Private Equity Funds of Funds’ Evolving Investment Strategies

Changes in Allocations
How have funds of funds changed their allocations to different private equity fund types?

Geographical Preferences
How can funds of funds offer advantages to smaller and less experienced LPs looking to get access to different regions?

Co-Investments and Secondaries
Fund of funds managers are often involved in the secondary market and co-investment opportunities. What are the latest developments?

Market Sentiment
How are fund of funds managers viewing the private equity industry at present? What are their attitudes towards first-time funds?
Data Source

The following report on funds of funds draws exclusively from Preqin’s New Funds of Funds Advanced Search. The new feature available on Preqin’s Investor Intelligence database allows users to identify individual funds of funds based on investment preferences, future plans and more. Subscribers are able to view comprehensive profiles for over 1,600 funds of funds in a separate fund profile.

Investor Intelligence is the leading tool in helping fund managers find institutional investors with a pre-qualified stated preference for their vehicle, along with direct contact details to get you in touch with the key decision makers.

For more information, or to request an online demonstration of the service, please visit www.preqin.com/ii.

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Fund of funds managers are an important link between institutional investors and private equity fund managers. For smaller LPs without the resources to hire dedicated private equity staff or to create a portfolio of investments with the required diversification, or for newer LPs that lack experience of the asset class, fund of funds managers can act as an outsourced private equity division.

However, ongoing volatility in global financial markets has left fund of funds managers feeling the strain and under pressure to find ways to maintain their position in the market. In 2011, funds of funds that reached a final close raised just $16.0bn, slightly more than in 2010 ($15.8bn) but significantly less than the $28.7bn raised by funds of funds that closed in 2009 and the $51.1bn raised by closed funds of funds in 2008. Fundraising conditions are extremely competitive and managers are frequently finding it challenging to secure commitments from cautious investors that are often willing to hold off from making new investments while conditions remain so volatile. Adapting to these uncertain times will be vital for fund of funds managers in the months ahead.

Funds of funds also offer investors the ability to gain exposure to regions they have no experience of investing in. Fig. 1 shows the breakdown of the total capital committed to funds of funds that reached a close during 2008-09 and 2010-11, and the target of those currently raising capital, by the regions in which capital is destined to be invested. Thirty-seven percent of the capital raised by funds of funds that closed in 2010-11, and 36% of the capital targeted by vehicles currently on the road, is allocated to North America, a decline from the 47% of capital raised by funds of funds that closed in 2008-09. Europe’s share of capital also declined from 37% for funds closed in 2008-09 and in 2010-11, to 23% among those currently seeking capital. Asia’s share of capital, on the other hand, has risen over this period, from 13% for funds closed in 2008-09 to 23% for funds closed in 2010-11 and to 34% among funds of funds in market. Rest of World has also seen an increase in allocation from 3% for funds closed in 2008-11 to 7% for funds of funds currently on the road. The increased allocations to Asia and Rest of World are a sign of increased limited partner appetite for exposure to the regions.

Funds of Funds
Closed 2008-09
Funds of Funds
Closed 2010-11
Funds of Funds
Currently Raising

<table>
<thead>
<tr>
<th>Region</th>
<th>2008-09</th>
<th>2010-11</th>
<th>Currently Raising</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>47%</td>
<td>36%</td>
<td>34%</td>
</tr>
<tr>
<td>Europe</td>
<td>37%</td>
<td>23%</td>
<td>23%</td>
</tr>
<tr>
<td>Asia</td>
<td>13%</td>
<td>37%</td>
<td>34%</td>
</tr>
<tr>
<td>Rest of World</td>
<td>3%</td>
<td>0%</td>
<td>7%</td>
</tr>
</tbody>
</table>

Identify Funds of Funds with Specific Mandates and Strategies

Preqin holds details of more than 1,600 funds of funds, including information on their investment plans, strategies and contact details for key personnel.

