LAVCA
The Association for Private Capital Investment in Latin America

CAMBRIDGE ASSOCIATES

Latin American Private Equity Limited Partners Opinion Survey

2018

Cambridge Associates/LAVCA Survey of Latin American Private Equity

Findings include:

- Limited Partners' (LPs') appetite for alternative asset classes
- Attractiveness of emerging markets for PE investing
- Risk/return equation for Latin American PE
- Means of accessing Latin American private equity
- Opportunities/challenges for private equity investment in Latin America
- Attractive sectors in Latin American private equity
- Direct investments and co-investing by LPs
- The exit market
- Drivers of Latin American PE returns
- Influence of environmental, social, and governance (ESG) considerations on LP investment decisions
- LPs' view on Latin American PE fund terms
- Respondent breakdown
- Research methodology

The Survey covers both domestic and international investors' views of private equity in Latin America, based on responses from 100 private equity investors (Limited Partners or LPs) from around the world.

Key Terms

Limited Partners (LPs): Investors in private equity funds

General Partners (GPs): Private equity fund managers

Private Equity (PE): Venture capital, growth capital, buyout, and mezzanine investments

"International" Investors: LPs headquartered outside Latin America

Over half of LPs plan to increase target allocations to PE

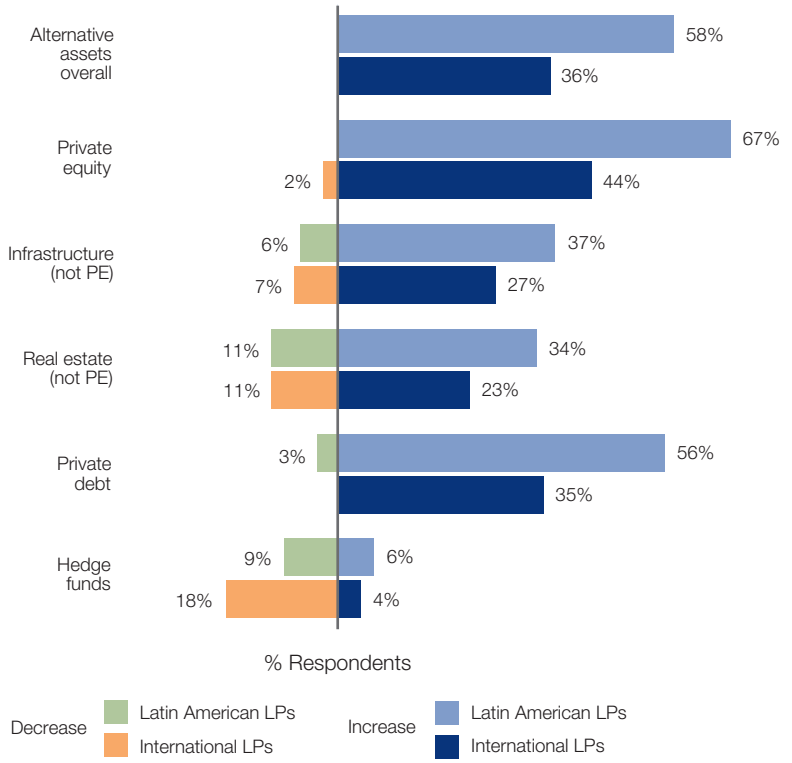
Appetite for alternative assets continues to be strong, with 45% of all LPs planning to increase their exposure to alternatives. As an indication of increased sophistication, 58% of Latin American LPs plan to up their alternatives allocation, a sizeable contrast with the 36% of international LPs expecting to do the same.

Notably, two thirds of Latin American LPs and 44% of international LPs expect to increase their target allocations to PE in the next 12 months. The percentage of LPs set to increase their exposure to PE went up from 46% in 2017 to 54% in 2018, while the percentage of LPs planning to decrease their allocations to PE decreased from 6% the previous year to only 1% in 2018.

56% of Latin American LPs and 35% of international LPs expect to hike their exposure to private debt, which is more or less on par with the 52% of Latin American LPs and 43% of international LPs that expressed the same the previous year.

Appetite for the infrastructure and real estate asset classes remains relatively stable in relation to 2017, while interest for hedge funds stays weak, with only 5% of LPs expecting to increase their target allocations to the asset class.

