Preqin Investor Outlook: Private Equity

The Opinions of 100 Leading Private Equity LPs on the Market and Their Plans in 2011

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Methodology:

Preqin, the alternative assets industry's leading source of data and intelligence, welcomes you to the 2011 edition of Preqin Investor Outlook: Private Equity, a unique look at investors in private equity, 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 2010. 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.

Contents:

Fundraising to the next level

We have a successful track record in raising capital for **private equity** and **real estate** firms from around the world.

Our ability to differentiate our clients in a highly competitive market and our longstanding relationships with active investors in North America, Europe, Asia and the Middle East are key to our success.

We are partners with each of our clients, helping them reach the next level in fundraising.

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Fundraising in 2010

The onset of the financial crisis saw private equity fundraising become a much more challenging prospect for fund managers. Many institutional investors which had previously been active in the asset class placed their investments on hold and GPs struggled to raise capital for new vehicles.

Fundraising has remained extremely difficult in 2010: funds that closed in the first three quarters of the year raised $191.7bn, less than the $233.1bn raised in the same period the year before.

To gain an indication of what can be expected in terms of fundraising in 2011, Preqin surveyed a global sample of 100 institutional investors in private equity in December 2010 in order to assess their current attitudes to the market and their plans for future investments in the asset class.

Low Levels of Activity in 2010

Last year's survey, conducted in December 2009, found that 40% of LPs had opted not to make any new commitments to private equity funds over the course of that year. Little changed in 2010. 42% of respondents to our December 2010 survey told us they had not made a single commitment to a fund during 2010.

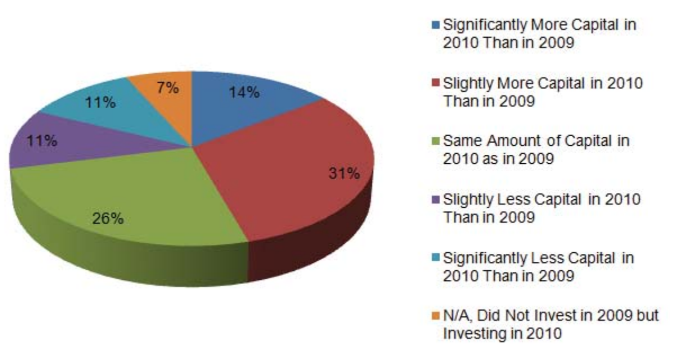
Fig. 1 shows, for those that committed to funds in 2010, how the amount of capital used for these commitments compared to the amount committed the year before. Although a significant 22% of respondents informed us the amount of capital they committed to funds in 2010 was less than the amount they committed across funds in 2009, almost a third (31%) committed slightly more capital in 2010 compared to 2009 and a notable 14% committed significantly more capital.

The vast majority of investors are currently at or above their target allocations to private equity. As Fig. 2 shows, 13% of investors are exceeding their target allocations. The proportion of LPs that have yet to reach their target allocations has fallen by 12 percentage points from 45% in December 2009 to 33% in December 2010 and more LPs are finding themselves at their targeted level of exposure to the asset class.

"The vast majority of investors are currently at or above their target allocations to private equity..."

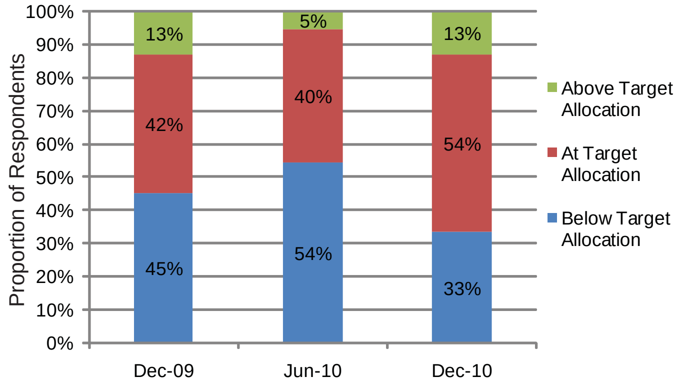
When the responses from LPs in different regions are compared, we can see that a considerable 18% of North American LPs are exceeding their target allocations, significantly more than the 10% of European respondents and 11% of Asia and Rest of World respondents that are also over-allocated to private equity. 40% of European investors are in fact below their target allocations.

