

Preqin Investor Outlook: Private Equity

H1 2012

The Opinions of 100 Leading LPs on the Market
and Their Plans for the Next 12 Months



Methodology:

Preqin, the alternative assets industry's leading source of data and intelligence, welcomes you to the H1 2012 edition of Preqin Investor Outlook: Private Equity, a unique look at investors in the asset class, their current opinions of the market and the outlook for fundraising in the year ahead.

Preqin Investor Outlook draws on the results of detailed interviews conducted with over 100 institutional investors from around the world during December 2011. The sample of LPs was selected from Preqin's Investor Intelligence database, the most comprehensive and accurate source of information on investors in private equity funds available today, and the interviews were carried out by our skilled teams of multi-lingual analysts.

Speaking directly to institutions located across the globe has enabled us not only to provide in-depth analysis of their current views and opinions, but to accompany this with comments from key investment professionals in their own words, providing readers with a unique insight into the attitudes of the leading investors in private equity.

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

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Fundraising in 2011

There was a strong start to fundraising in 2011, with the first half of the year seeing a quarter-on-quarter increase in the amount of capital raised by private equity funds, before it began to falter in Q3 as the eurozone crisis took hold. Despite volatile conditions in the wider financial markets, the vast majority of investors remain optimistic towards private equity, and are persisting with their private equity investment programs. Preqin interviewed a global pool of 100 institutional investors in December 2011 to discuss their opinions on the current private equity market and to assess their plans for the asset class going forward.

A sizeable 66% of investors made new fund commitments in 2011, an increase from the 58% that made new commitments over the course of 2010. Furthermore, a third of investors interviewed committed more capital to private equity funds in 2011 than in 2010, and a further 12% committed capital in 2011 having not made any commitments in 2010, as Fig. 1 indicates. Twenty-seven percent of investors committed the same amount of capital in 2011 as in 2010.

Impact of Volatile Markets

Sixty-one percent of investors have not changed their opinion of the asset class as a result of the economic instability caused by the European debt crisis, while a fifth (20%) of investors feel more positive about private equity as a result of market volatility over the second half of 2011. Nineteen percent of investors interviewed told us they view private equity more negatively as a result of volatility in wider financial markets, in particular as a result of the European sovereign debt crisis.

Like many investors we spoke to, an Australian superannuation scheme feels that “public markets are more volatile and risky in times like this, so private equity becomes more attractive.” A Canadian endowment told us: “[There is] more value in private equity after [the] fall in public markets.” Many investors we spoke to also feel that the current climate in Europe is opening up opportunities in certain markets, as a Singaporean investment company acknowledged: “The volatility has not negatively influenced our attitude towards

private equity since we feel there could be opportunities in the current situation in terms of distressed assets in need of funding.”

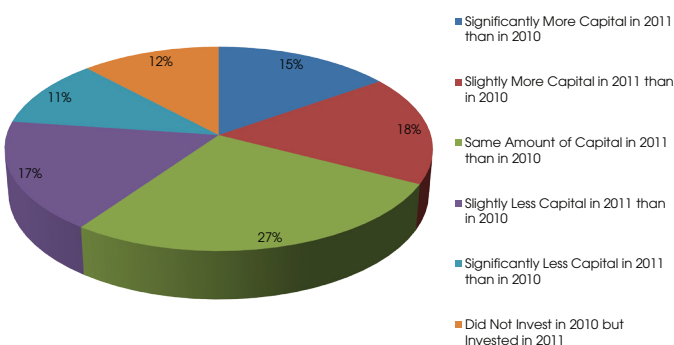
Allocation Levels

As Fig. 2 illustrates, 35% of investors are currently below their targeted level of exposure to the asset class and are therefore likely to make new commitments in 2012 as they build towards their target allocations. Forty-nine percent are at their target allocation and 16% are currently overexposed to the asset class.

