PitchBook

Crystal Ball Report

2018

Drawing from surveys of dozens of PE professionals & data from the PitchBook Platform

Contents

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Introduction

Key takeaways

- Survey respondents ranked the "state of the economy" and "dry powder levels" as the most important drivers of PE deal flow in 2018. "Regulations and/or tax policy" was ranked as the least important driver, though it's important to note that this survey was conducted prior to Congress' recent passing of revised tax legislation.

- A "heightened focus on operational improvements" was the most commonly cited method for adapting to higher deal pricing and the low-growth environment, followed by "increased use of add-on acquisitions" and "new deal sourcing tactics." Dealmakers have touted their emphasis on operations for years, but it may be more important than ever in today's landscape. Add-ons, meanwhile, are an effective way to find buyout acquisitions at lower multiples.

- Respondents ranked "high transaction multiples" and a "deal sourcing/lack of quality assets in the market" as the most important challenges for PE dealmakers in 2018. "Access to financing" was ranked as the least important, which is unsurprising given the prolonged period of low interest rates and recent growth in the prevalence of non-bank lenders.

In this edition of our Crystal Ball Report, we surveyed PE professionals about their plans and expectations for the coming year. Dozens of survey responses were collected via the PitchBook Newsletter and direct email outreach between October 17 and November 30, 2017.

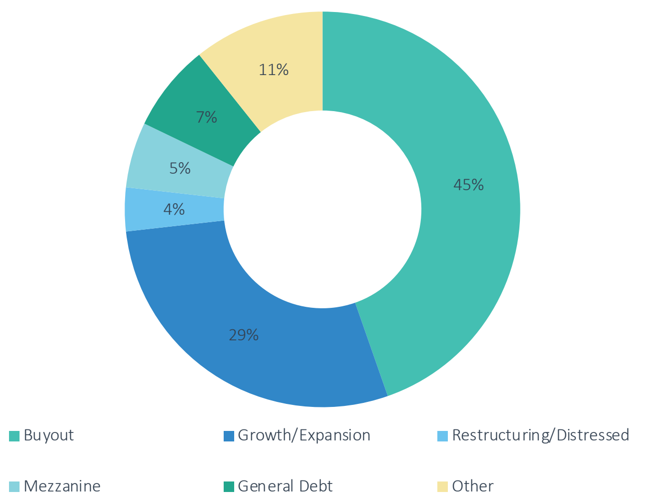
We hope this report is useful in your practice. As always, feel free to send any questions or comments to reports@pitchbook.com.

DYLAN E. COX

Analyst II

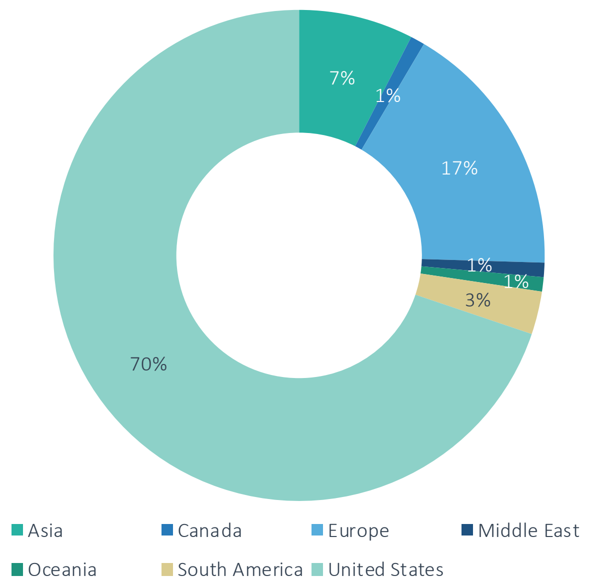
Respondent Overview

What primary investment strategy does your firm employ?
Proportion of respondents by count



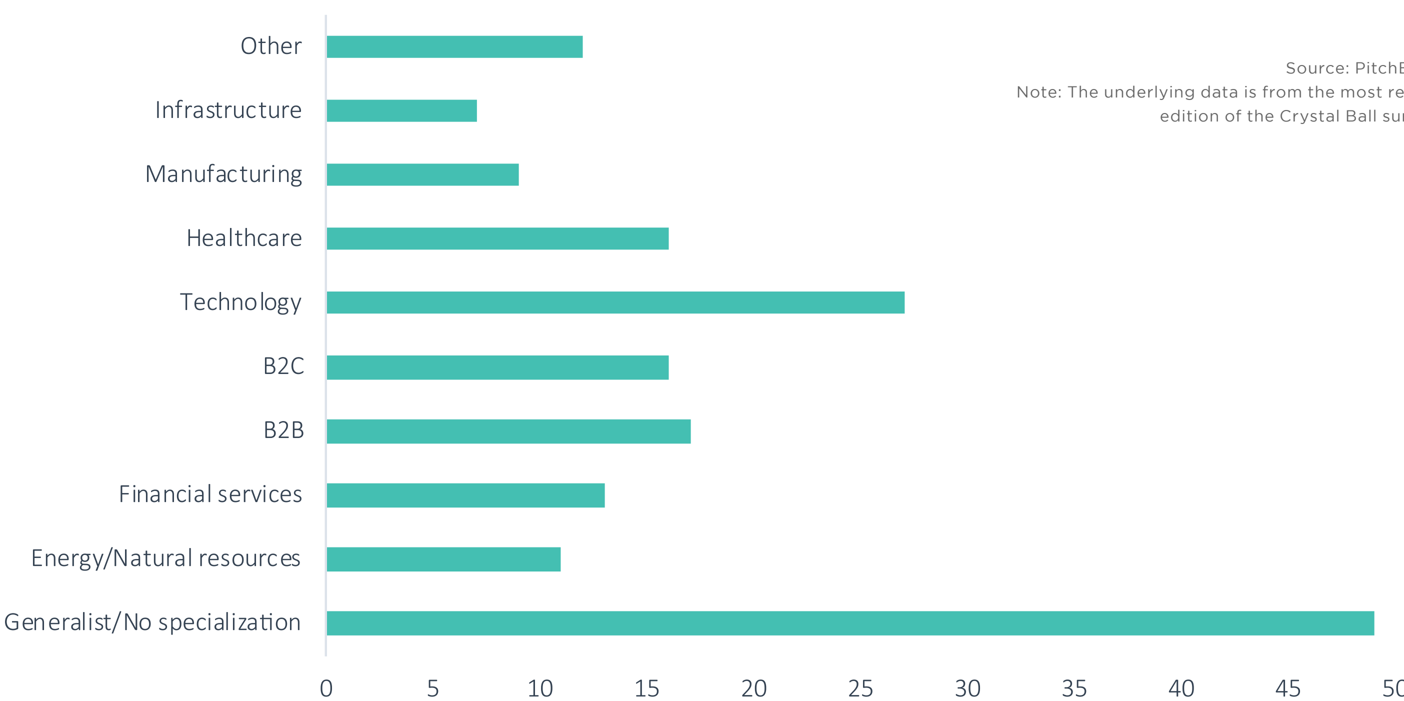
Source: PitchBook
Note: The underlying data is from the most recent edition of the Crystal Ball survey.

