KING&WOOD MALLESONS
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The Power of Together

Impact of COVID-19 on Private Funds

- One Year On

May 2021

Introduction

Last year in April 2020, shortly after COVID-19 was declared a pandemic by the World Health Organisation, we published the "Impact of COVID-19 on Private Fundraisings, Comparisons to GFC and Looking Ahead" article ("**2020 COVID Article**"), which summarised the fundraising environment at that time. Much has changed since then even though COVID-19 itself has not yet been defeated.

In summary, the pandemic did not adversely impact fundraising activity of private funds as much as many people had expected. The year of 2020 also turned out to be less similar to the 2007-2009 global financial crisis ("**GFC**"). Although 2020 can be compared to the GFC for its use of fiscal and monetary stimulus, unlike the GFC, the central bank-led recovery was much faster in 2020. Since the bottom of the market in March 2020, there has been a sharp increase in stock prices which has subsequently incentivised many retail traders to become interested in public markets again with valuations for many tech companies reaching stratospheric levels.

Our earlier 2020 COVID Article also discussed the silver lining of low valuations during times of turmoil. This was true in March – April 2020, but due to the prompt action of central banks, valuations recovered quickly and approached euphoric levels in some sectors with fund managers and investors are looking to position themselves for the post COVID-19 economy.

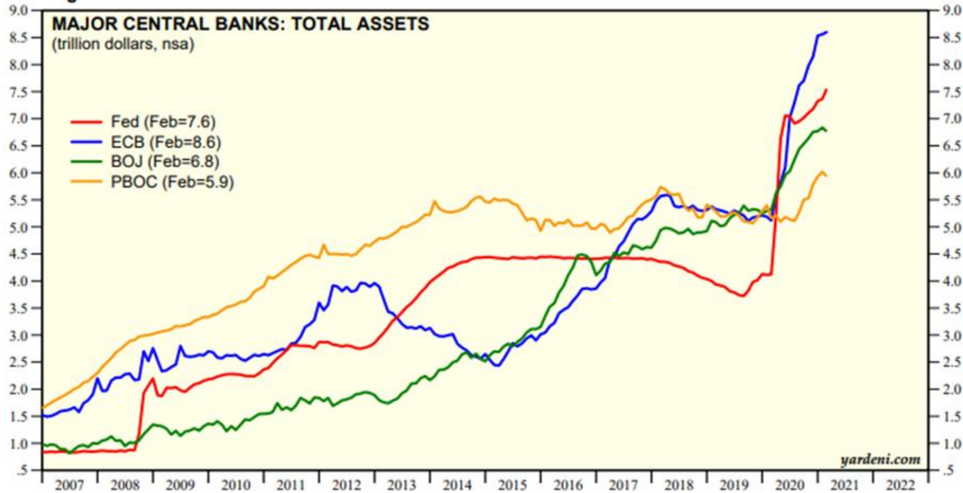
In this article, we discuss the current state of events at a macro level by looking at the general economic climate before delving into specific areas of fundraising. This will follow with our view on secondaries, dry powder, deals, valuations and returns, and the outlook for 2021.

Macroeconomic Climate

When we published the 2020 COVID Article, central banks and governments had already started to act to provide fiscal and monetary stimulus, but we expressed concerns whether these measures would continue to keep the liquidity moving within markets until COVID-19 subsided. Fast forward one year the main concern is when COVID-19 will end as opposed to issues on liquidity, solvency, fundraising, portfolios and the economy. Concerns about the real economy have been pushed into the distant future given fund managers' and investors' confidence that central banks have the willingness and ability to keep the economy and financial assets on life support until COVID-19 ends and the economy restarts. Central banks did not hesitate to use massive amounts of quantitative easing in 2020 as evidenced by the balance sheets of the major central banks as shown in Figure 1.

**Any reference to "Hong Kong" or "Hong Kong SAR" shall be construed as a reference to "Hong Kong Special Administrative Region of the People's Republic of China".*

Figure 1: Total assets of major central banks

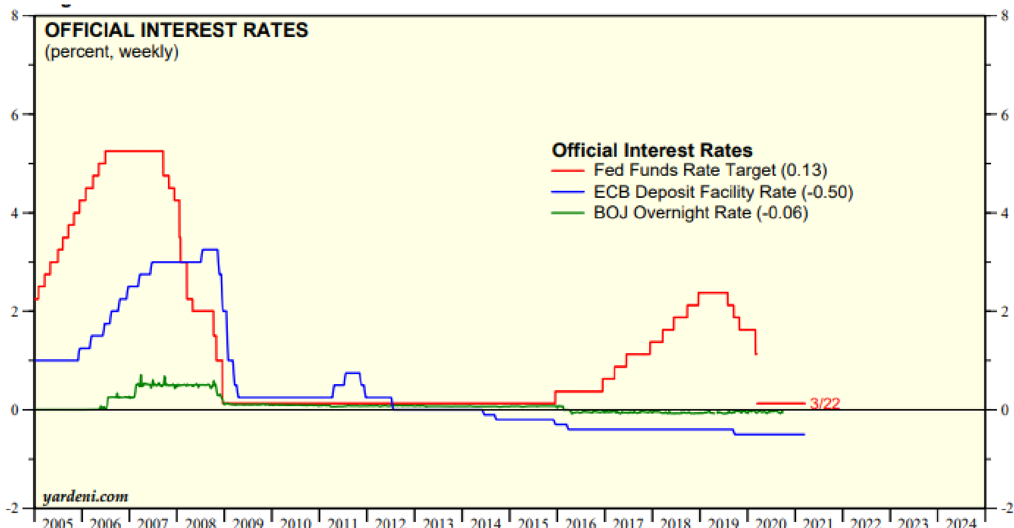


Source: https://www.yardeni.com/pub/peacockfedecbassets.pdf

From the chart above, not only is the quantitative easing used by central banks of much greater magnitude than that used by the central banks in the GFC, but the U.S. Federal Reserve (the "**Fed**"), the European Central Bank ("**ECB**"), the Bank of Japan ("**BOJ**") and the People's Bank of China ("**PBOC**") have all acted quickly in using massive amounts of quantitative easing, whereas in the GFC, it was mainly the Fed which used aggressive fiscal stimulus.

In addition to quantitative easing, most global central banks cut interest rates sharply and quickly in 2020, lowering borrowing costs for financial institutions, corporations and consumers. The Fed had room to cut interest rates, but with historically low interest rates in Europe and Japan, the ECB and the BOJ, respectively, had little room to move on interest rates, as seen in Figure 2.

Figure 2: Global short-term interest rates



Source: https://www.yardeni.com/pub/glir.pdf

This backdrop of fiscal and monetary stimulus led to a much more favourable macroeconomic climate for private fund managers and investors than many people had expected back in the beginning of 2020.

Fundraising

Aggregate Capital Raised and Number of Funds

A lot of the quantitative easing and fiscal and monetary stimulus of central banks and governments may not at first glance be strongly associated with fundraising for private funds, but the global financial system is increasingly interconnected and the fiscal stimulus has been unevenly distributed. In 2020, those who didn't lose their jobs could use stimulus checks and/or extra spare time and spending money from not being able to travel and lockdowns to invest in financial assets. Although most retail investors would invest in public markets, soaring stock prices together with numerous special purpose acquisition company ("**SPAC**") listings affected projected exit valuations for portfolio companies, justifying higher multiples on private transactions and increased interest in fundraising. The fiscal and monetary stimulus had a positive impact on fundraising volume in private markets. The number of private funds raised was at a multi-year low, but the aggregate capital raised was above 2016 levels and not that far off 2017-2019 levels, as seen in Figure 3 below.