“35% of investors are currently below their targeted level of exposure to the asset class”

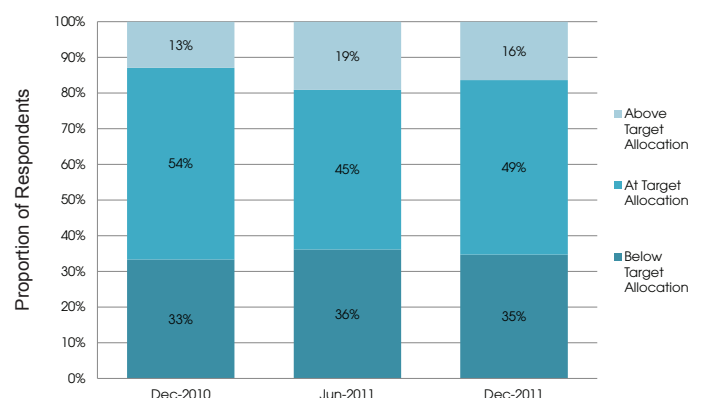
When comparing the results of LPs based in different regions, it is interesting to note that almost a third (32%) of investors based in North America are above their target allocations, compared to just 11% and 8% in Europe and Asia and Rest of World respectively. Forty-two percent of investors based in Europe are currently below their target allocations, compared to 14% of North American investors.

Fig. 1: Amount of Capital Investors Committed To Private Equity Funds in 2011 Compared to 2010



Source: Preqin

Fig. 2: Proportion of Investors At, Above or Below Their Target Allocations to Private Equity



Source: Preqin

Investors' Returns Expectations

With many investors commenting that they feel private equity is comparatively more attractive than other strategies within their portfolios in the context of volatile financial markets, we asked investors how satisfied they are with the performance of their private equity portfolios. The vast majority (81%) feel that their private equity investments have met or exceeded expectations.

As Fig. 3 shows, three-quarters of investors feel that their private equity portfolios have met their desired level of returns. However, just 6% feel that their private equity investments have exceeded expectations. Many investors have adjusted their expectations in light of recent instability in the wider markets; one UK bank we spoke to acknowledged: "We expected this year to be difficult so are satisfied with how our investments have performed."

"Almost two-thirds of investors expect their private equity investments to achieve returns in excess of 400 basis points over public markets..."

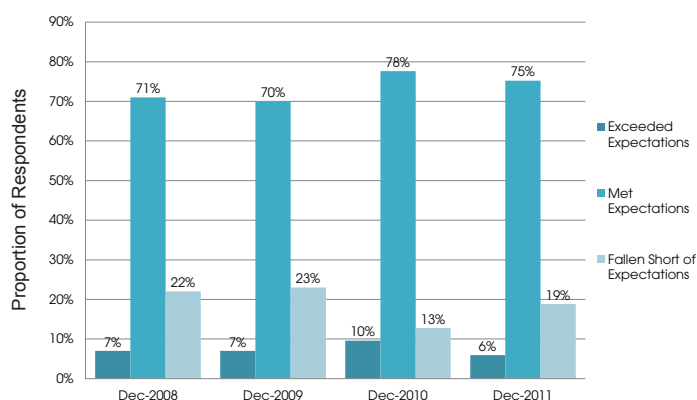
Nineteen percent of investors feel dissatisfied with the returns their private equity investments have delivered, a greater proportion than the 13% of investors that felt their private equity investments had fallen short of expectations when asked in a similar study at the same time last year. A Danish pension fund we spoke to noted: "Only one fund has lived up to our expectations, the rest have underperformed." An asset manager in the UK stated: "Distributions lately have been lower than expected."

A number of investors noted that their expected levels of returns vary for different types of fund and, while returns from certain strategies have been disappointing, private equity on the whole

has met expectations. One German public pension fund told us: "All [our investments have] met expectations except venture, which has had negative returns," while another pension fund, based in Canada, told us: "[Our private equity investments have] mainly met expectations but some have fallen below expectations."

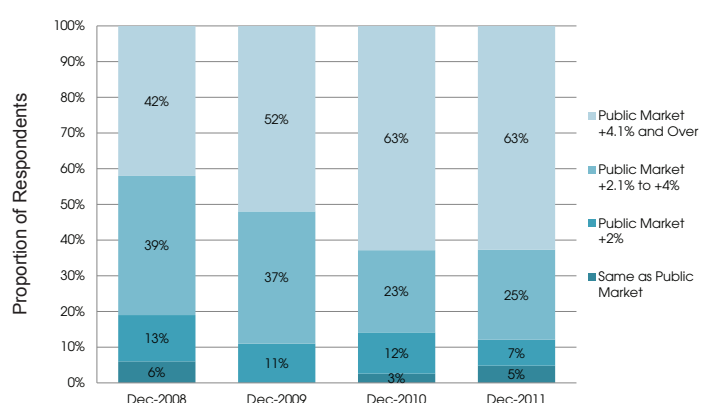
Fig. 4 shows that 95% of investors expect their private equity investments to garner returns of at least 200 basis points more than their public markets benchmark. Almost two-thirds (63%) of investors expect their private equity investments to achieve returns in excess of 400 basis points over public markets and a quarter expect their private equity portfolios to achieve returns between 2.1% and 4% over public markets.

