montana capital partners

mcp

# Annual Investor Survey 2022

The role of private equity in volatile times – how leading investors respond to the new market environment

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Oberneuhofstrasse 1
6340 Baar
Switzerland

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

**Dr. Marco Wulff**
Managing Partner & CEO
mw@mcp.eu

**Eduard Lemle**
Managing Partner
el@mcp.eu

**Maëlle Reichenbach**
Vice President
mr@mcp.eu

**Niklas Kleine Jäger**
Associate
nk@mcp.eu



# Summary

montana capital partners ("mcp") is pleased to present the results of its 10th Annual Investor Survey, which gathers the views of institutional investors, such as banks, asset managers, pension funds, insurance companies, and sovereign wealth funds (classified throughout the report as "institutional investors"), as well as reputable family offices and foundations/endowments ("family offices and foundations").

Since last year's edition of our survey, public market valuations have sharply decreased, inflation has risen dramatically, and Russia has declared war on Ukraine. Amid this challenging market environment, we hope that our report will provide valuable insights into the investment strategies and preferences of some of the world's leading investors in private equity.

## Key findings

- Investor allocations to private equity have surged in 2022. For 71% of family offices and foundations and for a third of institutional investors, the asset class now represents more than 15% of the portfolio. This represents a significant 45% and 59% year-over-year increase, respectively, and is primarily a result of the strong performance of the asset class and a robust fundraising environment that has seen GPs come back to market faster than ever and forced investors to accelerate their deployment. The "denominator effect" further contributed to this trend, as private equity valuations have not adjusted to the same extent as other asset classes

- An economic recession is investors' top concern at the moment, and fears that inflation could negatively impact private equity portfolios have become more prevalent than last year. To navigate this market environment, investors turn to resilient industries, such as healthcare and business services, and to investment strategies expected to be less impacted in a downturn, such as mid-market buyouts and secondaries

- Secondaries are the number two long-term strategic preference of investors, after mid-market buyouts and ahead of other well-established strategies, such as growth capital and VC, and with a predilection for complex secondaries and fund portfolio acquisitions. With a quarter of institutional investors expecting to sell positions in the next 12 months, we expect the strategy to see attractive investment opportunities in the near term

- Despite the current market volatility, private equity investors remain optimistic: A third of respondents will increase their allocation to private equity over the next 12 months, more than 60% expect positive stock market performance over the next 24 months, and concerns over long-term inflation have not increased since last year. In addition, more than 80% of investors have room for new commitments in 2023, and almost a third plan to increase their number of GP relationships

## About mcp

mcp is a Swiss-based private equity firm focused on attractive niches of the secondary market as well as customized asset management solutions. mcp acts as an investment advisor to five secondary funds with total assets under management of more than EUR 3.4 billion (USD 3.5 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, 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 can benefit from PGIM's worldwide network and expertise while providing PGIM's clients access to a new and differentiated investment opportunity set.

We hope that the mcp Annual Investor Survey 2022 offers you valuable insights. Should you have any questions or comments, please do not hesitate to get in touch.

# Investor allocations to private equity

**Private equity continued to be a sought-after asset class in 2022, with USD 512 billion in buyout deal value during the first half of the year[1], a figure that was on track to produce the second-highest annual total after the record level seen in 2021. Last year was also a record year for fundraising, with almost USD 800 billion raised by private equity funds[2]. However, as of the time of writing this report, market conditions have drastically changed, with ramping inflation, a war in Europe, and a sharp decline in stock market valuations. In this context, we have asked investors about their current private equity allocation and how they expect it to change over the next 12 months[3].**

