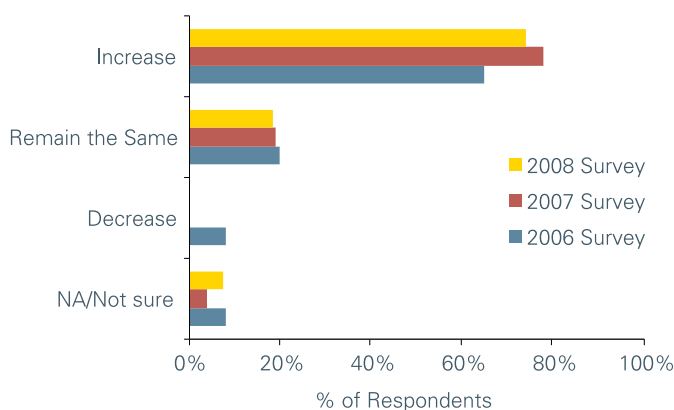


# LPs Continue to View Emerging Markets Favorably Credit Crunch Bears Little Impact on Investment Plans

The results of EMPEA's 2008 Survey of Institutional Investors suggest yet another year of growth in commitments to emerging markets private equity (EM PE). Seventy-four percent of Limited Partners (LPs) claimed their investments in EM PE would increase, pointing to the expected sustainability of strong returns, a deeper pool of quality GPs and improvements in the political and economic risk environments (see Exhibit 1).

**Exhibit 1: Expected Change in EM Commitments as Percentage of PE Portfolio**



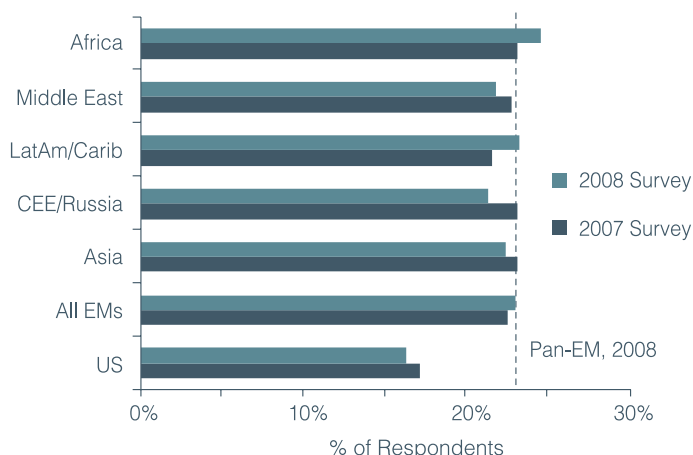
EMPEA tested the findings of our 2008 Survey of Institutional Investor Interest in EM PE at an LP-only breakfast during the IFC/EMPEA Global Private Equity Conference held in Washington, D.C. in May 2008.

Breakfast participants agreed that investors in the emerging markets were undaunted by market turmoil elsewhere, agreeing that the prevalence of growth capital and minimal use of leverage translated to less uncertainty than in the more mature buyout markets. One investor noted that "It's the buyouts in mature markets that seem questionable now. There's less uncertainty about whether to be in EMs. There may be rough waters ahead, but it doesn't mean we'll jump ship." The concern about the impact on exit environments, particularly delayed IPOs, was brushed off by the group. "As long as the growth is still there in these markets, there's a huge cushion on the IRR. It's just that the holding period will go up."

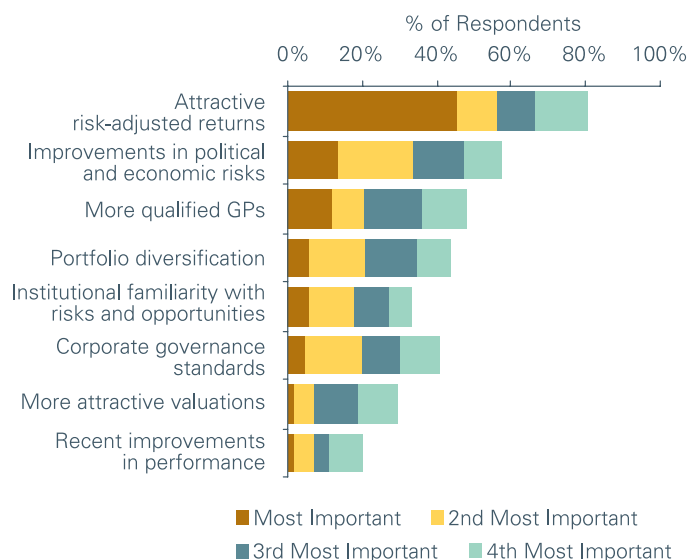
LPs at the event agreed with Survey respondents' assessment that EM PE funds are poised to continue generating strong returns—a function of both GDP growth resiliency and the emergence of more seasoned private equity managers. Surveyed LPs reported that their 2008 commitments to EM PE funds were expected to generate a 6.7% premium relative to US buyouts, a number that felt right to the group convened in May (see Exhibit 2).