Fig. 3: Proportion of Investors that Feel Their Private Equity Fund Investments Have Lived up to Expectations



Source: Preqin

Fig. 4: Investors' Returns Expectations for Their Private Equity Portfolios



Source: Preqin

Re-ups and New Relationships

Re-up commitments are an important source of capital for GPs raising new funds – almost three-quarters (74%) of funds that closed in 2010-2011 received more than half of their commitments from returning investors. With over 1,800 funds currently competing for capital, GPs continue to face challenging fundraising conditions as LPs remain highly selective about which funds they choose to commit to.

Fund managers should be encouraged that 38% of investors plan to increase the number of GPs they invest with over the longer term, as Fig. 5 shows. Additionally, almost half of LPs plan to maintain the number of GP relationships in their portfolio.

Fig. 6 shows that 84% of LPs will consider forming some new GP relationships over the next 12 months. Sixteen percent of LPs plan to only invest with existing managers in their portfolios while 3% of LPs will only be investing with managers they have not previously worked with in 2012.

“84% of LPs will consider forming some new GP relationships over the next 12 months...”

Managers should be aware that while many investors are likely to add some new GPs to their portfolios, several are also likely to terminate some existing relationships, as a UK pension fund told us: “[We] may invest with some new GPs and drop old ones to maintain the number in our portfolio.”

Attitudes to First-Time Funds

The uncertain financial climate is ensuring that emerging managers face tougher challenges as investors continue to be reluctant to commit to funds raised by new teams; 55% of investors told us they will not consider investing in a first-time

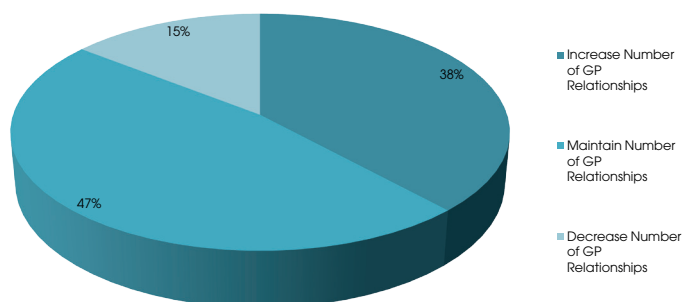
fund over the next 12 months. Just 18% of LPs told us they would readily invest in a first-time fund over the next 12 months, and an additional 17% would consider committing to a first-time fund should they see an appealing opportunity. One US pension fund told us: “We typically prefer GPs to have a track record, but if we saw a great opportunity and other investors were involved then we might commit.” Ten percent of investors will commit to a first-time fund only if managed by a spin-off team.

Securing a Commitment before the First Close

The majority of investors we spoke to are open to potentially being part of a first close; 46% told us they would invest before a first close and a further 15% would consider it. Several LPs told us they will commit before a first close to build and strengthen GP relationships, as well as to benefit from incentives such as more favourable terms. Others noted that investing before the first close can help access to top performing managers, as a German asset manager told us: “If it is a well placed manager it is good to secure your commitment and to have a footprint on the legals.”

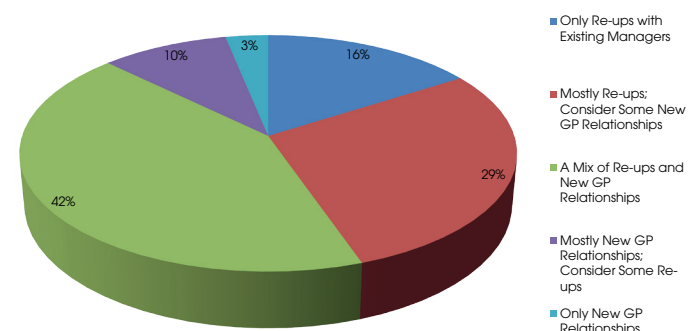
Thirty-nine percent of investors will not commit to a fund until after the first close; one Australian asset manager told us: “We would like to see the investments the fund manager has made before investing in the fund,” while a UK public pension fund said: “[We] like to see who else is participating in the fund.” For some LPs, being part of a first close is dependent on the track record of the fund manager.

