There is no doubt that 2009 was a challenging year for fund managers seeking to raise new funds. Fundraising over the course of 2009 was 61% down on the year before and 62% down on 2007. Competition for commitments from investors is set to remain intense over the course of 2010, with 1,561 funds on the road seeking an aggregate $698.5bn.

During December 2009, in order to assess LP appetite for private equity in the year ahead, we surveyed a representative sample of 106 significant institutional investors selected from Preqin’s Investor Intelligence database of 4,000 investors in private equity. A considerable 40% of our sample had not made a commitment to a private equity fund over the course of the year, as shown in Fig. 1. Moreover, many of those that had remained active had made commitments at a slower pace than in previous years.

Despite this low level of investor activity, as shown in Fig. 2, 45% of respondents to our survey told us they are below their long-term target allocations, demonstrating that a significant amount of capital has the potential to flow into the private equity asset class over the coming months and years. A further 42% of respondents to our survey are at their targeted levels of exposure. However, it is worth noting that 13% are currently exceeding their long-term target allocations to private equity.

So what lies in store for GPs that will be fundraising during 2010? We asked investors about their current appetite for private equity funds, the time frame for their next planned commitments, and the areas of the market that they feel present the best opportunities in the current climate.

Returning Investor Appetite

The good news for fund managers is that investors are gradually beginning to return to market. As shown in Fig. 3, our survey found that two-thirds of investors are planning to make new commitments to private equity funds during 2010. In fact, 51% of the sample intend to invest within the first six months of the year. A further 25% have yet to finalise the expected timing of their next commitment. No investors told us they were no longer looking to invest in private equity.

Different types of investor have varying investment motivations, objectives and liquidity requirements and consequently their plans for their next private equity investments have also been affected to differing degrees. 71% of public pension funds, private sector pension funds and asset managers, and 74% of insurance companies, banks and corporate investors, intend to make new commitments to private equity funds in H1 2010. One US insurance company told us: “We have not seen much of interest in 2009 but will continue looking for opportunities.
and feel more may arise in 2010.” Many endowments, family offices and foundations, however, will remain cautious in the coming year: 44% intend to commit to funds in 2010, and a further 44% are unsure at present as to the timing of their next commitment.

The amount of capital allocated by investors to new private equity commitments in 2010 is also set to rise. 51% anticipate committing a greater volume of capital to funds in 2010 than in 2009, as shown in Fig. 4, and a further 41% will continue to commit at the same pace as last year. Just 8% are intending to commit less in the coming year, and this is not always a reflection of their views on the quality of opportunities presented in the current market. For example, an endowment that intends to commit less in 2010 than in 2009 told us that it “made lots of commitments in 2009 to build up [its] allocation to private equity and so [expects] to invest just to maintain the allocation in 2010.”

**Investor Areas of Interest**

In the current financial climate, many investors have been reassessing their strategies with the aim of identifying which private equity fund types best take advantage of opportunities in the market at present. Without prompting with pre-defined answers, we asked investors to state which types of private equity fund are currently presenting the best opportunities and, in addition, which types of fund they intend to make commitments to over the course of 2010.

As Fig. 5 shows, the fund types most frequently cited by investors
as being most attractive at present were distressed private equity funds, with 35% of respondents naming this fund type, and small to mid-market buyout funds, with 36% of investors. 20% of investors felt secondaries funds presented attractive opportunities currently.

The fund types that investors are seeking to invest in over the next year or so varied significantly at times from the areas that investors informed us presented the best opportunities, often as a result of the restrictions placed on the investments they make. Small and mid-market buyout funds were the most frequently named fund types, with more than half of investors polled stating they would be seeking to invest in these fund types in the next two years. Nearly a third, 30%, informed us they would be looking to commit to distressed private equity funds. Both primary funds of funds and secondaries funds are set to receive considerable investor interest during 2010/11, with 16% and 17% of respondents citing these fund types respectively.

We also asked investors which areas of the market they would be avoiding where previously they would have invested. A considerable 42% told us they would continue to consider the same private equity fund types as they had in the past. Although 37% informed us they would no longer seek to invest in mega buyout funds, this was not always as a result of a lack of interest in, or negative view of, that sector; a US public pension fund told us "We are not staying clear of large buyout, but we are less likely to invest in it, just because we committed to a lot of large buyout funds in the past and have a lot of unfunded commitments from these funds." However, other investors did view these vehicles as unattractive in the current market, with one Danish pension fund informing us that it is "gradually moving out of mega buyouts and larger funds."

It is important to note that, for Fig. 5, institutions were not asked whether they felt each fund type was attractive. The results displayed signify the areas of the market that investors themselves named and consequently represent the areas that investors are either most or least interested in.

Establishing New GP Relationships

Most GPs need to secure capital commitments from LPs they do not have a prior relationship with in order to successfully raise their targeted level of capital. For funds closed in 2008 and 2009, the vast majority required a certain number of new LPs: only around one-fifth of funds had investor bases made up of more than 90% returning LPs. Furthermore, in today’s environment of increasing LP caution, and with LPs often lacking capital for new investments owing to a lack of distributions, it is possible that GPs will increasingly have to look outside their existing investor base when fundraising.
To assess how challenging a prospect this is likely to be in the current climate, we asked investors whether they would consider establishing new relationships with GPs during 2010. As shown in Fig. 6, more than half, 54%, said they were likely to commit to vehicles managed by firms with which they had no prior relationship compared to 37% that anticipated only making re-up commitments to vehicles managed by existing firms in their portfolios.

