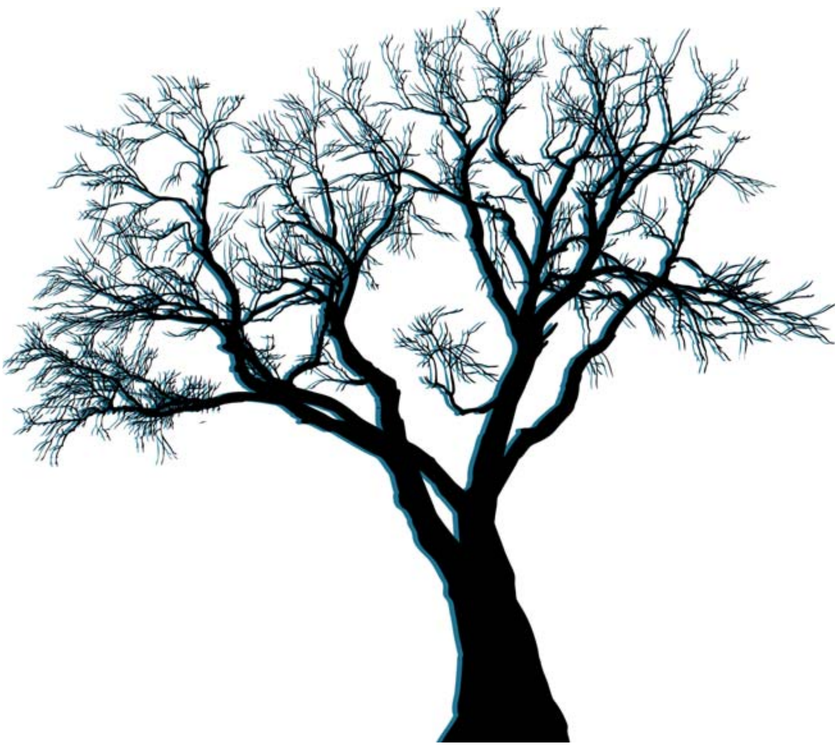
Preqin Special Report:

Funds of Funds
January 2011



alternative assets. intelligent data.

Market Overview

Funds of funds have long acted as an important conduit for the flow of capital into the private equity industry. They provide a means of accessing the asset class for investors that lack the finance, knowledge or experience required to select and participate in funds directly. They also represent a key and significant source of capital for private equity fund managers, often making repeat investments with the same firm. This duality has meant that in the wake of the financial crisis and a slump in overall private equity fundraising, the importance of funds of funds has grown while the managers of such vehicles have themselves faced difficulties in raising capital.

Fundraising Market

The fundraising environment for all private equity vehicles remains tough, with difficult conditions seen in 2009 persisting throughout 2010. Managers are bringing fewer vehicles to market and targeting less capital than during the industry's peak years of 2006-08, while the number of funds closing and the amount of capital secured have also declined in the past couple of years.

A drop in the market share of funds of funds in 2010 indicates that it has been a particularly difficult year of fundraising for managers of these vehicles (see Fig. 1). The capital raised by funds of funds represented just 6% of the 2010 market total at the time of publication in November 2010, compared to an average of almost 11% over the previous five years. Although the current market share is likely to increase by year-end, with December traditionally being a comparatively strong month for closes of funds of funds, it is unlikely to match the market share (12%) these vehicles held in 2009.

Changes in Investor Motivation

In the current market, some of the key reasons for investors participating in funds of funds are less compelling than they have been in the past. The attraction of fund of funds managers as providers of exposure to top-tier and difficult-to-access funds, for example, is no longer as relevant. The oversubscription of private equity funds that was seen in the asset class a few years ago is rare in today's market, making it easier for investors to participate directly in their chosen funds without the need to invest via fund of funds vehicles. Some managers are also dropping the minimum commitment levels, allowing smaller investors to adequately diversify their portfolio without using funds of funds.