In which region is your firm headquartered?
Proportion of respondents by count



Source: PitchBook
Note: The underlying data is from the most recent edition of the Crystal Ball survey.

What industries does your firm specialize in?
Respondents by count, selecting all applicable



Source: PitchBook
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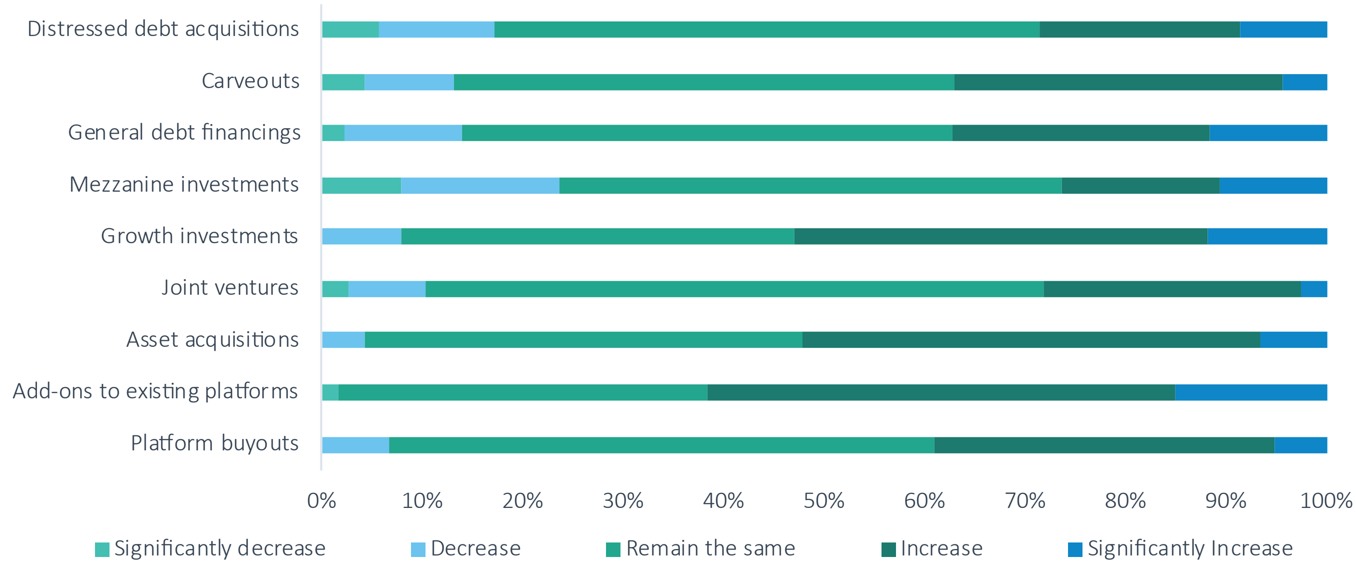
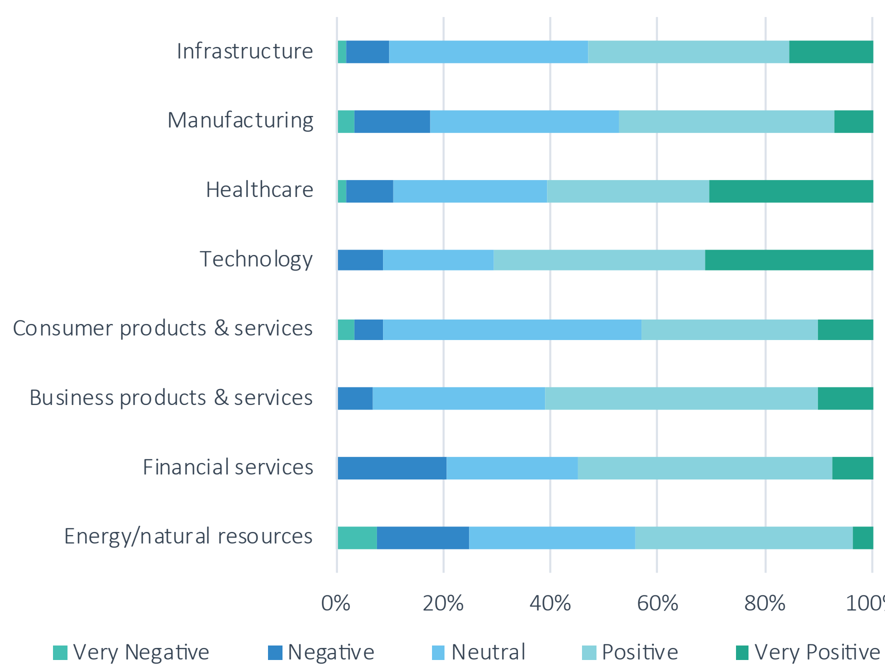
Deal Activity

Relative to 2017, how do you expect your firm's activity in the following areas to change in 2018?
Proportion of respondents by count



Source: PitchBook
Note: The underlying data is from the most recent edition of the Crystal Ball survey.