Figure 3: Fundraising activity, 2010-2020

Source: S&P Global Market Intelligence, 2021 Global Private Equity Outlook, page 4.

The fact that aggregate capital raised is generally in an up-trend whereas the number of funds raised is in a downtrend since 2017 suggests that funds are becoming bigger on average and some small- to mid-sized funds are starting to fall away.

Delays

As was the case one year ago, investors in private funds continue to see an impact on their investing activities or plans and personal business activities. We predicted in the 2020 COVID Article that the lack of face-to-face meetings might stall fundraising on funds which were about to launch. Due to the travel restrictions around the world, we did continue to see an initial preference amongst many investors to delay fundraisings by a few months, but realising that COVID-19 and travel restrictions would continue than initially planned, many investors gave way to pragmatic considerations and pushed forward with more frequent video conferences on Zoom, Webex, Microsoft Teams and other videoconferencing platforms to finalise their investments in funds.

At KWM, amongst our clients, the pace of fundraising did not slow down much but some fundraisings were initially delayed for 3-6 months as some investors had initially hoped to wait it out, thinking the pandemic might be over by mid-2020. Therefore, investor activity slowed down in the first-half of 2020, but picked up drastically in the second-half of 2020 and has continued to remain high in the first quarter of 2021. However, we are still seeing some investors waiting it out before they make fund investments with new fund managers as due diligence on fund managers and targeted assets is still hard to do and fund managers are finding it difficult to market to new investors due to travel restrictions, lockdowns and quarantine requirements.

Terms

In our 2020 COVID Article, we mentioned that some fund managers eager to close investors and hesitated due to COVID-19-related market volatility might consider including COVID-19-specific provisions in their fund documents to placate investors. This includes delaying the start of the investment period, holding regular meetings with investors to discuss the start of the investment period and to showcase the pipeline of deals, having a long stop date when either the investment period will automatically start or investors can withdraw from the fund and giving investors the ability to withdraw or pausing the investment period if future pandemic events occur again. However, as the year went on and the fundraising environment stabilised in 2020 due to fiscal and monetary policy support, we saw fewer investors asking for these types of provisions and fewer fund managers willing to make fund documentation more LP-friendly as a result of COVID-19. Some investors did ask for LP-friendly clauses, including to make it harder for an LP to be designated as a Defaulting LP, reduce management fees, obtain more protection through GP clawbacks and obtain withdrawal rights in case COVID-19 continued, but most GPs had enough bargaining power to push back on these requests, so we did not see any material shift to more LP-friendly fund documentation in general.

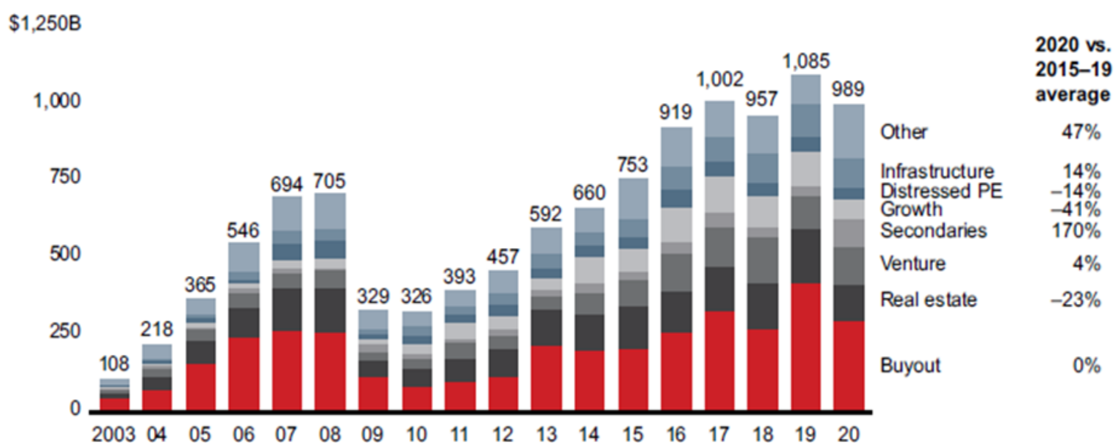
In line with our prediction in the 2020 COVID Article, we have seen an increase in managed accounts with targeted actual assets in the waiting as there were tangible assets to assess and these assets appealed to the risk-off mindset of investors in the first-half of 2020. Certain investors were willing to part with cash but only on the basis that they had a lot of control over deal allocation. For example, in one fund we advised which was raised with a single investor, the investor negotiated for a large re-up right, allowing the investor to adopt a wait-and-see approach to extra commitments.

Types of Funds

In terms of the types of funds raised this past year, we have seen an acceleration of the trends that were already in place during COVID-19. There has been a renewed focus on healthcare and biotech related funds as people realise more acutely the fragility of global health systems. At KWM, we have seen an increasing volume of fundraisings in sectors related to the internet economy and people's health, such as logistics, biotech, healthcare, medical devices, SAAS, online services, online education and cloud computing.

In terms of global trends in types of funds raised, as seen in Figure 4 below, 2020 saw an increase in infrastructure, secondaries, venture and other [1] funds and a decrease in distressed private equity, growth and real estate over the 2015-2019 average.

Figure 4: Global private capital raised, by fund type



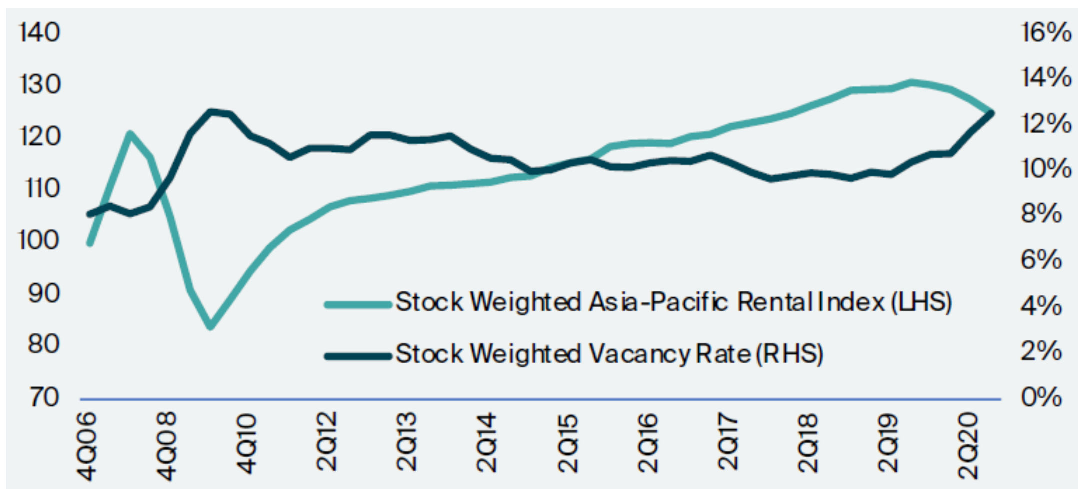
Source: Bain & Company, Global Private Equity Report 2021, page 19.

[1] Other includes SPAC fund-raising, private investment in public equity, hybrid funds, mezzanine and natural resources: Bain.