Fig. 5: Likely Changes to the Number of GP Relationships Maintained by Investors in the Longer Term



Source: Preqin

Fig. 6: Investors' Intentions Regarding Forming New GP Relationships over the Next 12 Months



Source: Preqin

Biggest Challenges Facing LPs

We asked investors what particular challenges they are facing with regards to their private equity programs in the current climate. Below is a sample of investors' concerns that GPs should bear in mind when approaching investors for new commitments in 2012.

"Issues with LP and GP governance; LPs need to act as stewards to make GPs increase their standards. Also issues with cash flow, timing and lack of deals at the moment." – [A UK public pension fund](#)

"Distance from the portfolio companies." – [A Norwegian corporate investor](#)

"The biggest challenge is finding a good manager with a reputable track record and cohesive team that does not deviate from its initial mandate. A lot of fund managers go off the agreed track halfway through which is frustrating." – [A Malaysian public pension fund](#)

"Finding the right partner and right opportunities. It's easy for GPs to prove records, but difficult to repeat records, so reliability is very important, but surprisingly hard to find." – [A Hong Kong-based corporate investor](#)

"For banks especially it is difficult as there are new regulations making it difficult to invest." – [An Austrian bank](#)

"Accessing the top-tier funds." – [A Swiss asset manager](#)

"Funding levels are so depressed. No-one is taking chances, and all is very conservative." – [A US public pension fund](#)

"So many competitors for the same fund managers all challenging for capital." – [A US endowment](#)

"Choosing the right fund manager in the first place, as once you have committed your capital, there is no turning back." – [A UK public pension fund](#)

"The biggest issue facing LPs is negotiating good terms, particularly with regards to carry structure." – [A Danish bank](#)

"Over-commitment and liquidity issues." – [A US foundation](#)

"Sifting through GPs as so many are fundraising at the moment, it is hard to find the good ones." – [A US insurance company](#)

"Exit environment; trying to keep the flow going." – [A US foundation](#)

Direct, Co-Investments and Secondaries

As investors look for new ways to access private equity investments, and to reduce the costs associated with investing in funds, we are seeing an increasing number of investors moving towards direct and co-investments in private companies. The secondary market has also become increasingly important, with many investors looking to purchase fund interests from existing LPs in funds.

As Fig. 7 shows, 40% of investors we spoke to look to invest directly in private companies. A third (33%) of investors will seek such exposure through co-investing alongside their GPs in portfolio companies and 22% look to make direct investments on a proprietary basis.

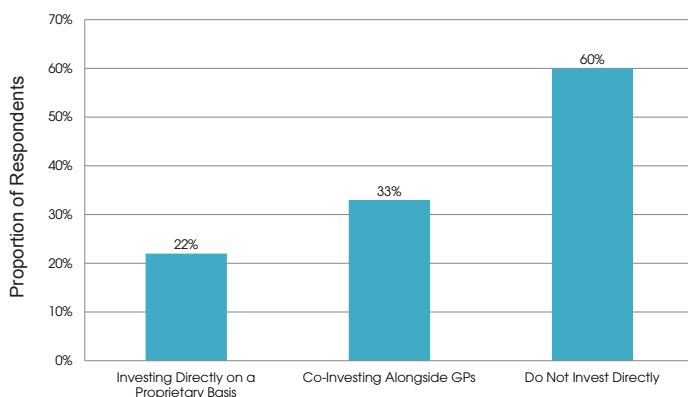
“Seventy-four percent of investors expect to increase their level of secondary market activity in 2012...”

LPs that expressed an interest in making direct and/or co-investments alongside fund managers were asked if they expect their level of activity in these areas to change in 2012 compared to 2011. As Fig. 8 illustrates, a significant proportion of LPs expect to increase their direct exposure in the coming year. Sixty-eight percent of those already involved in investing directly on a proprietary basis plan to increase their activity in this area in 2012, and 58% of those involved in co-investment plan to step up their level of co-investment activity over the next 12 months, while just 5% and 3% of LPs active in the respective areas expect to reduce their exposure to direct and co-investments respectively.