## What is your current allocation to private equity?

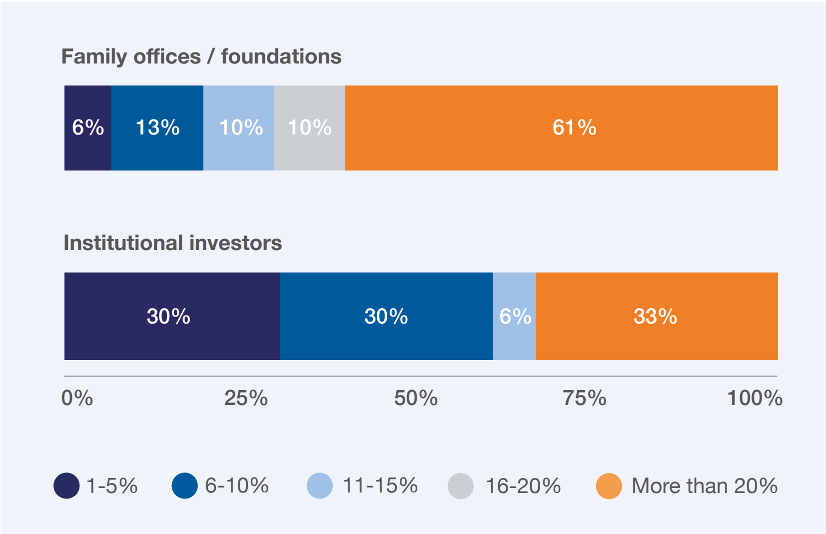



**Figure 1**

Allocations to private equity have significantly increased, with 71% of family offices and foundations and 33% of institutional investors reporting an allocation of more than 15% of their portfolio to the asset class. In 2021, that figure was "only" 49% for family offices and foundations and 21% for institutional investors.

An investor from a European asset management firm commented: **"Our private equity portfolio has experienced record performance over the last year, and as a result we reached our target allocation much faster than anticipated."**

## How has your allocation to private equity changed in the last 12 months? How do you expect it to change in the next 12 months?

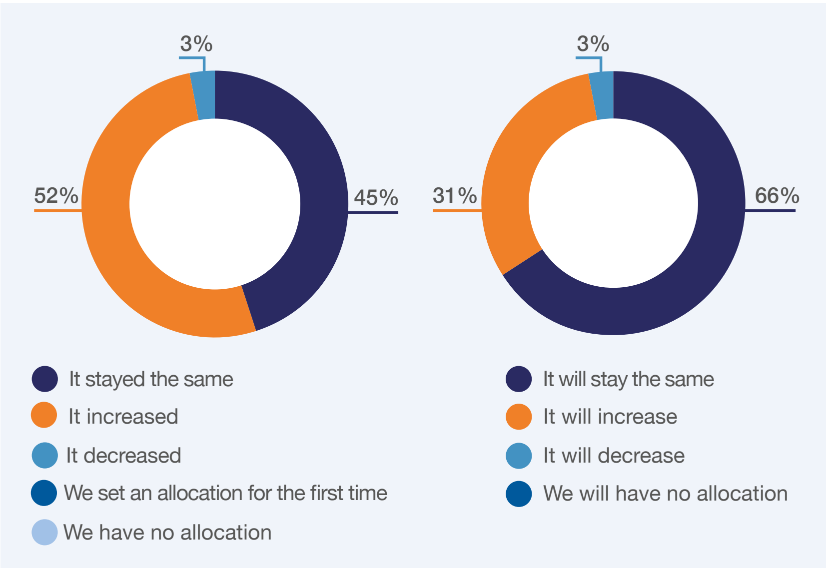



**Figure 2 & 3**

The current market uncertainties have not impacted the appetite of respondents for the asset class, and almost a third plan to increase their allocation to private equity next year. It is a slight decrease compared to last year but still represents a significant amount of capital flowing into the industry.

Another investor added: **"While we see some headwinds to private equity performance in the short term, driven by public markets volatility and increasing interest rates, we expect upcoming vintage years to deliver attractive returns, in line with previous post-recession vintage years."**

[1] *Source: Bain Private Equity Report Midyear 2022*
[2] *Source: PEI Fundraising Report H1 2022*
[3] *Responses were collected in August and September 2022*



# Investment preferences

**When asked about their investment preferences, respondents selected strategies and sectors expected to be resilient in a recessionary environment. However, return expectations have come down for all types of private equity strategies. Additionally, ESG criteria continue to gain importance and are perceived by many investors as a critical tool to mitigate risk.**

