Preqin Special Report:
North American Endowments as Investors in Private Equity Funds

Content Includes

Investor Universe
An insight into how North America-based endowments fit into the overall private equity investor space.

Appetite and Challenges
How do North American endowments view their private equity allocations? We investigate the likely outlook for this important investor type.

North American Endowment Study
Preqin reveals the results of our latest study into the attitudes, preferences and future investment plans of North American endowments.

and more!

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Methodology

Preqin, the alternative assets industry's leading source of data and intelligence, welcomes you to this **Preqin Special Report: North American Endowments as Investors in Private Equity Funds**, a unique look at endowments based in North America investing in the asset class, their current opinions of the market and their outlook for investments going forward.

This report is based on information taken from Preqin's **Investor Intelligence** database, the most comprehensive and accurate source of information on investors in private equity funds available today. It profiles over 4,000 investors actively committing to private equity funds, including 473 endowments. More details about the information available on the Investor Intelligence database can be found on page 9 of this report.

This report also draws on the results of detailed interviews conducted with 50 North America-based endowment plans between April and May 2012. The sample of endowments was selected from Preqin's Investor Intelligence database, and the interviews were carried out by our skilled teams of multilingual analysts.

We hope that you find the information included within this report useful and interesting and, as always, we welcome any feedback or suggestions you may have for future editions.

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North American Endowments as Part of the Limited Partner Universe

Preqin's Investor Intelligence database currently tracks 473 endowments worldwide that invest in private equity funds. Endowments account for 11% of all active investors in the asset class, making this investor group the fourth largest by number of LPs. As financial markets remain turbulent, it is interesting to look at the challenges faced by endowments and how they view the outlook for their private equity portfolios in the future.

Endowments represent a significant source of capital within the private equity industry, accounting for 8% ($110bn) of aggregate capital currently invested in the asset class (as of June 2011), an increase from 6% ($56bn) in 2009. Although institutions such as banks and insurance companies in developed regions are currently faced with stricter regulations, prohibiting the amount of capital they can invest in the asset class, endowments have more of a free rein, with private equity forming a significant part of many of their investment portfolios.

The vast majority (91%) of endowments that invest in private equity are based in North America. Europe accounts for 7% of endowments that invest in the asset class, while Asia and Rest of World is home to 2%. Since the vast majority of this investor type is based in North America, we have looked at the breakdown of North American endowments by their allocations to private equity. Fifty-seven percent allocate less than $50mn to the asset class, as shown in Fig. 1, while 28% allocate $50-249mn and 14% allocate $250mn or more.

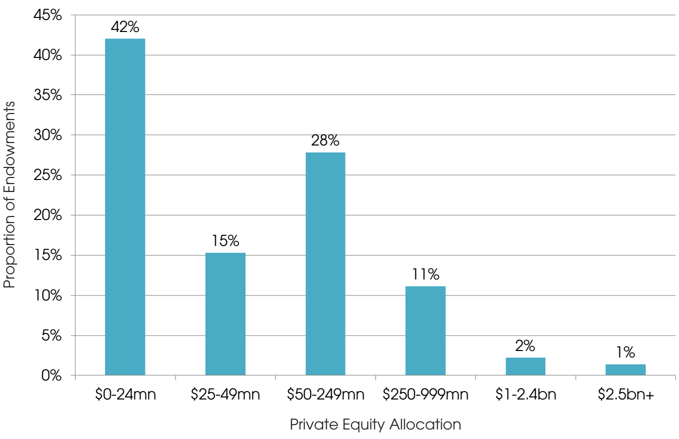
"North American endowments have steadily increased their allocations to private equity between 2007 and 2012"

However, it is important to recognize that, on average, the total assets managed by endowments tends to be smaller than other institutional investor types; 80% of North America-based endowments have total assets of less than $1bn. Furthermore, when looking at the proportion of capital that endowments allocate to private equity compared to other asset classes, it is clear that private equity represents a significant part of endowments' investment portfolios.

The 'endowment model' of investing, sometimes also referred to as the 'Yale model', places a large emphasis on illiquid assets such as private equity within an endowment's investment portfolio. This strategy aims to provide higher returns over a long period of time, maintaining purchasing power of these institutions.