The pool of new fund of funds investors is also smaller than in recent years. Some investors that invested in fund of funds in the past to gain experience of the asset class now feel that they have the necessary knowledge to commit to private equity funds directly, avoiding the additional fees attached to fund of funds investments. At the same time, fewer new investors, which have historically represented a strong source of capital for fund of funds, are entering the asset class for the first time as a result of market uncertainty. Conditions are therefore very challenging, and firms are having to work harder than ever in order to identify and attract new limited partners.

Performance of Funds of Funds

The performance of funds of funds has improved recently – the one-year horizon IRR to March 2010 was 10.5% compared to 0.2% and -12.0% to December 2009 and December 2008 respectively – but the long-term returns offered by these vehicles are considerably less attractive compared to those of direct investment funds: as at March 2010, the five-year horizon return for funds of funds was 5.5%, while the average across all private equity fund types was 16.8%.

Investor Appetite – Existing Investors

Preqin's October 2010 survey of 148 fund of funds investors indicates that half intend to make new commitments to funds of funds in the next three years, while an additional quarter will consider making new commitments in this period. As evidenced by the current fundraising market, however, investors are generally being more cautious than ever when making new commitments. One-third of survey respondents that plan to commit to a fund of funds in the next three years expect to do so in 2011, but 51% are yet to decide on the timing of any new activity (see Fig. 2).

Even for those fund of funds managers that do not have a new fund in the market, the indication is that they will need to carefully consider investor relations in order to secure re-up commitments in the future. Although investors commonly have long-established relationships with fund of funds managers, our survey also shows that just over half of respondents will remain open to investing with teams they have not made allocations to in the past.

Fund of Funds Managers: Changes in the Market

Mergers, acquisitions and spin-outs of management teams are themes that are not unfamiliar in the private equity fund of funds market (a number of the currently active firms were formed following such transactions), but 2010 has seen more activity than usual, with several prominent players involved. Consolidation was inevitable given the market contraction that has followed several years of considerable growth. The tough fundraising environment of the last two years has intensified competition for investor commitments, with the number of fund of funds previously coming to the market now unsustainable (196 vehicles targeting $67 billion were on the road in Q4 2008, compared to 146 vehicles targeting $45 billion in November 2010).

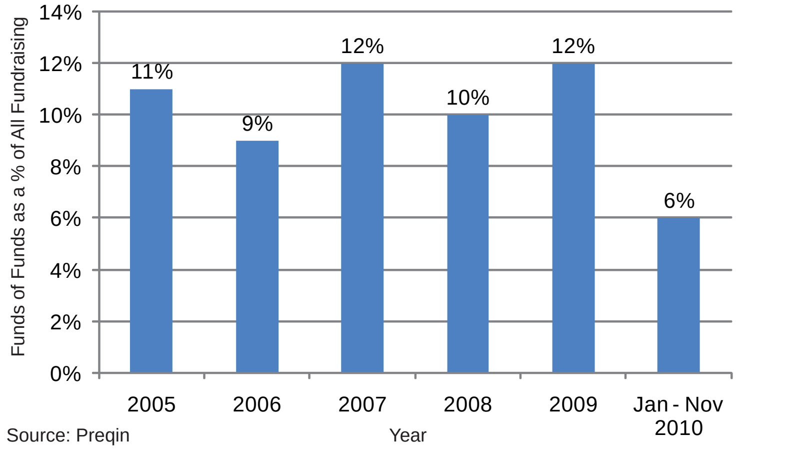
Changes in the ownership of some fund of funds units have also occurred as a result of financial groups increasingly seeking to focus on core operations. New regulations, such as the Dodd-Frank Act in the US, that place constraints on alternative investment activities of banks have been introduced in 2010. Although regulations have proved less severe than many expected, some banks have sought to dispose of private equity fund of funds arms.

As the fundraising climate remains uncertain, further consolidation is likely to occur in 2011. Similarly, as financial institutions continue to restructure and adapt to new legislation, further sales of fund of funds units to management teams and external parties could be seen.

