stock exchange, high prices for real estate drove attention to growth in smaller companies and entrepreneurs. Figures in emerging markets also created an interest to allocate a part of the wealth in alternative investments and new categories.

Thus, interests from institutional investors (as we saw in the Part II, Chapter 2, II – Institutional investments opportunities) and financial planners or independent investors are able to bring back the tendency for Private Equity. Searching for an income/risk ratio higher than the average public markets’ one, interest in seen for this asset class. Moreover, it is a great deal for institutions which want to improve their image and recognition. Invest in developing areas; take part into growth while respecting ethics is an added value. As a consequence, transparency over investments will be easier, driven by the desire to share the philosophy of a beneficial and responsible investment.
The amount of institutions investing in PE and considering it as a real asset class is high. Institutional investors are investors which funds are allocated by professional managers as pension funds, collective investment undertaking, insurance companies and speculative funds. Their activities and behaviours are well studied and estimated. They justify experience in this sector. Institutions are able to find investment solutions in a recession period. It let us think other categories of investors will follow this example about Private Equity and repeat it.

So do independent investors are able to support such investments? Are they ready to allocate a part of their wealth to a starting business or project?

As the SWOT analysis is showing below, we can work on image and recognition of the Private Equity market for people. This is how most of the people can perceive Private Equity.

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proof of performance compared to other asset classes;</td>
<td>Illiquidity;</td>
</tr>
<tr>
<td>Social and responsible impact. Ethics and support to growth;</td>
<td>Barriers and difficulties to entry into PE deals: Not provided by retail banks;</td>
</tr>
<tr>
<td>Success examples;</td>
<td>Lack of knowledge and experience;</td>
</tr>
<tr>
<td>Diversified markets, number potential deals increasing.</td>
<td>Trust and guaranties for such an investment.</td>
</tr>
<tr>
<td></td>
<td>High risk</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Opportunities</th>
<th>Threats</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of entrepreneur, business creation increasing.</td>
<td>Changes in regulations</td>
</tr>
<tr>
<td>Public and Institutional actors involved.</td>
<td>Excesses on speculation from PE actors, or presence on prohibited markets</td>
</tr>
</tbody>
</table>

Through the SWOT analysis, we can compare what is perceived with what is actually Private Equity market.

Correspondences are found regarding gross margins provided. It was proved in our last comments and is actually perceived from independents. This evidence is not the same looking at the outperformance of PE against other asset classes in recession. The second common point is illiquidity. This is true, PE market is considered as illiquid, but this is not totally right according to our secondary market survey. Through this market, liquidity can be found. Then most people
believe Private Equity is able to enjoy lots of opportunities. It is also able to interact with emerging markets, start-ups and "surf on trends" due to its easier management scheme.

Nevertheless, differences can be seen. Compared to what is perceived, lot of actors are selling PE products (without talking about venture capital) and online. Most people believe acquiring PE shares or venture capital is quite impossible. They are not used to that. The access actually easier than people expects it to be. The other characteristic is the high risk. According to some studies, and what is thought, a higher risk is explaining the performance. As we explained in the last paragraph, II Performance survey, the outperformance is not due to the higher risk. Last but not least, few parts of independents think it has a speculating activity. It has been changing mainly because of rules and regulations in the financial activity.

We can see there is a lack of knowledge from people about Private Equity. A gap of five years is observed between what it actually is and on how it is perceived.

Most of the time, Private Equity used to be reported as a negative activity by the media, and in many people’s minds too. A widespread image as “making money by slashing employee ranks and performing financial acrobatics with balance sheets” was shared, according to Timothy Spangler, a lawyer, from an article in Forbes, (Private Equity Public image Issues, 10th April 2013). This is difficult to understand because of proved efficiency and profitability by academic and professional studies. And as we studied in the last parts of the thesis, characteristics of Private Equity cannot be generalized as an extreme activity.

However, examples published in Medias are changing the downward trend. For example, in April 2012, Monomoy Capital Partners (a middle-sized Private Equity firm) undertook its portfolio quality measure. The firm wanted to optimise its earnings by working on owned companies’ inefficiencies. It had a positive impact on company’s recognition for working with its portfolio’s companies to fight for a higher effectiveness and efficiency.