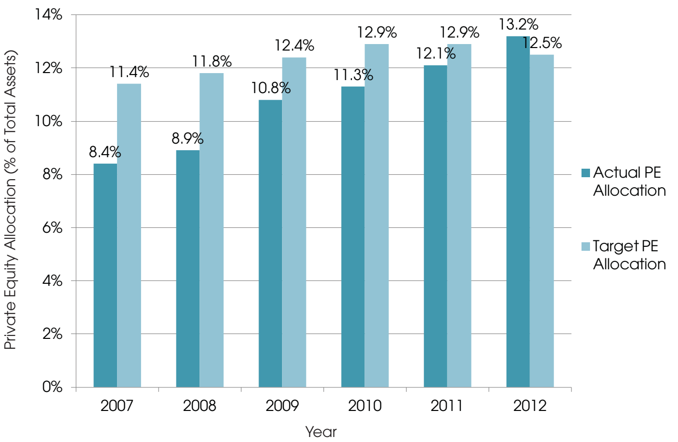
As shown in Fig. 2, the private equity allocations of endowments based in North America have steadily increased year on year, from an average allocation of 8.4% of total assets in 2007 to 13.2% in 2012. In addition to this, the target allocations for this investor type have increased in line with their actual allocations. Back in 2007, endowment plans maintained an average target allocation of 11.4% of total assets, which has increased to 12.5% in 2012.

Fig. 1: Make-up of North American Endowments that Invest in Private Equity by Current Allocation to the Asset Class



Source: Preqin Investor Intelligence Online Service

Fig. 2: North American Endowments' Average Actual and Target Allocations to Private Equity as a Percentage of Total Assets



Source: Preqin Investor Intelligence Online Service

Endowments account for 19% of all LPs based in North America, and their relative allocations to private equity are higher than other significant investor types based in the region. Public pension funds, which represent 13% of North America-based investors, have an average current allocation to private equity of 6.8% of total assets, with a target of 7.6%. North America-based foundations, which account for 27% of investors in the region and often have a similar investment strategy to endowments, have an average current allocation of 10.7%, with an average long-term target allocation of 11.5% of total assets.

North American Endowments' Appetite for Private Equity

Preqin recently conducted interviews with 50 North American endowments that invest in private equity, in order to investigate their current appetite for the asset class, and to ascertain their future investment plans. The endowments interviewed are a representative sample diversified by assets under management and allocation to private equity.

At present, 24% of North America-based endowments are below their target allocation to the asset class, while 48% are currently at their target allocation, as shown in Fig. 3. Almost three-quarters (72%) of endowments are therefore likely to continue investing in private equity as they build towards their target allocations to the asset class or look to maintain their current level of exposure.

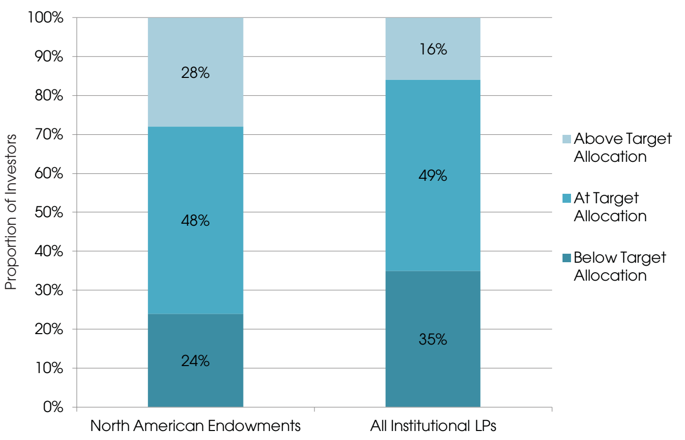
Just over a quarter (28%) of endowments are currently above their target allocation to the asset class. This is a higher proportion than the limited partner universe as whole based on a study conducted by Preqin in December 2011, which indicated that 16% of investors are above their target allocations to private equity.