The Road Ahead

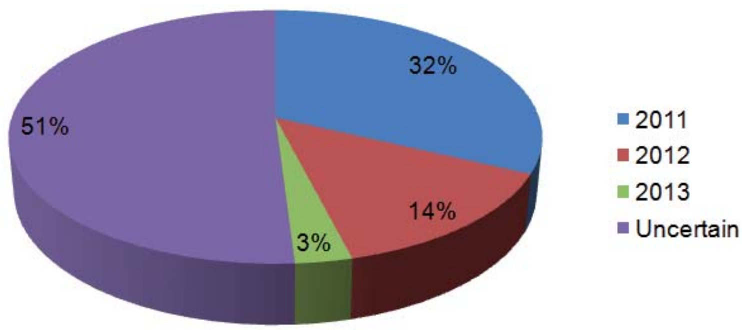
Despite recent changes in the market, funds of funds continue to play an important role in the private equity industry. The best managers of these vehicles will continue to attract capital in future and we expect the market to improve over the coming years. As in the past, the structure and inherent advantages of funds of funds mean that they will attract investors entering the asset class for the first time, as well as small investors that start to think about returning to the market after first participating during the boom years.

Fig. 1: Fundraising for Funds of Funds as a Proportion of Overall Private Equity Fundraising, 2005-2010



Source: Preqin

Fig. 2: Investors' Expected Timeframe for Next Commitment to a Fund of Funds



Source: Preqin

Other benefits that derive from participating in funds of funds, including diversification and superior fund selection, are difficult for investors to successfully replicate when acting alone and are particularly important amid continuing financial and economic uncertainty.

The ability of top managers to provide exposure to niche and emerging markets is also something that continues to be valued by investors. Funds of funds are likely to place greater emphasis on regions outside of North America and Europe in the next few years as they seek to expand their client base while benefiting from the attractive long-term growth rates anticipated in some markets, such as China and India.

Current Fundraising Market

- As shown in Fig. 3, 146 fund of funds vehicles are on the road as of November 2010, seeking an aggregate $45 billion in commitments. This represents a decrease in the number of vehicles seeking capital as of the same point in both 2009 and 2008, when 168 and 196 funds of funds were raising capital respectively.

- As of November 2010, private equity funds on the road are targeting an aggregate $567 billion, with fund of funds vehicles accounting for 8% of this total, the same proportion as in 2009 and 2008.

- The majority of funds of funds in market are targeting North America as their primary geographical focus. 77 fund of funds vehicles primarily focused on North America have an aggregate target of $28.7 billion. This represents over 60% of the global total sought by funds of funds and 53% of the total number of fund of funds vehicles in market.

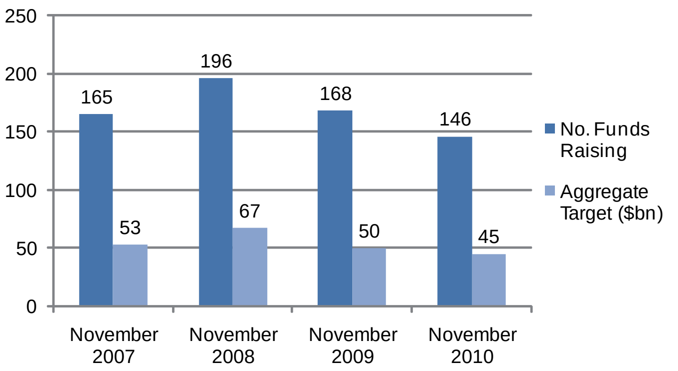
- European-focused funds of funds are seeking aggregate commitments of $7.7 billion across 41 vehicles as of November 2010. At the same point last year 53 funds of funds were seeking a total of $13.3 billion. In terms of the market share, Europe-focused vehicles represent 28% of the total number of funds on funds on the road compared to 32% last year.