## What are your strategic preferences in the current market environment?

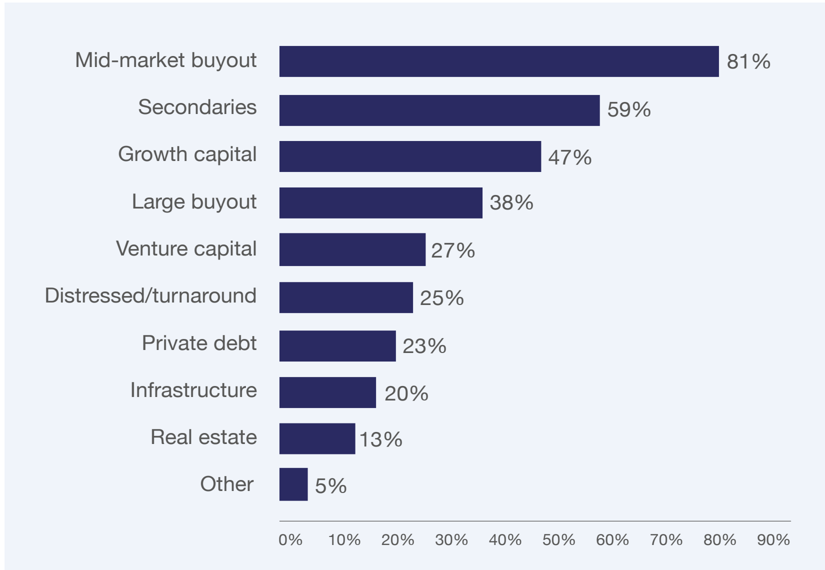



**Figure 4**

Mid-market buyout remains the respondents' preferred strategy, ahead of secondaries, which have regained second place as appetite for growth capital has decreased. Venture capital has also fallen out of favor, while more investors selected distressed/turnaround strategies, likely expecting them to perform well in a downturn.

An institutional investor mentioned: **"We are increasingly thinking about a first-time allocation to secondaries, as pricing is becoming very attractive, and secondaries have historically had strong performance after a downturn."**

## What are your geographic preferences?

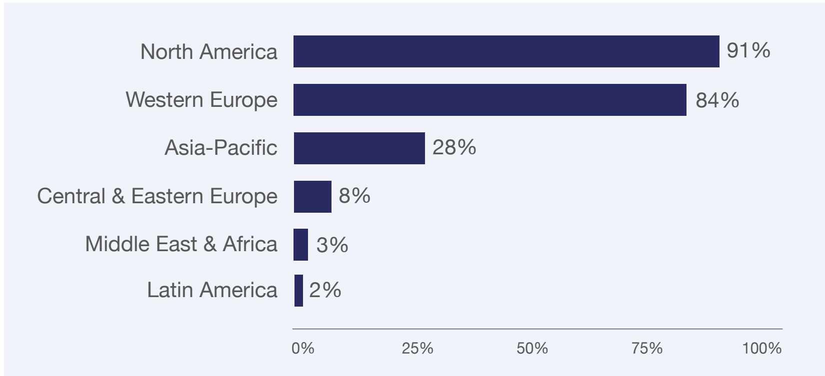



**Figure 5**

North America and Western Europe continue to be the respondents' preferred investment geographies, ahead of Asia-Pacific, Central and Eastern Europe, Middle East & Africa, and Latin America.