Moreover, if we focus on the lack of knowledge and trust for those investments, we may illustrate with an example how Private Equity can be approached with consumers.

As we saw through the Part II, Chapter 3, I, private investors already propose projects to their clients. Having more freedom than banks in their choice of partners and being more able to “surf on trends”, this is a real opportunity for them to diversify their activities.

The idea to invest in developing companies and take part into growth and development is really enthusiastic. And this is true from the typical fund placed in a portfolio by a bank until a project
launched by a private investor for its clients. It is only concerning an intermediary, but the principle is the same.

I have had the opportunity to work with a private investor who launched such projects. Gaining trust from its consumers, he had the ambition to invest in projects in emerging countries. Supported by a relative network (businessmen, attorneys in law, institutional, advisors, friends) he conducted studies to realize projects in the Third World. Most of them small sized business to purchase, in order to improve it with a capital, treasury, a dynamic management and connect it with consumers out of its frontiers. Clearly buy a business in its early stage of development and participate to its growth with dynamic supports (human and capital). Even if other projects as franchise or partnerships with local firms were concerning expansions, most of ideas were concerning early stage businesses.

As the listed part is explaining, the capitalization form consumers reached expectations and they were ready to follow their charismatic financial planner in this investment philosophy.

Through this part, we wonder on Private Equity’s perception from people. We work on a SWOT analysis confronting investor’s point of view and reality. It appears a lack of knowledge and curiosity was driving onto wrong acknowledgments. Even if most of the dynamic is understood, the cause for PE performance is, for example, not totally understood. Most of investors believe high risk is driving performance. We proved before that it was not totally true. The last example with Private Equity supported by a financial planner is underlining the importance of trust and behaviour in this procedure.

A change in the tendency is expected thanks to institutional investments, and the pursuit of ethic activities.
Chapter 3: the future of Private Equity

I – Recommendations

Rich from our elements of answer viewed before, we found attractive the idea to work on the future of Private Equity. Everything let us think this activity will continue to be a component of financial markets. If PE is flexible, can adapt to trends and follow promising entrepreneurs, businesses and companies, it also kept through years its principle values. Independency from public markets, low correlation with other asset class, ability to perform in recession periods, and also representing a support to growth and development let us know the sector will go to a consolidation over the years.

In the middle-term future, we saw institutional actors will play an important role in Private Equity. Capitalization from institutions is representative of the impact they can have on the activity if the tendency observed continues, as it is expected. Furthermore, secondary markets, as we saw before are providing more liquidity, transparency and concurrence. The dynamism of the market is an opportunity for an active management portfolio. It also represents an alternative for a new investor who would not like to be engaged for seven years or more in the same business. Then, online Private Equity issuers facilitate deals. Online deals represent a higher part of total deals every year (for professionals).

According to different sources, from academic and professional studies, results are optimistic for the future of Private Equity.

The first scenario believes in market’s sustainability and development. For instance, demand for alternative investments and diversification will continue to grow up. At the same time, other markets will stay uncertain, even if they will be the core of most of portfolios. This projection is based on three pillars that are really predictable regarding next economic stakes:

- Group’s concern about reputation is expected to increase. Because it is directly linked to trust, many organisations have a role to play with their image. Reputation has a significant impact on investment choices, when a person is looking for a financial institution for example. And according to marketing survey, brand image is more and more important. It is an efficient commercial strategy to share investments in ethic funds and private equity. Show a support for brilliant ideas, small companies in need, emerging markets, is adding a value to the group. It can be associated as a fight against inequalities and poverty. A human sense is appreciated when people are ready to invest. That is why companies, institutions,
financial groups and governments have a role to play on this market, and will probably
increase their allocation in Private Equity.