- As shown in Fig. 4, fund of funds managers that are headquartered in North America have 77 vehicles on the road, seeking a total of $30.1 billion in commitments. European fund managers are seeking $10.7 billion in commitments for 56 funds of funds, representing a 24% market share in terms of target commitments. Fund of funds managers based in Asia and Rest of World have 13 vehicles on the road seeking $4.1 billion as of November 2010, which accounts for 9% of the capital targeted by funds of funds globally.

- $3.5 billion in aggregate commitments is being targeted by fund of funds managers raising their maiden vehicles, accounting for 8% of the total capital sought by funds of funds as of November 2010.

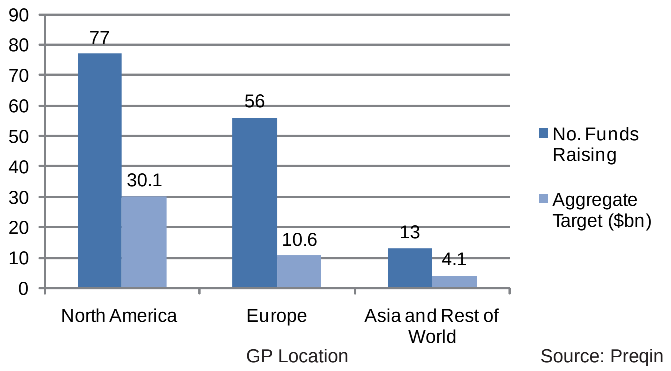
- 57% of funds of funds in market will target buyout funds, 44% will invest in venture funds, 21% distressed debt funds, and 16% mezzanine vehicles. Among other targeted fund types are special situations, infrastructure and real estate vehicles.

Fig. 3: Funds of Funds in Market over Time, 2007-2010



Source: Preqin

Fig. 4: Funds of Funds in Market by GP Location



Source: Preqin

Fund of Fund Managers as Investors

Geographical Preferences

- Fig. 5 shows the breakdown of fund of funds managers by the location of their main office. 46% of fund of funds managers are headquartered in North America. Europe accounts for 41% of fund of funds managers.

- A growing number of fund of funds managers are based outside North America and Europe. In 2009, 11% of managers were to be found in Asia and Rest of World; in 2010, this has risen to 13%. A number of new firms have been established outside North America and Europe over the past year and are raising their first funds of funds.

- Funds of funds have long been seen by investors as a useful way of accessing new markets and geographies. By investing in emerging markets through funds of funds, investors can not only benefit from managers' local knowledge and expertise but also gain diversified exposure to new geographies and build up their own knowledge and understanding of these markets.

- Just over three-quarters of active fund of funds managers (77%) invest in emerging markets, an increase from the 71% reported last year.

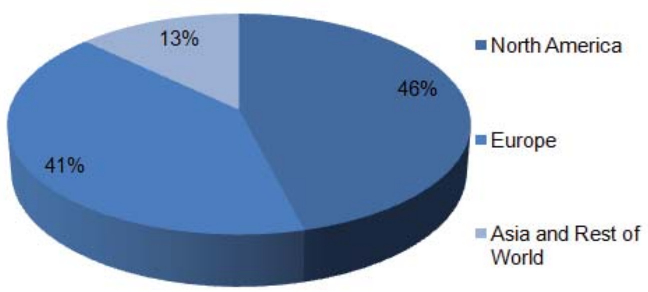
Allocations to Different Fund Types

- Fig. 6 shows how the capital secured by funds of funds that closed in 2007-10 is allocated across different types of fund. A significantly higher proportion (58%) of the aggregate capital raised by funds that closed in 2007 and 2008 is allocated to investments in buyout funds in comparison to the proportion of capital (49%) allocated by funds of funds that closed in 2009-10.

- By contrast, the proportion of capital allocated to other fund types, including distressed private equity, natural resources and mezzanine funds, has risen from 16% of aggregate capital raised by funds closed in 2007-8 to 25% of capital raised by funds closed in 2009-10.