It is interesting to note that none of the investors we spoke to with an interest in purchasing fund stakes on the secondary

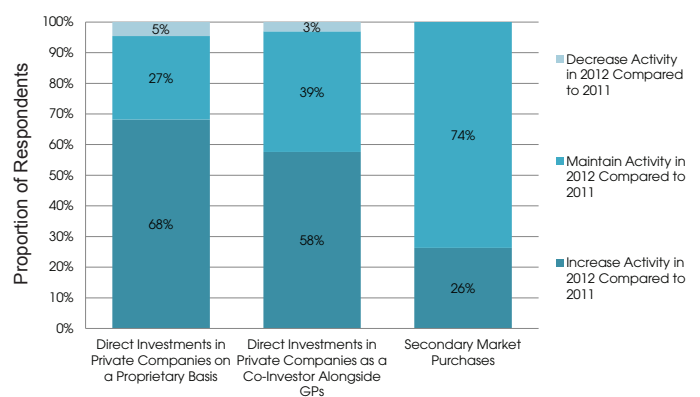
market expect to decrease their activity in this area in 2012. Twenty-six percent of investors expect to increase their level of secondary market activity in 2012 compared to 2011, and the remaining 74% of investors with an interest in making secondary market purchases expect to maintain their level of activity in this area of the market. A Peru-based pension fund we spoke to acknowledged that 2012 may bring some more secondary market opportunities, commenting: “Recent disruptions are creating new opportunities in the asset class. Banks selling their private equity portfolios are generating an opportunity in the secondary market, for example.”

Fig. 7: Investors’ Preferred Methods of Investing Directly in Private Companies



Source: Preqin

Fig. 8: Investors’ Expectations of Their Direct Investment and Secondary Market Activity in 2012



Source: Preqin

Key Geographies and Strategies in 2012

As LPs look to the year ahead, many have laid out clear investment strategies for 2012 and have decided where to place their capital in order to make the most of the opportunities available in the current market.

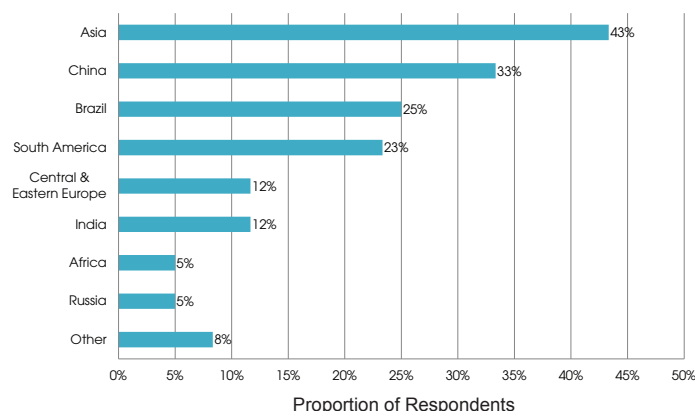
In terms of the regions that investors feel currently offer the best opportunities, 60% of investors view Asia as particularly attractive. North America is also an attractive region for several investors, named by 42% of LPs. Seventy percent of investors told us there are no regions that they are avoiding at present; however, of the investors that are avoiding certain regions, the highest proportion named Europe as a region they would not look to invest in where they would have previously sought exposure.

Appetite for Emerging Markets

Emerging markets continue to attract strong interest from investors. Seventy-six percent of investors will consider investing in emerging markets, an increase of six percentage points from December 2010, when 70% of investors were open to investing in emerging markets. Furthermore, 99% of investors that invest in emerging markets expect to maintain (66%) or increase (33%) their allocation to emerging markets over the next 12 months.

Fig. 9 shows the countries and regions within emerging markets that investors feel are currently presenting attractive investment opportunities. Asia remains the most cited region within emerging markets, named by 43% of investors. Thirty-three percent specifically named China as presenting attractive opportunities. It is interesting to note that fewer investors (12%) named India specifically as presenting attractive opportunities, a much lower proportion than in our December 2010 study, when India was named by 35% of LPs.

