

Preqin Special Report

Performance of Private Equity Funds of Funds

April 2011



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Using data from Performance Analyst, Prequin has examined the performance of private equity funds of funds, their underlying investments and the relationship between predecessor and successor fund performance. Prequin currently holds transparent net-to-LP performance data for over 5,300 private equity funds of all types and geographic focus. In terms of aggregate value, this represents around 70% of all capital ever raised by the industry.

For more information on Performance Analyst, the private equity industry's leading source of fund performance data, please visit: www.prequin.com/pa.

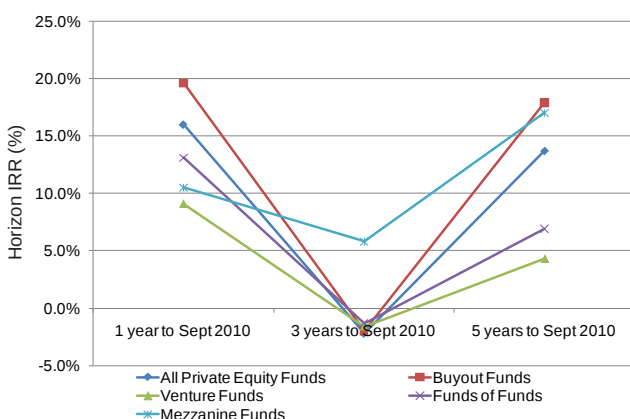
Identifying Top-Performing Fund of Funds Managers

The short-term performance of private equity funds of funds has improved recently, with the one-year horizon IRR to September 2010 standing at 13.1%, compared to 0.2% to December 2009 and -12.0% to December 2008. Over the long term, returns offered by these vehicles remain less attractive than those of direct investment funds: the five-year horizon return for funds of funds to September 2010 was 6.9% compared to an average of 13.7% across all private equity fund types (see Fig. 1). However, funds of funds continue to play an important role in the private equity industry, providing many investors with a reduced-risk route into the asset class through diversified investment portfolios and relatively low minimum commitment levels. With more than 280 active managers of funds of funds located around the world, a considerable number of options are open to these investors.

Relationship between Predecessor and Successor Fund Performance

Examining the relationship between predecessor and successor funds of funds reveals that past performance has been a good

Fig. 1: Private Equity Horizon IRRs, as of 30th September 2010



Source: Prequin

indicator of future performance. As Fig. 2 illustrates, 39% of fund of funds managers with a top quartile fund of funds have a top quartile follow-on fund, while only one in ten managers have a follow-on fund ranked in the bottom quartile. Furthermore, 62% of fund of funds managers administering a fund in the second quartile go on to outperform the median benchmark with their next offering. Only 12% of firms that manage a bottom quartile fund have a follow-on fund in the top quartile, 24% improve their ranking to Q2, and 64% manage a follow-on fund that underperforms the median fund.

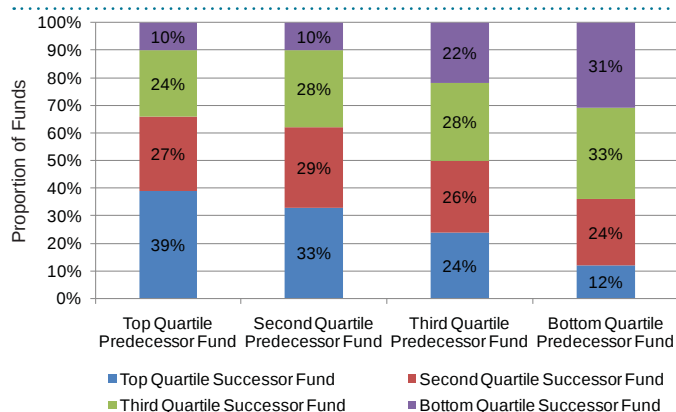
These results show that analysis of the track records of fund of funds managers is justified as a key part of investors' due diligence on potential fund of funds investments. They also demonstrate that there is a considerable degree of skill among the most successful managers, providing support to the argument that funds of funds offer value to investors, who can benefit from the experience and expertise of management teams.