Real Estate Funds

For targeted actual assets, we discussed in the 2020 COVID Article that some investors in private real estate funds had been concerned about the ability and willingness of current tenants to pay rents during COVID-19 and may wish to delay closing until there is greater certainty on this point. However, due to fiscal stimulus worldwide, many tenants were able to continue paying their rent throughout 2020, leaving real estate funds with vacancy rates which were higher than 2019 but not as bad as might have been expected at the onset of the pandemic. As seen in Figure 5 below, vacancy rates in the Asia-Pacific increased slightly in 2020 but are still not much higher than recent years.

Figure 5: APAC Prime Office Rent & Vacancy Index Chart



Source: Knight Frank Asia-Pacific, Asia-Pacific Real Estate Outlook 2021, page 11.

We made a note in our 2020 COVID Article that the rating downgrades in many industries might be a silver lining for private funds sitting on massive amounts of dry powder as it would lead to an increase in the availability of distressed assets, in particular in the hotels and retail sectors, whose valuations would snap back after COVID-19. There was a brief period last year where this was true. However, due to the strong fiscal and monetary stimulus measures of central banks, with the Fed even adding high yield bonds to the list of assets it can purchase, many heavily indebted industries were able not only to survive, but also to recover some or all of their valuations quicker than had been expected.

Once lockdowns and travel restrictions end, many real estate sectors, such as office, retail and lodging/resorts will benefit from decreased vacancy rates and fund managers raising real estate funds in these sectors will have an easier time convincing investors that vacancy rates for their targeted assets will be low. However, headwinds for office real estate funds are likely to continue as some companies may choose to extend work-from-home or work-from-anywhere policies.

Logistics and Data Centre Funds

In 2020, KWM saw an acceleration of logistics fundraising, which was no doubt partly driven by the growing trend in e-commerce and supply chain security by COVID-19. Although people will want to go out more after COVID-19 ends, retail commerce will struggle to maintain its market share as faster internet connectivity through 5G, greater internet coverage in developing countries and an improving delivery infrastructure lead to a continuation of the trend towards e-commerce. As seen in Figure 6 below, online retail penetration grew strongly in 2020, but still has a lot of room to grow in the future.

Figure 6: Online retail penetration and growth in 2020

Market	Est. end-2020 online retail penetration	Est. online retail growth in 2020 (%YoY)
Chinese Mainland	33%	12%
Japan	12%	20%
Australia	15%	13%
India	5%	8%
South Korea	30%	20%

Source: Knight Frank Asia-Pacific, Asia-Pacific Real Estate Outlook – 2021, page 14.

In addition, although supply chains will find some relief after COVID-19, building a supply chain which is not overly dependent on foreign countries has become an increasingly important priority for many countries, including the People's Republic of China, the United States and others.

In 2020, we have seen many logistics fund managers having a busy year. Among other logistics fundraisings, KWM advised LOGOS on the establishment of US$800 million logistics development venture in Mainland China, which aims to develop high-quality logistics and industrial facilities in key logistics markets servicing Beijing, Shanghai, Guangzhou and selected markets in the mid-west of Mainland China. Last year, LOGOS also raised a US$350 million joint venture in Vietnam, its first venture in Vietnam, which aims to develop a portfolio of logistics facilities across Ho Chi Minh City, Hanoi and the Greater Danang area. Vietnam is likely to continue to benefit in 2021 in its role as an alternative manufacturing hub.

2020 was also a busy year for Warburg Pincus-backed logistics platform New Ease which, amongst other fundraisings, raised a US$200 million joint venture in Mainland China with fund manager Actis and a US$600 million joint venture in Mainland China with JP Morgan Asset Management which both aim to invest in logistics facilities across Mainland China. There were also major logistics fundraisings last year by Hong Kong Special Administrative Region of the People's Republic of China ("**Hong Kong**") -based Baring Private Equity Asia, Singapore-based GLP and JLL affiliate and Chicago-based fund manager LaSalle Investment Manager, amongst many others.

In 2020, there was also an increase in data centre fundraising in Asia-Pacific as Hong Kong-based Gaw Capital Partners closed a US$1.3 billion fund in Mainland China with Abu Dhabi Investment Authority (ADIA) and other investors and Beijing-based GDS Holdings Ltd closed a RMB2.6 billion investment vehicle in Mainland China with a fund controlled by CITIC Private Equity Funds Management Co Ltd. This is likely to be a continuing trend in 2021 as increased usage of cloud computing and 5G will drive demand for data centres.

Logistics fund managers have also started 2021 on the front foot. Canadian pension fund manager QuadReal Property Group and New Ease recently raised a US$1 billion joint venture in Mainland China which aims to invest in and develop logistics properties in various Mainland Chinese cities. The shortage of high-quality logistics facilities in Mainland China together with the ongoing trends towards e-commerce and supply chain security, including the move away from just-in-time manufacturing, is likely to lead to strong logistics fundraising in the remainder of 2021.

First-Time Funds

In our 2020 COVID Article, we pointed out that COVID-19 would make it harder for first-time fund managers, especially those who had not had in-person meetings with investors. This is certainly how it has played out. If it weren't for COVID-19, typically many fund managers and investors would expect to meet each other in person before closing a fund together for the first time. Travel has been a big issue for first-time fund managers and we have not seen many first-time blind-pool funds able to raise money in this environment. Most of the funds we saw raised in last year involved investors following fund managers they are familiar with into new or successor funds. This is to be expected as fund management is a competitive business which relies heavily on track record and travel restrictions have raised the barriers to entry by making it harder to do roadshows and market funds. In order to raise a first-time fund in such environment, the team or key person would need to show they had a good track record under a previous umbrella.

For fund managers with a good track record and strong strategic partners, they are still able to raise significant amounts of capital without travelling and even in some cases turning down investors. SAAS was a particularly booming sector in 2020, especially in Mainland China. Although we saw a delay, on average, of about 3-6 months, the speed of fundraising also depends on the track record of the fund manager. For some big funds with a good track record, especially secondary funds, they were able to raise funds without delay and were oversubscribed, but for smaller funds without a track record, there were some funds whose fundraising has been delayed by a year or more due to the inability to meet certain investors face-to-face. It is especially difficult for first-time fund managers to raise funds as they lack existing connections with investors and cannot meet investors in person during COVID-19. And as mentioned in the Fundraising – Aggregate Capital Raised and Number of Funds section above, the fact that aggregate capital raised is generally in an up-trend whereas the number of funds raised is in a downtrend since 2017 suggests that funds are becoming bigger on average and some small- to mid-sized funds are starting to fall away.