LPs' expected target allocations to alternative assets in the next 12 months



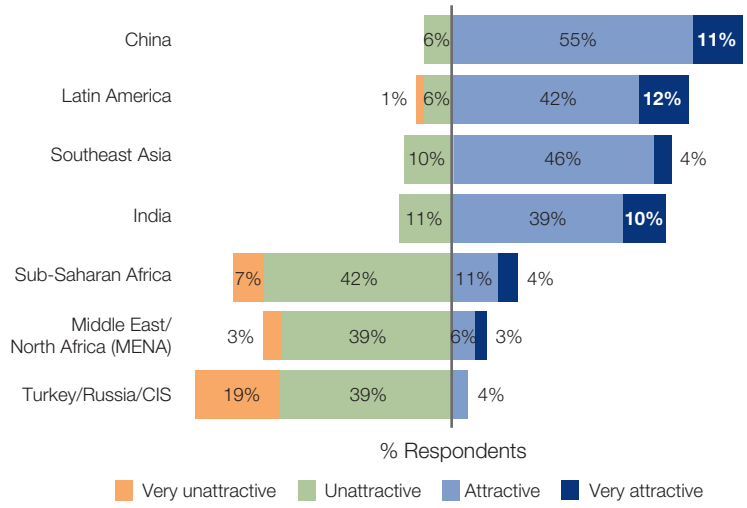
(Figure 1)

Latin America is seen as a preferred destination for emerging markets PE

54% of respondents believe that Latin America will be an attractive emerging market for PE investing in the next 12 months, placing the region only second to China, and ahead of Southeast Asia, and India. This result is likely attributed to entry valuations (see page 3) and a contrarian view among more sophisticated investors looking for opportunities in other emerging markets.

LPs cited Turkey/Russia/CIS as the least attractive emerging market for PE investing over the next 12 months.

Attractiveness of emerging markets for PE investing over the next 12 months – LPs' views

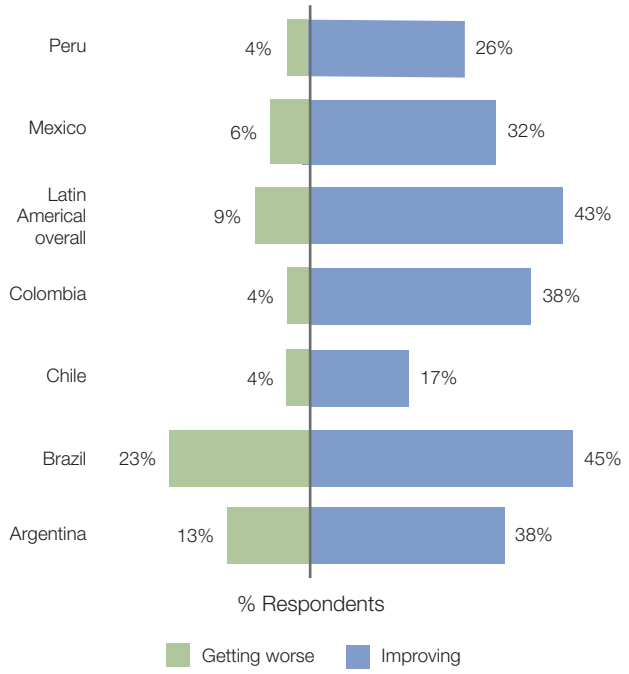


(Figure 2)

International LPs' view the risk/return equation for Latin American PE improving

Fueled by the recent presidential election super cycle in Latin America's largest PE markets, the North American Free Trade Agreement (NAFTA) renegotiation in Mexico, the ongoing corruption scandals in Brazil and economic struggles in Argentina, and the unforeseen resignation of Peru's president, the headline risk in Latin America reached peak levels in 2018. Nonetheless, international LPs view the risk/return equation for Latin American PE improving across markets and in relation to 2017, an indication that foreign institutional investors perceive an improvement of mid- to long-term opportunities for PE investments in the region.

The risk/return equation for Latin American PE – International LPs' views



(Figure 3)

Pan-regional funds are the most popular route to access Latin American PE

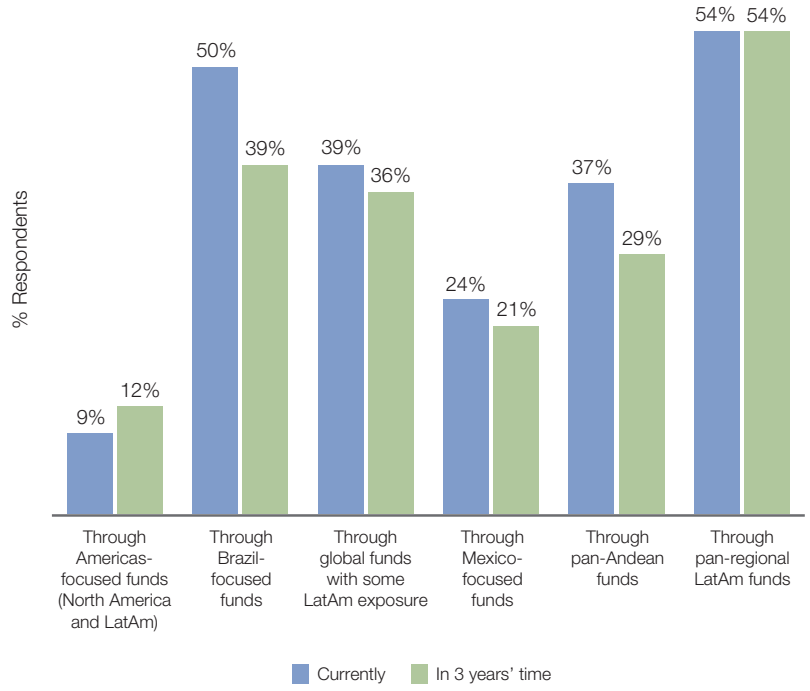
54% of LPs have current exposure to Latin American PE through pan-regional funds. The same percentage of LPs pointed out that they will rely on this route to access PE opportunities in the region in the next three years.