Fig. 9: Countries and Regions within Emerging Markets that Investors View as Presenting Attractive Opportunities



Source: Preqin

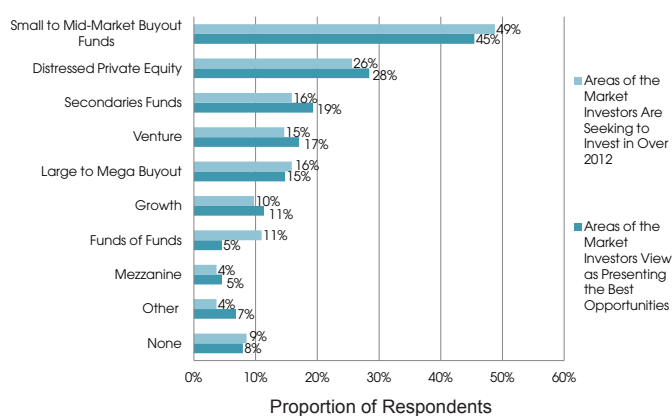
Key Strategies for 2012

Fig. 10 shows that small to mid-market buyout funds remain the most attractive to investors, with 45% of respondents naming these funds as presenting good opportunities in the current market, and 49% of LPs looking to invest in such funds over 2012. Distressed private equity and secondaries funds are also appealing to many investors, with over a quarter (26%) expecting to allocate capital to distressed funds in 2012 and 16% seeking secondaries opportunities.

“Seventy-six percent of investors will consider investing in emerging markets...”

For many investors, the fund types presenting attractive opportunities vary depending on which region they are targeting. An asset manager based in the Netherlands said: “The best fund types depend on the region – in Europe and the US buyout funds present the best opportunities, in emerging markets, growth and late-stage venture funds present the best opportunities.” Seventeen percent of investors feel venture funds are presenting attractive opportunities, and 11% feel growth funds are attractive to invest in at present.

Fig. 10: Investor Attitudes to Different Fund Types At Present



Source: Preqin

What Can GPs Do to Stand Out?

Fundraising looks set to remain challenging in 2012, with more than 1,800 funds currently on the road seeking aggregate commitments of over \$700bn. We asked investors what GPs can do to stand out from the crowd in order to improve their chances of securing a commitment.

“A lot of our GPs have introduced us to co-investments, which has improved transparency with them.” – [A Norwegian corporate investor](#)

“It’s all about differentiating yourself from other GPs and not just doing what everyone else does.” – [A Netherlands-based private sector pension fund](#)

“Excellent performance, stable returns and high levels of transparency.” – [A German asset manager](#)

“Knowledge of exit multiples. Building of trust between GP and LP is very important.” – [An Austrian bank](#)

“Must display a differentiated approach as well as an ability to access niche markets.” – [A Swiss asset manager](#)

“Personality, process, performance, price...generally the whole package.” – [A Swiss private sector pension fund](#)

“A clear investment proposition, what sort of value it will add against the management fees.” – [A UK private sector pension fund](#)

“Good strategy, proven track record, fair terms, exceptional team.” – [A Peruvian private sector pension fund](#)

“To stand out for the crowd GPs need to be willing to negotiate on carry structure.” – [A Danish bank](#)

“Good returns, alignment of interests, lower management fees so that they only cover operational costs and so fund managers only make money from carried interest; so they make real money from their investment success after five, six or seven years.” – [A Danish bank](#)

“Producing good materials and executive summaries that stand out at first glance.” – [A US insurance company](#)

“Need to make money in the current environment we live in today.” – [A US endowment](#)

“Bring more to the table than just capital. Also have operational experience in various fields.” – [A US foundation](#)

“Results over the short and long term in excess of benchmark.” – [A Canadian foundation](#)

Allocations and Intentions for 2012 and Beyond

With aggregate fundraising in 2011 having remained broadly similar to that in 2010, what can fund managers expect from investors in the year ahead?

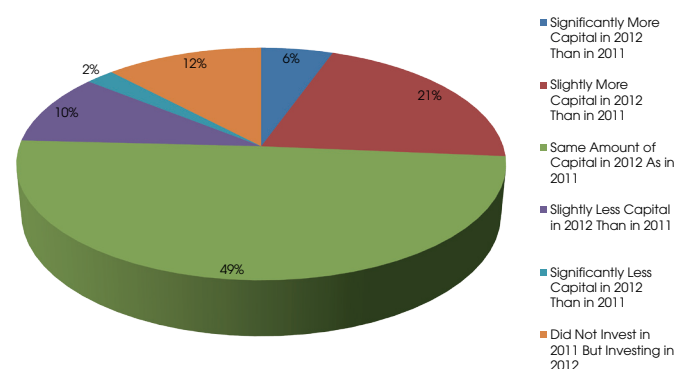
Investors remain extremely cautious, and will continue to be very selective about making new fund commitments. For many investors, the timeframe for their next private equity commitments is likely to be impacted by a number of factors, including distributions, liquidity issues and appealing investment opportunities.