Onshoring of Funds to Hong Kong SAR and Singapore

We have been seeing a continuing trend for fund managers to onshore their funds from offshore jurisdictions to onshore jurisdictions including Mainland China, Hong Kong SAR and Singapore. Over the past year, we have seen many Limited Partnership Funds ("**LPFs**") set up. The LPF regime was launched on 31 August 2020 and as of 30 April 2021, there have already been a total of 211 LPFs successfully established under the Limited Partnership Fund Ordinance (Cap. 637). KWM assisted its clients in establishing 68 LPFs, including the first LPF in Hong Kong, representing over 32% of the total LPFs established in Hong Kong. We have also seen some fund managers opting to onshore their funds using open-ended fund companies ("**OFCs**"), variable capital companies ("**VCCs**") and Singapore limited partnerships. However, the take-up of OFCs has not been as high as that of LPFs, VCCs and Singapore limited partnerships. The OFC regime was launched on 30 July 2018, but as of 30 April 2021, there were only 13 OFCs and 32 sub-funds currently registered by the Securities and Futures Commission ("**SFC**").[2] KWM assisted its clients in establishing 3 of these OFCs, representing over 23% of the total OFCs currently registered in Hong Kong. In Singapore, the VCC framework was launched on 15 January 2020 and as of 30 April 2021, there were a total of 263 VCCs registered on the business filing portal of ACRA.[3]

The OFC regime has struggled to gain traction. However, the government of the Hong Kong SAR was able to implement lessons learned from the OFC launch so the roll-out of the LPF launch was a lot more smoother. We continue to see a trend for Hong Kong and Mainland Chinese fund managers to want to explore using Hong Kong fund vehicles but higher uptake may only accelerate after they become more familiar with these fund vehicles. We have seen that Hong Kong LPFs are commonly used alongside offshore structures or as a feeder fund into offshore fund structures. For example, in one LPF we raised, individual investors came into a Hong Kong LPF which invested in a Cayman partnership which in turn invested into a Delaware partnership. Therefore, LPFs can serve as a vehicle to onboard Hong Kong and Mainland Chinese investors, while allowing investors from other regions to invest via an offshore structure if they prefer to invest via the offshore structure due to familiarity with established offshore vehicles. This could be in either a master-feeder structure or a parallel fund structure.

[2] https://www.sfc.hk/en/Regulatory-functions/Products/List-of-registered-open-ended-fund-companies.

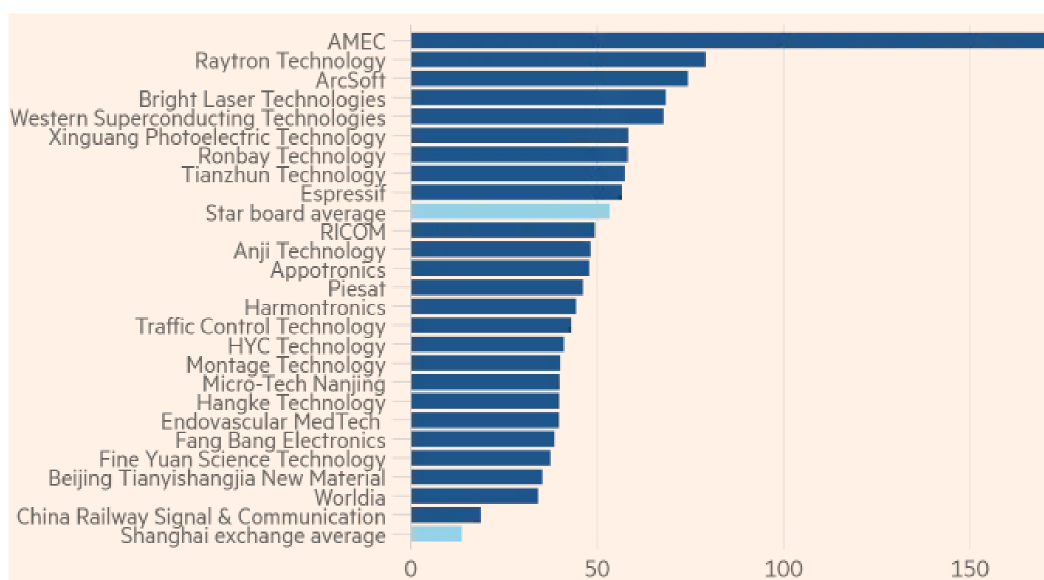
[3] https://www.vcc.bizfile.gov.sg/p/IShop/SearchRegister?UEN=VkND.

Mainland China Funds

As the pandemic caused lockdowns in some parts of Mainland China in early 2020, fundraising activity was much slower in the first half of the year than usual. However, the market was very active in the second half of the year. In Mainland China, we also saw leading fund managers finding it easier to raise funds, especially those which are focused on innovative industries were often oversubscribed. For mid-size and underperforming funds, fundraising was made more difficult by COVID-19.

For fund managers raising funds in Mainland China, they focused more on RMB funds than USD funds last year, as most people without Mainland Chinese passports were unable to enter Mainland China. At first, they thought they could resume fundraising for USD funds in the second half of 2020, but by that stage, although the situation had stabilised in Mainland China, the situation had not stabilised in other countries and inbound and outbound travel restrictions were and are still in place as we speak. Traditionally, there have been more USD funds than RMB funds raised, which is partly due to capital controls and stricter regulations on RMB funds. However, fund managers in Mainland China now have more exit options for portfolio companies in Mainland China with the Shanghai Stock Exchange STAR Market which allows companies to list there before they are profitable and also allows foreign companies to list there. So now there is a shift towards fund managers and investors setting up more RMB funds which is strengthening the valuations of portfolio companies in Mainland China. As can be seen in Figure 7 below, the first 25 companies to list on the Shanghai Stock Exchange STAR Market had an average P/E ratio which was much higher than the average P/E ratio of stocks listed on the Shanghai Stock Exchange.

Figure 7: Price to earnings ratios for the first 25 companies to list on the Shanghai Stock Exchange STAR Market

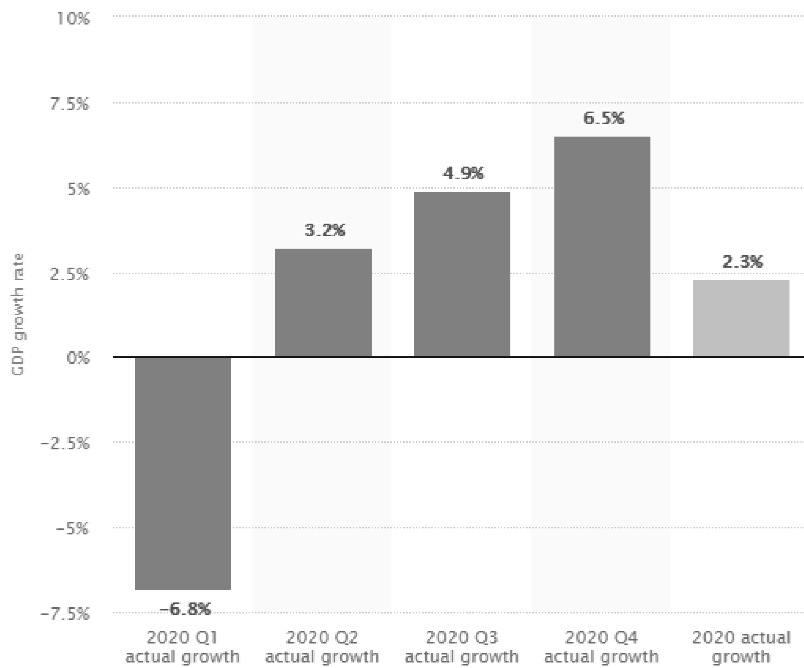


Source: https://www.ft.com/content/3a3115d4-a86c-11e9-984c-fac8325aaa04

Having said that, not all of our clients were switching from USD funds to RMB funds. We continue to see some clients who previously invested in RMB funds want to try to invest in USD funds raised by Mainland Chinese fund managers so that they are more freely able to utilise investment gains offshore.

