Private Equity in 2012: Fundraising, Deals and Investor Attitudes

Antonia Lee takes a look back over the key features of the 2012 private equity fundraising market, to examine the trends in fundraising, investor appetite and, deal activity, and looks at what we can expect from the private equity market in 2013.

The fundraising environment in 2012 has continued to be testing for fund managers, with the number of funds reaching a final close over the course of the year standing at 698 compared to 910 in 2011. The aggregate capital raised by the funds that closed in 2012, however, has seen a small improvement on 2011 levels, with funds closed having raised an aggregate $315.4bn over the course of the year, slightly more than the aggregate $311.7bn raised by funds that closed in 2011. Preqin's December 2012 private equity investor study also revealed that the majority of LPs remain active in the asset class, continuing to seek investment opportunities in the future.

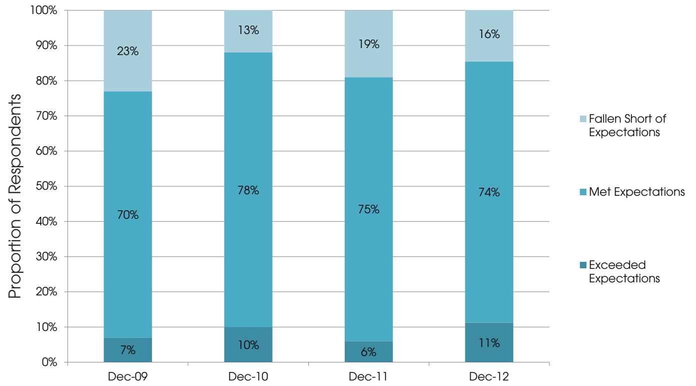
Are Investors Still Satisfied With Their Private Equity Investments?

Investors remain positive about the performance of their private equity investments, with an increasing proportion of investors stating that their private equity investments have exceeded their expectations. Eleven percent of investors interviewed by Preqin in December 2012 felt that their private equity investments had exceeded their expectations, almost double the proportion that gave this response in 2011. In addition, 74% of LPs interviewed felt that their expectations have been met, similar to the 75% of investors that gave this response in December 2011. At the same time, the proportion of investors interviewed that felt dissatisfied with their private equity investments has shown a decrease of three percentage points, from 19% in December 2011 to 16% in December 2012, suggesting that LPs currently have a more positive view of the asset class than they did at the same time last year.

Private equity investments require long-term commitments from investors, but also have the potential to provide superior returns to public markets, even amid global economic uncertainty; investors expect a premium on performance to compensate for the lack of liquidity. Examining horizon IRRs for the asset class, which provide a snapshot of the performance of the private equity industry over a set period of time, reveals that over one and three years to 30 June 2012 the performance of private equity as a whole is similar to that of the S&P 500. However, since investing in private equity is generally a long-term commitment, it is also important to view performance over longer term horizons. Over the five and ten years to 30 June 2011, private equity has demonstrated outperformance over the S&P 500. The 10-year horizon return to 30 June 2012 for the private equity industry as a whole is 12.3%, highlighting that over the long term, private equity can offer attractive returns to investors.

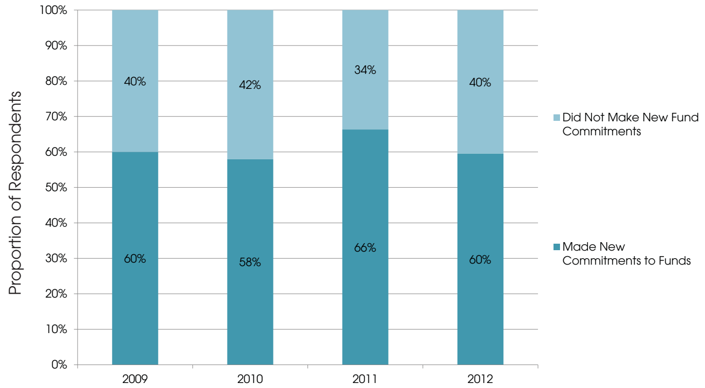
Investors are also continuing to make new commitments to the asset class, with 60% of investors interviewed in December

Fig. 1: Proportion of Investors that Feel Their Private Equity Fund Investments Have Lived up to Expectations



Source: Preqin Investor Survey, December 2012, 2011, 2010 and 2009

Fig. 2: Proportion of Investors that Made New Commitments to Funds, 2009 - 2012



Source: Preqin Investor Surveys, December 2012 and 2011

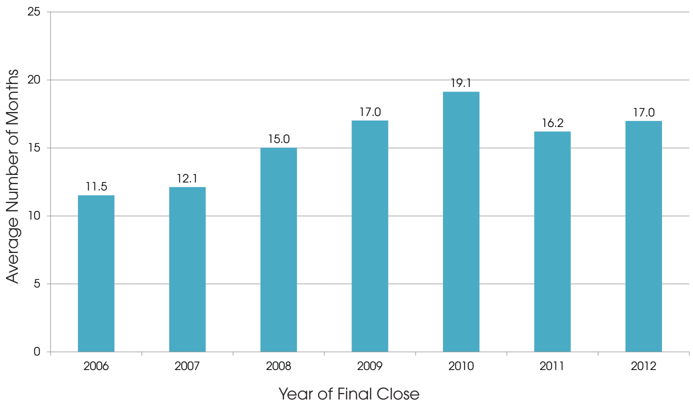
2012 having made new commitments to private equity funds in 2012, indicating that the majority of investors remain active in the asset class. However, this figure is slightly below the two-thirds of investors in a similar survey in December 2011 that reported making new fund commitments in 2011 (Fig. 2).

