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montana capital partners

mcp

Annual Investor Survey **2021**

Finding outperformance in private equity –
how leading investors actively manage their portfolios

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Oberneuhofstrasse 1
6340 Baar
Switzerland

Phone: +41 41 511 79 50
www.mcp.eu

Dr. Christian Diller
Managing Partner
cd@mcp.eu

Dr. Marco Wulff
Managing Partner
mw@mcp.eu

Eduard Lemle
Partner
el@mcp.eu

Maëlle Reichenbach
Vice President
mr@mcp.eu

Niklas Kleine Jäger
Associate
nk@mcp.eu

Graphic Design: taz-communication.ch

Summary

Montana Capital Partners ("mcp") is pleased to present the results of its ninth Annual Investor Survey, which this year again gathers the views of some of the world's leading investors in private equity, from institutional investors such as banks, asset managers, pension funds, insurance companies, and sovereign wealth funds (classified throughout the report as "institutional investors"), to leading family offices and foundations/endowments ("family offices and foundations").

We hope that the findings of the survey will prove useful to both fund managers ("GPs") and investors ("LPs") as they look for opportunities and navigate challenges in the current market environment, characterized by record-high deal activity, high valuations, and concerns over rising inflation.

KEY FINDINGS

- Private equity continues to be a highly sought-after asset class. In the last 12 months, 60% of the investors in our survey have increased their allocation to private equity. About a third of institutional investors, and 87% of family offices and foundations reported an allocation of more than 10% of their portfolio to the asset class
- Secondaries remain one of the top three long-term strategic preferences of investors, ahead of other well-established strategies such as large buyouts and venture capital. More than half of respondents dedicate at least 5% of their private equity allocation to secondaries strategies, primarily to mitigate the J-Curve and to improve the liquidity and risk-return profile of their portfolio
- Elevated valuation levels is the dominant theme which keeps investors awake at night: 72% of respondents stated that GPs buying into companies at too high EBITDA multiples is their top concern regarding market activity over the next 12 to 24 months, well ahead of other risk factors such as a slowdown of economic growth or rising consumer price and wage inflation
- Investors are increasingly taking an active role in managing their private equity portfolio. Instead of merely relying on their GPs to find the right opportunities, more than two third of investors actively investigate sectors expected to benefit in the current environment, and 60% invest with GPs that follow new market trends. Investors also have a strong view on which industry sector exposures are most attractive in the current environment and predominantly selected technology and healthcare

ABOUT MCP

montana capital partners ("mcp") is a European-based private equity firm focused on attractive niches of the secondary market, as well as on high-quality asset management solutions. mcp acts as advisor to five secondary funds with total assets under management of more than EUR 2.7 billion (USD 3.2 billion). All mcp funds were oversubscribed and closed at their hard cap.

The firm focuses on directly sourced transactions to create innovative and customized solutions that mutually benefit investors as well as sellers and GPs. Such solutions include structures like deferred payments, earn-outs, preferred equity and securitization elements, as well as tailored solutions for GP-led transactions such as tender offers, continuation funds (either entire funds or single/multiple assets), spin-outs, and stapled transactions.

In 2021, mcp joined forces with PGIM to strengthen its market positioning and global footprint. The firm will be able to benefit from PGIM's global network and expertise, while providing access to a new and differentiated investment opportunity to PGIM's clients.

We hope that the mcp Annual Investor Survey 2021 offers you many valuable insights. Should you have any questions or comments, please do not hesitate to get in touch.

Investor allocations to private equity

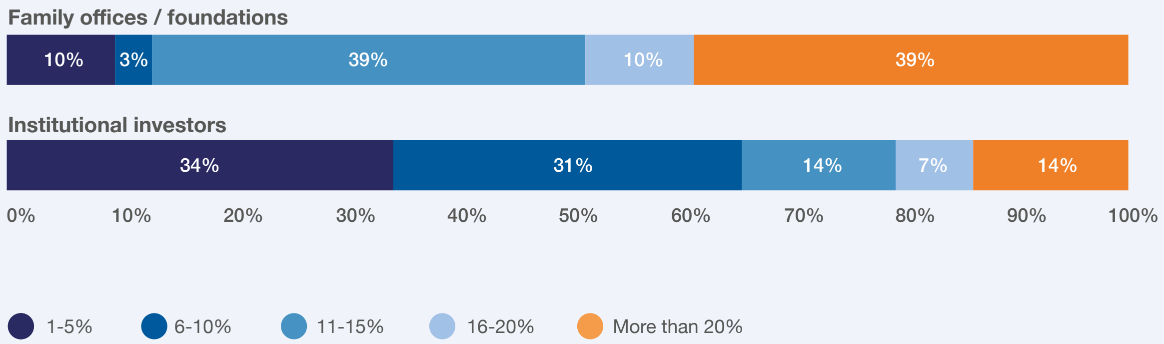
The appetite for private equity remains as strong as ever, with 35% of institutional investors and an impressive 88% of family offices and foundations reporting an allocation of more than 10% of their portfolio to the asset class (Figure 1). For both investor types, allocations to private equity have been gradually increasing over the past years, arguably as a key measure to increase portfolio returns and as a result of the relative outperformance of the asset class. Private equity returns have indeed consistently exceeded other private and public asset returns over the last 10 years.[1]

An investor from a European insurance company commented:

"The performance of our private equity portfolio has been excellent. Even through the Dot-com Bubble and the Great Financial Crisis, private equity returns have constantly outperformed. We definitely want to keep our allocation at a high level."

Figure 1

What is your current allocation to private equity?



In line with this positive sentiment around private equity, 60% of all respondents reported increasing their private equity allocations in the last 12 months (Figure 2), a higher figure than last year's 43%. Looking into the future, 55% of respondents are now satisfied with their private equity allocation and expect it to remain stable in the next 12 months, whereas 38% of investors indicated that it will increase further (Figure 3). In any case, the appetite for private equity remains strong and is unlikely to fade anytime soon.

An investor from a large European pension fund shared his view:

"Private equity has been the best performing asset class in our entire portfolio. Our allocation has increased on the back of higher-than-average returns, and we intend to keep it that way."

Figure 2

How has your allocation to private equity changed in the last 12 months?

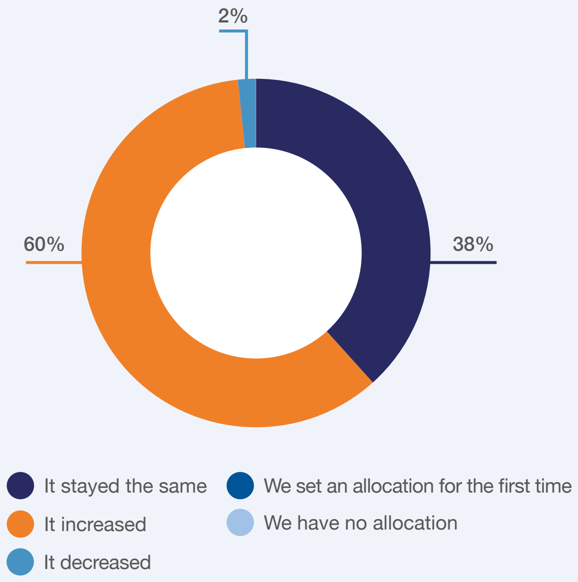
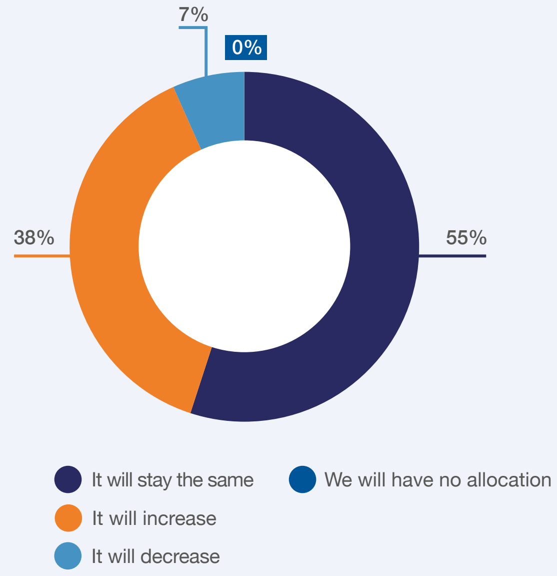


Figure 3

How do you expect your allocation to private equity to change in the next 12 months?