Given fund managers and investors based overseas may not have been able to travel to Mainland China, one might expect that foreign fund managers or investors' activities in Mainland China would slow down, but on the contrary we have seen increased activity from foreign fund managers and investors in Mainland China. This increased activity was no doubt a result of Mainland China coming out of the pandemic quicker, with most travel restrictions within Mainland China lifted in mid-2020 and Mainland China being one of the only major economies in the world whose GDP grew in 2020, with a 2.3% growth rate in 2020 as seen in Figure 8 below.

Figure 8: Mainland China's GDP growth rate in 2020



Source: https://www.statista.com/statistics/1102691/china-estimated-coronavirus-covid-19-impact-on-gdp-growth/

In terms of domestic travel and consumption, life in Mainland China is resuming back to normal and most investors in emerging markets still see Mainland China as one of the best places to invest due to the number of consumers and their rising purchasing power.

In Mainland China, we have also seen renewed interest in "new consumption" funds, which target investments in start-ups focusing on enabling the Mainland Chinese economy to be more self-sufficient and depend less on imports as a result of tensions between the U.S. and Mainland China on the trade policy.

We continue to see Qualified Foreign Limited Partnerships ("**QFLPs**") becoming a popular vehicle for foreign investors in Mainland China, especially in Shenzhen, Chongqing, Shanghai and Qingdao. People use QFLPs to invest in all kinds of investment products, including funds, bonds, loans, fixed income and equities. QFLP is locally regulated and more and more cities are adopting policies to allow QFLPs to be set up in their locality. The cities are competing amongst themselves to attract foreign investment into local QFLPs. This competition is good for investors as it entails more investor-friendly policies with greater flexibility in some areas. Fund managers and investors can talk to local governments to assess which localities offer them the most favourable policies and incentives. For foreign investors investing in private markets in Mainland China, QFLP provides an alternative to investing through a Wholly Foreign-Owned Enterprise ("**WFOE**") structure.

We are also seeing increased participation in the Qualified Foreign Institutional Investor ("**QFII**") and Renminbi Qualified Institutional Investor ("**RQFII**") regimes since the reforms last year, in which some restrictions on QFII / RQFII were relaxed, quota limits were removed, the application procedure was made faster, repatriation of funds is made easier and the scope of investment products available to QFII / RQFII is increased. In addition to stocks, bonds, futures and mutual funds, QFII / RQFII can now also invest in over-the-counter securities and shares, fixed income, interest rate and foreign exchange derivatives, commodity futures and options and private investment funds (provided that the downstream investments fall within the scope of investment products in which QFII / RQFII can invest).

Distressed Debt

In Mainland China, over the past year we saw a lot of interest in distressed debt funds, as the debt burden of many companies requires restructuring deals in the private market, which provides a lot of opportunities for distressed debt funds. Data from Mainland China shows an increasing amount of non-performing loans which present more opportunities for distressed debt investors. In August 2020, the head of the CBIRC set a target for 3.4 trillion yuan for non-performing loan disposals in 2020 and a higher target for 2021, as seen in Figure 9 below.

Figure 9: Annual non-performing loan disposals and write-downs by Mainland Chinese banks

Source: https://www.allaboutalpha.com/blog/2021/01/04/the-challenges-and-opportunities-of-chinese-distressed-debt/

The deleveraging in Mainland China poses a challenge to highly indebted companies, but also provides an opportunity to investors looking to take on more risk.

ESG

We have seen continuing focus on Environmental, social and governance ("**ESG**"). Many people view COVID-19 as an opportunity to reset the terms upon which we live in society and move more quickly towards decarbonisation, advocating that climate change is a much bigger threat to humanity than COVID-19 and epidemics in general. At KWM, we have seen a continuing increase in vigilance on ESG-related requirements by many investors in funds, especially Development Finance Institutions ("**DFIs**"). Although ESG has been a concern for many investors for some time, the requests are becoming more detailed. The requests we have seen in fund documentation regarding ESG have included mandating the fund to do the following:

- Establish and comply with an ESG policy;
- Establish an ESG sub-committee of the advisory committee which advises on ESG matters in accordance with the ESG policy;
- Ensure that the portfolio companies comply with the ESG policy and making sure that portfolio companies are contractually bound to do so;
- Comply with the investor's own ESG policy;
- Prepare an annual ESG report which reports on the fund's and portfolio companies' compliance with the ESG policy;
- Including update on ESG matters in quarterly reports;
- Comply with ILO Declaration on Fundamental Principles and Rights at Work;
- Comply with ILO Basic Terms and Conditions of Employment;
- Comply with IFC Performance Standards 2012;

- Comply with World Bank Group Environmental, Health and Safety Guidelines;
- Comply with AIIB Environmental and Social Policy;
- Comply with UN Guiding Principles on Business and Human Rights; and
- Comply with EDFI Principles for Responsible Financing.

In addition, consistent with the concerns of many investors about clean energy, we have also seen requests for the fund to be prohibited from investing in or for investors to have a right to be excused from investing in:

- Coal prospection, exploration, mining or processing;
- Oil exploration or production;
- Standalone fossil gas exploration and/or production;
- Transport and related infrastructure primarily used for coal for power generation;
- Crude Oil Pipelines;
- Oil Refineries;
- Construction of new or refurbishment of any existing coal-fired power plant (including dual);
- Construction of new or refurbishment of any existing HFO-only or diesel-only power;
- Plant producing energy for the public grid and leading to an increase of absolute CO2 emissions;
- Any business with planned expansion of captive coal used for power and/or heat generation; and
- Nuclear power generation.

Although there is nothing particularly new about these requests, the vigilance of investors about ESG requirements and volume of requests is increasing with time. Most fund managers are on the same page as investors want to raise funds which are ESG-friendly. However the increased amount of ESG guidelines that fund managers need to comply with and the increased amount of ESG reporting could increase time and costs spent on ESG-related administrative issues.

The focus on ESG is also evident in green bond issuance, which recovered strongly in the second half of the year to reach a record US$269.5 billion. Mainland China was the 4th largest green bond issuer in 2020, behind only U.S., Germany and France. We expect to see more fundraising with ESG investment restrictions and climate-related focus going forward as investors realise the impact certain activities have on the climate and/or seek to profit from disruptive climate-friendly changes to the economy.

Geographic Region

Different countries have been impacted by COVID-19 differently. For example, the most hard-hit countries are in Europe and the Americas. However, most investors are still taking a long-term view in which regions and countries are best to invest in. In Asia, we see a lot of interest in Mainland China and emerging Southeast Asian nations as labour costs are still much cheaper than the developed world. Populations in many countries, such as Vietnam, also exhibit favourable demographics given a lower median age of the population than developed countries. A focus for some investors has also been on how supply chain disruption may benefit certain economies such as Vietnam in manufacturing supply chains. At the same time, Mainland China's new investment treaty with Europe may bring about increased investment from European countries as investors there gain greater market access. U.S. President Joe Biden may also take a less confrontational approach to trade which may slow down supply chain diversification if there is greater confidence amongst investors in multilateral institutions, but if trade tensions between the U.S., Mainland China and other countries and regions remain, supply chain diversification is likely to remain an important priority.