Fig. 1: Amount of Capital Investors Committed to Private Equity Funds in 2010 Compared to 2009



Source: Preqin

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



Source: Preqin

LPs' Returns Expectations

Over the past couple of years, LPs have seen the valuations of many of their private equity fund investments fall significantly. Despite this, the vast majority feel their private equity investments have met or exceeded their expectations.

Fig. 3 shows how investors' levels of satisfaction with their private equity investments have changed over the past few years. In December 2007, 24% of LPs felt their private equity investments had exceeded their expectations. In December 2009, the proportion of LPs expressing this opinion had fallen to 7%. A slight improvement in LP satisfaction levels was seen in December 2010, when 10% of respondents felt their private equity investments had exceeded their expectations.

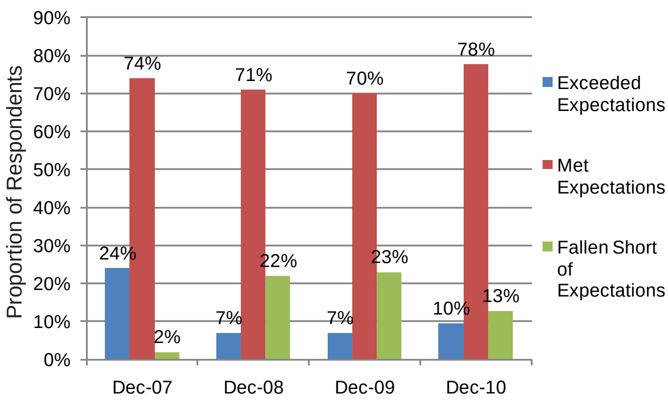
The proportion of investors that are dissatisfied with the performance of their private equity investments rose considerably from 2% in December 2007 to 23% in December 2009. However, in December 2010, the proportion of LPs expressing this view dropped back to 13%.

"Some of the respondents to our survey were keen to point out that investors need to rethink their return expectations..."

It is worth noting that investors' return expectations for their private equity investments have risen significantly over recent years. As Fig. 4 shows, in December 2010, a considerable 63% of respondents were expecting to receive returns of more than four percentage points over public markets, a significantly higher proportion than was seen in 2007, when just 17% of respondents to the survey had similar expectations for the returns from their private equity portfolios.

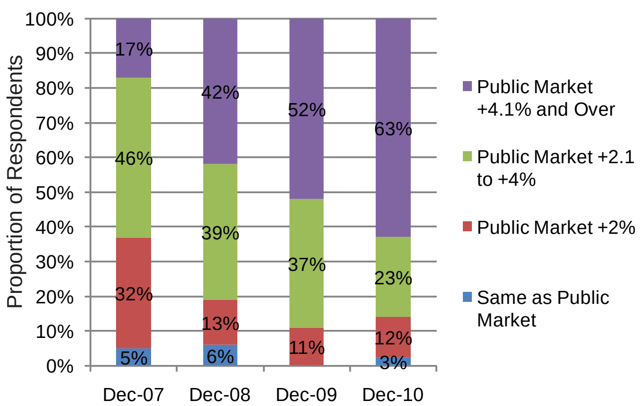
Some of the respondents to our survey were keen to point out that investors need to rethink their return expectations. As a Swiss pension fund stated, "LPs have to reassess the landscape and think about what are realistic returns going forward. Funds have achieved exceptionally high returns in recent years but LPs need to be realistic now. They need to find the best way to allocate and position themselves in the current market."

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



Source: Preqin

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



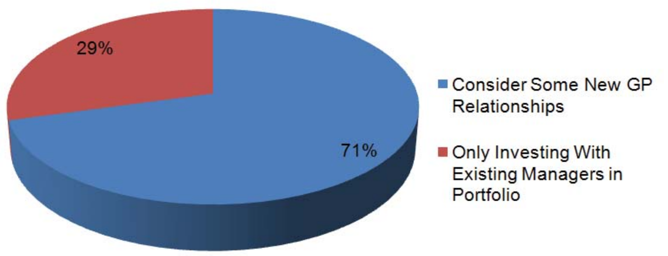
Source: Preqin

Re-Ups and New Relationships

More than half (57%) of funds that closed in 2008-9 secured over a quarter of their committed capital from LPs that had not invested with them previously. With investors placing the GPs in their portfolios under increasing scrutiny and investing at a slower pace, many will opt not to reinvest with certain managers in their portfolios, meaning GPs need to be prepared to source even more capital from new investors.