What's your outlook for the following sectors in 2018?
Proportion of respondents by count



Source: PitchBook
Note: The underlying data is from the most recent edition of the Crystal Ball survey.

- The vast majority of survey respondents expect activity to remain the same or increase across all deal types. Survey respondents say their firm's deal activity is most likely to increase for add-ons and growth investments, two common ways of combatting higher valuations. In the US, add-ons have increased from 56% of buyouts in 2010 to 64% in 2017[1], while growth investing could be fueled by niche fundraising and PE's interest in software.

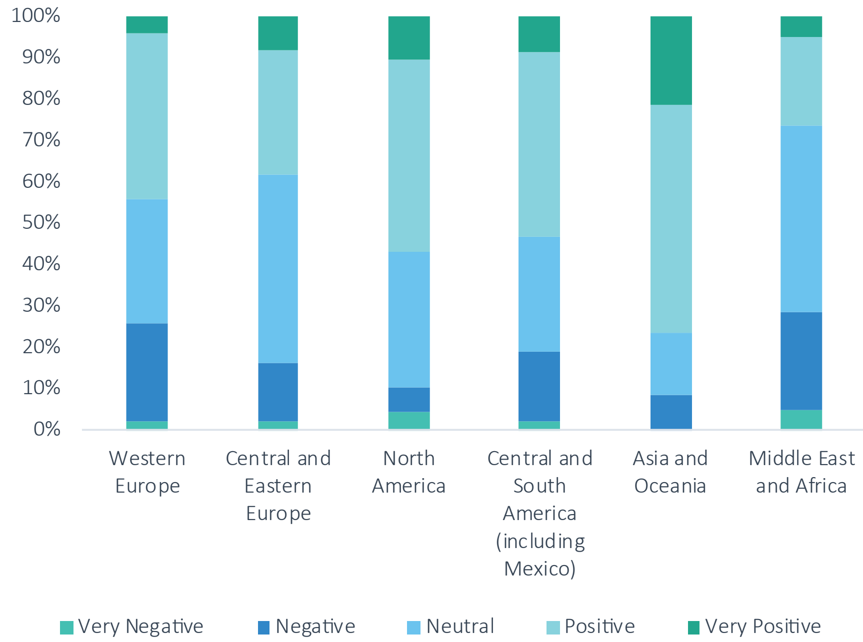
- PE dealmakers are most bullish about the technology and healthcare sectors in 2018. The former has become a staple of PE due to its growth prospects and recurring revenue models. Meanwhile, aging demographics, new regulations and stable revenue streams have contributed to a wave of consolidation in the healthcare industry, contributing to heightened competition and a sharp increase in multiples.

[1]: As of 9/30/2017

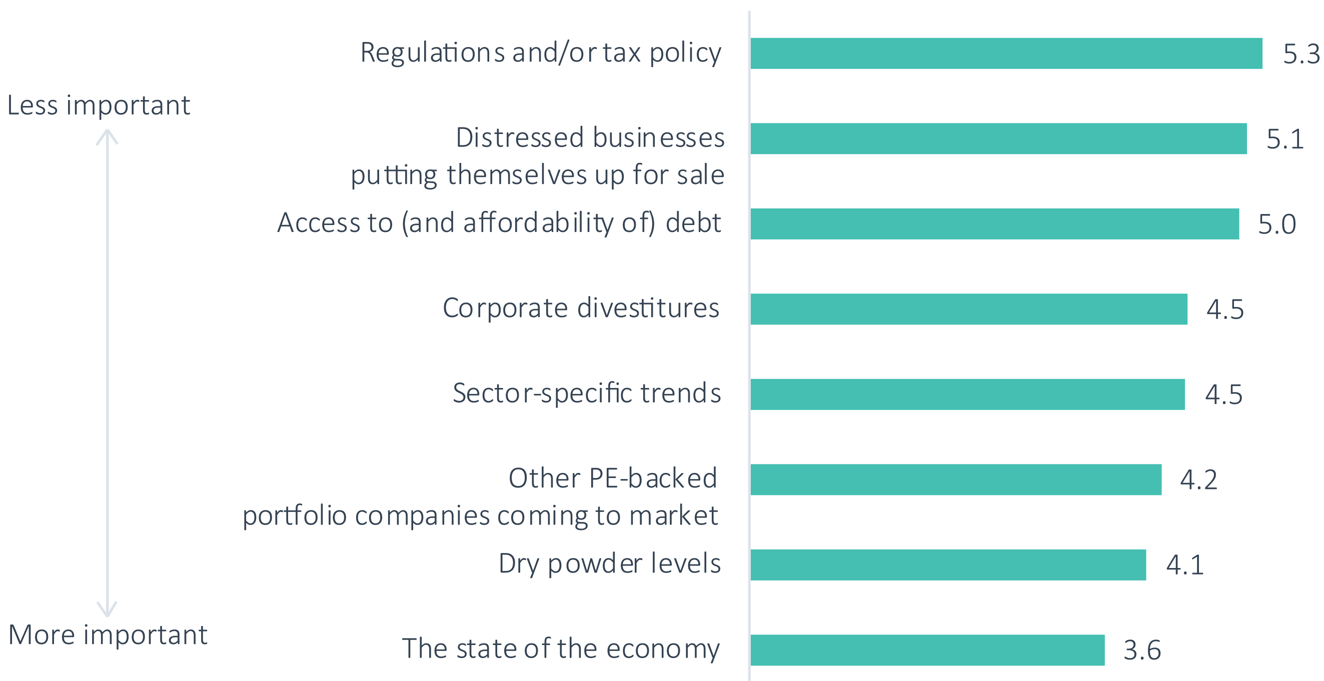
- Survey respondents are most enthusiastic about prospects in Asia and Oceania, where private market investing has been growing in recent years. Sentiment is most evenly distributed between the bulls and the bears about Middle East and Africa, where there is political turmoil, but also the opportunity for alpha generation that emerging markets often provide.