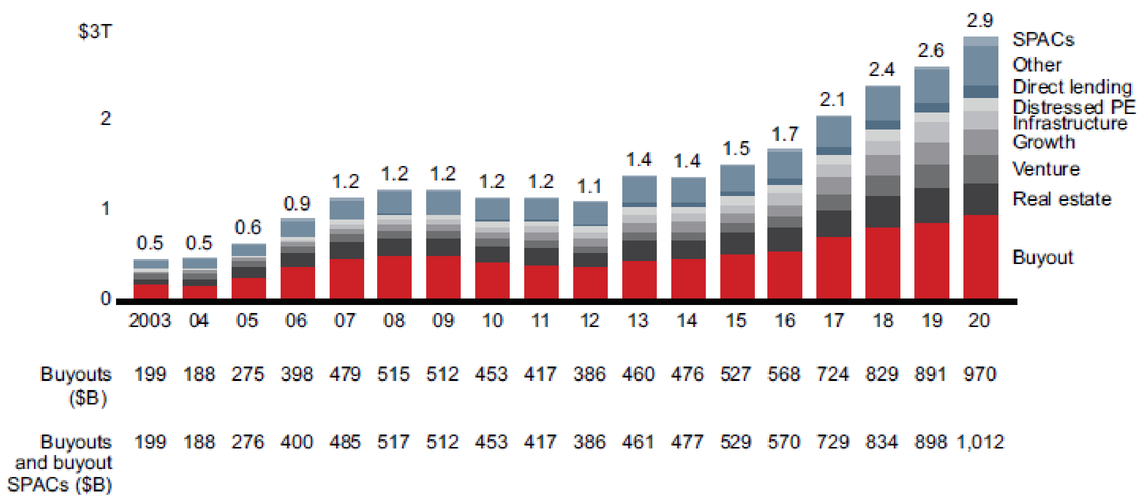
Secondaries Activity Generally

2020 saw an increase in secondaries fundraising globally as there was a 170% increase in amount of funds raised in 2020 over the 2015-19 average.[4] Before last year, we saw many secondary funds being set up in Mainland China, but we have seen more secondaries fundraising activity in Mainland China last year than usual. Broadly speaking, after the GFC, many funds were raised in early- to mid-2010s which are now coming towards the end of their terms and LPs may want to exit if there are extensions to the fund terms. Some LPs may also have liquidity issues due to COVID-19. Some LPs may also see it as a good time to exit with valuations still high. Another reason for increase in secondaries in Mainland China has been that private markets in Mainland China have become more mature, with fund managers and investors being more sophisticated and familiar with secondaries. Beijing also established a pilot program last year which encouraged the formation of secondary funds.[5] Given the increasing sophistication of Mainland Chinese fund managers and investors and their increasing familiarity with secondaries, we expect the trend of increasing secondaries fundraising activity to continue in 2021.

Dry Powder

In private markets, funds are being raised quicker than they can be spent and this is leading to a continued increase in dry powder amongst private funds. As mentioned in the Fundraising – Aggregate Capital Raised and Number of Funds section, the aggregate capital raised was slightly below 2017-2019 levels, as seen in Figure 10 below there has been a consistent and uninterrupted increase in dry powder from 2012 – 2020.

Figure 10: Global private uncalled capital, by fund type



Source: Bain & Company, Global Private Equity Report 2021, page 13.

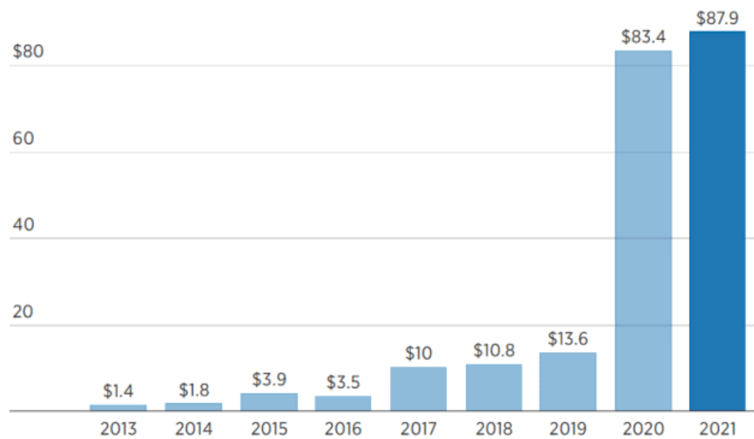
SPACs

2020 was the year of the special purpose acquisition company ("**SPAC**") with a record number of SPAC IPOs and the SPAC euphoria continues in 2021 as U.S. SPACs have already raised more money in the first 3 months of 2021 as they did in the whole of 2020, as see in Figure 11 below.

[4] Source: Bain & Company, Global Private Equity Report 2021, page 19.

[5] Source: https://en.ciftis.org/en/xwzx/fmdt/2020123018513541010/index.html; http://jrj.beijing.gov.cn/jrgzdt/202103/t20210329_2331029.html

Figure 11: Total capital raised from U.S. blank-cheque deals (US$bn)



Source: https://www.cnbc.com/2021/03/19/spacs-break-2020-record-in-just-3-months.html

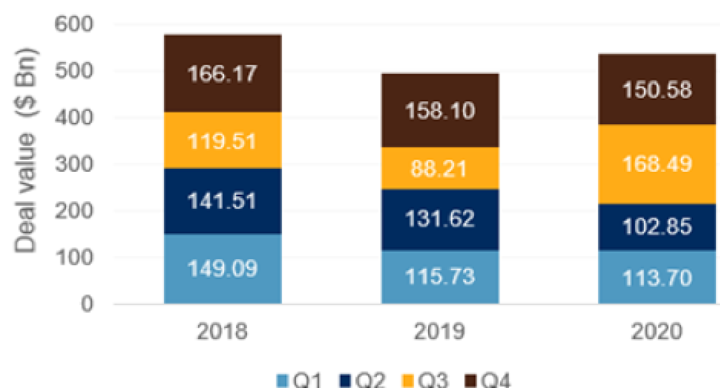
From sports stars such as Shaquille O'Neal, Serena Williams, Stephen Curry, Alex Rodriguez and Colin Kaepernick, former politicians such as Larry Kudlow, Wilbur Ross and Paul Ryan to pop stars such as Ciara have helped raise a SPAC since the start of 2020.[6] Therefore, for funds with investments in the hot sectors, last year has been characterised by high valuations and a good time to exit investments, whether by sale to a private fund, an IPO or sale to a SPAC. SPAC listings have only accelerated in the U.S. in 2021 and we may see more SPACs in other jurisdictions going forward. For example, in Hong Kong, the SFC and Hong Kong Exchanges and Clearing ("**HKEX**") announced earlier this year that they are looking at proposals to allow SPACs to raise capital on the Hong Kong stock exchange.[7] In addition, on 31 March 2021, the Singapore Exchange ("**SGX**") released a consultation paper on a proposed listing framework for SPACs on the Mainboard of the SGX.[8]

Deal Making

Deal Value

In terms of deal-making last year, there was a sharp decrease in deal-making in Q1 and Q2, however a sharp increase in deal-making in Q3 and Q4 made up for lost ground in Q1 and Q2, as seen in Figure 12 below.

Figure 12: Value of PE/VC Deals Globally, 2018-2020



Source: https://www.spglobal.com/marketintelligence/en/news-insights/research/2021-global-private-equity-outlook

This is consistent with KWM's on-the-ground perception of what occurred last year in 2020 and is similar to the observation we made above in the Fundraising – Delays section about the delay in fundraising – investors were waiting it out in the first-half of 2020.