Half of LPs are currently invested in Latin American PE via Brazil-focused funds, a percentage that is expected to decrease to 39% of LPs in three years' time.

The percentage of LPs that invest in PE in Latin America through global and Mexico-focused funds could experience a minor decrease in the next three years, while interest in pan-Andean funds is anticipated to decrease by 8% during the same period.

PE funds investing across the Americas region are expected to experience a slight increase in interest from LPs in the next three years.

Proportion of LPs accessing Latin American PE via particular routes – currently and in 3 years' time



(Figure 4)

Entry valuations seen as attractive in Latin America vs other emerging markets

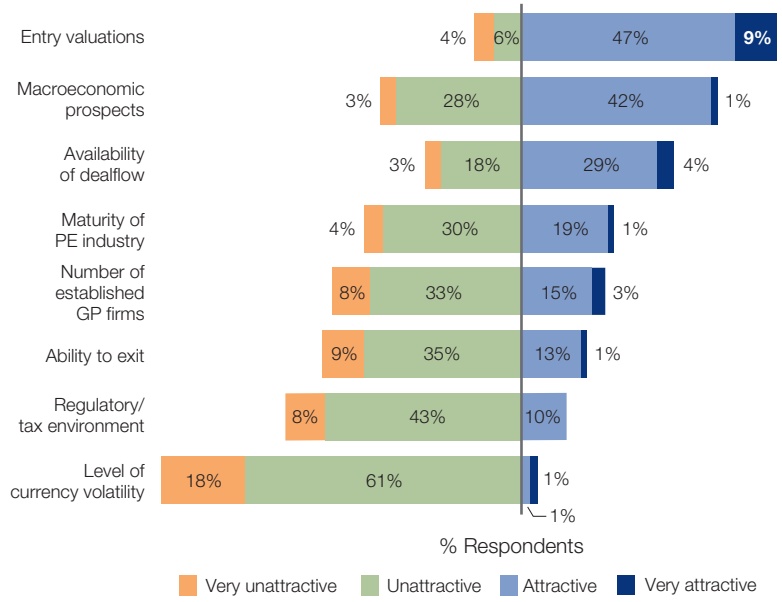
56% of all LPs cited that entry valuations are more attractive compared to other emerging markets. Interestingly, Latin American and international LPs with PE portfolios in Latin America have varying opinions in terms of what factors are most attractive relative to other emerging PE markets.

67% of international LPs believe that entry valuations are more attractive relative to other emerging markets, compared to 39% of Latin American LPs.

By contrast, 52% of Latin American LPs and 37% of international LPs view the macroeconomic prospects in Latin America as more favorable when compared to other emerging markets. In 2017, just 27% of Latin American LPs and 23% of international LPs cited this factor as stronger than other emerging markets.

LPs with current exposure to Latin American PE continue to see currency volatility, the regulatory/tax environment, and the ability to exit in the region as less attractive than those in other emerging markets.

Attractiveness of Latin American PE vs other emerging PE markets – views of LPs currently invested in Latin American PE



(Figure 5)

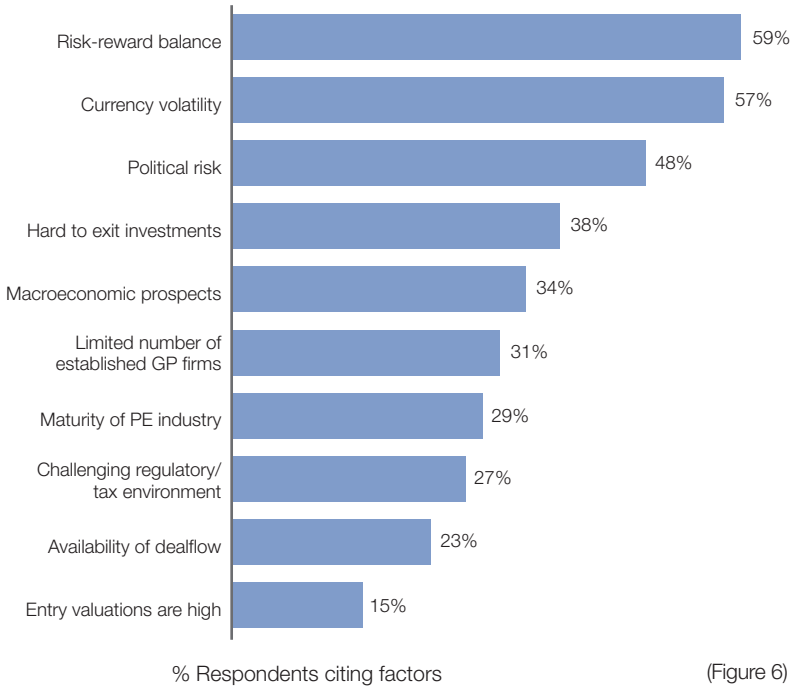
Risk-reward balance is the biggest deterrent for prospective LPs

59% of LPs evaluating a first-time commitment to Latin American PE view the risk-reward balance as the biggest deterrent to investing in the region.