"Fifty-eight percent of North America-based endowments expect to make their next private equity commitment before the end of 2012"

Forty-five percent of endowments we spoke to have not made new commitments to private equity funds since the beginning of 2012; however, of those investors, just over a quarter (26%) made new commitments in 2011. The majority of endowments we spoke to (55%) have made new private equity fund commitments in 2012.

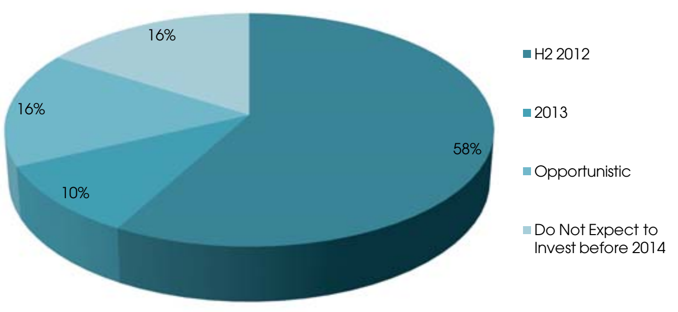
Looking forward, it is encouraging to note that a significant 58% of North America-based endowments expect to make their next private equity commitment before the end of 2012, and a further 10% plan to make their next new fund commitment in 2013, as Fig. 4 shows. This demonstrates the sustained interest of North American endowment plans in the private equity asset class. An additional 16% of endowments are taking an opportunistic approach to new fund commitments over the coming year, and are therefore likely to make new commitments should favourable opportunities arise.

Fig. 3: Proportion of North American Endowments and All Institutional Investors At, Below, or Above Their Target Allocation to Private Equity



Source: Preqin

Fig. 4: Timeframe for North American Endowments' Next Intended Commitments to Private Equity Funds



Source: Preqin

Impact of the Financial Crisis and Biggest Challenges Facing Endowments' Private Equity Programs

Although a number of years have passed since the onset of the global financial crisis, many investors are still feeling the effects in their portfolios given the continued volatility in financial markets. We asked endowments what impact this has had on their private equity investments, what they see currently as the biggest challenges when investing in private equity, and their attitudes towards selling fund interests on the secondary market.

Fifty-one percent of endowments noted that the financial crisis has affected their investment strategy. A number are taking a more conservative approach to new investments, as one stated: "We are being more cautious and selective in terms of managers," with another telling us: "We have had to slow the pace of new commitments to private equity funds."

Appetite for Secondary Market Sales

As a result of the financial crisis, a number of endowments were impacted by the denominator effect and became over-allocated to the asset class. Despite this, very few have turned to the secondary market as a solution. As Fig. 5 shows, 92% of the endowments we spoke to told us they have not sold any fund interests on the secondary market as a result of the financial crisis, preferring to hold on to their private equity assets until maturity. In the future, 12% of endowments expect to sell fund interests on the secondary market, and a further 12% would consider doing so.

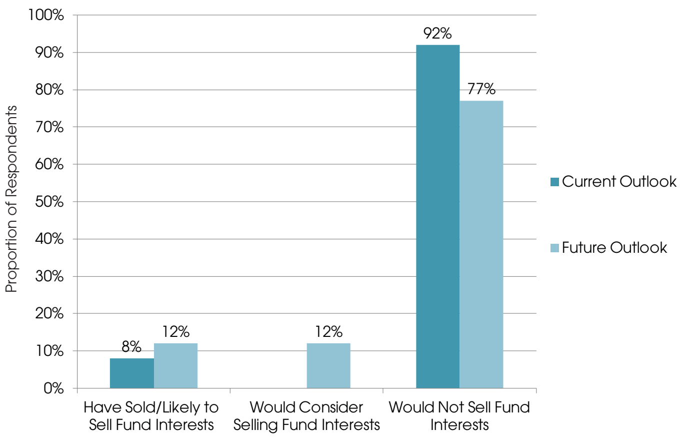
Biggest Challenges Facing Endowments

We asked endowment plans what they see to be the biggest challenges facing them when seeking to operate an effective private equity program in the current financial climate. One endowment, along with 27% of respondents overall (see Fig. 6), stated: "As ever, the biggest challenge is gaining access to top quartile fund managers." A fifth of endowments feel that liquidity is the biggest challenge they are facing in the current environment, while 16% feel that achieving high returns is their biggest issue, and the same proportion noted the continued volatility in the financial markets as their biggest challenge. One endowment told us: "The biggest challenge is predicting the future of the markets; to know when to put money in and take it out again." Other challenges mentioned by endowments include finding the right balance between risk and return, and the longevity of private equity investments.