[6] Source: https://edition.cnn.com/2021/02/23/investing/spac-arod-kaepernick-celebrities/index.html; https://finance.yahoo.com/news/5-celebrity-spacs-consider-shaq-222007933.html

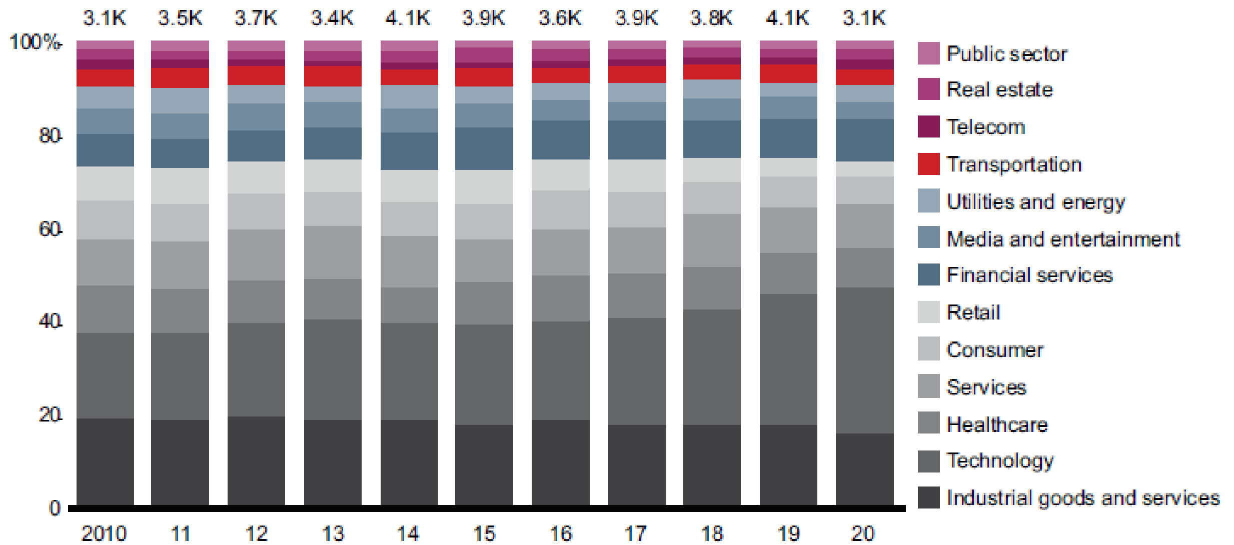
[7] Source: https://www.reuters.com/article/us-hong-kong-spac-idUSKCN2AU0CA

[8] Source: https://www.sgx.com/regulation/public-consultations/20210331-consultation-paper-proposed-listing-framework-special; https://www.bloomberg.com/news/articles/2021-04-06/spac-bubble-fears-lead-hong-kong-singapore-down-cautious-path

Types of Deals

Although there were fewer global buyout deals in 2020 than in previous years, as seen in Figure 13 below, the technology sector continues to occupy an ever greater share of global buyout deal activity.

Figure 13: Share of global buyout deal count, by sector



Source: Bain & Company, Global Private Equity Report 2021, page 16.

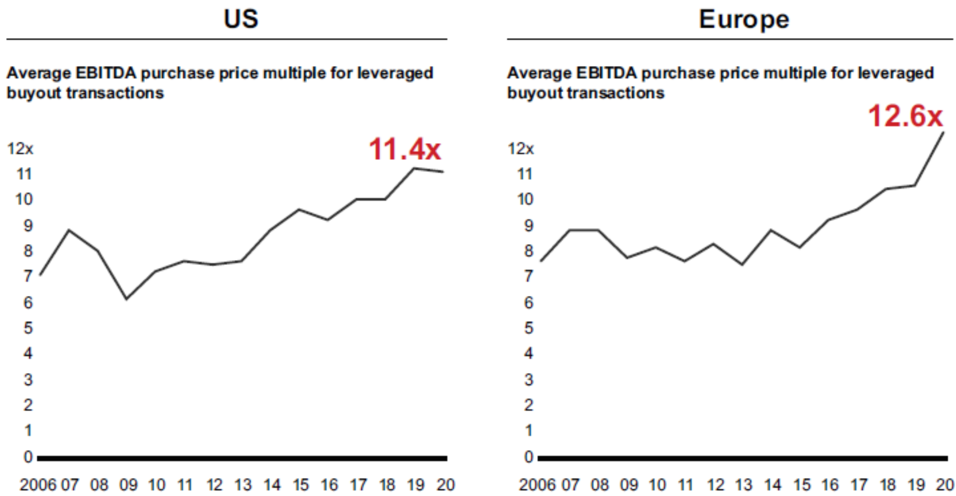
One theme running through many of the sectors which have benefited from the acceleration of trends started before the COVID-19 pandemic is that they are industries which involve innovative products that are not yet developed and/or online services with unpredictable future revenue streams which are difficult to value given the inherent uncertainty of forecasting future earnings for companies looking to be disruptive but not yet making a profit or sometimes even sales. On the fiscal side, there is more money in the economy due to quantitative easing. On the monetary side, money is easier to borrow and debt is easier to roll-over given the backdrop of lower interest rates and government schemes in certain countries to allow companies to borrow extra money during the pandemic (e.g. to pay wages). As mentioned in the Dry Powder section above, there is more dry powder. And in public markets, 2020 was the year of the SPAC as outlined in the SPAC section above. Therefore, both dry powder in private markets and money raised by SPACs is competing for deals. This backdrop has allowed portfolio companies in these sectors to reach higher valuations much more quickly and with less proof of concept and made it easier for portfolio companies to exit by IPO or SPAC-merger at an earlier stage. In 2019, WeWork faced heavy scrutiny when it filed its IPO paperwork and eventually ended up withdrawing its listing application after prospective IPO investors soured on the company following the disclosures in their IPO paperwork and its valuation took a heavy hit. In contrast, if the average-first day return of an IPO (the "**IPO Pop**") is anything to go by, 2020 was a much more favourable environment for companies to go public. In the U.S., for example, last year saw 471 companies go public on U.S. stock exchanges and the IPO Pop was 38%, which is the highest IPO Pop since the dot-com bubble, where the IPO Pop was over 50% in 1999-2000. [9] Although investment banks do often price in an IPO Pop of some sort, the fact that the IPO in 2020 almost reached dot-com bubble levels suggests that investor enthusiasm last year exceeded even the expectations of investment banks.

[9] Source: https://www.nasdaq.com/articles/trends-in-ipo-pops-2021-03-04.

Valuations

Frothy valuations are evident not only in the public markets but also in buyout transactions, as seen in Figure 14 below, with EBITDA multiples at or near record high levels in the U.S. and Europe.

Figure 14: Deal multiples in the US and Europe



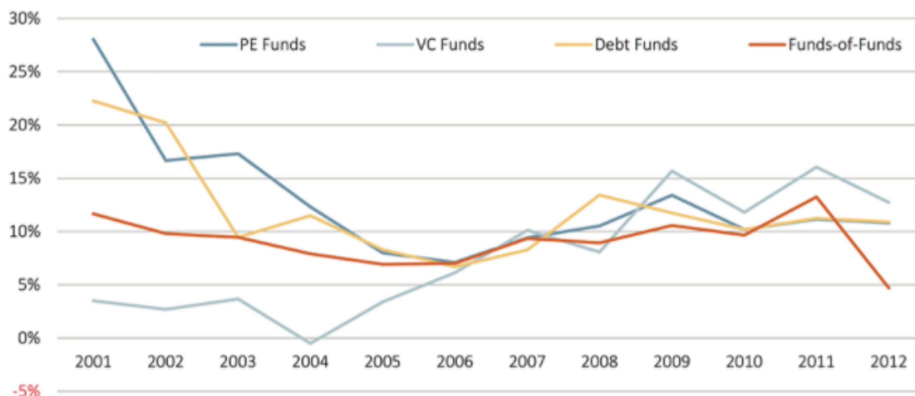
Source: Bain & Company, Global Private Equity Report 2021, page 11.