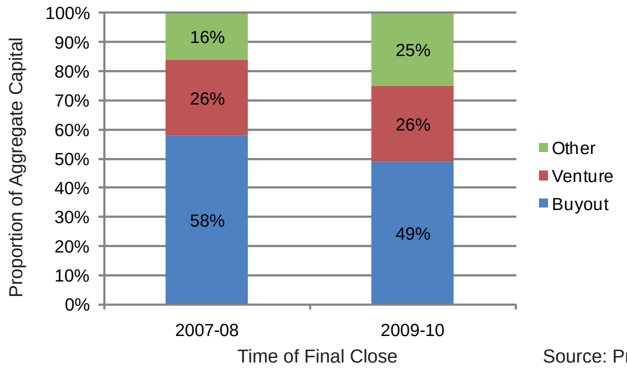
- 86% of fund of funds managers named small to mid-market buyout funds as particularly attractive at present. Distressed private equity funds also received a lot of attention from fund of funds managers, with more than half of those polled (56%) naming this type of fund. No fund of funds managers felt large or mega buyout funds were presenting interesting opportunities in the current climate.

Fig. 5: Fund of Funds Managers - Regional Breakdown



Source: Preqin

Fig. 6: Proportion of Capital Allocated to Each Fund Type by Funds of Funds



Source: Preqin

Historical Fundraising

- Funds of funds have on average accounted for around 11% of the private equity fundraising market in previous years. However, the proportion of the market held by funds of funds has decreased in 2010 to 6% of overall fundraising, half of the market share held in 2009.

- Between January and November 2010, 20 funds of funds with a primary focus on North America closed with $2.4 billion in aggregate commitments. 11 Europe-focused funds raised $3.6 billion, and six fund of funds vehicles with a primary focus on Asia and Rest of World raised $1.9 billion, as Fig. 7 shows.

- While the amount of capital secured by Asia and Rest of World-focused vehicles in 2010 is at a five-year low, their share of the market has almost doubled from 2009. Vehicles with a primary focus on Asia and Rest of World account for nearly one-quarter of all capital raised by funds of funds in January to November 2010, up from 13% in 2009.

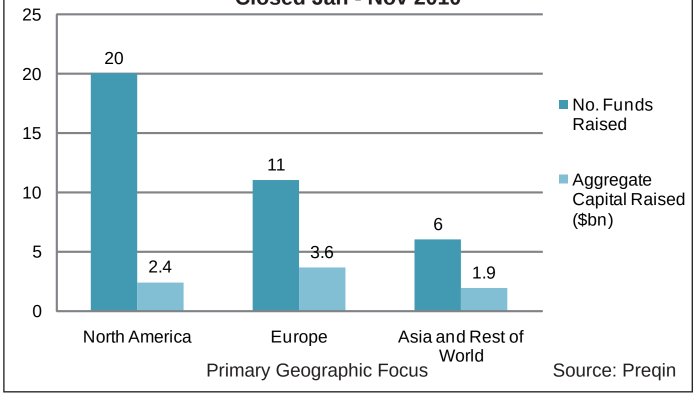
- The mean size of funds of funds increased from $289 million in 2006 to $375 million in 2007, then decreased slightly to $363 million in 2008, and has continued to decline since, with the average amount of capital raised by funds of funds standing at $313 million in 2009 and $239 million in January to November 2010.

- The highest proportion (38%) of funds of funds that closed in 2010 raised between $101 million and $250 million in overall capital, as Fig. 8 shows. A further 34% of vehicles secured less than $100 million in overall commitments. 13% of funds secured between $251 million and $500 million, while 9% received total commitments in the range of $501-750 million. The smallest proportion (6%) of vehicles raised capital in excess of $750 million.

- 3% of aggregate capital secured by fund of funds managers in January to November 2010 was secured by managers raising vehicles for the first time. This is a lower proportion than the 7% of aggregate capital secured by first-time fund of funds managers in 2009.