- Survey respondents ranked the "state of the economy" and "dry powder levels" as the most important drivers of PE deal flow in 2018. "Regulations and/or tax policy" was ranked as the least important driver, though it's important to note that this survey was conducted prior to Congress' recent passing of revised tax legislation.

What's your outlook for the following regions in 2018?
Proportion of respondents by count

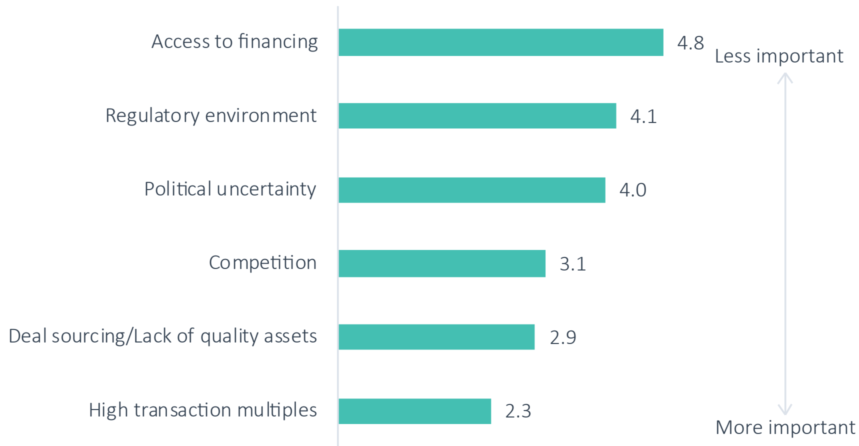


What do you expect to be the most important drivers of PE deal flow in 2018?
Mean of responses by category, ranking in order of importance with 1 as most important and 9 as least



Source: PitchBook
Note: The underlying data is from the most recent edition of the Crystal Ball survey.

What do you anticipate to be the biggest challenges for PE dealmakers in 2018?
Mean of responses by category, ranking in order of importance with 1 as most important and 7 as least



Source: PitchBook
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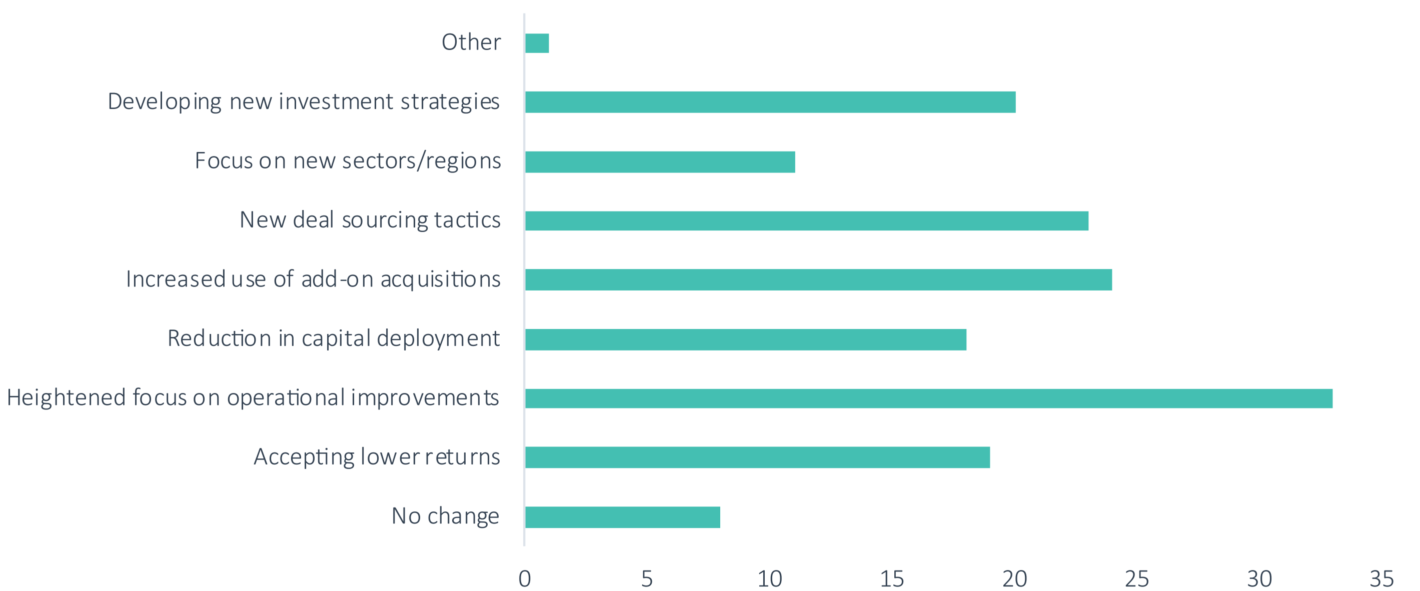
- Respondents ranked "high transaction multiples" and a "deal sourcing/lack of quality assets in the market" as the most important challenges for PE dealmakers in 2018. "Access to financing" was ranked as the least important, which is unsurprising given the prolonged period of low interest rates and recent growth in the prevalence of non-bank lenders.