- Innovation and progress will be always needed. The gap between a real situation and
technology possibilities, as we saw before in the part... is a source of development, thus a
source for a Private Equity investment. Knowledge and experience acquired by a group can
be shared and implemented in a project which will need an investment. A double stake for
PE can be found regarding innovation. On the first hand, supporting innovation by financing
high technology firms, researchers and laboratories. On the other hand, helping for its
implementation by financing infrastructure projects, building projects, optimised factories,
manufactures and sectors using high technologies. We can underline another time the
importance of Private Equity investments and operational advices in the change
management. Unless world will make up the progress, this gap between real situations and
possibilities offered by innovation will be a source for business affairs and Private Equity
deals.

- Demand of management and labour supply. We also studied this phenomenon before:
unemployment rates reached peaks lately. Big firms are limiting their costs, sometimes
relocating overseas putting employees out of work. The crisis also touched smaller
companies. Over pessimism due to this environment, managers’ recently unemployed and
also active people believe it is the moment to launch a business, or to associate with a
partner. Entrepreneurs movements have been observed through Europe and North America
driven by hope of “being its own boss”. Need of capital to raise funds and launch a business
is consequent. From associations, until institutions, every actor is playing a role supporting
this dynamic. Surveys expect entrepreneurs to beneficiate from money saved in accounts of
wealthy Europeans and North Americans. A change in the strategy could be seen, according
to what we saw before about alternative investment, diversification and capital gains
demand. Low returns on monetary assets for example may be allocated through those new
drivers of growth, in order to increase their revenue while participating to development.

If we focus on the market, the crisis helped the market to consolidate. Number of actors decreased
between 2005 and 2010. Main actors as KKR were strong of their size, treasury, independence and
reputation on the market. But as we saw above, professionals are ready to be involved in small and
middle-sized market. According to a survey from KPMG, Heads up: What’s next for Private
Equity?, 2007, the market will probably split into three sub-categories: a large one with leveraged
buyouts transactions directed by international firms; a middle-market group driven by subsidiaries,
local banks, cooperatives; and a venture capital market. Even if this survey from KPMG is not
recent, we may confront this statement with examples illustrated in the thesis and observe similarities.

For instance, we can imagine venture capital both in developed and emerging markets will be the most profitable investments in the future. Transaction’s volume will probably increase while value will be reduced. Furthermore, those data let us think the middle market, driven by secondary market opportunities, will allow active portfolio management which will seduce more investors. To rebalance a portfolio, in difficult economic periods for example, companies will be looking to unload money in the Private Equity interest in the second market. It is also a way for reducing the number of PE relationship an entity is managing. Last but not least, credit rates being lower than before the crisis and number of distressed companies waiting for a takeover will strengthen the large market with leveraged buyout activities.

Through our second part, sources and opportunities for a Private Equity investment, we try to estimate where the activity will perform. This research is working on geographic areas and activity sectors. Focuses on developed and emerging markets are estimating which activities are supporting growth, and will support it. In developed countries, we retain high technologies, buildings and infrastructures, health, industry and ecology. For emerging countries, agriculture, natural resources, infrastructure, finance and tourism will support growth.

According to our thesis, we believe the persistence and attraction for those investments will be real. Lot of sectors are undeveloped, markets not concurrence. Flexibility of Private Equity and strong believes from its actors may continue to be a strategy for advised investors encouraged to provide support to start-ups, businesses and entrepreneurs. Also, as seen above, the concern about reputation will be endorsed by many groups.

However, if through this thesis we have been optimistic about Private Equity, different scenarios can occur, especially due to changing environment in the entire World. It is important to debunk a few clichés.

Social, environmental and governance problems are affecting sustainability of the activity. Assets invested may be managed wrong, with intention of fraud. They can be derivate from their target and aim. That is why control or intuit personae needs to be strong when considering such investment.

Conflicts are also a threat for Private Equity activity. As we focused on emerging markets like Sri Lanka, inner tensions were high over the last decades. Foreign direct investments were blocked due to instable context. Now that stability came back, government as the board of investment is
attracting capital over the frontiers. And the market is expanding. It has been the same for Latin American countries as Colombia, now an important pillar to growth in the area.

To conclude, we saw promising future opportunities for Private Equity sector. Need of recognition for groups like institutions, innovations and change management, qualified and entrepreneur supply are positive factors for the next decades’ activity. Both in developed and emerging markets, numerous projects are waiting for capital invested.
Thanks to this study, our findings reveal that:

Private Equity can be considered as an investment strategy. It is able to provide significant performance compared to public markets. Professionals are highly advising to enter in the market. Part I - Chapter 1, 2 and 3, Part III - Chapter I.

