This report is an excerpt from: **Preqin Quarterly: Private Equity, Q3 2012**. To download the full report please visit: https://www.preqin.com/docs/quarterly/PE/Private_Equity_Quarterly_Q3_2012.pdf

Attracting LP Capital in an Evolving Market

As the private equity market evolves, many investors are exploring alternative ways to access the asset class beyond the traditional closed-end commingled structure. In order to diversify and add value to their portfolios, we are seeing growing numbers of LPs awarding separate account mandates, and looking at secondary market, direct and co-investment opportunities. In such competitive fundraising markets, it is important that GPs carefully consider LP requirements when seeking to secure capital commitments from them.

Separate Accounts

In recent months we have heard of numerous LPs allocating capital to separate accounts with fund managers. As shown in Fig. 9, 55% of active investors on Preqin's Investor Intelligence database are currently expressing some level of interest in separate accounts. While separate accounts have been offered by some fund managers for years, particularly by fund of funds managers, there is now an increased desire from investors to invest in the asset class via this route.

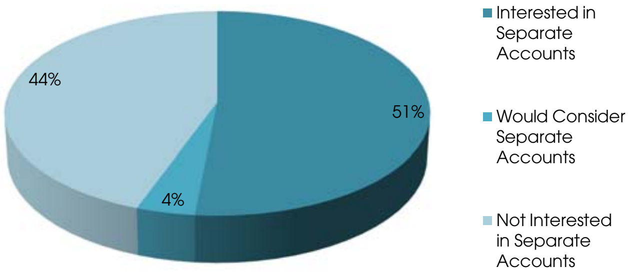
One of the biggest attractions of separate accounts is that they can be highly customized by the LP, allowing the investor to gain exposure to particular sectors and regions it wishes to target, and giving it more of an influence over its portfolio than a regular fund investment. These arrangements can also benefit LPs by forging closer relationships with fund managers, allowing the negotiation of better terms and more frequent reporting from the GP.

It is beneficial for fund managers offering separate accounts to identify the types of institution that are gaining exposure to private equity via this route. Fig. 10 illustrates the breakdown of investors on Preqin's Investor Intelligence database that have indicated an interest in investing through a separate account. Public pension funds account for 43% of all LPs looking at issuing separate account mandates, which is unsurprising as some of these institutions are among the largest investors in private equity, with typical ticket sizes large enough for a separate account to be viable. One particular public pension fund with an interest in separate accounts is California Public Employees' Retirement System (CalPERS). It has awarded numerous separate account mandates to private equity firms, including a $500mn separate account awarded to the Blackstone Group in May 2012 to target global investment opportunities.

Direct, Co-Investments and Secondary Market Investments

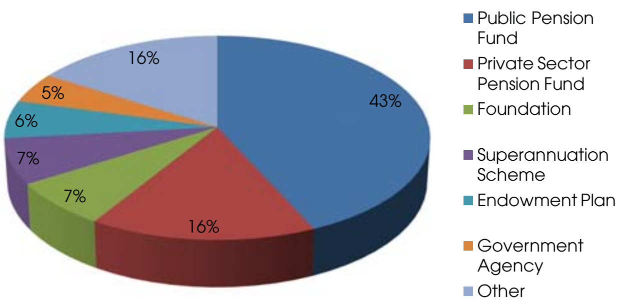
As well as separate accounts, we have recently seen an increasing number of investors seeking to gain direct exposure to private equity. Additionally, many LPs have looked to the secondary market as a way of accessing funds they may not have been able to access during the initial fundraise.

Fig. 9: Investor Appetite for Separate Account Mandates



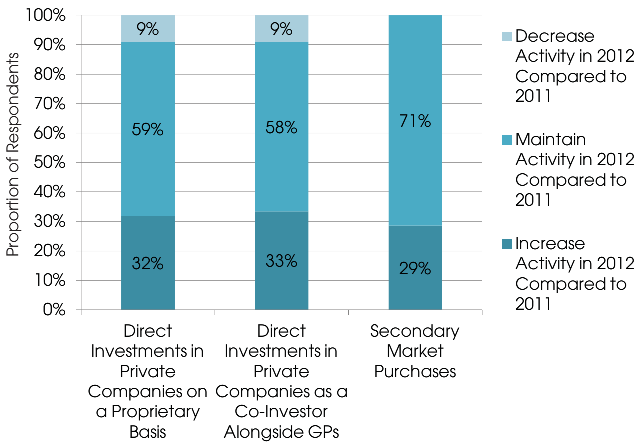
Source: Preqin Investor Intelligence

Fig. 10: Breakdown of Investors Considering Separate Account Mandates by Type



Source: Preqin Investor Intelligence

Fig. 11: Investors' Expectations of their Direct Investment and Secondary Market Activity in 2012 Compared to 2011



Source: Preqin Investor Outlook: Private Equity, H2 2012

Preqin interviewed a sample of 100 global LPs in June 2012 in order to find out their views on the private equity market and their plans for future investments in the asset class. Investors were asked how their expectations for the level of activity in direct and secondary market investments in 2012 compared with their activity in 2011 (see Fig. 11). Investor appetite for direct investing looks set to continue to grow, as 91% of investors already active in direct and/or co-investing expect to maintain or increase their activity in these areas in 2012 compared to 2011. Just 9% of these investors expect to reduce their activity.