Fund Selection Performance of Funds of Funds

Superior selection and due diligence capabilities that enable the creation of top performing fund portfolios are factors often cited as a benefit of investing in funds of funds. These vehicles have also offered access to well-established top-tier fund managers that have, at certain points in the past, been out of reach for many investors, particularly those that are new to the private equity asset class or have limited experience of specific geographic regions or fund types.

In order to gain a measure of the fund selection skills of fund of funds managers, we analyzed data from Prequin's Investor Intelligence online database, which contains 9,200 fund investments made by fund of funds managers. Taking

Fig. 2: Funds of Funds - Relationship between Predecessor and Successor Fund Quartiles



Source: Prequin

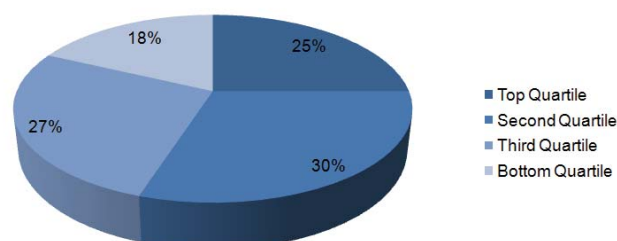
into account only fund of funds managers for which we have performance data for at least ten underlying funds in their portfolios, we studied 5,667 fund investments across 134 fund of funds managers.

As shown in Fig. 3, over half (55%) of fund of funds managers' underlying investments beat the median benchmark and are ranked in the top two performance quartiles. Furthermore, only 18% of their portfolio funds post net IRRs in the bottom quartile.

We also rated the portfolio held by each fund of funds manager, scoring each top quartile direct fund in the manager's portfolio as one, each second quartile fund as two, and so on. If a manager's portfolio of funds was spread equally across all four quartiles, then its average ranking would be 2.5. If a portfolio is skewed towards the upper quartiles, its average ranking will be below 2.5 (i.e. a ranking of 1.0 would be awarded if a manager succeeded in selecting exclusively top quartile funds).

Supporting the findings of Fig. 3, approximately three-quarters of the fund of funds managers analyzed this way were positively weighted towards the two upper quartiles. Fig. 4 presents some of the best performing fund of funds managers analyzed in this way; however it is important to note that this is based upon a sample of known investments for each manager and in many

Fig. 3: Breakdown of Underlying Fund Investments Made by Fund of Funds Managers by Quartile Ranking



Source: Preqin

cases we do not have information on their complete portfolios. While most of our performance data comes from sources independent of individual fund of funds managers, some data is provided to us by managers and consequently there may be a bias in this information towards the upper quartiles. Despite

Fig. 4: Top Fund of Funds Managers by Average Underlying Fund Quartile Ranking

Fund of Funds Manager	Manager Country	No. of Underlying Funds with Performance Data	Q1	Q2	Q3	Q4	Average Quartile Rank
Cuyahoga Capital Partners	US	19	42%	32%	26%	0%	1.84
Advanced Capital	Italy	11	55%	9%	27%	9%	1.91
57 Stars	US	23	57%	17%	4%	22%	1.91
VenCap International	UK	17	41%	29%	24%	6%	1.94
TIFF	US	19	42%	26%	26%	5%	1.95
Storebrand Kapitalforvaltning	Norway	32	28%	47%	22%	3%	2.00
North Sky Capital	US	13	46%	23%	15%	15%	2.00
Morgan Stanley Alternative Investment Partners	US	10	50%	20%	10%	20%	2.00
Fort Washington Capital Partners	US	47	30%	45%	19%	6%	2.02
Henderson Equity Partners	UK	23	52%	9%	22%	17%	2.04
Quilvest Private Equity	France	32	44%	22%	16%	19%	2.09
Twin Bridge Capital Partners	US	10	40%	20%	30%	10%	2.10
Commonfund Capital	US	39	31%	36%	26%	8%	2.10
Adveq	Switzerland	18	39%	22%	28%	11%	2.11
Greenspring Associates	US	50	30%	36%	26%	8%	2.12

Source: Preqin

this, we believe that this only has a limited impact and that the conclusion of a positive fund selection effect remains.