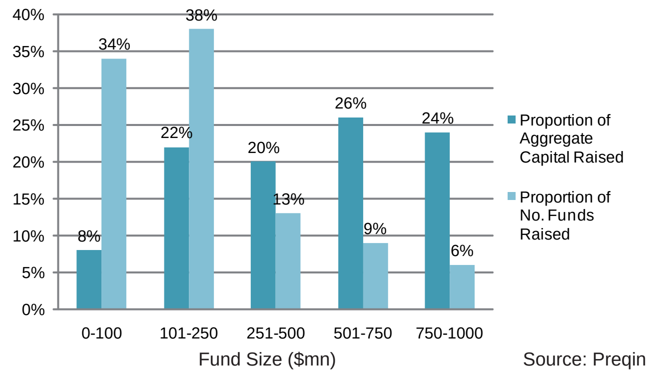
- 12% of funds of funds that closed in 2010 were first-time vehicles. This suggests that first-time funds of funds are typically smaller in size than vehicles managed by more experienced firms. The proportion of first-time funds of funds raised in 2009 was at a similar level.

Fig. 7: Funds of Funds by Primary Geographic Focus, Funds Closed Jan - Nov 2010



Source: Preqin

Fig. 8: Breakdown of Fundraising by Fund Size, Funds Closed Jan - Nov 2010



Source: Preqin

Performance

- Fund of funds vehicles are traditionally viewed as relatively low-risk investments compared to direct investment funds. Fig. 9 shows that the majority of funds of funds are collected around the benchmark and over half (60%) of all funds of funds have net IRRs within +/-5% of their median benchmarks

- The high cluster of funds of funds that can be seen performing close to their benchmarks and the few outliers demonstrates that funds of funds represent a relatively low-risk strategy.

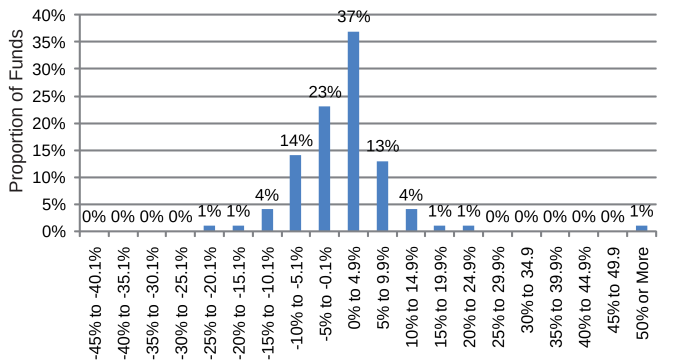
- Horizon IRRs indicate how the private equity industry is performing during defined periods (i.e. over one year, three years or five years) The one-year horizon returns as of 31st March 2010 show that all private equity strategies produced positive returns over a one-year period. The private equity industry as a whole posted returns of 21.8% over the year to March 2010, while funds of funds generated average returns of 10.5% for the same period.

- Fund of funds investment vehicles typically mature at a slower rate compared to direct private equity funds. As an example, for funds of funds with vintage year 2002, the median value of distributed capital is 56.6% compared to 109.3% for direct buyout funds with the same vintage year, while the median remaining value is around 80% higher than the 45% for vintage 2002 buyout funds

- Fig. 10 shows the median net IRRs and quartile boundaries for vintages 1998 to 2008, where all first quartile funds have IRRs above the top quartile line and those with IRRs below the bottom quartile boundary are fourth quartile funds. More than 75% of funds of funds with vintages before 2004 have returns above zero, with the median IRR ranging between 5.0% and 11.0% for each vintage year.

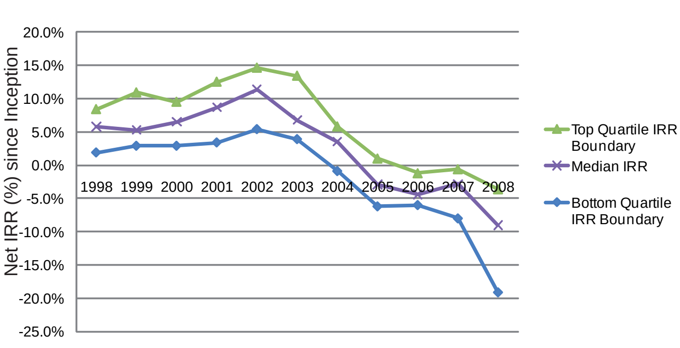
- The net multiple is used to illustrate how much capital investors have received, or are likely to receive, from their investments. The median and weighted multiples are generally closely correlated for most vintage years, which demonstrates that the larger funds do not tend to perform significantly differently from other vehicles.