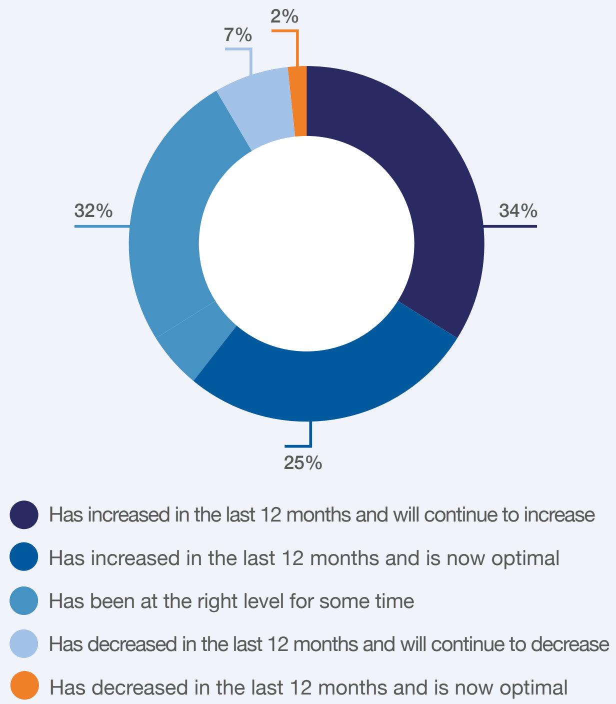
Respondents increased their allocation to private equity in the last 12 months not only by committing larger amounts to funds managed by their existing GPs, but also by increasing the number of GPs they invest with, an answer selected by 59% of respondents (Figure 4). About a third expect the number of managers they invest with to continue increasing, which is good news for GPs currently raising capital. Only a small portion (9%) of investors have reduced the number of their GP relationships.

This trend towards a larger number of GP relationships is counter to the conventional wisdom during the past decade that LPs are trying to reduce the number of GPs they invest with. It is even more noteworthy given the faster re-up pace among many GPs, which forces some LPs to focus on their most important relationships. One investor from a large European pension fund indicated:

"We have seen GPs return to market with their newest flagship fund at a much faster pace than in the past, which forces us to be highly selective and reinvest with only the best-performing managers."

Figure 4

The number of managers you invest with:



[1] *Source: Preqin, Private Capital Performance, Private Capital Quarterly Index, March 31, 2011 to March 31, 2021*

Investment preferences

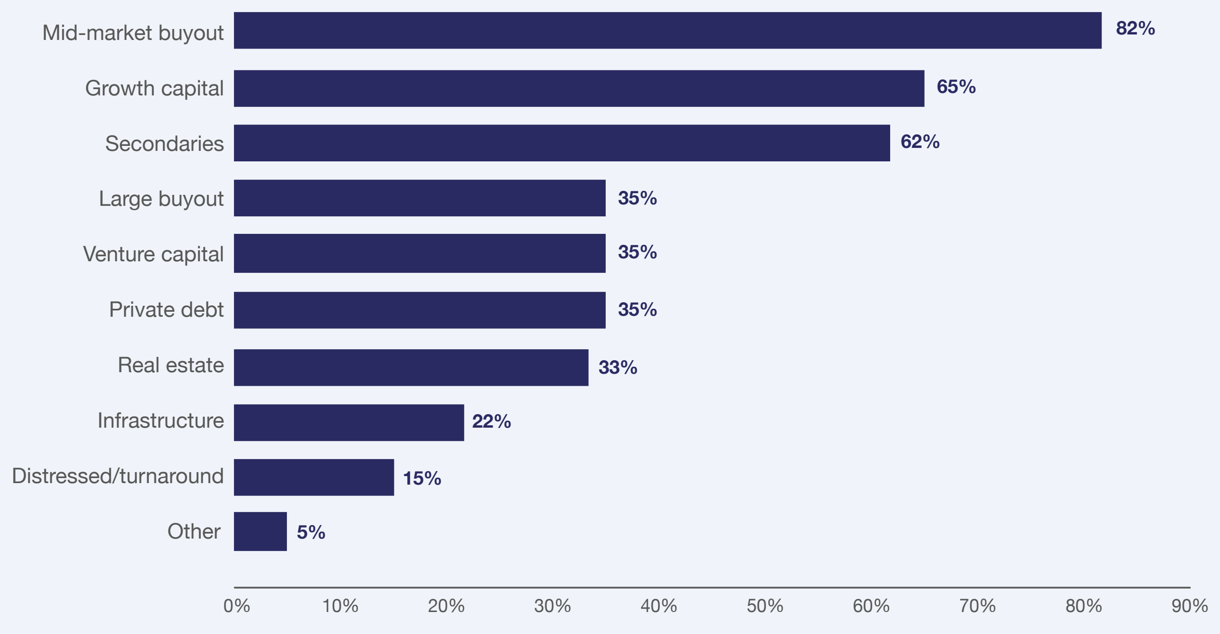
Mid-market buyout remains the preferred strategy for investors in the current market environment, followed by growth capital with 65% and secondaries with 62%, ahead of other well-established strategies such as large buyout and venture capital (Figure 5).

The appetite for growth capital has steadily increased in the last years, with a 25% increase in respondents selecting growth as their preferred strategy compared to our 2020 Annual Investor Survey, where only 52% of investors selected venture and growth capital (combined) as a strategic preference. Growth funds typically invest in sectors such as software and technology, which have strongly outperformed other sectors in 2020 and 2021 on the back of an accelerated digital transformation fueled by the Covid pandemic.

Since 2017, secondaries have consistently ranked among the top three strategic preferences of investors. Characterized by a high level of diversification and mature assets, secondaries funds are typically more cash generative and have less volatile returns than other private market strategies. In addition, the secondaries market is one of the fastest-growing segments of the private equity industry, supported by innovative solutions developed by secondaries GPs to adjust to the evolving needs of investors and managers.

Figure 5

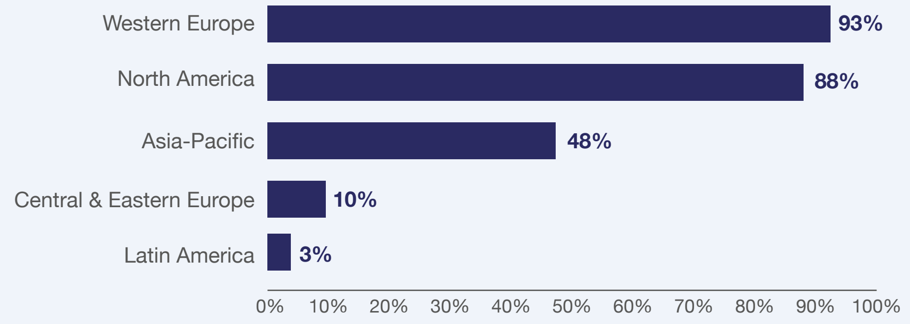
What are your long-term strategic preferences in the current market environment?



Geographic preferences of investors remain in line with prior years, with Western Europe and North America clearly ahead of other markets such as Asia-Pacific and Central and Eastern Europe (Figure 6).