57% of LPs also cited the currency volatility in Latin America as an important challenge.

Political risk has become a bigger impediment for LPs considering a first investment in the region, with 48% of respondents indicating it as a factor, versus the 43% of LPs that did so 2017.

Challenges facing PE in Latin America – views of LPs considering a first investment in Latin American PE



(Figure 6)

Agriculture/agribusiness rises as new top sector for Latin American PE

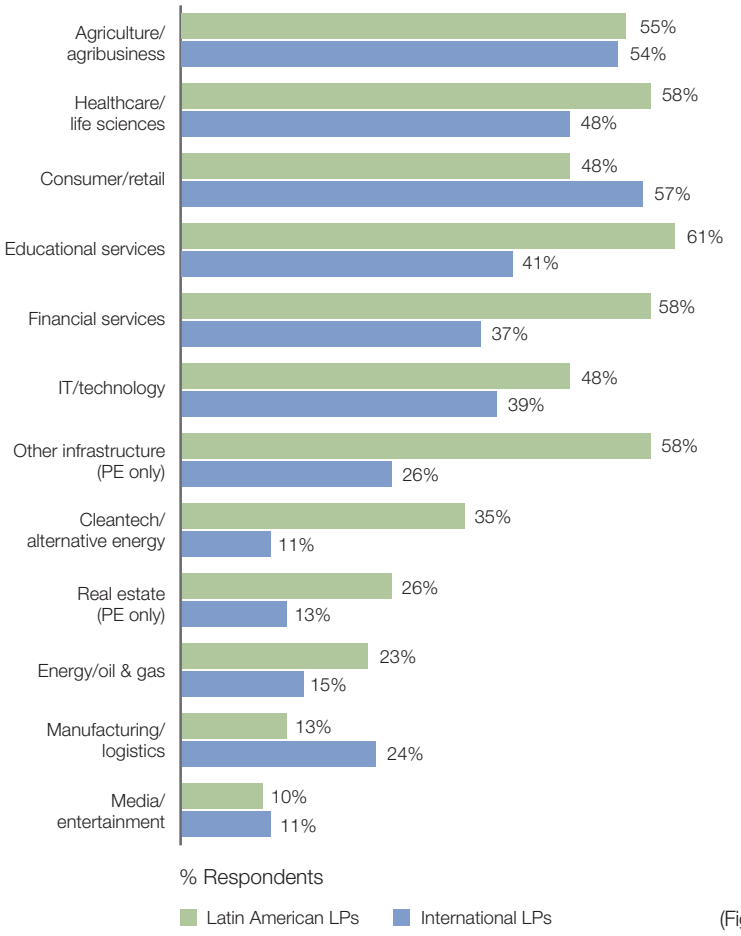
When asked about the most attractive sectors to invest in, over half of Latin American and international LPs responded agriculture/agribusiness, making it overall the most attractive sector for Latin American PE in the next three years.

58% of Latin American LPs and almost half of international LPs view healthcare/life sciences as the second most attractive sector for PE investing across Latin America.

Ranked in the third place, consumer/retail is no longer the preferred sector for PE investments in the region (a position it had held since 2011).

More than half of Latin American LPs show strong interest in infrastructure, educational and financial services, while international LPs also indicated appetite for IT/technology.

LP views of attractive sectors for Latin American PE over the next 3 years



(Figure 7)

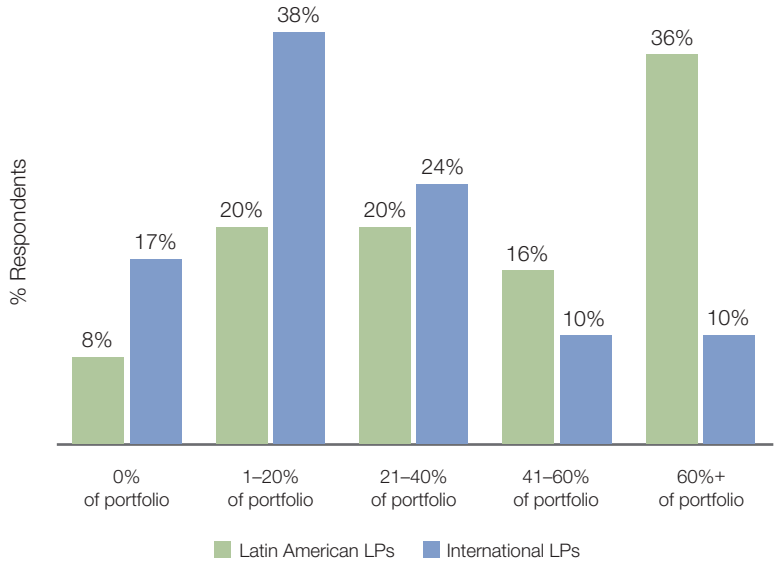
Direct and co-investment exposure continues upward trend