"Twenty-seven percent of endowments feel that gaining access to top quartile managers is their biggest challenge"

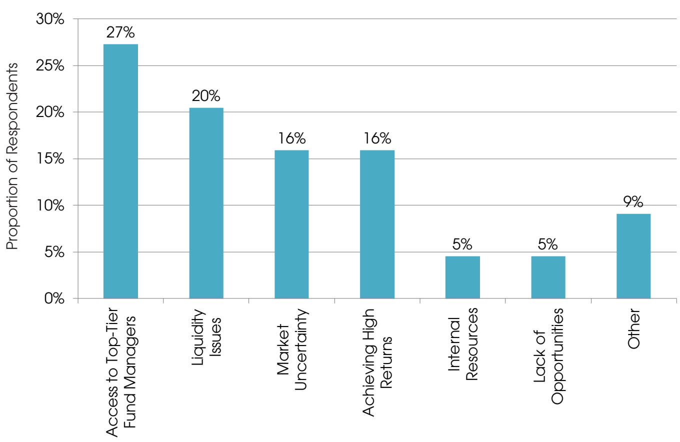
Although the vast majority of North American endowments that have been affected by the financial crisis feel that it has had a negative impact, it is important to note that some feel that the market volatility has created an advantageous investment environment. With fundraising struggling and some investors scaling back the pace of new commitments, top quartile fund managers could have become more accessible, as one endowment suggested: "[The financial crisis] has created a better opportunity to deploy funds with high-quality partners."

Fig. 5: Proportion of North American Endowments that Have Sold or Would Consider Selling Fund Interests on the Secondary Market as a Result of the Financial Crisis



Source: Preqin

Fig. 6: Biggest Challenges Currently Facing North American Endowments Seeking to Operate Effective Private Equity Programs



Source: Preqin

Key Geographies over the Next 12 Months

As market uncertainty persists, we asked endowments which regions they feel are currently presenting favourable investment opportunities, and which regions they expect to avoid in the near future where they might have considered investing previously.

Fig. 7 shows that almost three-quarters (72%) of North American endowments feel that their home region is presenting the most attractive investment opportunities. One endowment explained: "North America still has some very good opportunities, particularly in the small-cap space." None of the endowments we spoke to are avoiding this region.

Many North American endowments are open to investing outside their domestic market. One endowment mentioned: "International markets are most appealing right now. The North America market is like a rollercoaster and continually up and down."

Interest in Europe also remains, with 31% of endowments stating that the region presents attractive opportunities in the current financial climate. However, some endowments are cautious towards investing in Europe in light of continued market volatility and the sovereign debt crisis; 15% of North America-based endowments expect to avoid investing in this region in the next 12 months.

A quarter of North American endowments feel that Asia is presenting attractive opportunities at the moment, with only 4% of endowments expecting to avoid this region over the next 12 months. Thirteen percent of endowments feel that regions outside of North America, Europe and Asia are presenting attractive investment opportunities at present. Encouragingly, 76% of the endowments we spoke to said there are no regions they are avoiding at present. Many endowments feel that despite wider financial uncertainty, there are still good opportunities to be had, as one endowment explained: "All regions have good opportunities if you pick the right partner."