Figure 6

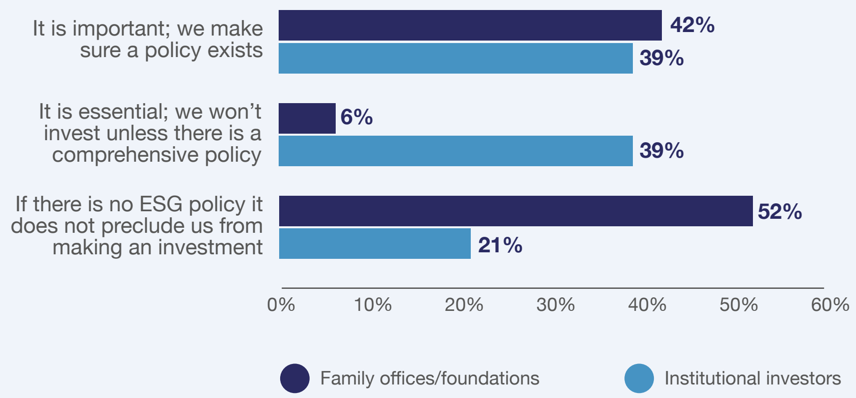
What are your geographic preferences?



While an ESG policy is important or essential for 78% of institutional investors, family offices and foundations maintain a more flexible approach with only 48% of respondents from this category indicating that such a policy is important or essential for them to make an investment (Figure 7). That said, ESG considerations have become significantly more important over time, particularly for institutional investors: in 2018, only 17% of them considered an ESG policy as essential.

Figure 7

To what extent does a GP's ESG policy impact your decision to invest in a fund?



Respondents indicated higher net return expectations for primary funds, secondaries funds, and direct/co-investments this year than in the past years (Figure 8). Most investors expect primary funds to return between 16-20%, while the expectation for direct/co-investments is higher with 44% of respondents expecting returns of more than 20%. Return expectations have also moved upwards for secondaries funds, with more than 4 out of every 10 respondents now expecting a net return of at least 16%, in comparison to just around 2 out of every 10 respondents last year.

Higher net return expectations this year may be driven by the strong performance of private equity funds over the past 12 months. This may have led investors to be more optimistic and have higher expectations for future private equity returns.

Figure 8a

Return expectation for primary funds

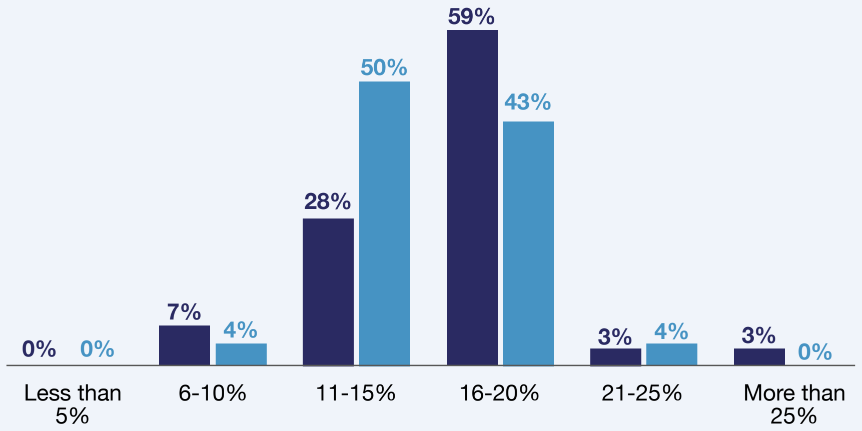


Figure 8b

Return expectation for secondaries funds

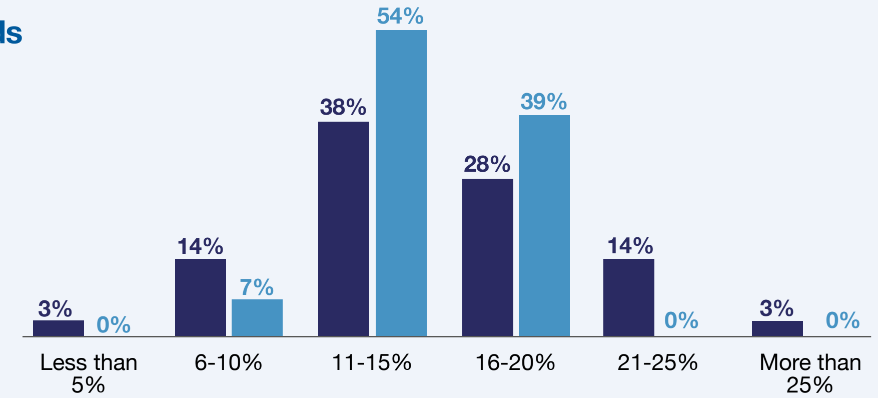
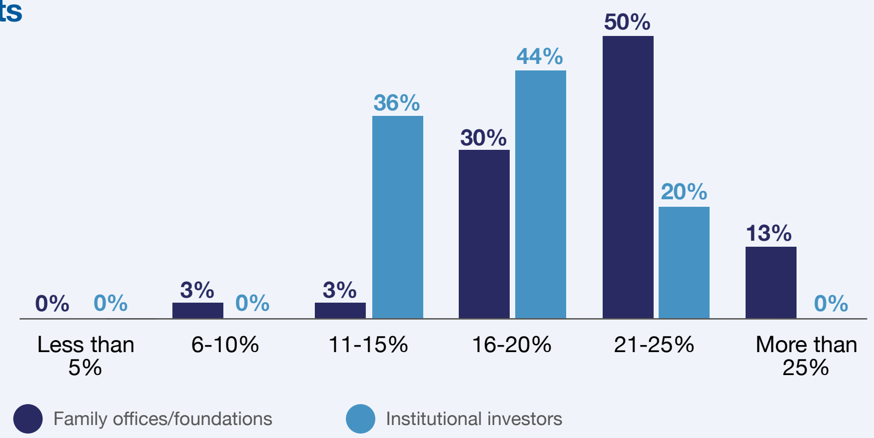


Figure 8c

Return expectation for direct/co-investments



Secondaries

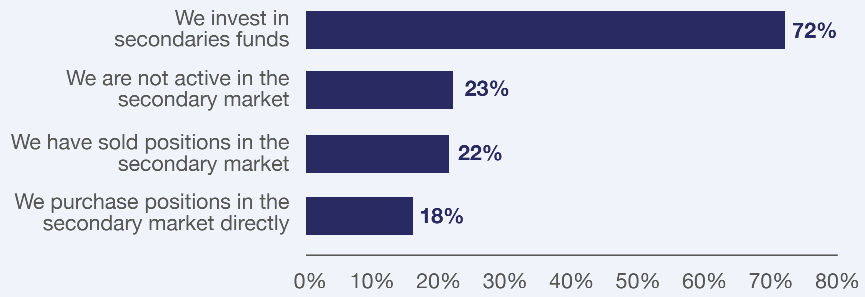
72% of respondents invest in secondaries funds, as shown in Figure 9. While there are a number of different reasons for investors to do so, an investor from a European family office commented that they invest in secondaries to mitigate the J-Curve effect in their portfolio and increase their returns. To date, their secondaries investments have performed strongly and even outperformed their primary investments.

This year's survey results show that only 23% of respondents are not yet active in the secondary market.

31% of institutional investors have sold positions in the secondary market compared to only 13% of family offices and foundations, illustrating the lower propensity of investors from the latter category to sell. This may be the result of a longer-term investment horizon and potentially also a higher reluctance to sell assets at a discount among family offices and foundations.

Figure 9

How would you describe your relationship with secondaries?