87% of LPs plan to have co-investments or direct PE investments in Latin America in three years' time, an increase from the 81%, 78% and 68% of LPs who indicated the same in 2017, 2016 and 2015, respectively.

Quite notably, in the next three years, 36% of Latin American LPs expect to have 60%+ of their Latin American PE portfolios allocated to co-investments or direct investments, more than tripling the percentage of international LPs planning to do the same.

Perhaps driven by the lack of presence on the ground, international LPs' planned exposure to co-investments or direct investments in the region over the next three years is concentrated in the 1–20% range of their Latin American PE portfolios, with 38% of foreign investors citing this preference.

Co-investments and direct investments as a proportion of LPs' Latin American PE exposure in 3 years' time



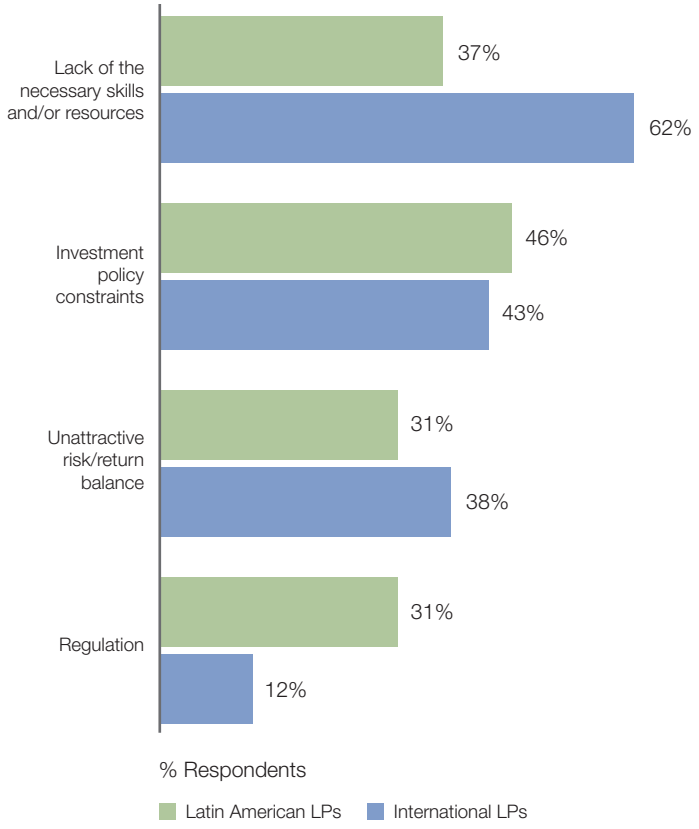
(Figure 8)

Lack of the necessary skills and/or resources and investment policy limit co-investments and direct investments

62% of international LPs mentioned the lack of the necessary skills and/or resources as the biggest impediment to increase their exposure to co-investments and direct investments.

Almost half of Latin American LPs consider investment policy constraints as the most important deterrent to making more co-investments and direct investments. A third of domestic investors also view unattractive risk/return and regulation as barriers for making more co-investments and direct investments.

Factors preventing LPs from making more co-investments and direct investments



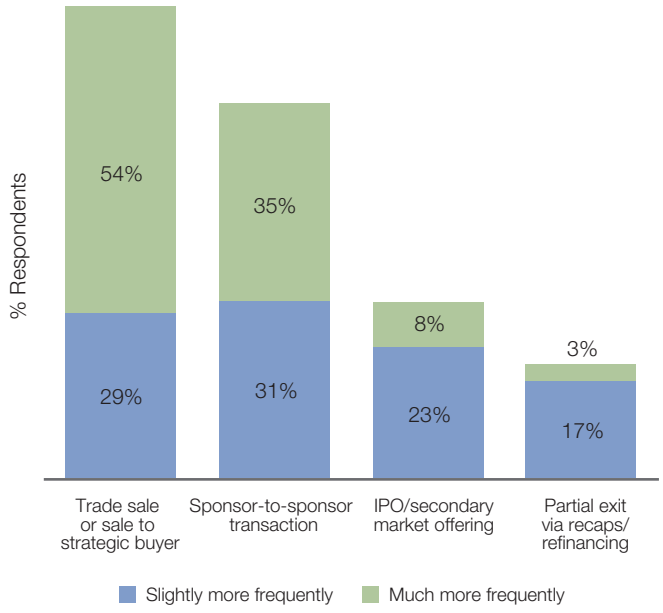
(Figure 9)

Trade sales or sales to strategic buyers reign as the top exit route for Latin American PE

83% of LPs anticipate that trade sales or sales to strategic buyers will be the most popular exit strategy in the next one to two years, up from 72% in 2017.