In our 2020 COVID Article, we mentioned that fund managers able to close funds in 2020 may be in a better position to deliver returns for Investors, compared to fund managers who closed earlier. We also noted that as long as the economy recovered without undergoing a long recession, fund managers and investors who survived the COVID-19 outbreak would benefit from the contraction in deal multiples. However, due to the strong central bank response, there was no fall-off in deal multiples and deal multiples remain at or near historical highs U.S. and Europe and fund managers and investors who survive COVID-19 will face stiff competition for and need to pay up for assets.

In the GFC, there was a steep decline in asset values which only recovered slowly, allowing funds which were raised in 2009 at the start of a long recovery to earn outsized returns. Whereas in 2020, there was a steep decline in asset values, but asset values recovered very quickly leaving less opportunities for funds which are raised in 2020-2021.

Therefore, going forward, fund managers will need to manage expectations of investors accordingly, including in marketing documents issued to investors, as 2020-2021 vintage year funds may struggle to find deals which are attractively priced and therefore such funds may be less likely to achieve high IRRs for their funds such as those which came out of the 2009 vintage year. As seen in Figure 15, the median IRRs coming out of all fund types raised in 2009 were above 10%.

Figure 15: Global Median IRR by Fund Type and Vintage Year

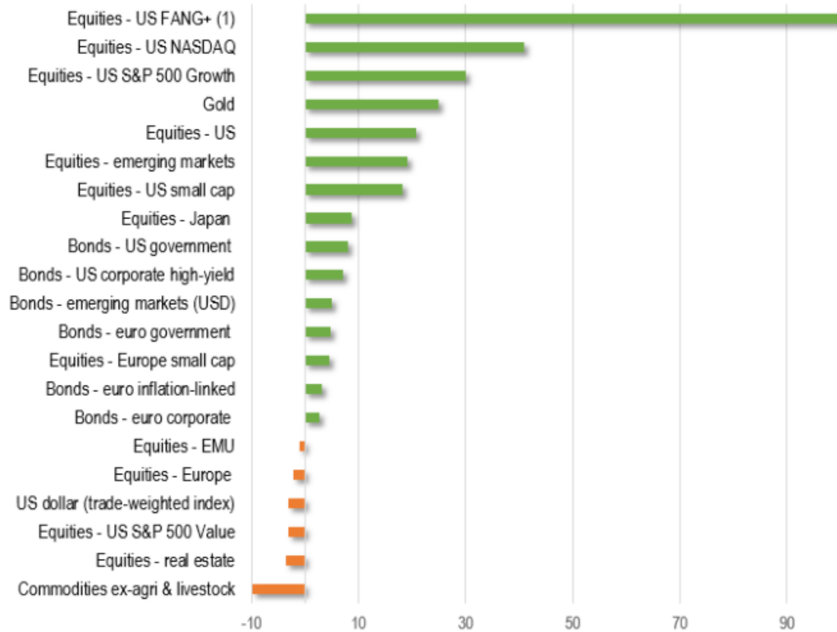


Source: https://pitchbook.com/news/articles/video-draft-3q-2015-pe-vc-benchmarking-report

Returns on Investment in Public and Private Markets

In terms of returns, as seen in Figure 16 below, asset class returns also exceeded initial expectations, with returns in equities in most sectors, bonds and gold ending 2020 in positive territory despite large drawdowns in early 2020. FANG+ which includes Facebook, Apple, Amazon, Netflix and Google benefited and the tech heavy NASDAQ were amongst the largest beneficiaries of the stay-at-home economy in 2020.

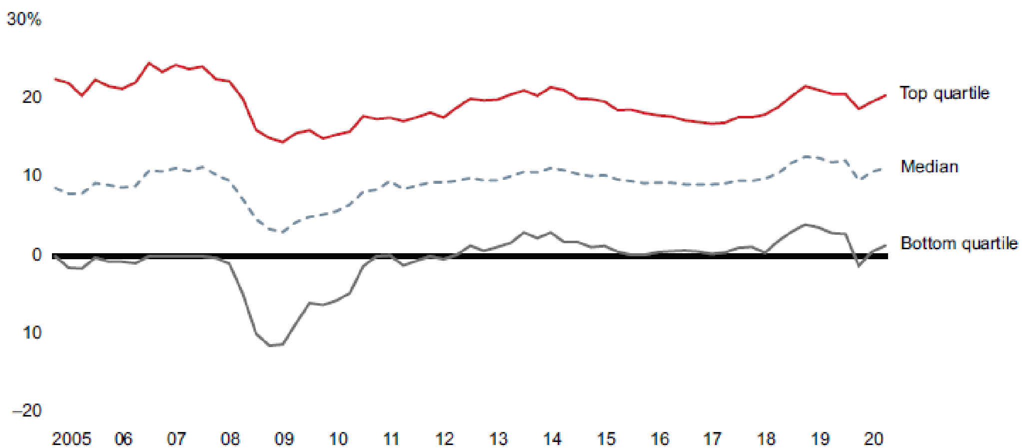
Figure 16: Asset class total returns in local currency (in %)



Source: https://investors-corner.bnpparibas-am.com/markets/chart-of-the-week-2020-market-wrap/

Positive portfolio performance has been felt by investors in private markets. As seen in Figure 17 below, the 10-year annualised IRR for global buyouts actually increased in 2020, which is not a result many would have expected in the depths of the pandemic. Contrary to what many had expected early last year, 2020 turned out to be nothing like the GFC thanks to the fast action taken by the major global central banks.

Figure 17: 10-year annualized IRR for global buyouts



Source: Bain & Company, Global Private Equity Report 2021, page 22.

However, as we mentioned earlier, with deal multiples at or near historical highs in U.S. and Europe, fund managers and investors need to be wary of extrapolating this trend into the future.

Outlook for 2021

Many of the trends which accelerated during COVID-19 will likely continue as they were brought by fundamental shifts in the economy. However, with the high valuations across industry sectors, it is not necessarily beneficial for all investors who invest in those sectors. Nevertheless, whether an investment has a valuation which is justified based on traditional valuation metrics does not seem to matter for some investors in 2021. If there are enough of those investors, this may in turn influence the supply and demand for these assets and some investors might make some money, at least in the short-term. Moreover, given the macroeconomic backdrop and the signs of euphoria in the markets, valuations may continue to remain high for some time.

However, as evidenced by history, global central banks will eventually take away the punch bowl by raising interest rates and reducing quantitative easing and concerns on COVID-19 will give way to other concerns and there will be other black-swan events. At the moment, however, fund managers and investors are most worried about the knock-on effects of the COVID-19 pandemic and changes in the macroeconomic environment. The post COVID-19 world will be a new normal, but this will also provide opportunities to fund managers and investors who adapt quickly to changes to the world brought about or accelerated by the pandemic.

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