- A "heightened focus on operational improvements" was the most commonly cited method for adapting to higher deal pricing and the low-growth environment, followed by "increased use of add-on acquisitions" and "new deal sourcing tactics." Dealmakers have touted their emphasis on operations for years, but it may be more important than ever in today's landscape. Add-ons, meanwhile, are an effective way to find buyout acquisitions at lower multiples.

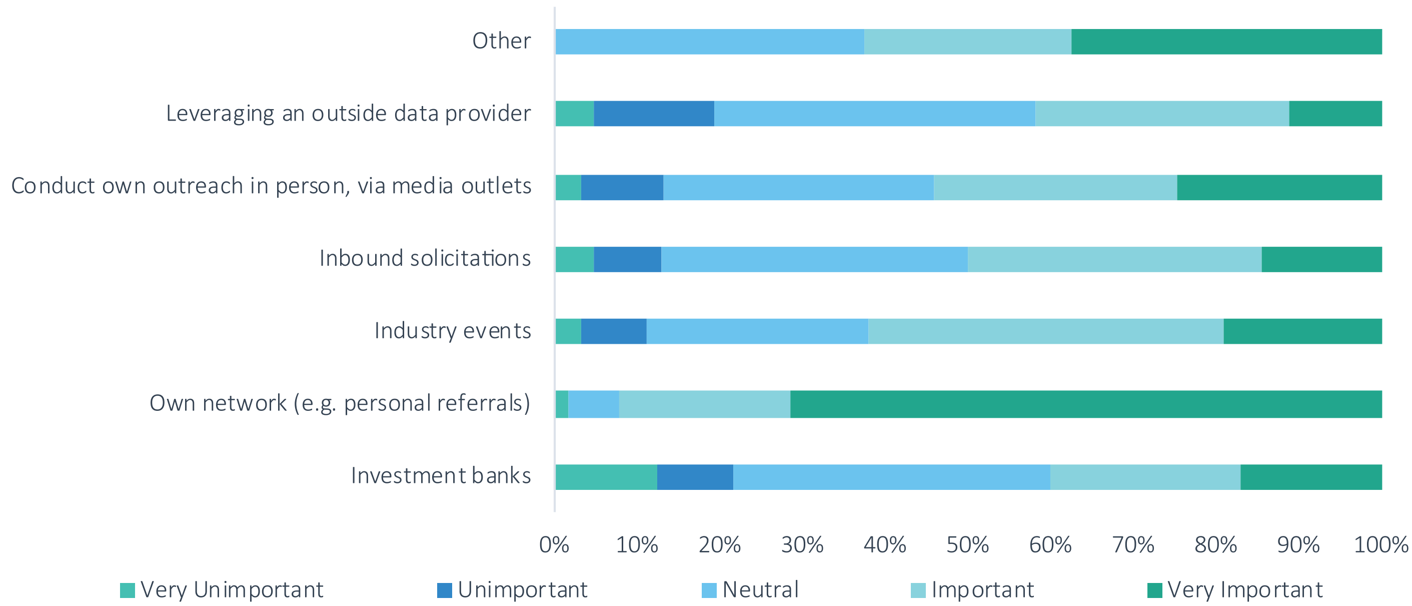
How, if at all, have you adapted your strategy in response to higher deal pricing & the low-growth environment?
Responses by count, with all that are applicable selected



Source: PitchBook
Note: The underlying data is from the most recent edition of the Crystal Ball survey.

Deal Sourcing & Financing

How important are the following deal sourcing strategies to your firm?
Proportion of responses by count

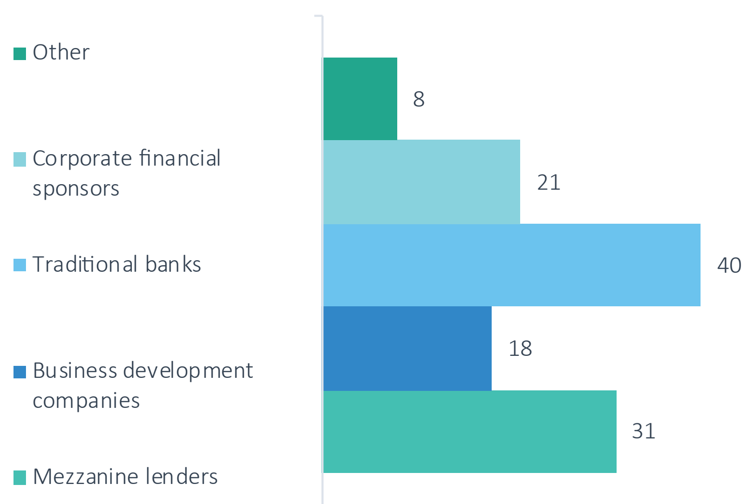


Source: PitchBook
Note: The underlying data is from the most recent edition of the Crystal Ball survey.

- Unsurprisingly, dealmakers cite their own networks as the most important deal sourcing strategy. Industry events and personal research were cited as the next-most important. Given that deal sourcing was also cited as one of the main challenges to deal activity in 2018, it's safe to say that virtually all managers will continue to tout their access to proprietary deal flow as being a competitive advantage.