66% of respondents believe that sponsor-to-sponsor transactions will be a frequent exit route for PE investments in Latin America in the next one to two years, a steep increase from the 43% of LPs that singled out this liquidity path the previous year. This result is likely a consequence of LPs' views on the IPO market for the next one to two years in Latin America. According to LAVCA data, only one PE/VC-backed IPO took place in the first half of 2018.

Expected change in exit routes for Latin American PE in the next one to two years



(Figure 10)

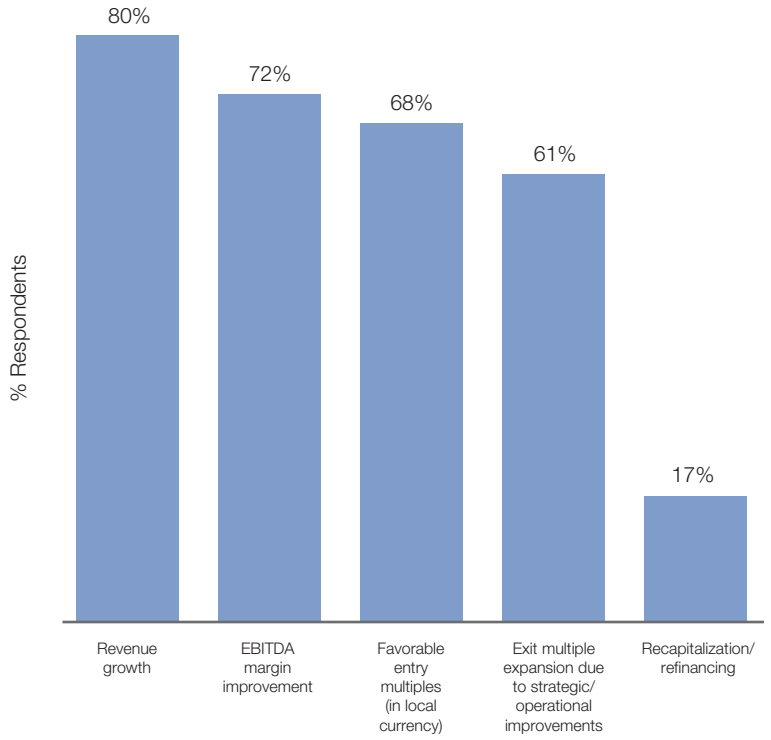
Revenue growth becomes the most important driver of PE returns

80% of LPs think revenue growth will be the top driver of PE returns in Latin America in the next three years, which is consistent with the previous result showing that LPs see the macroeconomic prospects in the region as more attractive in relation to other emerging markets.

EBITDA margin improvement is the second most important return driver for Latin American PE, with 72% of respondents citing it as a factor.

Recapitalization/refinancing continues to be a minor driver of returns given the relatively little leverage employed in Latin American PE.

Important drivers of Latin American PE returns in the next three years – % of investors citing individual factors



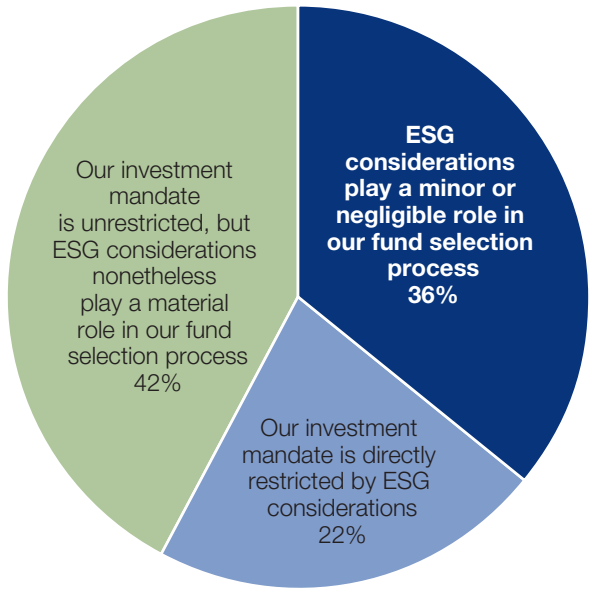
(Figure 11)

Most LPs incorporate ESG considerations in fund selection

Two thirds of LPs expressed that environmental, social, and governance (ESG) considerations are important in their fund selection process.

At the same time, in terms of ESG monitoring, 55% of LPs make no specific reporting demands to their GPs.