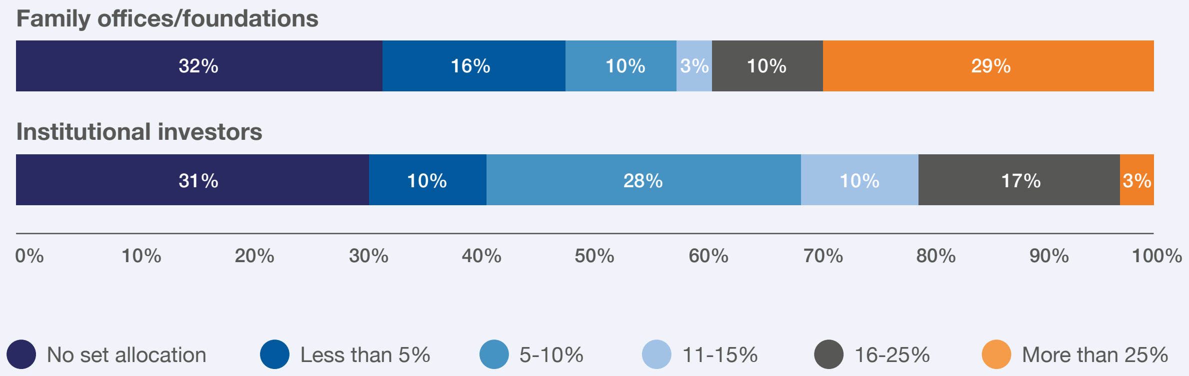
58% of institutional investors dedicate more than 5% of their private equity allocation to secondaries strategies (Figure 10), representing a significant amount of capital given the large average portfolio size of this investor group. This also represents a sharp increase from last year's 45%. Similarly, family offices and foundations have increased their allocation, with 39% of them now allocating over 15% of their private equity portfolio to secondaries.

One investor indicated that:

"Secondaries funds have an attractive risk-return profile due to the level of diversification they offer. In addition, they return capital faster than other private equity funds, which is helpful to manage the cash flows in our portfolio."

Figure 10

What proportion of your private equity allocation is dedicated to secondaries strategies? *

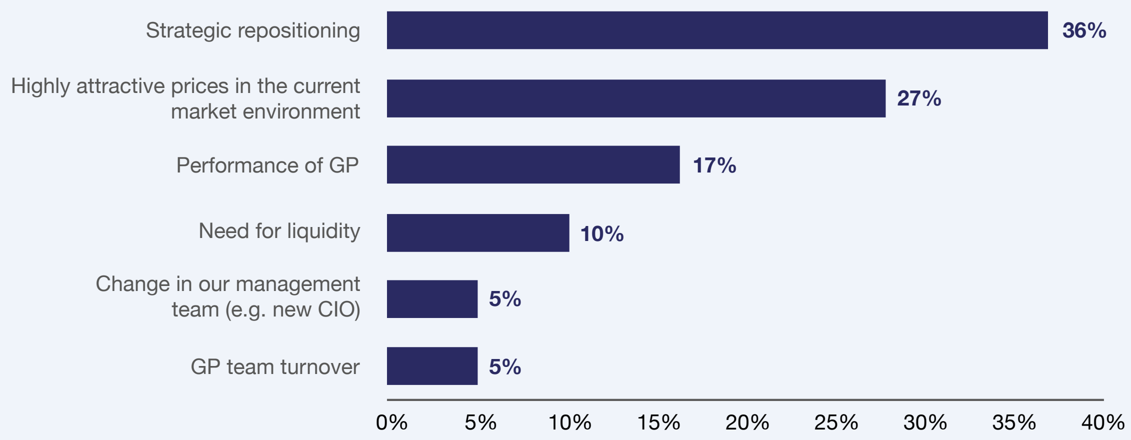


** Commitments to secondaries funds and/or direct secondaries purchases*

Strategic repositioning remains the most likely reason for investors to pursue active portfolio management via secondaries, with 36% of all investors selecting this answer (Figure 11). This year, however, 27% of investors mentioned highly attractive prices in the current market environment as a likely reason to sell, a sharp increase from only 11% last year. This may be due to the record-high EBITDA multiples seen in the private equity market, as well as an increase in secondary pricing, which has rebounded from the lows seen at the height of the Covid crisis. Prices for buyout fund stakes have increased to approximately 96% of NAV on average during the first half of 2021[2]. This could prove attractive for investors looking to divest some of their assets.

Figure 11

What would be your most likely reason for pursuing active portfolio management via secondaries in the current market environment?



[2] *Source: Jefferies Global Secondary Market Review – H1 2021*

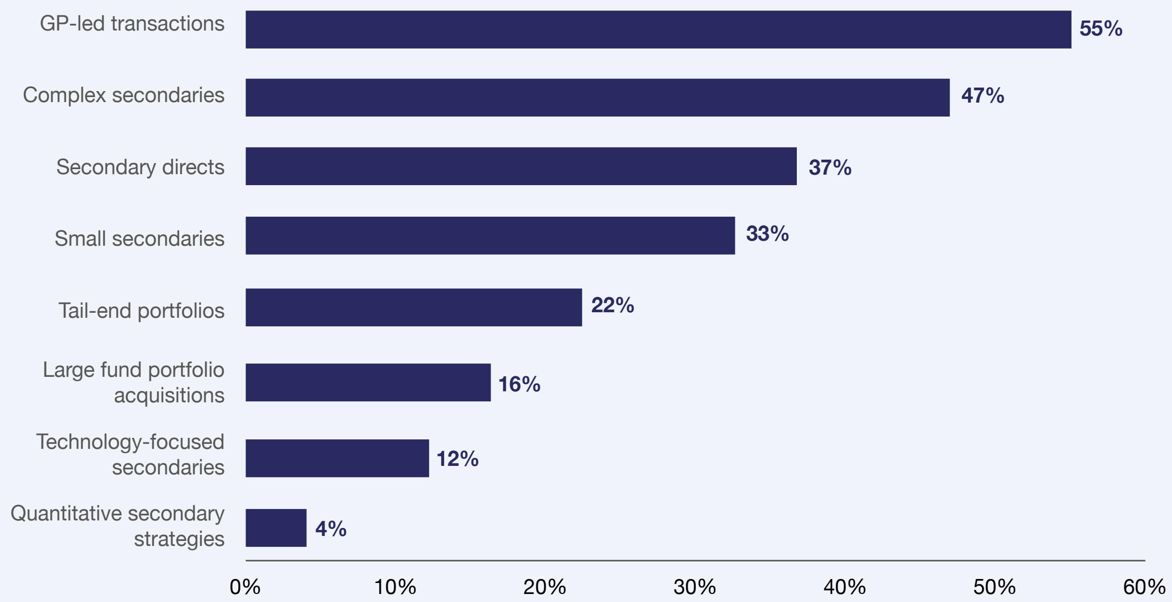
Only 10% of respondents selected "need for liquidity" as their most likely reason for pursuing active portfolio management, a figure that is not surprising given the high levels of liquidity in the market.

Investors continue to favor complex secondaries and GP-led transactions, whereas small secondaries significantly decreased in popularity compared to the results from prior years (Figure 12). GP-led transactions ranked ahead of all other strategies, in line with the recent market trend that has resulted in a record number of GP-led transactions, which accounted for more than half of total secondaries volume during the first half of 2021, compared to less than 40% in H1 2020[3].

Currently emerging themes such as technology-focused secondaries and quantitative secondary strategies, with the latter using advanced data analysis to enhance and improve investment underwriting, are still relatively unknown among the broader investor community, but are already being considered by some industry leaders.

Figure 12

As an allocator of capital to secondaries strategies over the next 12 months, which two would you prioritize:



[3] *Source: PJT Park Hill Secondary Market Insight, September 2021, Evercore Private Capital Advisory H1 2021 Secondary Market report, Campbell Lutyens H1 2021 Secondary Market Overview*

A large, well-known institutional investor commented on technology-focused secondaries:

"A large portion of the outperformance across our portfolio has been driven by GPs investing in technology companies, which offer the potential for breakout returns. While conventional wisdom is that secondaries funds should keep a generalist investment focus, there may be room for sector-focused funds with expertise in technology in secondaries as well, with the potential for outsized returns."