Are Fundraising and Investment Conditions Beginning to Improve?

Investor confidence in their private equity investments has helped the private equity fundraising market stabilize in recent years, despite global economic uncertainty. While the fundraising market was very competitive in 2012, and the proportion of investors making commitments decreased slightly compared to 2011, the year ended with slightly more capital collected by closed funds than in 2011. Since 2008, the average amount of capital raised globally has stabilized at approximately $300bn each year, with 2012 showing a slight improvement at $315.4bn. Additionally, a high proportion of funds managed to close at or above their targets in 2012, demonstrating that there is still demand among LPs for funds which can present attractive investment opportunities. In 2012, 20% of funds closed on target, a decrease on the 22% of funds reached their target exactly in 2011. However, a greater proportion of funds in 2012 exceeded their fundraising targets. In 2011, 36% of funds that held a final close raised more than 100% of targeted capital, but this increased to 40% in 2012.

However, as demonstrated in Fig. 3, the amount of time taken to raise a fund has increased over the past year, from an average of 16.2 months for funds that achieved a final close in 2011 to 17 months for funds closed in 2012. Nonetheless, this represents an improvement on the length of time taken to secure capital commitments by funds that closed in 2010, when the average fund took 19.1 months to raise capital from investors and hold a final close.

Fig. 3: Average Time Taken for Funds to Achieve a Final Close by Year of Fund Close



Source: Preqin Funds in Market

Deals and Exits

Deal flow and exit flow have also both shown improvement over 2012, meaning investors saw slight increases in capital call-ups and the level of distributions from their investments. While there was a difficult opening to the year due to continued turbulent market conditions, 2012 has seen buyout deal flow approach the post-Lehman high level of deal flow for 2011 in deal number and aggregate value. In particular, North America recorded a post-2008 high of 1,590 buyout deals valued at an aggregate $152.3bn. In contrast, European deal levels have fallen from 951 in 2011 to 813 in 2012. Venture capital deal flow also saw an increase, with 5,117 deals valued at $39.1bn announced globally in 2012, a 13% increase in the number of venture capital deals globally in comparison to 2011.

Although buyout exit flow in 2012 has witnessed a decrease in comparison to the previous year, the $275.2bn in exits during the year represents the second strongest year for buyout-backed exits since 2006, as private equity firms continue to exit some of their investments made during the buyout boom era of 2005-2007 and distribute their returns to their investors. This includes major exits in 2012, such as the $6.6bn sale of Cequel Communications to BC Partners and CPP investment Board by a group of investors including Goldman Sachs, Merchant Banking Division, Quadrangle Group, Oaktree Capital Management and others, which acquired the firm in 2006, and the $3bn sale of a majority stake in AOT Bedding Super Holdings by Ares Management and Teachers' Private Capital to Advent International.

Investor Strategies for the Next 12 Months

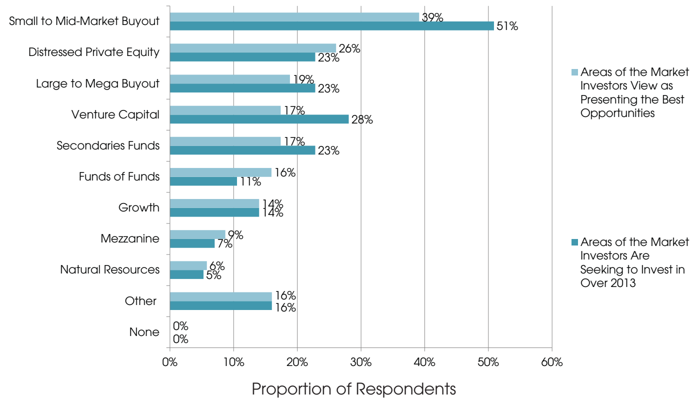
Fundraising levels will likely continue to be impacted by investor confidence in the asset class. Encouragingly, many LPs are looking to make new investments in the future, with the majority of investors expecting to maintain the level of their private equity allocations over the next 12 months. Fifty-nine percent of investors expect to maintain their allocations to private equity in 2013 and 48% expect to maintain their allocation into the longer term. In addition, the percentage of investors that plan to increase their private equity allocations in the longer term has increased by five percentage points from 28% in December 2011 to 33% in December 2012.