It can be introduced in a portfolio as an asset class. Because of the diversification and added performance, we believe it is strategic to allocate a part of wealth in Private Equity. The dynamic provided fits with equities, bonds, monetary assets, and other classes. Low correlation with other assets and economic cycle comfort us in this choice. Part II - Chapter 2 and 3, Part - III Chapter 1 and 3.

Private Equity is not outperforming because of a higher risk. Risk is limited when a rigorous selection is undertaken. Moreover, “due diligence”, flexibility of the company, efficient network and experience proved successful results. Part I – Chapter 2, Part III - Chapter 1 and 2.

It is not well known. Affected by financial markets reputation, it is often linked to speculation or profit-focused philosophy. Fortunately ethic and innovative investments respecting targeted entity and the Private Equity firm are good examples. Institutional investors are also taking part in this activity. Part I - Chapter2, Part - III Chapter 2

Multiple stakes emerges for the future. We believe domination of public markets will decrease and interest in Private Equity and venture capital will find a way to support a sustainable recovery. Trends for ethic and profitable investments will become the norm. Through various examples, win-win relationships will increase in developed and emerging markets. Part III – Chapter 3.
Conclusion

Private Equity’s flexibility and performance allows us to think the activity will play a major role in economy in the next years. If “big deals” are not dominating the market anymore, small and middle-sized businesses are important opportunities. We can see increasing phenomenon of independence in developed countries. Start ups and entrepreneurs become trends, as Rockstart Amsterdam. They support entrepreneurs in their business plan and organize meetings with investor clubs. As we saw before through our various examples, new ideas and companies to develop need significant investments.

Emerging markets are known for their growth and dynamism. Pacific Asia, Latin America, some African countries, Eastern Europe show annualized growth about 5%. Technologic and experience retained in developed countries, where consummation is at the lowest, are needed in emerging markets. We saw Private Equity firms are supporting exchanges to encourage growth and development in such countries.

Studies and professionals let us believe Private Equity and venture capital firms will be actors of an expected recovery. Even if it takes a long time, returns in developed and emerging markets will contribute to sustainable growth. Because most of the economy is supported by small and middle-sized businesses, encourage finance access with Private Equity and venture capital will improve it.

Private Equity sector is actually developing while public markets are not performing and unpredictable. In the next years, interest will probably become stronger for this asset class. Success of innovative and ethic investment will become a trend.
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CHART 3. PUBLIC AND PRIVATE EQUITY PERFORMANCE. IV
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CHART 5. IRR COMPARED TO INVESTMENT MATURITY. V
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CHART 8. INFRASTRUCTURE RISK SCALE. VIII
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Table 1. 2012 and 2013 market outlook.

<table>
<thead>
<tr>
<th>Stock Indices</th>
<th>Asset Type</th>
<th>Currency</th>
<th>Level as of 31/12/2012</th>
<th>YTD Performance since 31/12/2012</th>
<th>2011YTD Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>in local currency</td>
<td>in euro</td>
<td>in local currency</td>
</tr>
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<td>CAC 40</td>
<td>Paris Equity Index</td>
<td>EUR</td>
<td>3,641.07</td>
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<td>Nikkei 225</td>
<td>Japan Equity Index</td>
<td>JPY</td>
<td>10,285.18</td>
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<tr>
<td>Hang Seng Index</td>
<td>Hong Kong Equity Index</td>
<td>HKD</td>
<td>22,658.82</td>
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<td>MSCI Asia Ex-Japan</td>
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<td>Swiss Eurozone Convertible Bond</td>
<td>Convertible bonds</td>
<td>CHF</td>
<td>2,968.39</td>
<td>18.19%</td>
<td>-9.66%</td>
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<td>Swiss capitalise</td>
<td>Moneymarkets</td>
<td>EUR</td>
<td>140.88</td>
<td>0.24%</td>
<td>0.68%</td>
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<td>Euro 3 mois</td>
<td>Moneymarkets</td>
<td>EUR</td>
<td>0.19%</td>
<td></td>
<td></td>
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<table>
<thead>
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<th>Currency</th>
<th>EUR/USD</th>
<th>GBPAUD</th>
<th>AUDJMY</th>
<th>JPYCHF</th>
<th>CHFJPY</th>
<th>JPYHKD</th>
<th>HKDCHF</th>
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<tr>
<td></td>
<td>1.3040</td>
<td>0.8552</td>
<td>1.4327</td>
<td>128.97</td>
<td>126.00</td>
<td>10.0914</td>
<td>7.8914</td>
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</tbody>
</table>