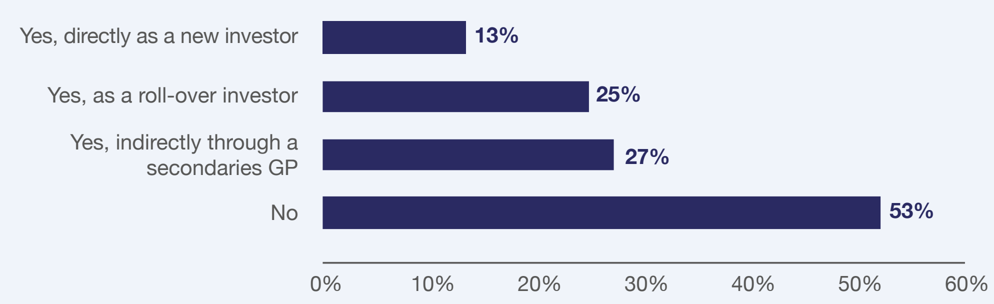
45% of all GP-led transactions during H1 2021 were single-asset deals, a significant increase from about 30% last year[4]. We therefore asked investors whether they had ever participated in such transactions (Figure 13). More than half of respondents have never participated in a single-asset GP-led transaction, while 25% participated as a roll-over investor. 27% participated indirectly through a secondaries GP whose fund they were invested in, and only 13% invested directly in a continuation fund.

One investor commented:

"We like single-asset GP-led transactions as they allow us to perform comprehensive due diligence on a specific company. In addition, GPs are well-placed to identify whether an asset presents further upside potential as they have been working with the company for several years. This reduces some of the uncertainty inherent to new investments."

Figure 13

To date, have you participated in a single-asset GP-led continuation fund? [5]



[4] Source: PJT Park Hill Secondary Market Insight, September 2021, Evercore Private Capital Advisory H1 2021 Secondary Market report, Campbell Lutyens H1 2021 Secondary Market Overview

[5] Please note that percentages do not add up to 100% as respondents could indicate multiple answer choices.

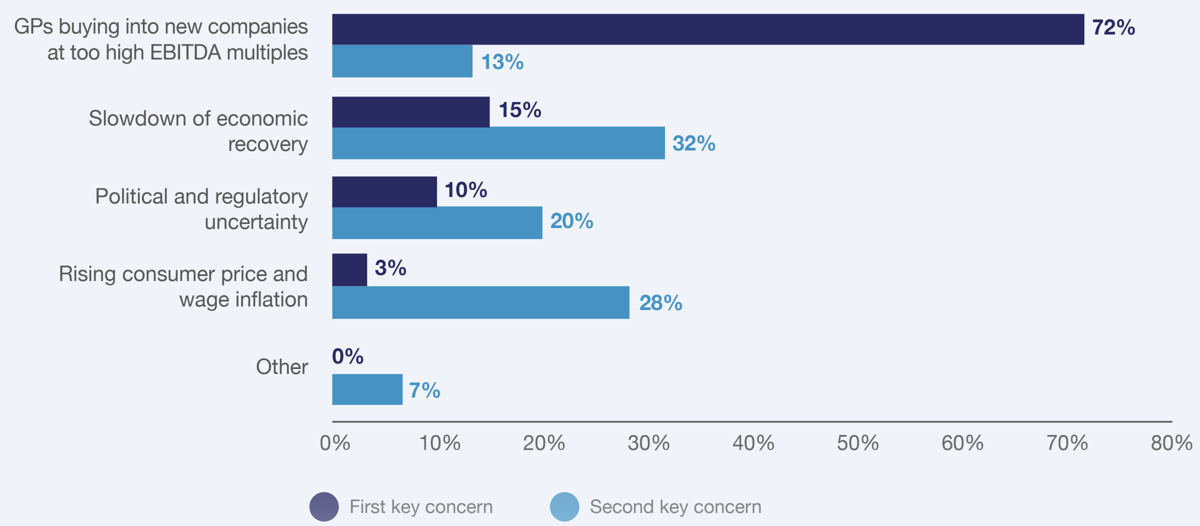
Market trends

Similar to public market stock prices, private equity valuations have continued to trend higher over the past year, with average EBITDA entry multiples for leveraged buyout transactions at 11.4x in the U.S. and 12.6x in Europe in 2020.[6] This represents a record-high level that even exceeds private market valuations seen in 2007, shortly before the Great Financial Crisis. High quality, non-cyclical companies in sectors that are most favored by investors such as healthcare and technology frequently command prices exceeding 15x, or even 20x EBITDA. It is therefore no surprise that GPs buying into new companies at too high EBITDA multiples was selected as the top concern regarding market activity by over 70% of respondents (Figure 14).

Last year, amid the Covid crisis, 47% of respondents were most concerned about a potential lack of economic recovery, whereas this year only 15% of investors cited a slowdown of economic recovery as their top concern, and 32% selected it as their second key concern. This could suggest that the high degree of uncertainty caused by Covid has eased, shifting investors' attention again to the high price environment and, to some extent, to rising consumer price and wage inflation. The latter was selected by 28% of respondents as their second key concern.

Figure 14

What are your top two key concerns on the market activity for the next 12 to 24 months?



[6] Source: Bain & Company Global Private Equity Report 2021

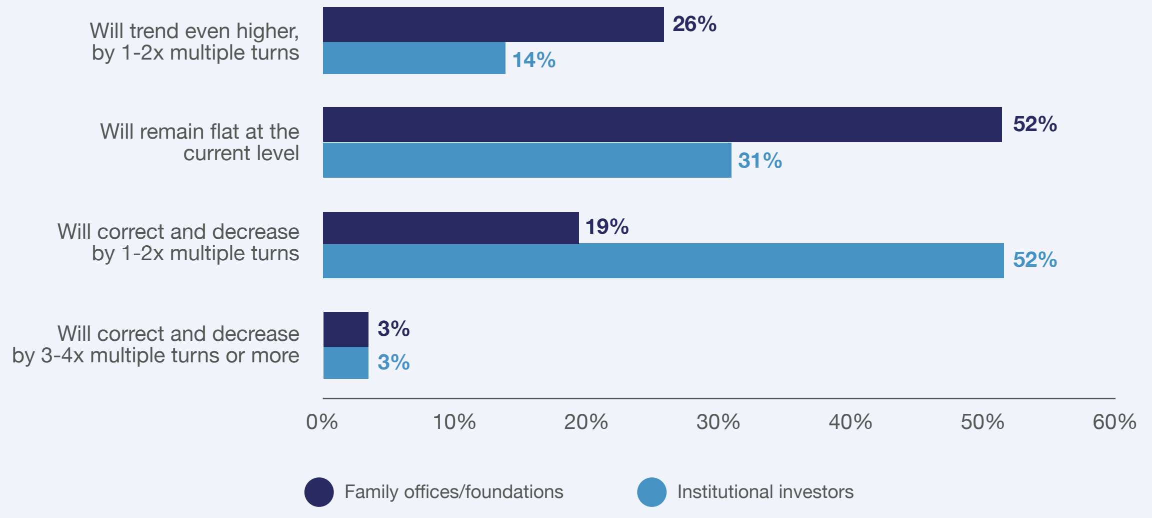
Family offices and foundations and institutional investors diverge in their views on the likely evolution of private equity valuation levels over the next 12 months. 55% of institutional investors expect EBITDA multiples to correct and decrease by at least one multiple-turn, whereas a majority of respondents from family offices and foundations believe they will remain flat (Figure 15). 26% of family offices and foundations, and 14% of institutional investors even expect multiples to continue trending higher.

An investor from a European asset management firm indicated that the benefits of the asset class outweigh the risks:

"We are still in the process of building up our private equity portfolio and have a very positive outlook on the asset class, which presents plenty of upside despite current valuation levels."