Securing commitments for a first-time fund is typically a far more challenging prospect than raising capital for a vehicle managed by an established firm. Not only do first-time fund managers (excluding spin-out firms) lack an extensive track record as a team, but they also have the additional challenge of having to secure the majority of their commitments from LPs that have no prior knowledge of their firm. We asked respondents to our survey that are looking to invest in 2010 whether they would consider investing in first-time funds during this time frame, and the results are shown in Fig. 7.

Just under a third of respondents will invest in first-time funds during the coming year and a further 12% will consider such investments. 19% will invest in a fund that is raised by a spin-out team that has a prior track record as a combined entity at another firm. 38% will not invest in either first-time or spin-out funds in 2010. It is worth noting, however, that some investors, including California Public Employees’ Retirement System (CalPERS), Oregon State Treasury and California State Employees’ Retirement System (CalSTRS), have awarded separate account mandates to investment consultants or fund of funds managers with the specific purpose of gaining exposure to emerging managers.

We also asked respondents whether, during the next two years, they anticipate the number of GP relationships they maintain will increase, decrease or remain the same. Just under a third, 32%, anticipate increasing the number of fund managers they maintain relationships with, as shown in Fig. 8, and a further 45% expect the number will stay the same. However, many of these respondents stressed the fact that they will still be seeking to establish new relationships with managers and will also carry out stringent ongoing assessments of existing managers in their portfolios in order to make sure they only maintain relationships where deemed appropriate. A fifth of respondents also informed us that they would be seeking to reduce the number of GPs they maintain relationships with in the coming two years.

**Appetite for Emerging Markets**

Emerging markets are, at present, attracting a significant degree of attention from investors, with two-thirds of respondents to our survey either currently having exposure to these markets or intending to invest there in the future. In fact, 58% told us they invest in emerging markets and an additional 9% will consider...
gaining exposure, while a third of investors polled will not invest outside North America and Europe at present.

Fig. 9 shows the regions and countries that investors informed us were currently presenting the best opportunities for investment. Once again, investors were not prompted with predetermined answers. China was cited as an area of interest by just over half of respondents, a fact that is supported by the strong fundraising for vehicles targeting this country in the past couple of years. Asia as a whole is also receiving considerable investor interest, with 45% of respondents informing us that this region is attractive at present.

**Portfolio Performance Expectations**

The latter half of 2008 and the first half of 2009 saw significant declines in the valuations of many private equity funds and it is unsurprising that investors’ views of their private equity portfolios should likewise be affected. Nevertheless, 70% of respondents to our survey felt that their private equity fund investments had met their expectations and a further 7% felt their portfolios had exceeded their expectations.

As shown in Fig. 10, a considerable 23% of respondents to our survey felt their portfolios had fallen short of their expectations. Although this shows a marked decline in investor satisfaction from the levels seen in our December 2007 LP survey, when 24% felt their portfolios had exceeded their expectations and just 2% felt their portfolio had failed to meet their expectations, investors are still, on the whole, relatively satisfied with their private equity investments.

It is also worth noting that, although on average the majority of investors felt their portfolios had met their expectations, others were less than satisfied with certain areas of their portfolios. A European insurance company said: “We have a variety of funds in our portfolio, some of which have exceeded our expectations and some that have not, typically the result of some misjudgements about what will happen in the market.”

Although there is some dissatisfaction among investors at the returns they have been receiving from their private equity investments, it is important to bear in mind that the expectations investors have for private equity returns have also shifted in relation to public markets. As Fig. 11 shows, whereas in December 2007, just 17% of investors expected their private equity portfolios to provide returns of more than 4% over public markets, this rose steeply to 52% of investors in December 2009. Similarly, although 78% of investors in December 2007 sought returns of between 2% and 4% above public markets, just 48% had similar expectations in December 2009.
Continuing Investor Appetite

The results of the December 2009 survey of investor attitudes to private equity are, on the whole, encouraging: growing numbers of investors are set to return to the market and make fresh private equity commitments in the year ahead and the pace at which they make commitments also looks set to increase.

In general, attitudes to private equity amongst institutional investors have remained relatively strong. As Fig. 12 shows, 65% of respondents told us they intend to maintain their allocations during 2010, and a further 22% expect to increase their allocations. 13% of investors are looking to reduce their exposure to the asset class in the next 12 months.

Investors’ longer-term plans for their private equity allocations also look reasonably promising for fund managers. The vast majority of investors intend to either maintain or increase their allocations over the next three to five years, although 11% plan to reduce their exposure over this period. In addition, it is to be expected that capital will continue to flow into the market from new entrants to the asset class, and Preqin is currently tracking over 100 investors that are considering setting their maiden allocations to private equity or are exploring a variety of alternative assets, potentially including private equity.

GP seeking to raise fresh capital for funds in 2010 can take many positives from the results of this survey. However, fundraising is certainly set to remain challenging in the coming year. Investors are showing a greater aversion to risk in their portfolios and many are conducting much more intensive due diligence processes. In 2010, the challenge for fund managers will be firstly to identify potential sources of capital for their funds from within the overall universe of limited partners in private equity, and secondly to secure commitments from those institutions in a marketplace full of many, potentially similar, vehicles on the road. Standing out from the crowd will be vital in the year ahead and identifying a unique strategy that best takes advantage of prevailing opportunities will be essential.

Preqin Research Report: Private Equity Investor Survey
February 2010

Fig. 11:
Investors’ Return Expectations for Their Private Equity Portfolios

Source: Preqin

Fig. 12:
Investors’ Intentions for Their Private Equity Allocations

Source: Preqin

Preqin’s Investor Intelligence database is a vital tool for all professionals involved in the capital raising process for private equity funds. It contains up-to-date profiles for 4,000 investors in private equity, including key information on investment preferences, investment plans both for the next 12 months and over the longer term, and key contact information for appropriate personnel at each institution.

For more information or a free demo of Investor Intelligence, please contact:
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