Encouragingly for GPs intending to fundraise in 2011, a significant proportion of investors are still open to forging new fund manager relationships. 71% of respondents to the survey that are seeking to make new commitments to private equity funds during 2011 will consider forging new relationships with GPs during this time.

Fig. 5: Proportion of LPs Currently Investing That Are Considering Establishing New Relationships with GPs in 2011

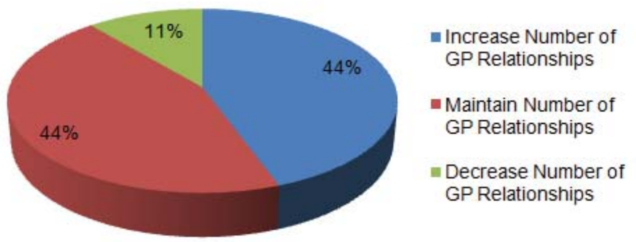


Source: Preqin

Many LPs are also keen to increase the number of relationships they maintain with fund managers, as shown in Fig. 6. During 2011-12, 44% of respondents that will make new commitments during this timeframe anticipate increasing the number of GP relationships they possess and a further 44% expect to continue to invest with the same number of managers. Just 11% anticipate reducing the number of GPs in their portfolios.

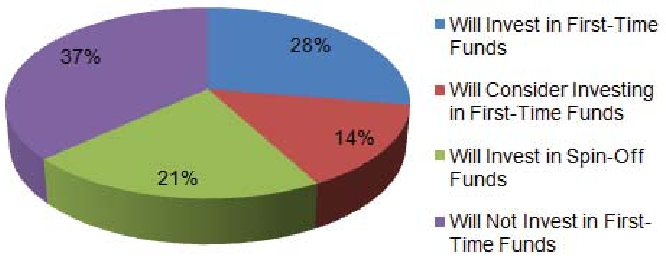
Investors have remained relatively cautious with regards to funds being raised by emerging managers. As shown in Fig. 7, a considerable 37% will not invest in first-time funds. Just 28% are open to investing in first-time funds managed by new teams, although a further 14% will consider such an investment in exceptional circumstances. It is worth noting that when asked about their attitudes to first-time funds in December 2009, 47% of respondents to that survey informed us that they would not invest in first-time funds, a significantly higher proportion than the December 2010 survey.

Fig. 6: Likely Changes to Number of GP Relationships Maintained by Investors in Next Two Years



Source: Preqin

Fig. 7: Proportion of Investors That Will Consider Investing in First-Time Funds in the Next 12 Months



Source: Preqin

What Can GPs Do To Stand Out?

With more than 1,600 funds on the road seeking aggregate commitments of $600 billion as of December 2010, fundraising in 2011 is set to be extremely competitive. What can GPs do to improve their chances of securing commitments to their funds? We asked LPs for their insights into what makes a GP or fund stand out from the crowd.

“GPs need to show a decent track record, recent realized performance, a stable portfolio and good returns in the last two to three years, a value-added aspect and a stable team even during the downturn.” A Swiss private sector pension fund

“GPs will need to show a differentiated strategy, something different from the ‘beaten track.’” A German family office

“I like good terms on co-investment deals, and more sweetheart deals.” An Irish family office

“We look for managers that encourage co-investments. Managers that are in the news a lot for good reasons are also attractive to us.” A US investment company

“We want LP-friendly terms, close to ILPA [Institutional Limited Partners Association] standards, a good track record and a good team.” A Canadian private sector pension fund

“We seek a good track record, strong performance and competitive fees and carry.” An Israeli pension fund

“Funding private equity investments with high levels of debt is no longer a viable option. Private equity firms need to roll up their sleeves and get stuck in, making improvements and adding value to companies.” A UK private sector pension fund

“We require more transparency on fund structure.” A Swedish corporate investor

“Many average investors prior to the financial crisis rode the wave of leverage buyouts and did it very well. Now these managers are struggling. Managers now need to be able to add value to companies rather than loading them with debt.” A UK private sector pension fund

“GPs need to show that they have managed the crisis well. Their portfolios need to be in good shape and they need to be able to show they can do deals going forward.” A German asset manager

“Track record, operational experience, and having a ‘good feeling’ about a fund – this is obtained through good marketing, personal references and connections. Network investing is very important.” A Danish bank

“To secure a commitment it takes the right fund being presented at the right time.” A UK public pension fund

Key Geographies and Strategies in 2011

As 2010 draws to a close and LPs look to the year ahead, many will be laying out investment strategies for 2011 and planning where to place their capital to best take advantage of opportunities in the current market.