Using the Fund of Funds Advanced Search feature on Investor Intelligence, you can filter vehicles by:

- Fund Type Preferences
- Country/Regional Allocations
- Planned Investments in Next 12 Months
- Attitudes to First-Time Funds
- Allocations to Secondaries and Co-investments
- Fund Size
- And more...

For more information on Investor Intelligence, or to register for an online demonstration of the service, please visit www.preqin.com/ii or contact us at info@preqin.com.
Changes in Allocations to Different Fund Types

Fund strategy can provide an additional dimension of diversification to a fund of funds vehicle offering broad exposure to the asset class, with many vehicles investing in both buyout and venture capital, as well as strategies that have increased in popularity recently, such as distressed debt or special situations. Over the years, as investors’ appetite for particular fund types has evolved, fund of funds managers have also changed their strategies to meet their investors’ requirements.

Fig. 2 show the proportion of capital allocated to each fund type by funds of funds, derived from the estimated allocations stated by vehicles that held a final close in the period 2008-09 and 2010-11, and from the target of funds of funds currently raising capital. Buyout remains the most supported strategy, rising from 54% for vehicles closed in 2008-9 to 59% for vehicles closed in 2010-11 and dropping slightly to 55% among funds of funds currently on the road. Venture capital’s allocation declined to 24% for vehicles closed in 2010-11 but has increased again among those vehicles raising capital to 37%.

The proportion of capital allocated to other fund types remained steady at 17% for funds closed in 2008-09 and 2010-11. However, it has decreased slightly for funds of funds currently seeking capital as they typically expect to invest 8% in other fund types. Nonetheless, these other types, including distressed private equity, growth capital, natural resources, special situations and mezzanine, continue to gain a considerable amount of attention in the current climate.

During a survey of over 100 fund of funds managers carried out by Preqin in Q4 2011, fund of funds managers were asked which types of funds they felt were offering the most attractive opportunities for private equity investors in the prevailing financial climate. As Fig. 3 shows, a considerable 79% of fund of funds managers selected small to mid-market buyout funds as particularly attractive. Venture capital was selected by 42% of the managers, an increase from 14% of those surveyed the previous year. Growth capital and distressed private equity funds were also a popular selection with over 39% and 36% respectively indicating those fund types as attractive in the current climate. Nine percent of respondents indicated that large to mega buyout funds were attractive, compared with none of those surveyed in the previous two years.
In addition to making primary commitments to private equity funds, fund of funds managers will often set aside a proportion of their vehicles’ capital to make purchases of fund interests on the secondary market or to invest in direct co-investments alongside GPs in certain portfolio investments. Typically, such investments are done on an opportunistic basis and managers consequently will set a maximum amount of capital that can be used for investments of these types.

Fifty percent of funds of funds that closed in 2008-09 had the capacity to purchase fund interests on the secondary market, compared with 62% of funds of funds that closed in 2010-11. This has decreased slightly for funds of funds currently raising as 58% have the capacity for secondary investments.

Forty-four percent of funds of funds on the road are able to use capital to make direct co-investments, compared with 41% of funds of funds that closed in 2010-11 and 34% of funds of funds that closed in 2008-09.

Fig. 4 shows how the aggregate capital committed to funds of funds is planned to be split between the different strategies. This is based on the allocations initially set aside by fund of funds managers. Since both secondary market and direct investments are typically undertaken on an opportunistic basis, planned allocations have been analyzed to estimate the proportions of capital to be used for each type of investment.

The proportions allocated to secondary investments increased from 7% for vehicles closed in 2008-09 to 12% for vehicles closed in 2010-11, evidence of the growing degree of interest shown by institutional investors in gaining access to the secondary market and taking advantage of the opportunities available. However, this has decreased slightly for funds of funds currently raising capital as they will typically allocate 9% of capital to secondary investments.

While there has been a decrease in the allocation to secondary investments in funds of funds currently raising, there has been an increase in the proportion of capital allocated to direct co-investments. Funds of funds currently raising plan to invest approximately 14% of capital in direct co-investments, compared with just 7% for vehicles that closed in 2010-11, which shows that fund of funds managers and their investors are willing to take on the greater risks associated with such investments in return for reduced fees and potentially higher returns.