Fig. 9: Fund of Funds Net IRR Deviation from Median Benchmark



Source: Preqin

Fig. 10: Fund of Funds Median Net IRRs and Quartile Boundaries by Vintage Year



Source: Preqin

Listed Funds of Funds

- There are a number of investment vehicles listed on stock exchanges conducting private equity investments in the same way as traditional private equity partnerships. Some of these employ strategies similar to those of unlisted funds of funds, chiefly investing in private equity through primary commitments to direct investment funds, as well as participating in secondary transactions and direct co-investments.

- Listed private equity funds of funds are generally managed by specialist asset managers that are dedicated to alternative investments and often manage other, unlisted, funds of funds.

- One of the benefits of listed funds of funds is their ability to provide investors with significant diversification across vintage years. While the 10-year life span of many unlisted funds of funds limits the extent of vintage diversification offered to limited partners, listed vehicles are typically able to invest across a more prolonged period, which helps to mitigate the effects of the 'J-curve' and the effects of economic cycles.

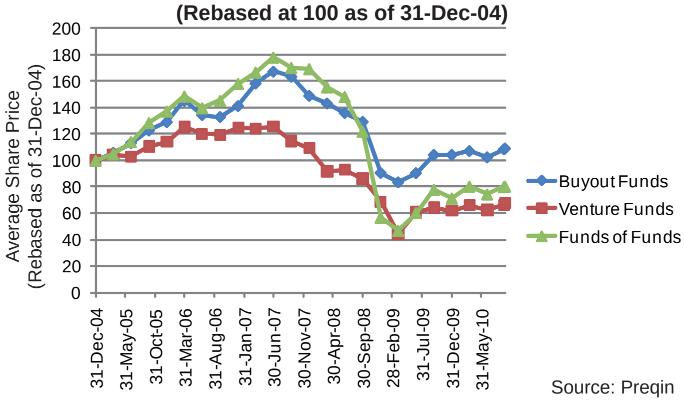
- Fig. 11 shows the historic average prices of listed buyout funds, venture funds and funds of funds between December 2004 and September 2010. All share prices are rebased at 100 as of December 2004. Buyout and fund of funds share prices reached a peak in June 2007 before declining and reaching their lowest levels in March 2009. Listed buyout, venture and fund of funds vehicles have all experienced similar trends, with the biggest decrease occurring in late 2008 and early 2009.

- Since December 2007, all fund types have been trading at a discount to net asset value (NAV), reaching their highest discount to NAV levels in early 2009. Since then, listed private equity share prices have improved and the discounts to NAV have reduced.

- To reduce risk and increase diversification, listed funds of funds typically seek to gain exposure to markets in various countries and regions. As Fig. 12 indicates, a significant proportion of the investments of listed vehicles are focused on the traditional private equity markets of North America and Europe.

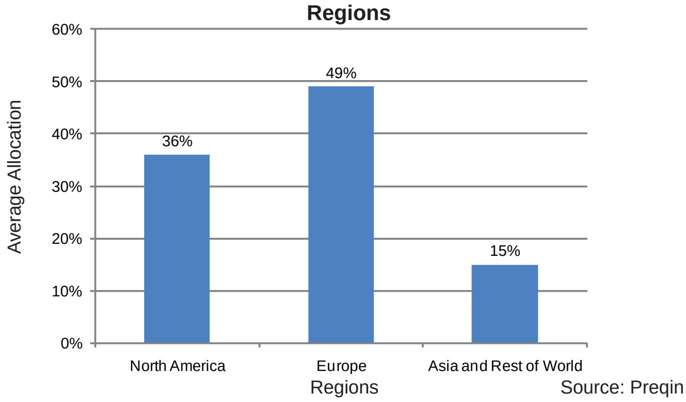
- As with unlisted funds of funds, listed vehicles frequently make secondary and direct investments alongside their primary commitments to funds. This helps managers bring further diversification to their portfolios. The proportion of fund portfolios made up of secondary and direct investments varies across listed funds of funds, but allocations to each of these strategies are typically less than 20%.