Impact of environmental, social, and governance (ESG) considerations on LPs' fund selection processes in Latin America



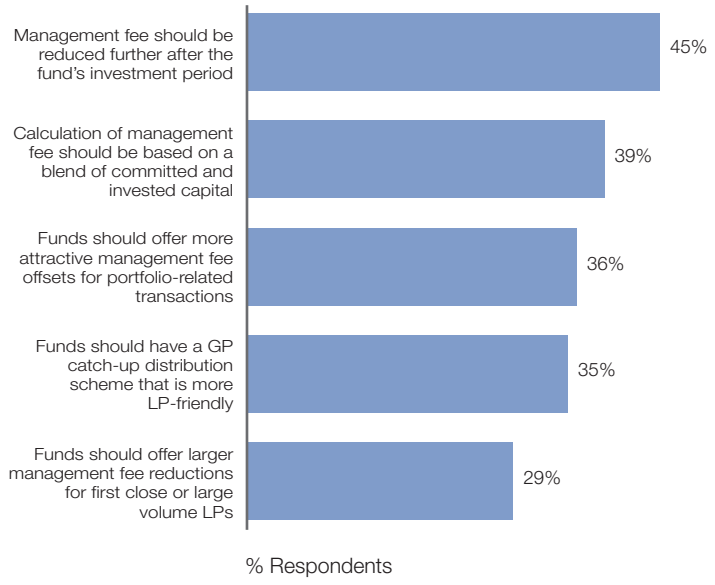
(Figure 12)

Latin American PE fund terms remain unchanged

Despite the challenging political and macroeconomic scenario the region has been through in the last three years, three fourths of LPs said that terms of Latin America-focused PE funds have not become friendlier during this period.

Among key aspects that Latin American PE fund terms could improve, LPs cited a further reduction in management fees after the fund's investment period, and the calculation of management fees based on a blend of committed and invested capital.

LPs' views on aspects that could make Latin American PE fund terms more attractive



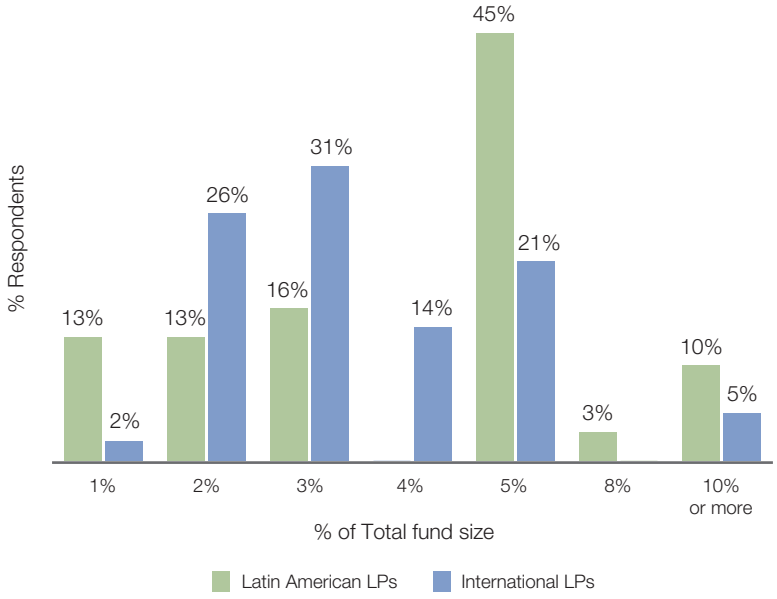
(Figure 13)

Latin American LPs favor larger GP commitments

GP-LP alignment is a meaningful consideration for LPs, who prefer to invest with fund managers who make relevant GP commitments in order to ensure a strong alignment of interest.

According to LAVCA's Private Capital Fund Terms & Compensation report, at least 2% of GP commitments are deemed standard in developed markets. However, 40% of all LPs believe that the GP commitment should be 5% or more, and 73% of all LPs think it should be at least 3% of the total fund size.

Latin American PE fund terms – LPs' views on GP commitment



(Figure 14)

Latin American and international LPs differ on the funding of GP commitments

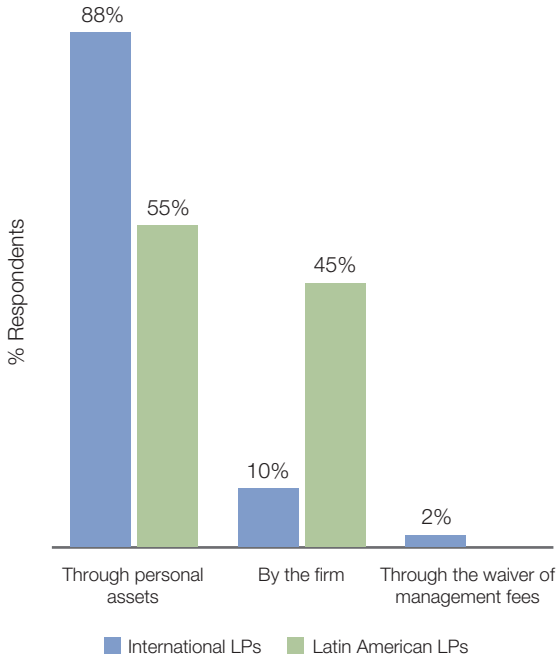
In terms of the source of funding for GP commitments, international LPs have sharply different views than their Latin American peers.