We asked investors which types of fund they feel are presenting the best opportunities in the current climate and which they are looking to make commitments to during 2011. Respondents were invited to name any fund types that they felt fit these categories and were not prompted to give their opinions on each fund type individually. Therefore the results, displayed in Fig. 8, represent the types of fund that are at the forefront of LPs' minds.

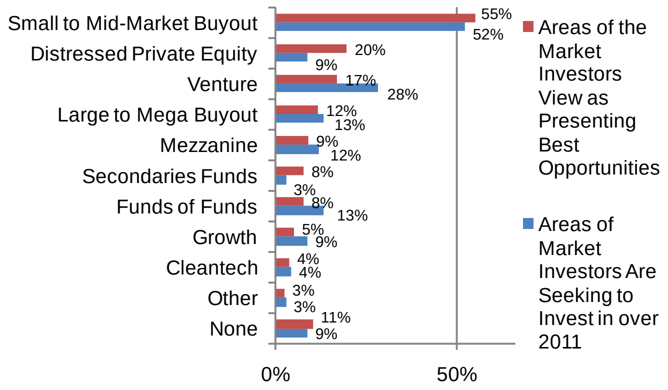
"Investor appetite for distressed private equity funds rose considerably over the past couple of years ..."

Small to mid-market buyout funds are continuing to attract a significant degree of investor interest, with 55% of respondents naming them as a fund type currently presenting good opportunities and 52% stating an intention to make commitments to funds of this type in 2011. Investor appetite for distressed private equity funds rose considerably over the past couple of years and our December 2010 survey saw these funds continue to attract a significant degree of interest, with 20% of respondents naming these funds as attractive in the current market. However, it is worth noting that just 9% stated an intention to make commitments to these vehicles.

The proportion of LPs with an appetite for investments in emerging markets has shown little change over the past year. 70% of respondents to our December 2010 survey either currently invest or will consider investing in emerging markets, in comparison to 67% of respondents to our survey the year before.

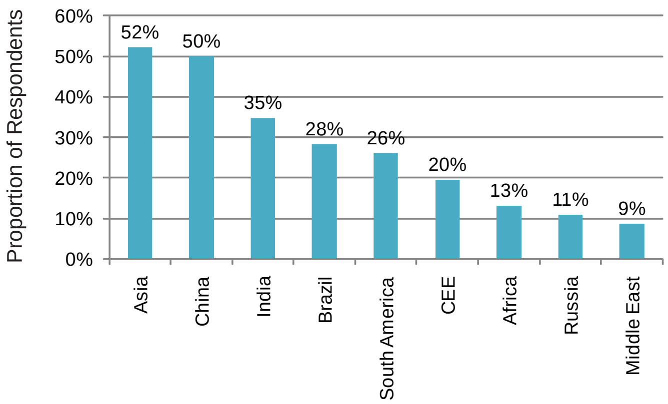
Fig. 9 shows the regions or countries within emerging markets that investors told us were presenting the best opportunities for investment at present. Half of respondents told us China was particularly attractive and 52% named Asia. Other regions/countries to receive particular interest from LPs include India (named by 35% of respondents), Brazil (28% of respondents) and South America (26% of respondents).

Fig. 8: Investor Attitudes to Different Fund Types at Present



Source: Preqin

Fig. 9: Regions and Countries within Emerging Markets That Are Viewed as Presenting the Best Opportunities in the Current Financial Climate



Source: Preqin

Direct, Co-Investments and Secondaries

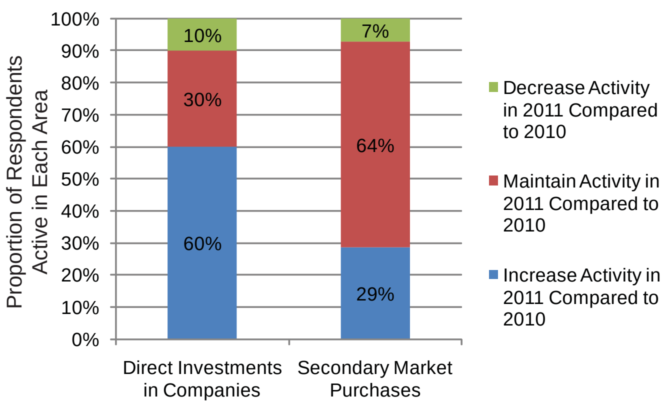
Investors that have traditionally gained the entirety of their exposure to private equity through primary investments in funds are increasingly looking at other ways to access the asset class. Direct private equity investments in companies and purchases of fund interests on the secondary market are being seen as attractive alternatives by a growing number of LPs.