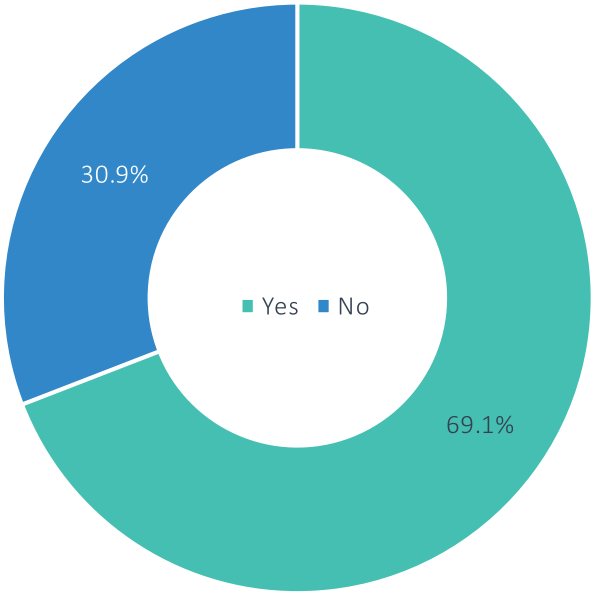
- While traditional banks remain the most common source of financing, a smaller proportion of respondents say they will rely on traditional banks than in last year's survey. Mezzanine lenders and corporate financial sponsors have become more prevalent sources of debt financing, consistent with the uptick in private debt fundraising in recent years.

Where will your firm be accessing debt financing in 2018?
Responses by count, with all applicable selected



Source: PitchBook
Note: The underlying data is from the most recent edition of the Crystal Ball survey.

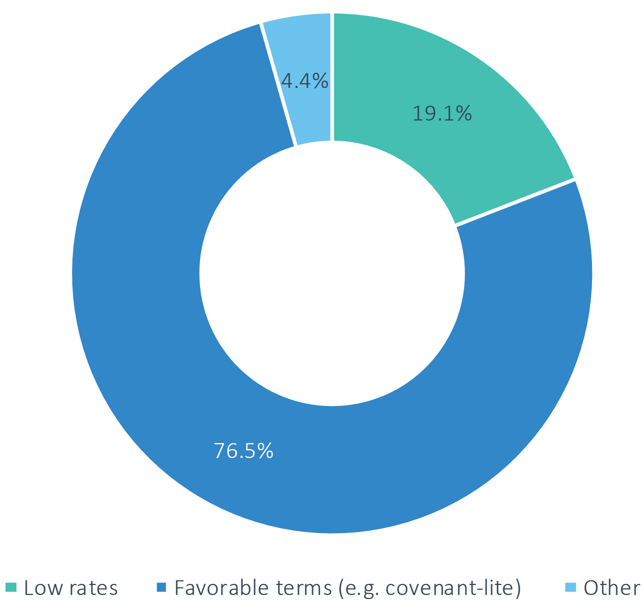
Do you expect to use more equity in transactions in 2018?
Proportion of responses by count



Source: PitchBook
Note: The underlying data is from the most recent edition of the Crystal Ball survey.

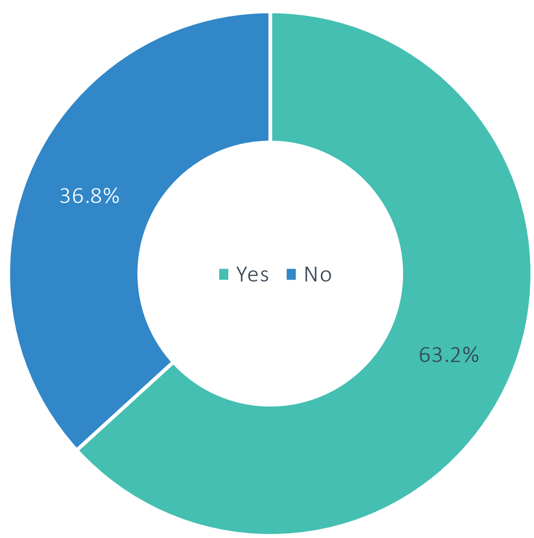
- 69% of respondents expect to use more equity in transactions in 2018, reflective of ever-increasing valuations and changes to interest deductibility. This response is particularly significant given the readily available cov-lite debt financing for most PE deals. In the long run, higher equity contributions could adversely impact PE returns.

When borrowing, what is most important to your firm?
Proportion of responses by count



Source: PitchBook
Note: The underlying data is from the most recent edition of the Crystal Ball survey.

Are you willing or able to close a deal without a debt package already lined up, in anticipation of refinancing later?
Proportion of responses by count



Source: PitchBook
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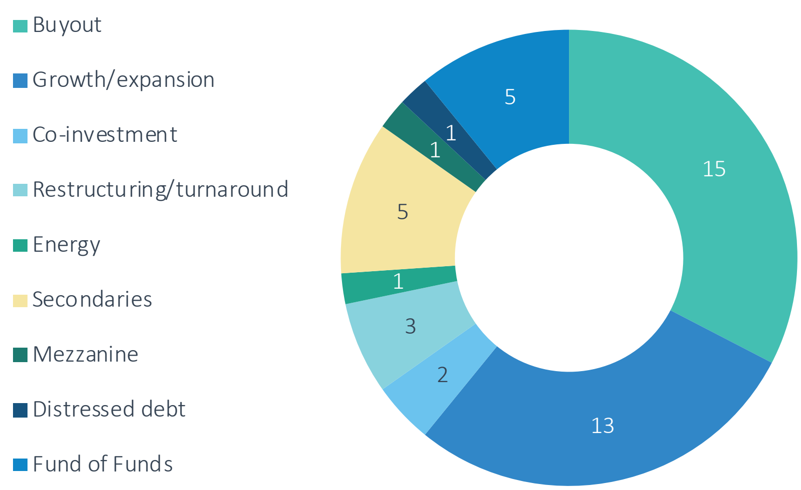
Fundraising

- PE fundraising is showing signs of continual strength despite the already-hefty sums raised in recent years. 52% of survey respondents report that their firms will embark on a new fundraising process in 2018, compared to just 40% last year.

