MEDIA ALERT

C.P. Eaton Partners 2010 Global Fundraising Outlook

It's back to 2004 levels
for fundraising, asset valuations and underwriting standards…

United States

- The economic downturn of 2009 severely impacted the fundraising industry, reflected by the lowest levels of capital commitments since 2004. As a result, the amount of time taken to raise a fund increased significantly, averaging approximately 18 months (twice as long as in 2005), as more general partners remained on the road seeking a severely limited supply of capital. The outlook for 2010 is brighter: according to a recent Preqin survey, a majority of LPs plan to make their next allocation(s) to private equity this year, saying that their current private equity investments have met or exceeded their expectations. Also, now that the associated risks of leverage-generated returns are better understood, LPs and GPs expect a return to private equity fundamentals (i.e. value-add strategies and a realignment of interests between LPs and GPs). Yet it is clearly still a "buyers market" and LPs are most apt to select strategies and managers where they have familiarity with proven pedigrees or realizations versus ones that are opportunistic, novel or emerging.

- ***Lower- and middle-market buyout and growth equity*** strategies make up the most broadly popular private equity funds at this time. These funds may be too small for large state plans and sovereign wealth funds, but more LPs talk about these strategies than any other. A "back to basics" movement has brought GPs to the surface that can build value for investors by working with investee companies to improve operations, management and market reach – achieving returns in tough credit markets without financial engineering. In addition, deals are getting done at a growing pace given the tens of thousands of companies that make up the lower- and middle-markets, and the financing crunch the majority have faced.

- ***Distressed*** funds have gained significant traction within the past year as managers move to take advantage of numerous distressed sellers offering quality assets. Distressed plays are interesting across private equity, real assets and soon, real estate; the attraction goes far beyond owning distressed securities as control is paramount. The general consensus is that the opportunity to make significant gains in liquid trading strategies has passed; rather, distressed-for-control remains popular given a wealth of ongoing market opportunities, and given that control funds resemble closed-end private equity funds, they are a natural fit for most investors.

- The timing for ***mezzanine*** is also very attractive right now, resulting in its growing popularity as LPs see the ability to: (a) diversify within the lower- and middle-markets, (b) add downside protection and (c) earn buyout-like returns with less risk. Mezzanine is also popular given opportune timing and strong recent returns. The demand for mezzanine capital is enormous given the private equity overhang and a wave of debt coming due soon which will drive a flood of refinancings. The supply of mezzanine financing has decreased significantly as hedge funds, business development companies and others have or are exiting the space. New mezzanine financing requirements over the next five years for private equity activity could amount to $400 billion. This could double when refinancings are taken into account. Today, only a mere $21 billion is being sought by mezzanine funds actively fundraising, according to Preqin.

- With regard to ***secondaries***, residual effects from the credit crisis continue to apply pressure on managers to unload non-core portfolio holdings. While significant global interest in owning strong underlying portfolios from historically well-performing GPs remains, the bid-ask spread generally remained great enough to consistently stall execution. Secondary funds-of-funds seem to have high

return hurdles and at this time last year were only looking for deals from highly motivated sellers and corresponding deep discounts. Seller distaste resulted in a pronounced removal of offering from the market. However, we anticipate that 2010 should see increased deal activity as buyers and sellers begin to align their expectations. New buyers like pensions, endowments and foundations will also continue to make their appetite known, as many see a perfect buying opportunity to buy into funds at a discount from managers they know and have already internally due diligenced and approved. To this point, a recent industry study predicts the secondary volume of partnership interests to double this year as compared to 2009.

- ***Real assets*** strategies stood out in the past year as investors sought strong and stable cash flows with downside protection. We expect real assets to continue drawing interest as lower commodity prices combined with seller distress should result in a favorable deal-entry environment. Fund managers are opportunistically stepping in to fill the financing gap left in the wake of decreased traditional capital markets activity and are finding attractive entry points in investments associated with oil and gas exploration and production; pipelines and other midstream energy investments; utility-scale wind and solar installations; timber, agriculture, mining and other commodity-focused investments; and other energy infrastructure. Real assets strategies will continue to attract investors as they seek to position themselves for an environment of increasing inflationary pressures over the medium to longer term as the global economy continues to recover.

- Interest in ***infrastructure*** in particular has cooled as we wait to see if deal flow in North America ever materializes in the volume predicted. Even as states face huge financial problems, the obstacles to privatizing infrastructure (both political and financial) prevailed in 2009. Given that $90 billion in fund capital has been raised over the last 5 years, and only $6 billion in 2009, LPs are clearly waiting for proof of investment thesis, not to mention that well over half of the $90 billion has yet to be deployed. However, given that trillions of dollars of assets, resources, and companies are owned privately in the energy and power industries in particular, LPs have been able to mount exposure to these industries and play the infrastructure card, versus waiting for bridges and tunnels to come to market or perform.