LPs opting to invest directly in companies can do so as either a co-investor alongside GPs in their portfolios or as a direct investor investing on a proprietary basis. Of the 43% of respondents to our survey that invest directly in companies, 51% (or 22% of overall respondents to the survey) invest in companies directly on a proprietary basis and 71% (or a third of overall respondents to the survey) co-invest alongside the GPs in their portfolios.

Fig. 10 shows the proportion of LPs active in direct investments that plan to increase, decrease or maintain the level of their activity in this area in 2011. 60% of investors that already invest directly plan to increase their activity in direct investments or co-investments in 2011 and a further 30% plan to continue to set aside the same amount of capital to direct investments in 2011 as they did in 2010.

The secondary market attracted a considerable degree of attention from LPs in the wake of the financial crisis, with many keen to take advantage of opportunities to purchase fund interests from distressed sellers at attractive discounts to NAV. The majority (80%) of the investors surveyed in December 2010, however, informed us that they are not active as purchasers of fund interests on the secondary market. Of those that are, 29% informed us that they intend to deploy more capital in this area during 2011 than they did in 2010 and a further 64% intend to set aside the same amount of capital for secondary market purchases.

Fig. 10: Investors' Expectations of the Level of Both Direct Investment and Secondary Market Activity in 2011 Compared to 2010



Source: Preqin

Challenges Facing LPs in 2011

We asked investors what particular challenges they were facing in relation to their private equity investments at present. These issues should be taken into consideration by GPs when approaching LPs for investments in the year ahead.

“Unlike the bull days when many private equity managers had positive returns attributable to market movements not skills, nowadays LPs have to ensure they work with the right managers and have the appropriate private equity strategy for their risk profile.” A South African investment bank

“There’s a shortage of good funds. It has become a huge business and is now filled with too many players who don’t know what they are doing. LPs have to be very careful with due diligence.” A US asset manager

“There is still intense competition for entry into high-quality funds, especially with smaller managers.” A UK investment trust

“A lot of LPs have deviated from the long-term strategies they set out three or four years ago and have taken on a short-term outlook and are missing the opportunities that are far more significant.” A US asset manager

“The liquidity squeeze since 2007 has got many investors in private equity in trouble.” A Danish bank

“Maintaining a balance between capital calls and distributions to stay at target.” A Canadian private sector pension fund

“There is pressure on GPs to invest due to the backlog of commitments, which is leading to them overpaying on deals, meaning poor returns; new commitments and the subsequent J-curve effect are also amplifying current negative returns.” A US endowment

“A large amount of capital is chasing few deals, which has a negative impact on returns. The challenge is finding GPs that source proprietary deals and are able to operate in a low-growth environment to generate value from portfolio companies.” An Austrian family office

“Re-adjusting to poorer returns is a challenge.” A US public pension fund

“The biggest challenges facing LPs currently are falling secondary market prices for private equity funds, illiquidity in private equity portfolios, and questionable or nil premiums over public markets for private equity investments.” A UK private sector pension fund

“Banks face great uncertainty as to how Basel III will impact their private equity portfolios.” An Italian bank

“Regulations – specifically the expected Solvency II regulations which might impose higher equity requirements for private equity investments.” A Finnish insurance company

“The market is not very transparent. Reports from GPs are quarterly so there are lags from fund events... GPs are not very forthcoming with additional information requests.” A Danish public pension fund

“We do not feel there are any real challenges. There are a lot of good opportunities right now and the only hindrance is risk appetite and the capital available to the LP.” A UAE investment company

Allocations and Commitments: 2011 and Beyond

Despite encouraging evidence that suggested a return of investors to private equity, the amount of capital committed to new private equity funds during 2010 fell below expectations. So what can be expected for fundraising in 2011?