“Seventy-three percent of investors plan to make new commitments in 2012...”

However, managers planning to launch new vehicles in 2012 can be encouraged that 73% of investors plan to make new commitments in 2012. Sixty-two percent expect to invest in H1, and another 11% plan to make their next commitments in the second half of the year. Comparatively, a smaller 63% of investors interviewed in December 2010 told us they planned to make new commitments in 2011, which suggests that more investors are coming back to the market this year. Seventeen percent of investors plan to make new commitments on an opportunistic basis and are therefore likely to consider new commitments should they be presented with attractive opportunities.

Managers can take further confidence from the fact that almost half of LPs (49%) making new commitments in 2012 expect to commit at the same rate as they did in 2011, as Fig. 11

Fig. 11: Amount of Capital Investors Plan to Commit to Private Equity Funds in 2012, Compared to 2011

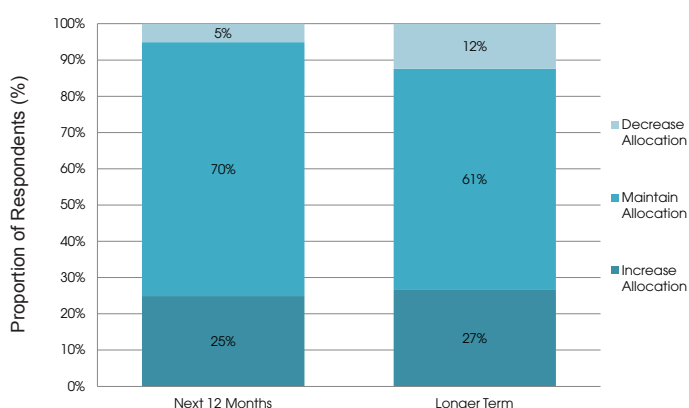


Source: Preqin

shows, and a further 27% expect to increase the pace of their commitments. Investors' reasons behind increasing their private equity commitment rate were varied; one Canadian asset manager told us: “[Our] appetite is growing and we have received some distributions so have more capital to commit.” Many LPs plan to commit more to private equity in order to build towards their target allocations to the asset class, while others noted they are seeing more attractive opportunities in the market. Twelve percent of LPs expect to commit less capital in 2012 than they did in 2011. A further 12% of investors expect to make new commitments in 2012 having held off from committing to new funds in 2011, perhaps an indication that a number of the LPs are regaining their confidence in the asset class.

Overall, investors are set to continue investing in private equity funds, as Fig. 12 illustrates. More than a quarter of LPs (27%) expect to increase their allocations to private equity in the longer term and 61% plan to maintain their exposure, while just 12% of investors expect to reduce their allocations to private equity in the next three to five years.

Fig. 12: Investors' 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.

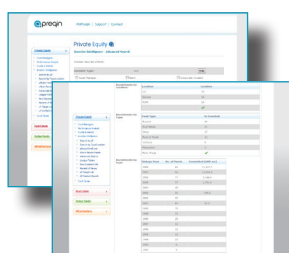
Preqin's Investor Profiles products and services provide comprehensive and exclusive data on investors in private equity that can help you to achieve your fundraising goals. Our international teams of multi-lingual analysts speak to more than 4,000 investors in private equity each year, as well as tracking every available news and information source, to ensure that our data is as up to date and comprehensive as possible.

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Find out how you too can benefit from the industry-leading data that Preqin has to offer.

Investor Intelligence

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- All key information is included: assets breakdown including PE allocations, sample investments, key contacts, investment plans, fund preferences, plus much more.
- Intricate search options help to identify the best targets for your funds.
- Receive fully customized email digests of updates and news on investors on a daily or weekly basis managed through the Preqin Alerts Centre.

- 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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- Fund Performance
- Fundraising
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Preqin regularly releases research and information on fundraising and all other aspects of the private equity industry as both research reports, and as part of our monthly Spotlight newsletter. To register to receive more research and analysis, please visit: www.preqin.com/research

If you have any comments on this report, please contact:
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