Figure 15

Median private equity buyout multiples have reached record-high levels. Do you expect that over the next 24 months, average multiples:



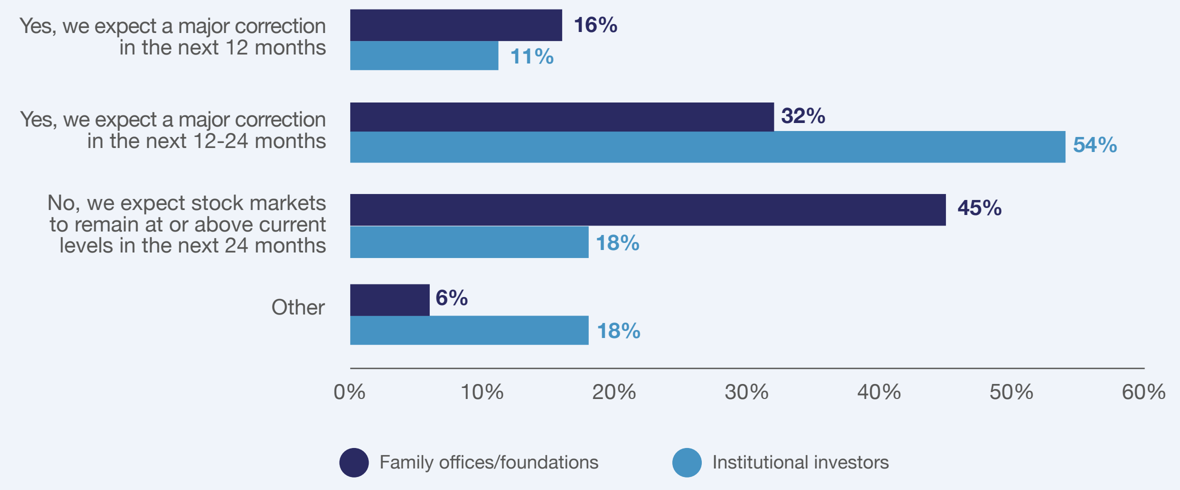
Family offices and foundations and institutional investors also have different opinions on whether a major correction will take place, and when. 45% of family offices expect stock markets to remain at or above current levels in the next 24 months, compared to only 18% of institutional investors (Figure 16). 54% of institutional investors expect a major correction to take place in the next 12-24 months, while only 32% of family offices and foundations agree with that statement.

Only 14% of all respondents expect a major correction in the next 12 months, showing increased market confidence – or confidence in governments and central banks – compared to a year ago, when approximately one third of respondents expected a correction in the near-term.

Our survey also asked investors how they are adjusting to the current high valuations in the private equity market (Figure 17). 80% of respondents indicated that they would focus on GPs or management teams that can provide operational improvements and grow EBITDA. 57% would invest with GPs that have a track-record of investing at conservative multiples, and 38% would focus on recession-resilient sectors. These results show that many investors actively look for ways to adjust to current market conditions, instead of merely relying on their GPs or adjusting their return expectations downwards.

Figure 16

Since the initial shock in March 2020, stock markets have rapidly regained pre-Covid levels and consecutively reached all-time highs. Do you expect a major correction to eventually take place and if so, when?



A European investor commented:

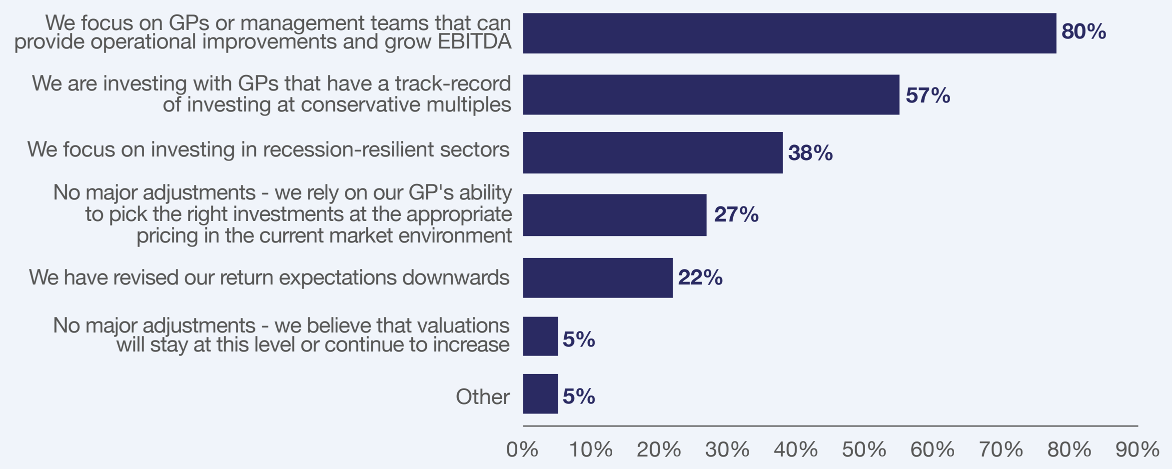
"Private equity portfolio companies can rely on high-quality GPs and management teams to create value, pursue a buy-and-build strategy, or restructure them appropriately. This creates tangible value for private equity investors who are able to identify the right managers."

Another investor added:

"The current high valuations have made recent times very attractive, as portfolio companies have been marked-up and our private equity allocation shows strong returns. To protect our portfolio against the impact of a potential correction in the future, we focus on GPs that can provide expertise to their portfolio companies, not only capital."

Figure 17

How are you adjusting to the current high valuations in the private equity market?



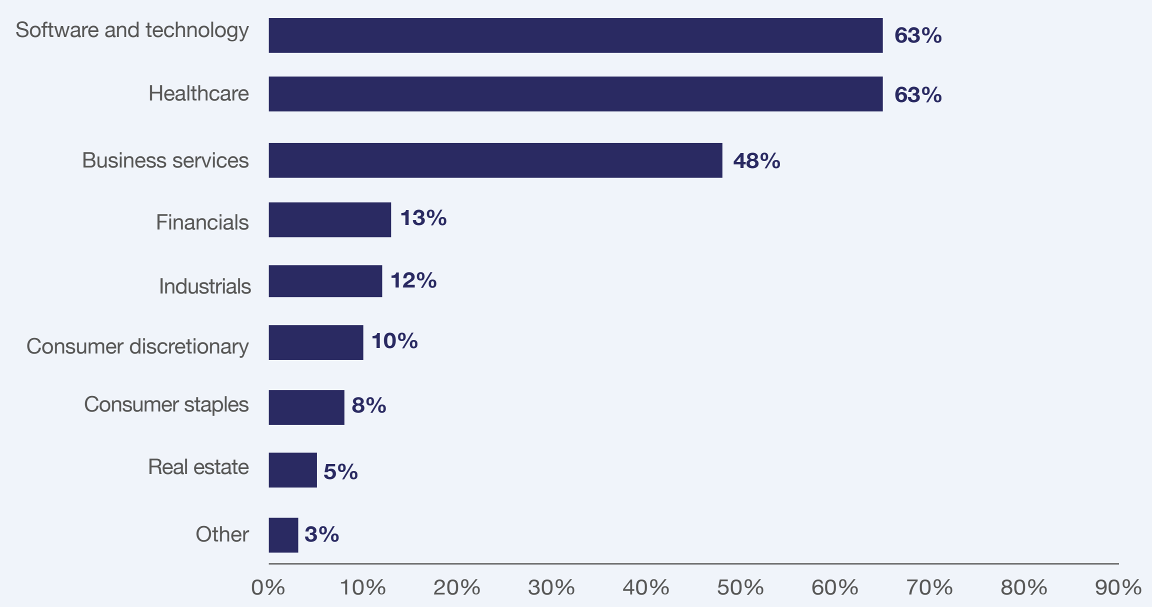
Active portfolio management to find outperformance

Software & technology and healthcare are viewed as the sectors that present the most attractive risk-return profiles in the current market environment and were each selected by 63% of respondents (Figure 18). This is followed by business services, which was selected by 48%. These sectors happen to be the ones that have performed particularly well in investors' portfolios throughout the Covid pandemic, based on our observation.

Software & technology, in particular, has benefitted from tailwinds arising from the pandemic, driven on the one hand by a higher prevalence of people working from home and the need for companies to prioritize digitalization, and on the other hand by fundamentally attractive business models that stood up well to the crisis due to highly recurring revenues, e.g. in the case of Software-as-a-Service (SaaS) business models.