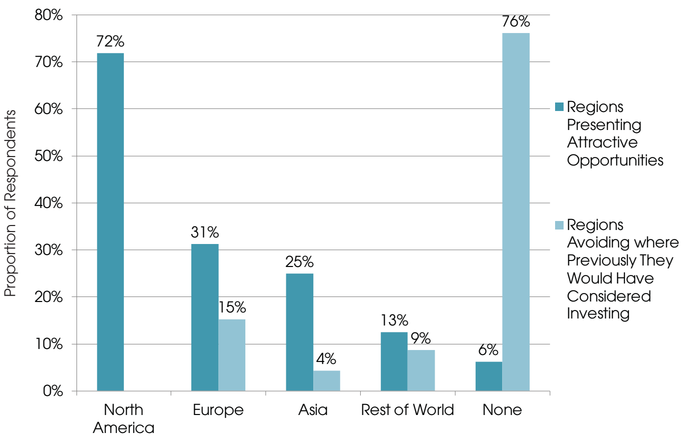
Appetite for Emerging Markets

A significant 82% of North American endowments invest in emerging markets, while a further 8% are considering doing so in the near future. This is a higher proportion than is seen in the investor universe as a whole, where 76% of investors invest or consider investing in emerging markets.

Asia was named by 43% of the endowments that have an appetite for emerging markets as currently presenting attractive opportunities within such markets, as shown in Fig. 8. China specifically was named as presenting appealing investment opportunities by 38% of North American endowments, followed by India, named by 29% of respondents. One endowment told us: "We are still very excited about Asia, especially China and India."

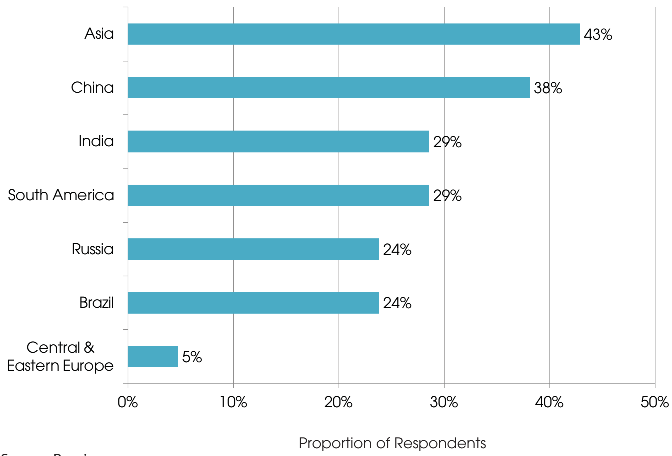
A significant 29% of endowments feel that South America is currently offering attractive opportunities within emerging markets, and Brazil was specifically named by 24% of endowments.

Fig. 7: Attitudes of North American Endowments towards Different Geographic Regions



Source: Preqin

Fig. 8: Countries and Regions within Emerging Markets that North American Endowments View as Presenting Attractive Opportunities



Source: Preqin

Despite the popularity of emerging markets among North American endowments, it is important to recognize that some investors feel that certain regions within emerging markets are becoming less appealing, as one endowment explained to us: "We are avoiding emerging markets because of price run-ups and nationalization concerns." Another told us: "The pricing in India is too high and we are also concerned with the pricing in Brazil."

Key Strategies over the Next 12 Months

With the majority of North American endowments seeking to make new private equity fund commitments over the next 12 months, we asked which fund types they feel are presenting attractive opportunities in the current financial climate, and where they expect to place their capital in the year ahead. We also asked endowments about their appetite for co-investment opportunities.

As shown in Fig. 9, 34% of endowments believe that small to mid-market buyout funds are presenting attractive opportunities in the current financial climate, and 37% expect to invest in this fund type over the next 12 months. Distressed private equity investments remain popular given the current financial climate, with 26% of endowments looking to target them in the coming year.

A similar proportion of endowments plan to make commitments to fund of funds vehicles during the next 12 months, providing them with exposure to a wide variety of assets through a single commitment, which is useful for those without the internal resources to maintain a diverse portfolio of direct fund investments. Other fund types named by endowments as presenting the best opportunities include energy and natural resources funds.