Attitudes Towards First-Time Funds

Fund of funds managers are prominent backers of first-time funds. Fund of funds managers possess the experience and expertise to perform thorough due diligence on this group of managers that lack an investment track record as a combined entity. Institutional investors often prefer to access emerging managers through funds of funds for this reason, as well as the diversification offered to mitigate the risks involved with investing with new managers, while potentially gaining from outperformance over established managers.

Fig. 5 illustrates individual fund of funds vehicles’ attitudes towards first-time funds. The overall proportion of funds of funds that have some level of interest in investing in first-time funds has increased over time. Eighty-four percent of funds of funds that closed in 2008-09 would consider investing in first-time funds, including spin-off funds, compared with 85% for funds of funds that closed in 2010-11 and 91% of funds of funds currently on the road seeking capital.
As part of the survey of fund of funds managers carried out in Q4 2011, respondents were asked which factors they thought were of the most importance to the private equity industry. Managers were invited to rank each factor on a scale of 1 to 5, where 1 means “not important” and 5 means “very important”. Fig. 5 shows the average ratings that fund of funds managers gave each factor. Economic uncertainty is at the forefront of concern for fund of funds managers with the highest average rating of 4.1, up from the 3.6 average rating in the Q4 2010 survey. This is unsurprising given the continuing sovereign debt crisis in Europe that threatens to derail recovery. Exit opportunities continue to be viewed as an important issue with an average rating of 3.9 (the same as Q4 2010). Investor confidence has been hit by the economic uncertainty impacting the reliability of the stock markets in particular as an exit avenue.

Despite a number of concerns facing fund of funds managers, they are set to remain prominent investors in the asset class over the next 12 months. Of the fund of funds currently deploying capital that have stated their investment plans for the next 12 months, 32% will be committing $1-20mn to new funds over the next year, a further 23% will be committing $21-50mn and 19% will be committing $51-100mn. A considerable 26% of active funds of funds will be committing over $100mn to private equity funds over the next year.

Preqin’s Fund of Funds Data

Preqin provides comprehensive information on all aspects of private equity fund of funds data, including:

- Profiles for more than 300 managers actively investing in funds, including key contacts, past investments, preferences and future investment plans
- Filter actively investing funds of funds to identify vehicles targeting specific regions, fund types and strategies
- Details of over 1,400 funds of funds raised historically
- Over 160 funds of funds on the road seeking capital
- Performance information for more than 730 fund of funds vehicles.

For more information on the fund of funds data available through Preqin’s Private Equity Online Platform, or to register for an online demonstration of the service, please contact us at info@preqin.com.
2012 Preqin Private Equity Fund of Funds Review

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.

Now into its sixth edition, the 2012 Preqin Private Equity Fund of Funds Review has been completely updated to provide the most comprehensive and up-to-date guide available yet.

Key content includes:

- Detailed Manager Profiles
- Fund Profiles: Recent and forthcoming vehicle-specific details for each manager’s funds.
- Sample Investments & Fund Preferences: On both a fund- and firm-specific basis.
- Performance: Key fund performance metrics for over 600 individual funds of funds
- Listed Vehicles: Detailed profiles for 25 listed funds of funds
- LP Investors: Detailed profiles for 150 LP investors investing in funds of funds and key investors to watch.
- Fundraising: In-depth listings of all funds of funds closed during 2010 and 2011 and funds currently raising capital.
- Analysis: Detailed analysis on all aspects of funds of funds.

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Preqin provides information, products and services to private equity and venture capital firms, funds of funds, investors, placement agents, law firms, investment banks and advisors across the following main areas:

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• Buyout Deals
• Fund Performance
• Fundraising
• Investor Profiles
• Fund Terms
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Our customers can access this market intelligence in three different ways:

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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

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