88% of international LPs believe that GPs should fund their commitments through their personal assets, a significantly higher percentage than the 55% of Latin American LPs that expressed the same.

Almost half of Latin American LPs think that GP commitments should be funded by the balance sheet of PE firms.

Both international and Latin American LPs agree that GP commitments should not be funded through the waiver of management fees.

Latin American PE fund terms – LPs' views on the funding of the GP commitment



(Figure 15)

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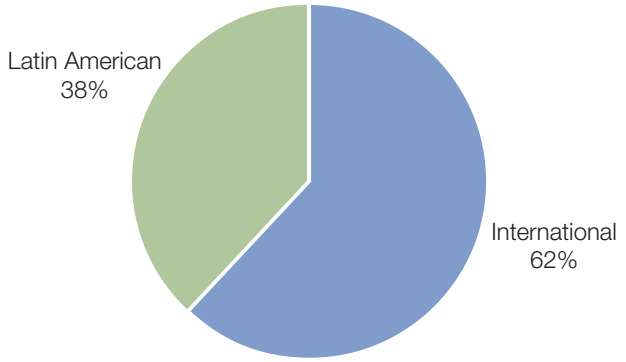
Latin American Private Equity Limited Partners Opinion Survey

Research methodology

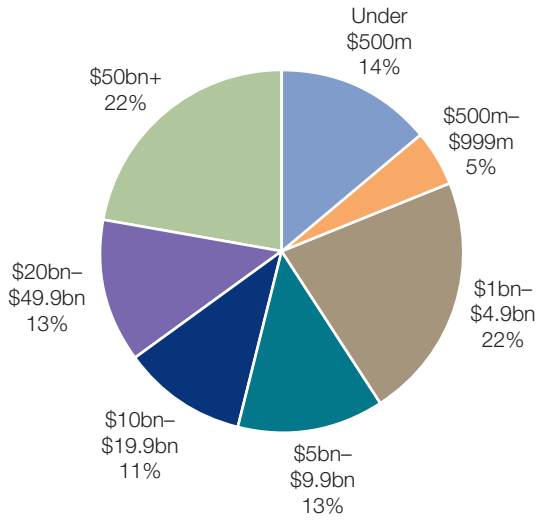
The Survey researched the plans and opinions of 100 investors in private equity funds. These investors, based in Latin America, North America, Europe, and Asia-Pacific, form a representative sample of the LP population worldwide. Fieldwork for the Survey was conducted by LAVCA and Cambridge Associates in June–August 2018.

Respondents by region



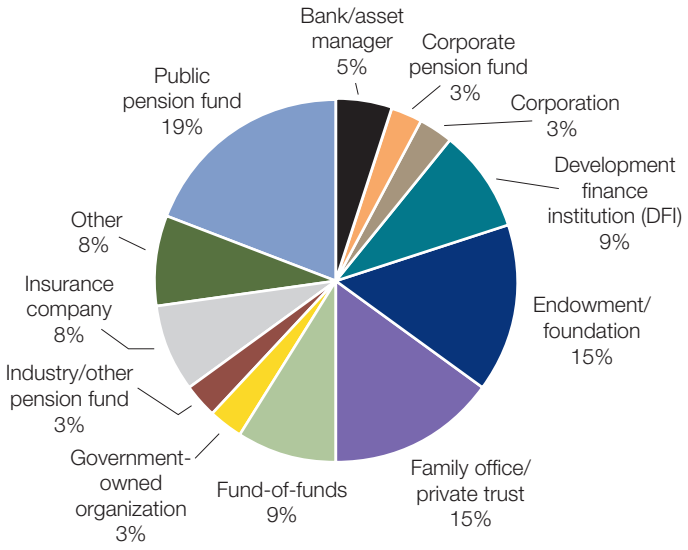
(Figure 16)

Respondents by total assets under management



(Figure 17)

Respondents by type of organization



(Figure 18)

About Cambridge Associates

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About LAVCA

LAVCA is the Association for Private Capital Investment in Latin America, a not-for-profit membership organization dedicated to supporting the growth of private capital in Latin America and the Caribbean. LAVCA's membership is comprised of over 190 firms, from leading global investment firms active in the region and local fund managers to family offices, global sovereign wealth funds, corporate investors, and international pension plans. Member firms control assets in excess of US$65b, directed at capitalizing and growing Latin American businesses. LAVCA's mission – to spur regional economic growth by advancing private capital investment – is accomplished through programs of research, networking forums, education and advocacy of sound public policy. Visit www.lavca.org for more information.

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