Our survey found that 62% of LPs are intending to make new commitments to funds during 2011. In fact, just under half (49%) of respondents anticipate making their next commitment to a private equity fund by mid-2011. A considerable 30% of respondents have yet to decide on their future private equity plans; many of those surveyed were in the process of finalizing their investment plans for 2011 and were unable to say whether they would make new commitments to funds in the year.

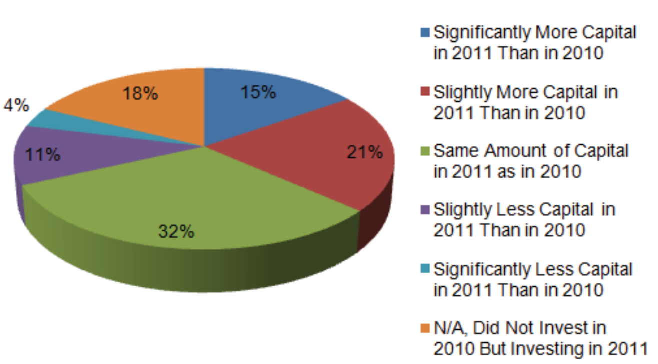
"There will also be many investors that do have capital available to commit – to the right private equity funds..."

The pace at which investors make new commitments to funds is also in many cases set to increase in 2011. As Fig. 11 shows, more than two-thirds, 68%, of LPs that are looking to make new commitments in 2011 expect to either increase or maintain the pace of their commitments that year in comparison to 2010. In fact, 15% of respondents anticipate committing significantly more capital to private equity funds in 2011 than in 2010. Just 15% expect to commit less capital. An important 18% of respondents to this question did not make new commitments to private equity funds in 2010 but expect to do so in 2011, evidence that a growing number of LPs that had suspended their private equity investments during 2009-10 are intending to return to the asset class in the next year.

The results of Preqin's December 2010 survey of LPs point to a gradual improvement in fundraising over the coming year. The longer-term outlook is also promising, with 90% of LPs intending to increase or maintain their allocations to private equity over the next three to five years, as illustrated by Fig. 12. Private equity will therefore remain an important part of many investors' portfolios.

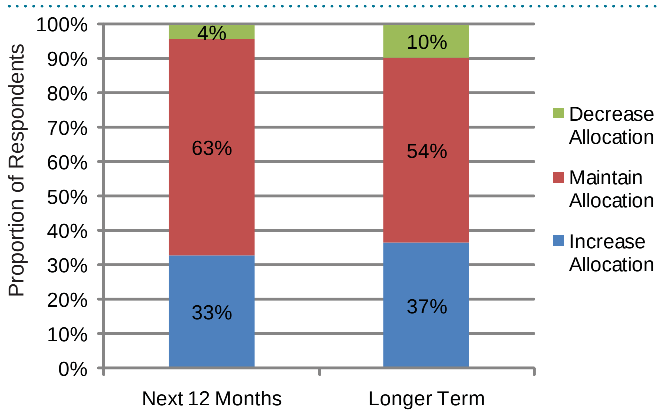
There will still be investors without capital available to commit to new funds in the coming year: as a Middle Eastern LP told us, "There are a lot of good opportunities right now and the only hindrance is the risk appetite and capital available to the LP." However, there will also be many investors that do have capital available to commit – to the right private equity funds. Competition for LP dollars will therefore remain fierce. Managers with strong track records and with interesting offerings may find fundraising conditions somewhat easier in 2011 than in 2010, although those showing weaker fund performance will struggle to raise capital in the year ahead.

Fig. 11: Amount of Capital Investors Plan to Commit to Private Equity Funds in 2011 Compared to 2010



Source: Preqin

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.

Thousands of industry professionals regularly rely on Preqin's data to help focus their investor relations and fundraising activities, with hundreds of top fund managers and 19 of the top 20 placement agents regularly using Preqin products and services to assist them in identifying investor targets and to ensure that they are up-to-date on the latest developments in the institutional investor universe.

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

Investor Intelligence

Investor Intelligence is a powerful online database featuring details of over 4,000 LPs, with more being added every day. Constantly updated by our team of dedicated researchers, it represents the most comprehensive and accurate source of investor information today, with global coverage and exclusive information not available anywhere else.

- 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.
- Premium subscribers can download targets and contact details to Excel.
- Included as part of Preqin's Private Equity online service, or available as a separate module.

Preqin 2010 Limited Partner Universe

The Limited Partner Universe is a 600-page publication featuring a directory of over 2,700 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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