Fig. 11: Listed Private Equity Share Prices, (Rebased at 100 as of 31-Dec-04)



Source: Preqin

Fig. 12: Listed Funds of Funds' Average Allocation to Various Regions



Source: Preqin

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 fund of funds closed during 2009 and 2010 and funds currently raising capital.
- Analysis: Detailed analysis on all aspects of funds of funds, of funds managers as investment consultants.

More information:
www.preqin.com/foff

2011 Preqin Private Equity Fund of Funds Review - Chapters

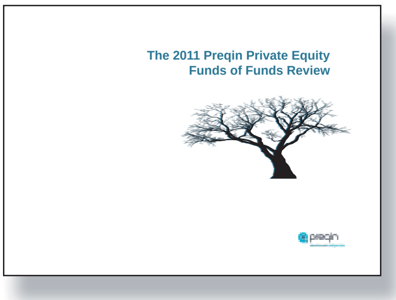
2011 Preqin Private Equity Funds of Funds Review

preqin
alternative assets. intelligent data.

The 2011 Preqin Private Equity Funds of Funds Review has been completely updated to provide the most comprehensive and up to date guide available yet.

Full Contents Include:

- Manager Profiles: Detailed profiles for over 230 fund of funds managers
- Fund Profiles
- Sample Investments & Fund Preferences
- Performance for over 600 individual fund of funds vehicles
- Listed Vehicles: Detailed profiles for 25 listed funds of funds
- LP Investors: Detailed profiles for 150 LP investors investing in funds of funds
- Fundraising: In depth listings of all fund of funds closed during 2009 and 2010 and funds currently raising capital
- Analysis: Detailed analysis on all aspects of the funds of funds market
- Survey Results: Results from surveys of fund of funds and investors



www.preqin.com/pefof

For more information visit: www.preqin.com/pefof

I would like to purchase the 2011 Preqin Private Equity Funds of Funds Review:

Single Copy:

- ☐ £885 + £10 Shipping
- ☐ $1,495 + $40 Shipping
- ☐ €995 + €25 Shipping

Additional Copies:

- ☐ £110 + £5 Shipping
- ☐ $180 + $20 Shipping
- ☐ €115 + €12 Shipping

Shipping costs will not exceed a maximum of £15 / $60 / €37 per order when all shipped to same address. If shipped to multiple addresses then full postage rates apply for additional copies.

Data Pack:

- ☐ $300 / £175 / €185

Data Pack contains all underlying data for charts and graphs contained in the publication. Only available alongside purchase of the publication.

Completed Order Forms:

Post (to Preqin):
Equitable House,
47 King William Street,
London, EC4R 9AF

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

Samsung Hub
3 Church Street
Level 8
Singapore 049483

Fax:
+44 (0)87 0330 5892
+1 440 445 9595
+65 6408 0101

Email:
info@preqin.com

Telephone:
+44 (0)20 7645 8888
+1 212 808 3008
+65 6408 0122

Payment Details:

☐ Cheque enclosed (please make cheque payable to 'Preqin')

☐ Credit Card ☐ Amex ☐ Mastercard

☐ Visa ☐ Please invoice me

Card Number: ______________________

Name on Card: ______________________

Expiration Date: ______________________

Security Code: ______________________

American Express, four digit code printed on the front of the card.

Visa and Mastercard, last three digits printed on the signature strip.

Shipping Details:

Name: ______________________

Firm: ______________________

Job Title: ______________________

Address: ______________________

____

____

City: ______________________

Post/Zip: ______________________

Country: ______________________

Telephone: ______________________

Email: ______________________