- There is a noticeable barbell effect in the amount of experience managers have in the strategies they are raising. Nearly half of respondents either have more than six funds under their belt or no experience at all in raising a fund of that type. We believe this is due to the growth in first-time funds in recent years.

What type of fund will your firm be raising?

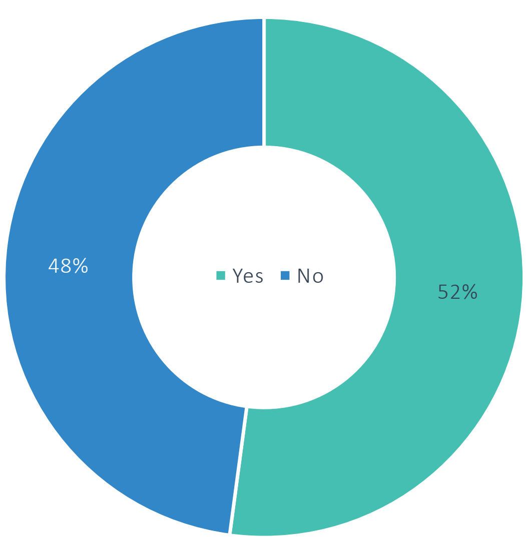
Responses by count (if raising more than one fund, select all applicable)



Source: PitchBook
Note: The underlying data is from the most recent edition of the Crystal Ball survey.

Is your firm currently raising a fund or has plans to embark on a new fundraising process in 2018?

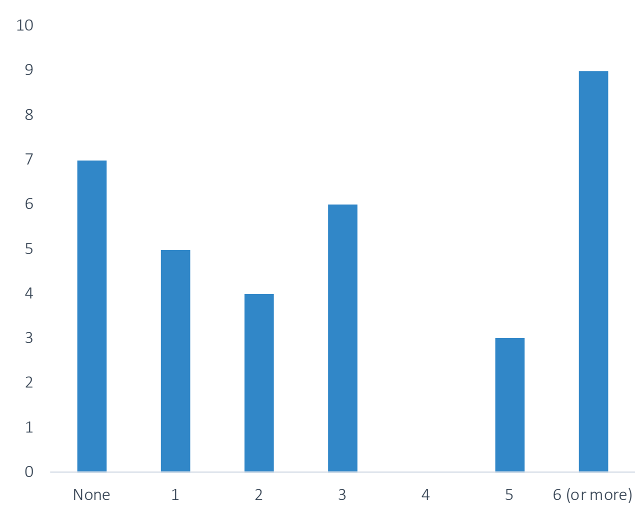
Proportion of responses by count



Source: PitchBook
Note: The underlying data is from the most recent edition of the Crystal Ball survey.

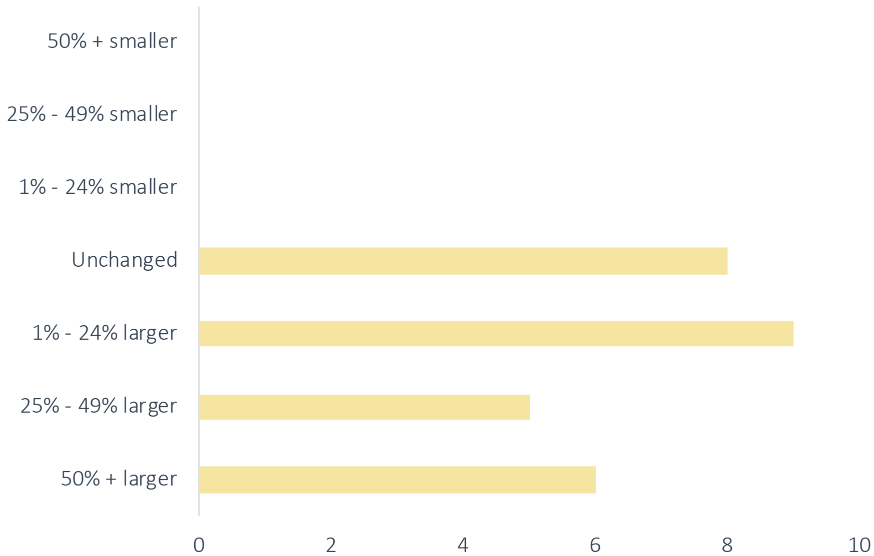
How many funds has your firm previously raised for this strategy?

Responses by count



Source: PitchBook
Note: The underlying data is from the most recent edition of the Crystal Ball survey.

How does the target size of the new fund compare to its predecessors' size?
Responses by count



Source: PitchBook
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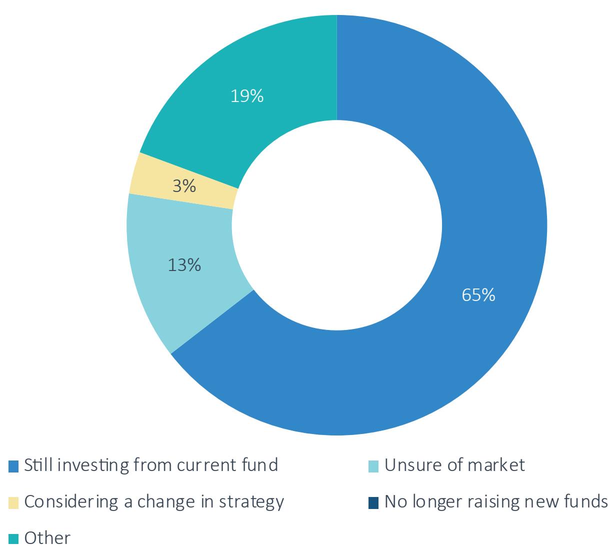
- Consistent with the growth in median fund size, 21% of respondents say that their next fund will be at least 50% larger than its predecessor. None responded the next fund will be smaller than its predecessor. PE firms have been able to grow fund sizes and AUM amidst expanding LP interest in the asset class.