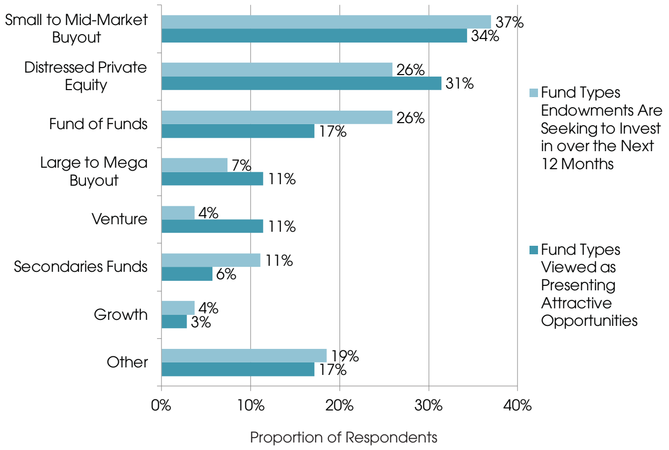
As the private equity market evolves, many investors are looking for new ways to access it, and a number are looking to co-invest alongside fund managers in deals. Co-investments offer many benefits to LPs, including building stronger relationships with their fund managers, getting closer to deals and taking advantage of the potentially higher returns and reduced costs associated with co-investments.

"34% of endowments believe that small to mid-market buyout funds are presenting attractive opportunities"

As shown in Fig. 10, 26% of endowments already co-invest alongside their GPs, with the majority of these taking an opportunistic approach to such investments. A significant 72% of endowments do not consider co-investment opportunities alongside GPs at present, with the most common reason for this being the size and internal capabilities of the endowment plan in question. A number of respondents told us they lack the resources to operate a successful co-investment program, with one endowment stating: "We would consider co-investing but we don't currently have the staff and expertise to do so."

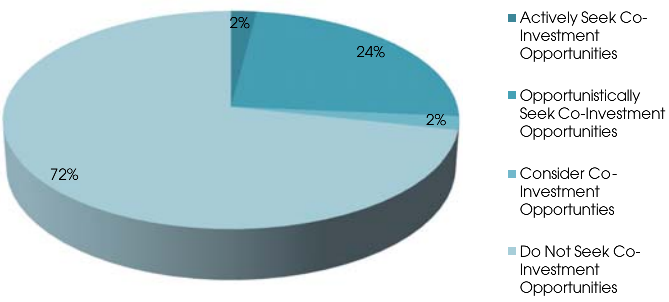
Of those endowments that do co-invest, none expect to decrease their co-investment activity in the future. Thirty-one percent of endowments that currently co-invest plan to increase their level of co-investments, and the remaining 69% will maintain their exposure to co-investments going forward. One US endowment stated: "We expect there to be more co-investment opportunities in the future and so we will increase our activity."

Fig. 9: North American Endowments' Attitudes towards Different Fund Types at Present



Source: Preqin

Fig. 10: North American Endowments' Attitudes towards Co-Investments



Source: Preqin

GP Relationships and Outlook for Endowments Investing in Private Equity

As a high proportion of endowments expect to allocate further capital to private equity funds over the next 12 months, we asked if they will be looking to invest with managers they have a prior relationship with, or if they will consider forming new GP relationships. We also asked about their future intentions regarding their private equity allocations.

With a record number of funds on the road seeking capital, it is encouraging to see that many endowments are looking to make new commitments to private equity funds in the coming year. What is even more positive for those fund managers on the road looking to secure commitments from outside their existing investor base is that 85% of North American endowments that are looking to make new commitments expect to form some new GP relationships over the coming year, as shown in Fig. 11.

Attitudes towards First-Time Funds

Although a number of endowments are looking to make new fund commitments and form new GP relationships over the coming year, emerging managers may still struggle to source capital from them. A number of investors remain cautious towards first-time funds given the continued difficult market conditions. Over half (53%) of the endowments we spoke to will not consider investing in a first-time fund in the next 12 months, preferring to invest with GPs with a proven track record.

Thirty-five percent of the endowments we spoke to will consider investing in a first-time fund over the coming year should a favourable opportunity arise. A further 12% will consider investing in first-time fund over the next 12 months if managed by a spin-off team. One endowment noted: "We may invest in a first-time fund, depending on the background and pedigree of the managers; they would most probably have to be a spin-off."