Source: Bloomberg

---

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<th>Stock Indices</th>
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<td>in euro</td>
<td>in local currency</td>
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<td>CAC 40</td>
<td>Paris Equity Index</td>
<td>EUR</td>
<td>2,929.61</td>
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<td>20.04%</td>
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<td>18.06%</td>
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<td>S&amp;P 500</td>
<td>USA Equity Index</td>
<td>USD</td>
<td>1,600.28</td>
<td>10.82%</td>
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<tr>
<td>Nikkei 225</td>
<td>Japan Equity Index</td>
<td>JPY</td>
<td>12,677.32</td>
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<td>22.84%</td>
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<td>HKD</td>
<td>20,803.29</td>
<td>-5.82%</td>
<td>-27.48%</td>
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<td>MSCI Asia Ex-Japan</td>
<td>Asia ex-Japan Equity Index</td>
<td>USD</td>
<td>509.30</td>
<td>-0.61%</td>
<td>7.27%</td>
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<td>MSCI World</td>
<td>World Equity Index</td>
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<td>14.42%</td>
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<td>303.81</td>
<td>0.14%</td>
<td>11.24%</td>
</tr>
<tr>
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<td>Convertible bonds</td>
<td>CHF</td>
<td>3,035.11</td>
<td>2.25%</td>
<td>18.19%</td>
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<tr>
<td>Swiss capitalise</td>
<td>Moneymarkets</td>
<td>EUR</td>
<td>140.93</td>
<td>0.04%</td>
<td>0.24%</td>
</tr>
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<td>Moneymarkets</td>
<td>EUR</td>
<td>0.22%</td>
<td></td>
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</table>

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<th>AUDJMY</th>
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<th>CHFJPY</th>
<th>JPYHKD</th>
<th>HKDCHF</th>
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<td>1,3010</td>
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<td>1.4227</td>
<td>128.97</td>
<td>126.00</td>
<td>10.0914</td>
<td>7.8914</td>
</tr>
</tbody>
</table>

Source: Bloomberg
Chart 1. 2012 outlook per quartile.

Source: Bloomberg and HSBC Asset Management, data as of December 2012.
Chart 2. Future attractive asset subclasses.

Source: Bloomberg, data as of April 2013.

Annualized buyout performance measured against the MSCI Europe.

Chart 4. Public and Private Equity volatility.

Volatility of buyout performance vs. MSCI’s [Q1 2000 – Q2 2011]

Source: Thomson Reuters and European Private Equity market outlook for 2012.
Chart 5. IRR compared to investment maturity.

As of June 2011, Private Equity returns rebounded strongly over three and five years’ periods in comparison with public indices. Private Equity remains among the highest-performing asset classes over three and five years’ periods.


Chart 7. Emerging markets exposure.

Figure 1.23: LPs maintained their target allocations to emerging markets and continue to increase their exposure.

Figure 1.24: Brazil and the rest of Latin America have emerging markets for PE.

Table 2. Infrastructure category scale.