However, 19% of investors plan to decrease their private equity allocations in the longer term, an increase of seven percentage points compared to December 2011. Competition in the fundraising market remains intense, with 1,940 private equity funds in market targeting an aggregate $795bn as of January 2013, an increase from the 1,814 funds that were on the road at the same time last year. As a result, it is essential for fund managers to know where investors wish to allocate their capital. In our December 2012 investor study, we asked LPs which fund types they think are currently presenting the best opportunities in the current market and which funds they will be looking to target over the next 12 months.

As illustrated in Fig. 4, small to mid-market buyout funds continue to be the fund type that investors view as offering the best investment opportunities. Thirty-nine percent of investors believe these funds are presenting the most attractive opportunities, while 51% of LPs told us they plan to invest in funds of this type in 2013. This is promising for fund managers, as buyout funds are seeking the greatest proportion of the aggregate capital sought by funds on the road of any strategy at the beginning of 2013; 270 buyout funds are targeting a collective $229.8bn from investors. Distressed private equity also remains highly attractive to many LPs, as 26% of investors believe they are presenting the best opportunities and 23% are seeking to invest in distressed private equity funds in 2013, which is encouraging for the 70 distressed private equity funds targeting an aggregate $49.8bn from investors.

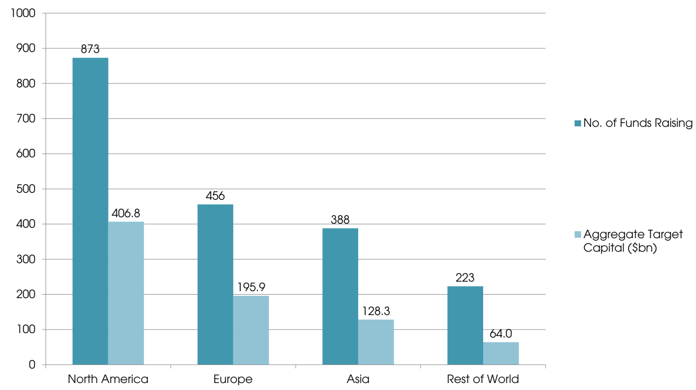
Investors were also asked which regions they feel are currently presenting the best opportunities in the current financial climate. North America was the region named by the highest proportion of investors we interviewed, with 44% of investors viewing the region as offering attractive investment opportunities at present. This is encouraging news for managers as funds primarily focused on North America are the most numerous, with 873 vehicles targeting $406.8bn in aggregate commitments (Fig. 5). Despite recent

Fig. 4: Investor Attitudes Towards Different Fund Types at Present



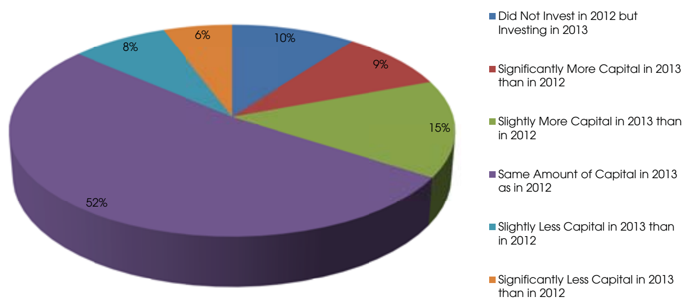
Source: Preqin Investor Survey, December 2012

Fig. 5: Breakdown of Funds Currently on the Road by Primary Geographic Focus



Source: Preqin Funds in Market

Fig. 6: Amount of Capital Investors Plan to Commit to Private Equity Funds in 2013 Compared to 2012



Source: Preqin Investor Survey, December 2012 volatility in Europe, 40% of investors feel that Europe remains an attractive region to invest in and there are currently 456 Europe-focused funds on the road seeking an aggregate $195.9bn in capital commitments. Forty-one percent of investors named Asia and Rest of World as presenting the best opportunities.

Expectations for 2013 and Beyond

Despite continuing uncertainty in financial markets, LPs maintain an appetite for investing in the private equity asset class, with over three-quarters of LPs (76%) expecting to commit more or the same amount of capital to private equity funds in 2013 as in 2012. Fifteen percent of LPs expect to commit slightly more in 2013 than they did in 2012, six percentage points lower than the number of LPs that gave the same answer in December 2011. Additionally, 10% of investors which did not invest in 2012 are planning to make new commitments to private equity funds in 2013, showing that there are investors returning to the asset class despite financial uncertainty.

Due to record numbers of funds on the road, the fundraising market will remain crowded in the coming year. Fund managers will have to continue to work hard to secure capital from investors, particularly as many investors remain cautious and are looking to make new commitments on a very selective basis going forward. Nevertheless, with a significant proportion of investors looking to commit more capital to the private equity asset class over the coming year, demonstrating confidence in the asset class, the fundraising outlook for 2013 is relatively positive. Fund managers raising small to mid-market buyout funds and distressed private equity funds are likely to see encouraging levels of interest from investors, with North America continuing to be seen as the most attractive region for investment.

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