Outlook for Endowment Plans' Investments in Private Equity

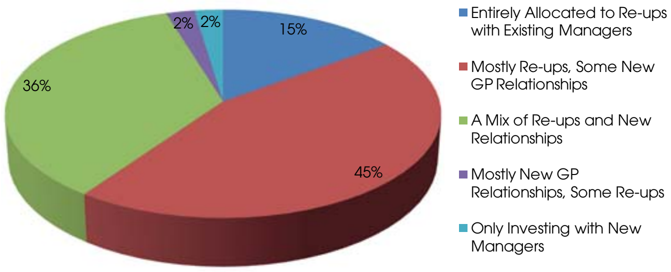
Twenty-six percent of endowments plan to increase and 54% expect to maintain the number of GP relationships in their portfolio over the longer term. However, it is important to recognize that while over half of the endowments we spoke to anticipate keeping the same number of managers in their portfolio, they may not look to continue investing with the same teams. As one endowment told us: "We plan to maintain the number of managers in our portfolio but will trade one for one," indicating that endowments may not re-up with those GPs that do not perform as expected.

"Ninety-four percent of endowments plan to increase or maintain their exposure to private equity in the longer term."

The impact of the financial crisis and the continued volatility in the financial markets can still be felt within many investors' portfolios; a number of endowments are currently over-allocated to private equity and contending with liquidity issues, which are likely to have an impact on their future investment activity. Therefore, like many types of investor, a number of endowments are likely to take a cautious approach to private equity over the coming months.

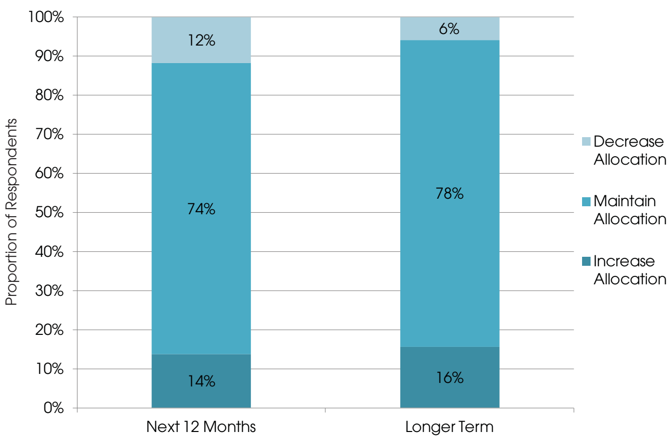
However, it is encouraging to note that 88% of endowments expect to either increase or maintain their allocation to private equity in the next 12 months, as shown in Fig. 12. Over the longer term, an even higher proportion (94%) plan to increase or maintain their exposure to private equity, suggesting that endowments are likely to continue to be a key source of capital for the industry.

Fig. 11: North American Endowments' Intentions for Forming New GP Relationships over the Next 12 Months



Source: Preqin

Fig. 12: North American Endowments' Intentions for Their Private Equity Allocations



Source: Preqin

Preqin: A Direct Approach to Investor Intelligence

Unique, Industry-Leading LP Data

The private equity institutional investor universe is ever-evolving and investor preferences are continually changing. Fundraising conditions have never been more competitive and a focused fundraising effort is vital to ensure success in the market.

Preqin's Investor Profiles products and services provide comprehensive and exclusive data on investors in private equity that can help you to achieve your fundraising goals. Our international teams of multi-lingual analysts speak to more than 5,000 investors in private equity each year, as well as tracking every available news and information source, to ensure that our data is as up to date and comprehensive as possible.

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Investor Intelligence

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- Premium subscribers can download targets and contact details to Excel.

- Included as part of the Preqin online private equity services, or available as a separate module.

Preqin 2012 Limited Partner Universe

The Limited Partner Universe is a 600-page publication featuring a directory of over 2,800 of the most important investors in private equity worldwide, as well as detailed, vital analysis on all the latest trends affecting the private equity universe.

- Features all the most important investors in private equity, and their contact details. Investors are arranged by country and region (including US split by census region).

- Use latest trends and analysis on the market to construct a targeted strategy and identify the most likely sources of funding for your new vehicle.

- An excellent complement to the online service, as well as providing a useful fundraising tool in its own right.

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- Venture Capital Deals
- Buyout Deals
- Fund Performance
- Fundraising
- Fund Terms
- Fund Manager Profiles
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Our customers can access this market intelligence in three different ways:

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