- Of those respondents who are not raising a new fund in 2018, the majority cited existing dry powder as the primary reason. Most of those who answered "other" elaborated that they don't use fund structures, exemplifying the extent to which we are in a strong fundraising market.

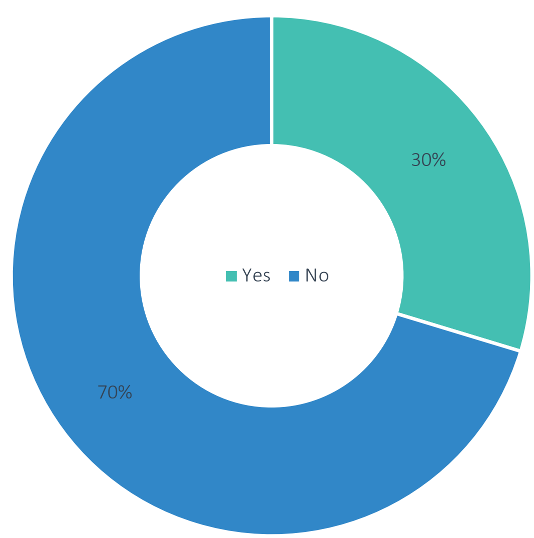
- 70% of respondents do not offer special incentives during fundraises, implying that GPs still retain most of the power in fundraising negotiations. Of those that do, co-investments and fee breaks were equally common.

Why has your firm decided not to raise funds in 2018?
Proportion of responses by count (only for respondents who are not currently and do not plan to raise a fund in 2018)



Source: PitchBook
Note: The underlying data is from the most recent edition of the Crystal Ball survey.

Do you offer any special incentives (e.g. fee breaks, co-investment opportunities) to LPs who make early and/or large commitments?
Proportion of responses by count



Source: PitchBook
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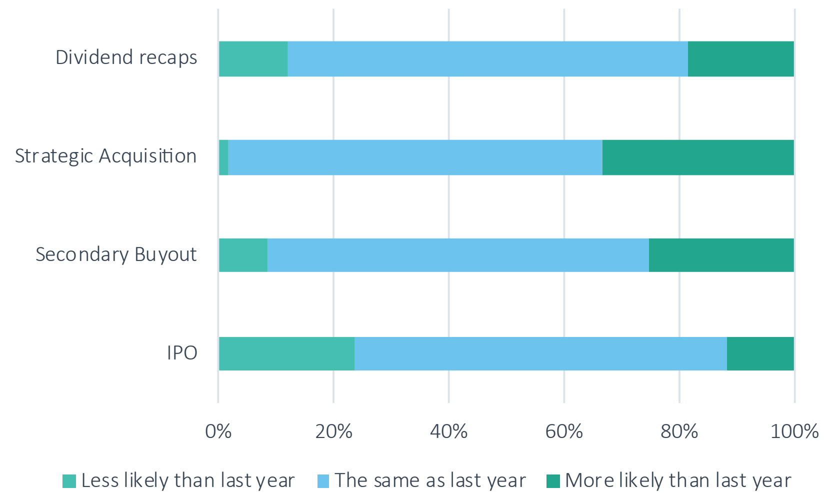
Exits

• PE fund managers are least likely to use IPOs at a faster pace than last year. Strategic acquisitions are predicted to see the largest uptick after a year that saw record proportions of secondary buyouts.

• More than one fifth of GPs feel pressure from LPs to exit investments early. This is likely contributing to the record fundraising for secondary funds in 2017. Secondary funds are increasingly engaging in GP-led transactions and stapled secondaries, which is indicative of a shift to tie up capital longer with high-quality managers.

• PE managers are holding onto their winners. Asset appreciation and strong performance was cited as the most likely reason for holding portfolio companies longer than expected. That said, delayed operation improvements and sector-specific headwinds are also quite common, indicating that there are still plenty of challenges to finding liquidity.

How likely are you to use the following exit routes in 2018?
Proportion of responses by count



Source: PitchBook
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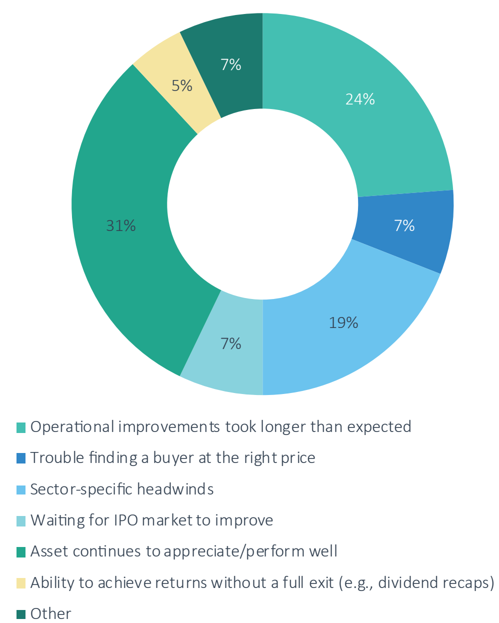
If you are currently holding portfolio companies longer than originally expected, why?
Responses by count



Source: PitchBook
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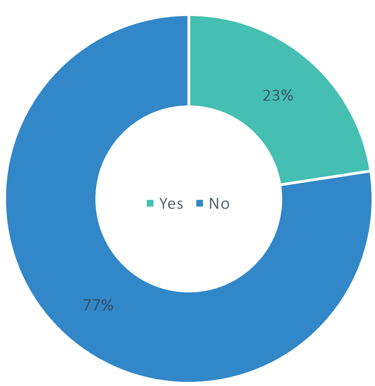
Do you feel pressure from LPs to exit investments early?
Proportion of responses by count



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