- After a turbulent 2008, ***hedge funds*** responded well in 2009. On average, managers were up 20%, making the past year the best for the industry in a decade. By the second half of 2009, redemptions had stabilized and investment activity increased as investors positioned to reduce their cash reserves and redeploy cash released by managers who had invoked gate. This trend was confirmed in the third quarter when funds experienced net inflows for the first time since the recession. Some limited partners who invest across asset classes looked to decrease their exposure to illiquid investments in favor of more liquid strategies, including hedge funds. This year looks to be a promising year for the industry as a renewed focus on liquidity and transparency will continue to drive investor interest among institutional limited partners. In the same way 2004 was a record year for hedge fund growth on the back of a market rebound in 2003, this year has the potential to be impressive from a capital-raising standpoint.

- ***Real estate*** transaction volume was down significantly from the peak years of 2006 and 2007, largely due to the return of traditional underwriting standards, much higher equity requirements and a nearly nonexistent CMBS market that last saw meaningful issuance volumes in the first half of 2008. For 2010, we expect to see both fund managers and investors continue to focus on troubled legacy assets as headline transactions (largely work-outs) will begin to set new comparable values enabling investors to mark their existing portfolios. It is anticipated that mid-2010 will reflect the bottom for commercial property values, much as the United Kingdom is said to have bottomed in the Summer of 2009. Fundraising remains available only to the highest quality Tier 1 managers without legacy distractions and with a demonstrated track record of distressed performance and/or those niche oriented operators who can unlock value through repositioning.

Europe

- European investors have seemingly retreated from the global stage, focused on local managers on the Continent. We believe European investors continue to chase alpha but are more protectionist at the same time, supporting European managers in their domestic and global efforts.

- ***Private equity*** continues to avoid large cap and highly leveraged buyout transactions given rebounding capital markets are unwilling to support significant debt and PIK financing. As a result, institutional investors feel the best opportunities in the space include lower- and middle-market buyout, growth equity and sector and country funds. Distressed, secondary and direct purchases of fund interests on the secondary market have also gained notice and commitments from European LPs.

- The majority of European LPs have pushed their 2009 ***real estate*** allocations into 2010 due to concern over the global macroeconomic picture and capital adequacy ratios. Uncertainty regarding the U.S. and Asian macro-economic situations and currency risks have mitigated European demand for non-Europe domiciled funds. Current LP interest in the UK market has shown indications of leveling valuations and a turnaround in the commercial real estate market. Additionally, there is building interest in Western Europe, but it lags the U.S. recovery given it is increasingly viewed as a local market. Continued stabilization of property markets, combined with revaluations downward of existing portfolios should drive improved LP interest for European focused opportunities.

Asia

- 2009 was characterized by increased confidence in ***private equity*** throughout Asia due to its relative better performance during the financial crisis as compared to the U.S. and Europe. Managers have recognized the significant market potential for China, India and Japan, leading many to establish country-specific funds to take advantage of those regional economies. Funds-of-funds continue to be attractive as well given that they allow LPs to access a number of geographies that require strong local networks and experience. Asia and other emerging markets continue to have a compelling value proposition – growth capital for growth companies in growth markets.

- In terms of ***real estate***, Asia, especially China, proved itself one of the most resilient property economies globally with its markets and deal rankings in 2009. Seven out of 10 of the most active real estate markets in the world are located in China, led by Shanghai, which is recognized by Urban Land Institute Asia as the most attractive market for development or investment in the Asia region for 2010. The three most active global buyers of property are all Chinese development companies. Indeed, most investors believe the best proxy for China's organic growth may be real estate. Investors are also realizing that securing a local partner and a local operating partnership is a critical key to success in China, as tax efficiency and local networks provide distinct advantages.

- ***Real assets*** strategies have been relatively slow to gain traction. The need for investment in India, Southeast Asia and other emerging markets is large, but we do not believe LPs are being offered the right opportunities. Real asset investment in most parts of Asia, especially in terms of infrastructure, is dominated by government initiatives or led by government-owned entities. The private sector has found it difficult to secure deals at an appropriate risk-adjusted return level. In addition, management teams that are both strong in operations and politics/regulations are critical to strategy execution. Funds focused on more liquid assets like transportation and toll roads have gained better traction with LPs.

- 2010 is likely to see a disproportionately positive rebound in fundraising for Asia, especially in private equity and real estate. On the macro front, China and India expect to have GDP growth of 9% or greater in 2010, but investors should be wary of the overheating credit market and inflation threat in

the region. Look for private equity, specifically in the clean energy and infrastructure sectors, to gain significant ground this year as Chinese and Japanese authorities introduce regulations aimed at reducing the barrier for entry for private equity partnerships and allocations.

- The domestic LP base should continue to expand, especially as sovereign wealth funds including CIC and KIC replaced the void left by Western LPs last year. In fact, CIC reportedly may be due to receive a follow-on investment from Chinese authorities roughly equal to the $200 billion it launched with in 2007. Also, expect global LPs to target Asia to rectify relative under-allocation to Asian private equity in most institutional portfolios as well as to take advantage of strong regional economic performance.

If you would like to speak with **Jeff Davis**, Director in the U.S., **Frank Chang**, Director in London and/or **Dave Love**, Managing Director in Shanghai, about the trends/predictions noted above, please contact:

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