In addition to the promise of strong returns, EMPEA's Survey suggested that perceived maturation of the industry and improving investment environments are also driving LPs to emerging markets. Improvements in political and economic risks was ranked as very important by 34% of investors. Investors also noted a broader and deeper set of GPs and opportunities, commenting on a "deepening fund universe in emerging mar-

**Exhibit 2: What returns would you expect of potential 2008 commitments to funds investing in...?**



**Exhibit 3: Reasons LPs Choose to Increase Investment in Emerging Markets PE**

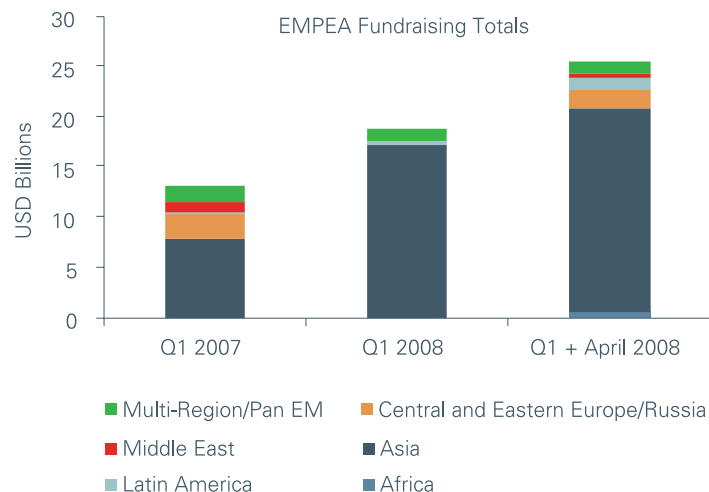


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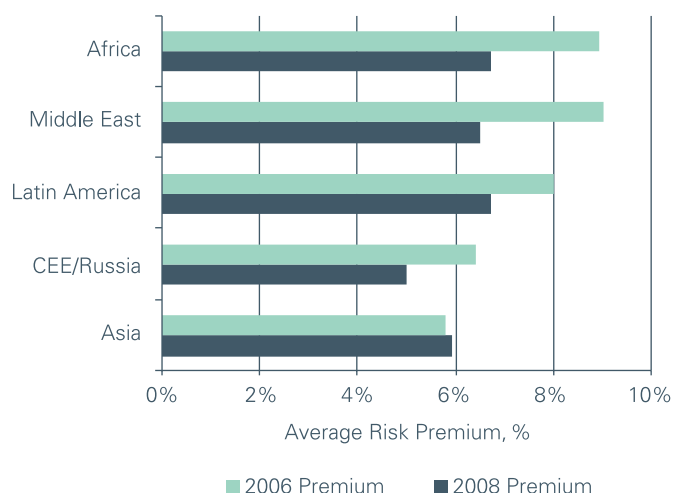
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kets” and “more proven deals and funds, more access.” Respondents also noted improvements in local investment environments, observing that, thanks to the “positive evolution of regulatory frameworks,” the total stability of the emerging markets have substantially increased (see Exhibit 3).

**Exhibit 4: EM PE Funds Raised, Q1 2007 vs. Q1 2008, Jan-Apr 2008**



**Exhibit 5: What do you believe is the appropriate risk premium for private equity investments in...?**



LPs surveyed revealed that Asia would continue to dominate commitments, with 89% expecting to invest there during the next five years, followed by Central and Eastern Europe with 75%. Respondents saw no saturation as of yet, reporting expectations that commitments would deepen in China and India, while allocations would also spread to other markets, building on increases reported in 2006 and 2007.

The 2008 LP Survey confirmed that emerging markets were neither as risky nor as expensive an investment proposition as the uninitiated might believe. Average management fees for EM funds at 1.95% are on par with US & European funds at 1.8%. However, one LP breakfast attendee noted that there are outliers. Reportedly, a small number of big brand US VC firms in India are charging management fees of 3%, with 30% of carry, for growth capital funds, as a sort of “land grab” tactic, allowing them to “start high then work fees down to fend off competitors.”

EMPEA President Sarah Alexander noted that EM PE funds had raised US\$25 billion through April 2008, versus US\$59 billion in all of 2007, already a two-fold increase over 2006 (see Exhibit 4). The group raised the question of whether there might not be a lag between the credit crunch in developed PE markets and a slowing effect on the pace of fundraising for EMs. Another issue raised was the absorptive capacity of EM PE funds, in light of growing EM fund sizes globally and particularly in Asia. One breakfast participant noted that the threat of severe overhang was remote, commenting that the more likely scenario was that the target companies themselves would continue growing at a pace to match the increasing availability of capital.

The LP Survey showed that assigned risk premiums had decreased over the last few years, falling from 9% for African and Middle East funds in 2006 to 6.5% in 2008. The risk premium assigned to Latin America fell from 8% in 2006 to 6.7% (see Exhibit 5). LP Breakfast attendees agreed that risk conditions had improved but countered that country risk was only one component of their assessment. They asserted that the pricing of risk must be asset specific and that it was hard to pin down a country risk premium in isolation of an evaluation of the quality of the fund manager. Breakfast participants welcomed the advent of a deeper pool of fund managers in emerging markets, driven in part by “the offspring of good GPs,” but judged as critical the assessment of whether the brand name, team, and strategy of a fund matches the target market. ■

**“I’m not so worried about whether companies will be able to absorb the capital from the larger funds being raised. I think the target companies themselves will keep growing at a pace to match the capital available.”**