Figure 18

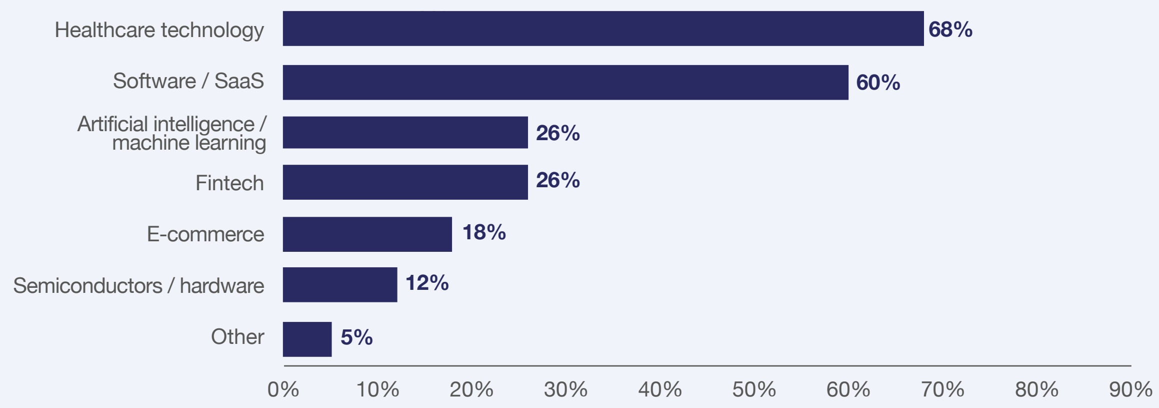
What sectors currently present the most attractive risk-return profile?



We also asked investors to indicate which themes within the technology sector currently offer the most attractive risk-return profile. Healthcare technology combines the two most attractive sectors mentioned above, and was selected by 68% of respondents, followed by software/SaaS (Figure 19). We expect these themes to remain attractive over the next year, as some of the transformations initiated or accelerated by the Covid pandemic, such as working from home or tele-medicine, are likely here to stay.

Figure 19

Within the technology sector, which themes present the most attractive risk-return profile?



Investors increasingly take an active role in managing their private equity allocation, instead of solely relying on their existing GPs to find the right opportunities for them. 68% of investors indicated that they would investigate industries and sectors that are expected to benefit in a post-Covid environment as a way to improve the risk-return profile of their portfolio (Figure 20). Considering the answers presented in Figures 18 and 19 above, we would expect a higher allocation to technology- and healthcare-focused GPs in the future. 60% of investors also indicated that they would actively invest with GPs that follow new market trends, such as digital transformation, impact investing, or e-commerce. Slightly more than one in four investors also indicated that they would increase their allocation to secondaries funds to improve their portfolio's risk-return profile.

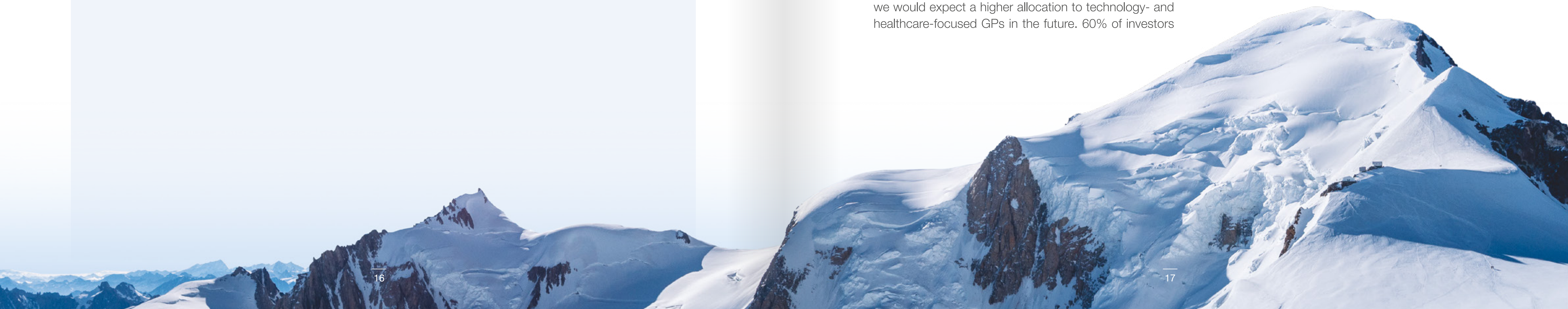
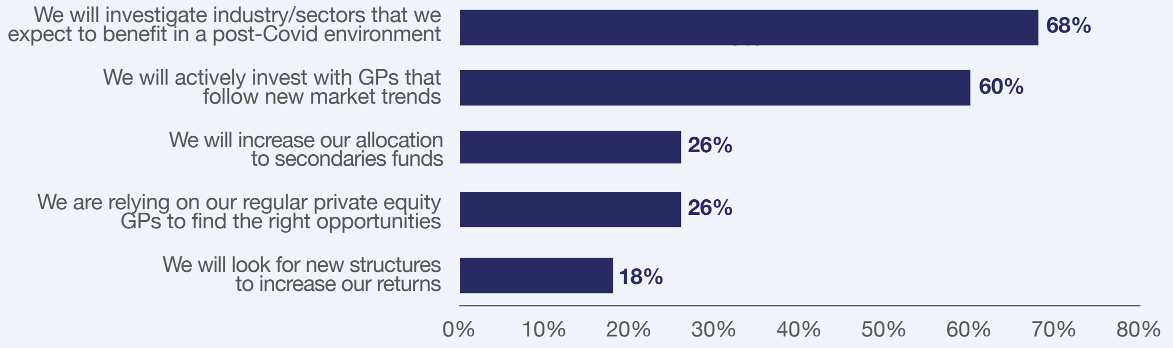


Figure 20

How do you plan to improve the risk-return profile of your private equity portfolio in the current environment?



When asked about the potential impact of consumer price and wage inflation on their private equity portfolio, investors expressed low to medium concern, particularly in the short term (Figure 21). Inflation is expected to have a higher impact in the longer term (Figure 22), posing a risk of eroding portfolio company margins.

To mitigate this risk, an investor from a European asset manager emphasized the need to maintain a consistent approach to investing, by allocating capital across various fund vintages in order to level out the impact of economic cycles.

Figure 21

From 0-10, how concerned are you about the potential impact of consumer price and wage inflation on your private equity portfolio over the next 12 months:

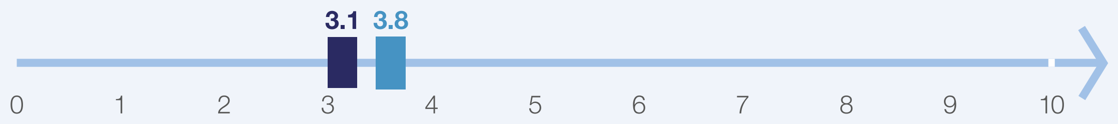
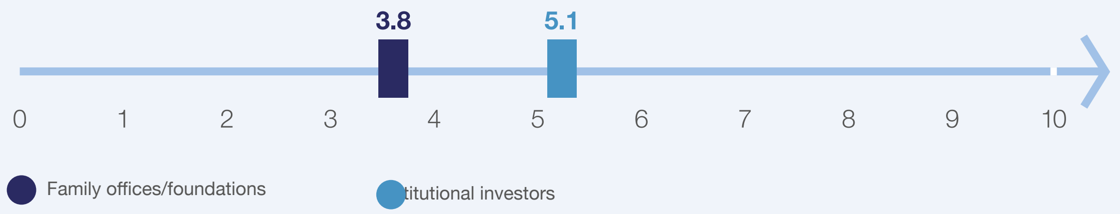


Figure 22

From 0-10, how concerned are you about the potential impact of consumer price and wage inflation on your private equity portfolio over the next 2-5 years:



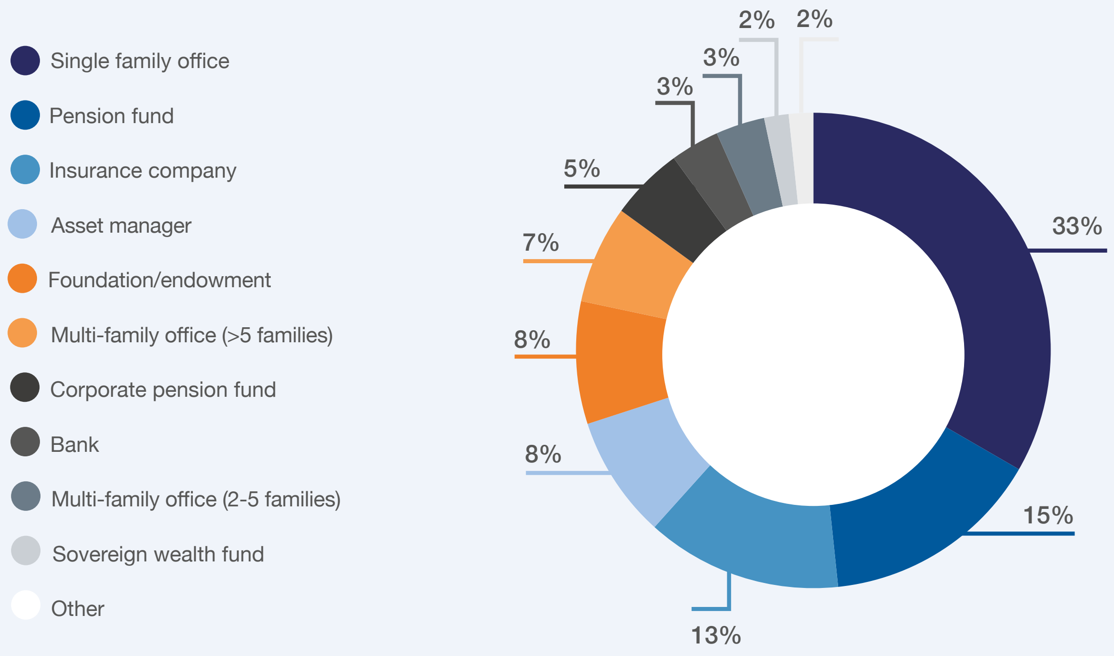
Participant information

As in prior years, we again collected input for our survey from a large group of leading investors in private equity during the months of August and September 2021. Throughout the report, we classified single family offices, multi-family offices and foundations/endowments as "family offices and foundations".

In total, this investor category represents 51% of the sample. Investors from insurance companies, pension funds, banks, asset managers, and sovereign wealth funds were all classified as "institutional investors" and represent 49% of the sample.

Figure 23

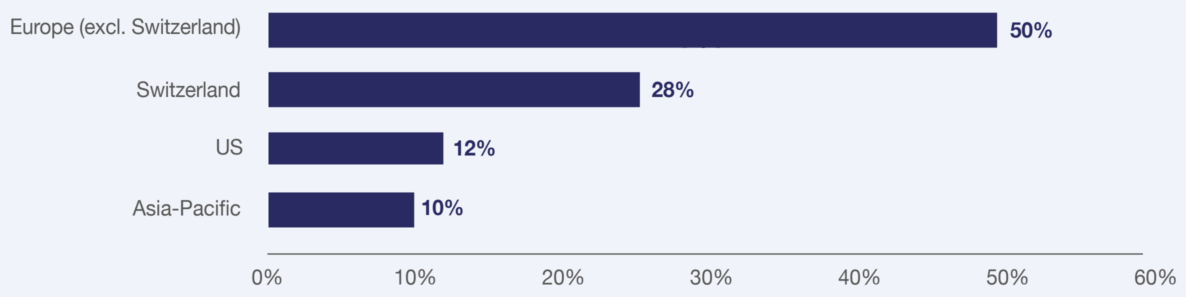
What is your institution type?



The majority of respondents are located in Europe, with additional participation from investors in the U.S. and Asia-Pacific.

Figure 24

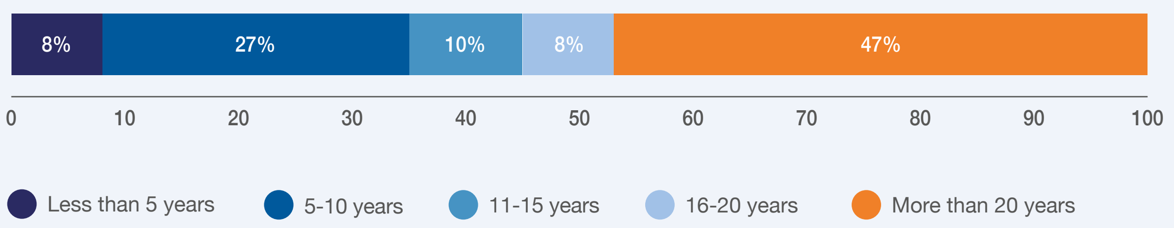
Where is your institution located?



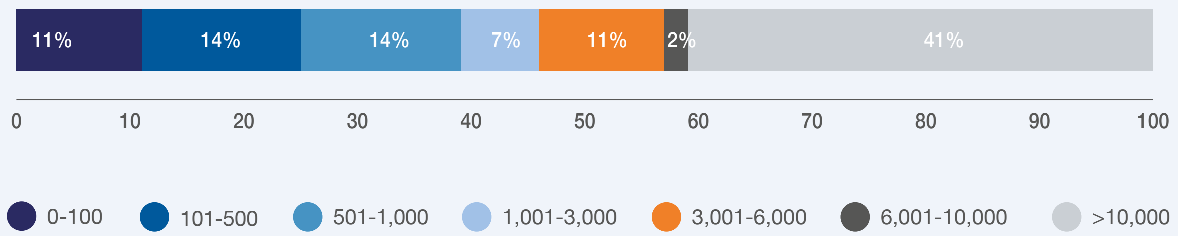
Respondents are well-established investors. 47% of them have been operating for more than 20 years, and 18% between 11 and 20 years. They also represent very large capital amounts, with 41% of respondents reporting an AuM larger than USD 10 billion.

Figure 25 & 26

How long have you been operating?



What is your AuM? (USD million)



About us

montana capital partners ("mcp") is a Europe-an-based private equity investment firm focused on attractive niches of the secondaries market globally. The firm has raised five funds so far, each closed at the hard cap with a total AuM of more than EUR 2.7 billion (USD 3.2 billion), thanks to the support of a broad investor base of well-known and reputable institutional investors such as pensions funds, insurance companies and sovereign wealth funds, as well as global family offices and foundations.

mcp focuses on complex transactions in the small to mid-sized segment, which are oftentimes directly sourced from sellers and GPs. This allows for customized solutions that take into account their specific requirements, in order to create beneficial outcomes for all parties involved.

To support sellers in reshaping their portfolios, mcp's solutions help address regulatory and strategic considerations, reduce specific risk factors, and optimize the cash flow profile of underlying portfolios. Transaction types include single fund positions, small portfolios, fund-of-funds, co-investments, and more complex structured transactions.

mcp also partners with leading GPs to create customized solutions that address their needs and allow them to provide liquidity to their investors. These GP-led solutions include tender offers, continuation funds (either entire funds or single/multiple assets), spin-outs, and stapled transactions.

In addition, mcp provides innovative solutions for primary investments and risk management advisory.

In 2021, mcp was acquired by PGIM, the USD 1.5 trillion global investment management business of Prudential Financial, Inc. mcp will retain its investment autonomy and independence, and benefit from PGIM's global, institutionalized set-up.

For further information or should you have any questions please do not hesitate to contact us.

montana capital partners AG
Oberneuhofstrasse 1
6340 Baar
Switzerland
Phone: +41 41 511 79 50
www.mcp.eu


montana
capital
partners