Many LPs see the secondary market for fund interests as an appealing way to access the asset class. Such investments can offer many advantages to LPs, including enabling access to funds they may not have been able to participate in during the original fundraising process, adding further diversity to their portfolios by giving exposure to funds across historical vintage years, and mitigating the effects of the J-curve. Those LPs that already participate in the secondary market seem satisfied with the strategy; 29% plan to increase their secondary market activity in 2012 compared to 2011, and 71% expect to maintain their activity. None of the investors we spoke to that actively participate in the market as buyers expect to reduce their secondary market activity during 2012.

LP Appetite for New GP Relationships

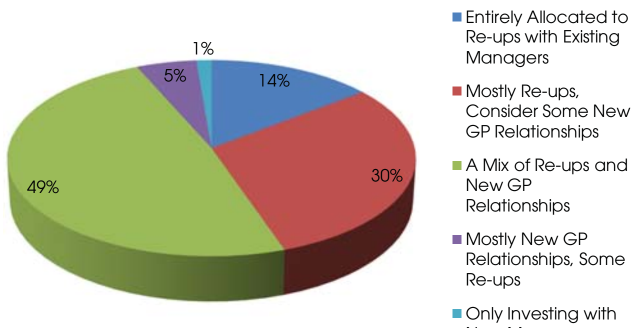
Despite the increasing use of alternative methods of accessing private equity by LPs, the majority (89%) of investors will continue to gain exposure to the asset class in the more traditional way by making primary commitments to private equity funds within the next 12 months. Fund managers must assess their existing LP base to establish how much capital they are likely to receive from these investors and how much capital they are likely to need to source from additional LPs. As illustrated in Fig. 12, of the LPs interviewed in June 2012 that plan on making new commitments over the coming year, just 14% plan to commit capital only to existing managers in their portfolios. Managers seeking capital outside their existing investor base can be encouraged that a substantial 85% of investors expect to consider at least some new manager relationships over the next 12 months, and 49% expect to commit to a more balanced mixture of existing GPs in their portfolios and managers they have not worked with in the past.

What Are LPs Looking for from Fund Managers?

While the majority of LPs are looking to make new commitments in the coming year, they are likely to be highly selective about where they deploy their capital in light of continuing economic volatility. In the June 2012 survey of LPs carried out by Preqin, investors were asked what GPs can do to stand out and secure a commitment from them.

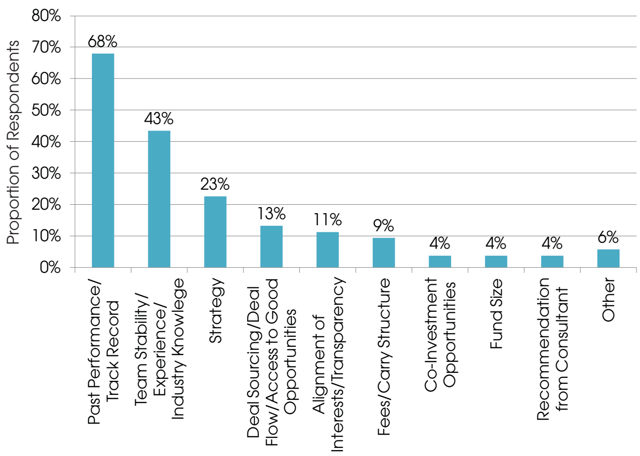
As shown in Fig. 13, the past performance and track record of a GP is the biggest factor LPs take into consideration when seeking new fund commitments, as it was named by 68% of respondents. Forty-three percent of investors regard team

Fig. 12: Investors' Intentions for Forming New GP Relationships over the Next 12 Months



Source: Preqin Investor Outlook: Private Equity, H2 2012

Fig. 13: What LPs Are Looking for from Fund Managers?



Source: Preqin Investor Outlook: Private Equity, H2 2012

stability, experience and industry knowledge as the most important factors when selecting new funds.

Outlook

Since the financial crisis, investors have become more selective when adding new private equity funds to their portfolios. They are seeking other ways to maximize returns and are choosing alternative routes, such as separate accounts, secondary market purchases, direct and co-investments, to access the asset class. While many LPs are continuing to set aside fresh capital for primary private equity commitments, they remain cautious, so finding investor capital is still a challenge for fund managers. In an ever-evolving and highly competitive market, it is more important than ever that fund managers carefully consider investors' needs in order to secure capital in the year ahead.