<table>
<thead>
<tr>
<th>Revenue volatility</th>
<th>Availability</th>
<th>Regulatory</th>
<th>Traffic</th>
<th>Market / Competitive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>- Operating costs</td>
<td>- Operating costs</td>
<td>- Operating costs</td>
<td>- Operating costs</td>
</tr>
<tr>
<td></td>
<td>- Delivery (e.g. service performance)</td>
<td>- Delivery</td>
<td>- Volume risk</td>
<td>- Competitive risks (high price and volume volatility)</td>
</tr>
<tr>
<td></td>
<td>- Regulatory risk</td>
<td>- Regulatory risk</td>
<td>- Limited pricing risk</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Volume risk (limited)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High</td>
<td>- Energy (gas and electricity) transmission, distribution, storage</td>
<td>- Transportation</td>
<td>- Waste</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Water and waste water</td>
<td>- Toll roads / tunnel / bridge</td>
<td>- Merchant power (no off-take)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Power generation (with off-take / feed-in)</td>
<td>- Light / heavy rail</td>
<td>- Communications infrastructure</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Airports</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Marine ports</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Examples:
- Social infrastructure (e.g. hospitals, schools, courts, public order, public sector accommodation)
- Transportation PPP

Infrastructure - large, unique and esoteric
Chart 8. Infrastructure risk scale.
Chart 9. Infrastructure market opportunities.

Table 3. Performance analysis and recession impact on PE-Backed Companies.

<table>
<thead>
<tr>
<th>Profit &amp; Debt</th>
<th>PE Backed Pre: Recession</th>
<th>Recession</th>
<th>Matched Private Pre: Recession</th>
<th>Recession</th>
<th>Listed Pre: Recession</th>
<th>Recession</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>Mean 7.707</td>
<td>Mean 9.670</td>
<td>Mean 5.581</td>
<td>Mean 5.712</td>
<td>Mean 0.765</td>
<td>Mean 1.038</td>
</tr>
<tr>
<td>Gross Margin</td>
<td>36.484</td>
<td>37.947</td>
<td>35.192</td>
<td>35.755</td>
<td>37.470</td>
<td>39.132</td>
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<tr>
<td>Debt/TA</td>
<td>35.904</td>
<td>33.636</td>
<td>38.565</td>
<td>38.249</td>
<td>26.459</td>
<td>25.731</td>
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<tr>
<td>Coverage</td>
<td>25.416</td>
<td>31.942</td>
<td>27.353</td>
<td>25.097</td>
<td>17.930</td>
<td>17.959</td>
</tr>
<tr>
<td>Ave Annual Change</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Growth Turnover</td>
<td>0.117</td>
<td>0.139</td>
<td>0.214</td>
<td>0.195</td>
<td>0.364</td>
<td>0.286</td>
</tr>
<tr>
<td>Growth Employment</td>
<td>0.036</td>
<td>0.056</td>
<td>0.051</td>
<td>0.061</td>
<td>0.161</td>
<td>0.141</td>
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<tr>
<td>Growth Value Added</td>
<td>0.164</td>
<td>0.200</td>
<td>0.243</td>
<td>0.184</td>
<td>0.325</td>
<td>0.159</td>
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<tr>
<td>Growth Profit</td>
<td>0.358</td>
<td>0.275</td>
<td>0.447</td>
<td>0.270</td>
<td>0.273</td>
<td>0.001</td>
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<tr>
<td>Working Capital</td>
<td></td>
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</table>

Table 4. Insolvency and failure rates.

<table>
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<th>Year</th>
<th>Companies</th>
<th>Insolvencies</th>
<th>All Companies</th>
<th>Failure Rate</th>
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<tbody>
<tr>
<td>1995-1998</td>
<td>174968</td>
<td>7716</td>
<td>4.41</td>
<td>7.61</td>
</tr>
<tr>
<td>1999</td>
<td>133441</td>
<td>6334</td>
<td>4.75</td>
<td>7.94</td>
</tr>
<tr>
<td>2000</td>
<td>284424</td>
<td>8191</td>
<td>2.88</td>
<td>8.76</td>
</tr>
<tr>
<td>2001</td>
<td>400159</td>
<td>10566</td>
<td>2.64</td>
<td>6.89</td>
</tr>
<tr>
<td>2002</td>
<td>445758</td>
<td>11663</td>
<td>2.62</td>
<td>7.07</td>
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<tr>
<td>2003</td>
<td>551072</td>
<td>11036</td>
<td>2.00</td>
<td>5.68</td>
</tr>
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Source: Private Equity Company performance through the recession (BVCA).
HSBC Private Bank

and

EDHEC Business School