The managers presented in Fig. 4 pursue an array of strategies, indicating that the best performing firms are competent in selecting successful GPs regardless of investment stage or focus. Cuyahoga Capital Partners, for example, makes primary and secondary investments with a focus on niche and less efficient markets. It primarily participates in funds targeting lower and middle market opportunities in the US. Conversely, another US-based firm, 57 Stars, avoids investing in domestic markets, preferring to focus on emerging markets around the world, including Latin America, Asia and Central and Eastern Europe.

UK-based VenCap International's core focus is on venture capital investments. The fund of funds manager primarily targets opportunities in the US but also allocates capital to Europe, China and India. Storebrand Kapitalforvaltning is another firm that invests in North America, Europe and Asia. However, the Norwegian manager has made buyout opportunities the key focus of its strategy, with limited capital being allocated to other fund types, such as venture, mezzanine and distressed debt funds.

The funds of funds managed by Fort Washington Capital Partners are designed to build portfolios of around 25 funds that are broadly diversified across geography, vintage year and industry. The Ohio-based firm also aims to provide investors with exposure to various fund types and investment stages, allocating capital to small, medium and large buyout funds and to venture capital funds targeting early to late stage opportunities. Each of Adveq's funds of funds employs a focused approach to investing, with individual vehicles targeting specific regions, strategies and sectors. The Zurich-based firm's Opportunity program, for instance, targets small buyout and small to medium-sized turnaround funds investing in the US. This sits alongside several other distinct series of funds of funds, including separate vehicles focusing on European buyouts, the Asia-Pacific region, and the US technology sector.

Although investors commonly have long-established relationships with fund of funds managers, re-up commitments are no longer assured due to a difficult fundraising climate in which a wealth of choice exists. Investors have to make their investment decisions carefully to ensure they make the right choice and managers of funds of funds have to prove their ability to identify and access the best GPs. As fund of funds managers work harder to identify the best prospects, managers of direct investment funds may also find that automatic re-ups are no longer guaranteed.

The 2011 Preqin Funds of Funds Review

The 2011 Preqin Private Equity Fund of Funds Review is the ultimate guide to the PE fund of funds universe, featuring detailed profiles for over 230 fund managers, 25 listed funds of funds, over 150 investors, and analysis and data on all aspects of the industry. Now into its fifth edition, the 2011 Preqin Fund of Funds Review has been completely updated to provide the most comprehensive and up to date guide available yet.

Maintaining intelligence on the fund of funds sector is essential for all fund of fund managers, private equity firms seeking capital, investment advisors, institutional investors, placement agents, law firms, consultants and other private equity professionals.

Key features of this publication include:

- **Manager Profiles:** Detailed profiles for over 230 fund of funds managers from around the globe, including firm and individual contact details.
- **Fund Profiles:** Vehicle-specific details for each manager's most recent and forthcoming funds, with a breakdown of investments by fund type, location and investment type (primary, secondary and direct).
- **Sample Investments & Fund Preferences.**
- **Performance:** Key fund performance metrics for over 600 individual fund of funds vehicles, comparing each fund against a fund of funds benchmark and the Preqin Synthetic Benchmark.
- **Listed Vehicles:** Detailed profiles for 25 listed funds of funds, including breakdowns of investments.
- **LP Investors:** Detailed profiles for 150 LP investors investing in funds of funds.
- **Fundraising:** In depth listings of all funds of funds closed during 2009 and 2010 and funds currently raising capital.
- **Analysis:** Detailed analysis on all aspects of the fund of funds market.

More information:
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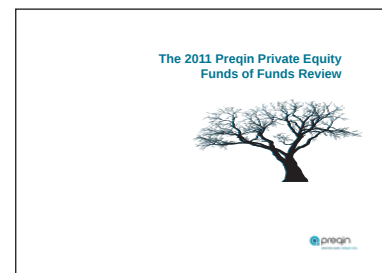
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Full Contents Include:

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- Survey Results: Results from surveys of fund of funds and investors



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- > Fundraising
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Equitable House
47 King William Street
London, EC4R 9AF
United Kingdom

Telephone: +44 (0)20 7645 8888
Fax: +44 (0)87 0330 5892

230 Park Avenue
10th Floor
New York, NY 10169
US

Telephone: +1 212 808 3008
Fax: +1 440 445 9595

Samsung Hub
3 Church Street
Level 8
Singapore 049483

Telephone: +65 6408 0122
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Email: info@preqin.com
Web: www.preqin.com