## Which sectors currently present the most attractive risk/reward profile?

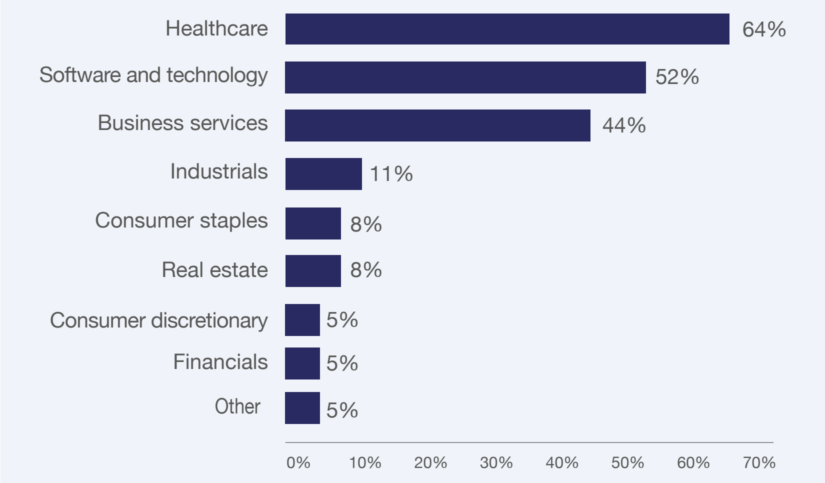



Figure 6

Respondents view healthcare as the sector with the most favorable risk-return profile currently. In addition, despite the recent stock markets correction, more than half of respondents still consider software and technology to be very attractive. Business services round up the top three.

An investor from an endowment commented: **"We see strong opportunities in software and technology, as valuations are starting to look very attractive again, growth rates remain strong and management teams have become more capital disciplined."**

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

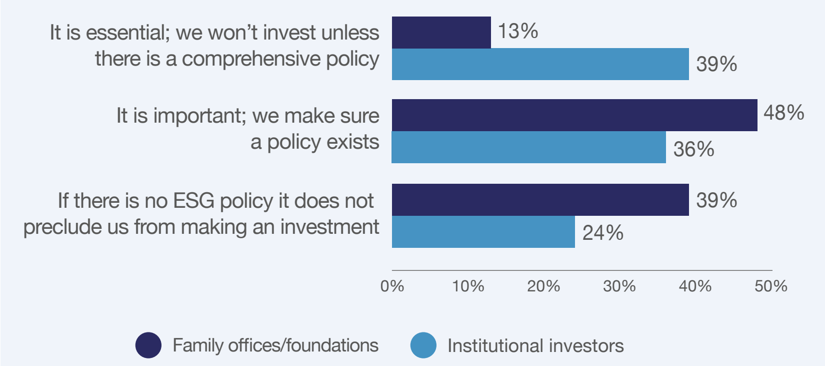



Figure 7

While having an ESG policy has long been important or essential for institutional investors to commit to a GP's fund, it has also become more relevant for family offices and foundations. More than 60% of them indicated that an ESG policy was influencing their decision to invest, up from about 40% four years ago.

## What are your top two reasons for including ESG criteria in your due diligence?

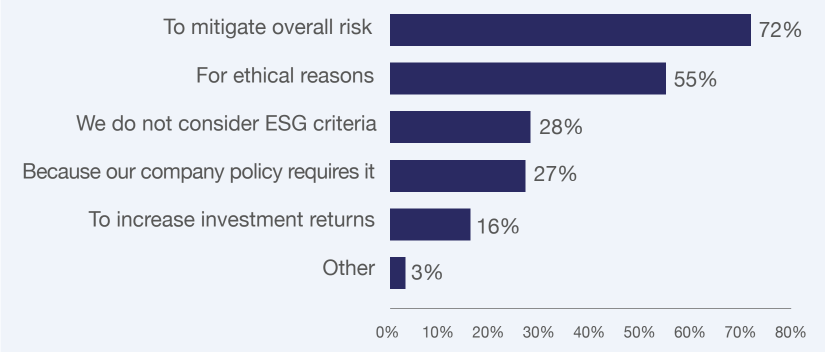



Figure 8

Overall investment risk mitigation and ethical reasons are the main drivers for investors to include ESG criteria in their due diligence process.





## What is your current expectation for private equity returns (net to investors) when you invest in primary funds, secondary funds, and direct/co-investments?

Return expectations have decreased, with most respondents expecting net returns for both primary and secondary funds between 11% and 15%. Direct/co-investments still command a premium, but expectations have come down compared to last year when 43% of respondents expected returns above 20% for that type of investment.

Figure 9a

### Return expectation for primary funds

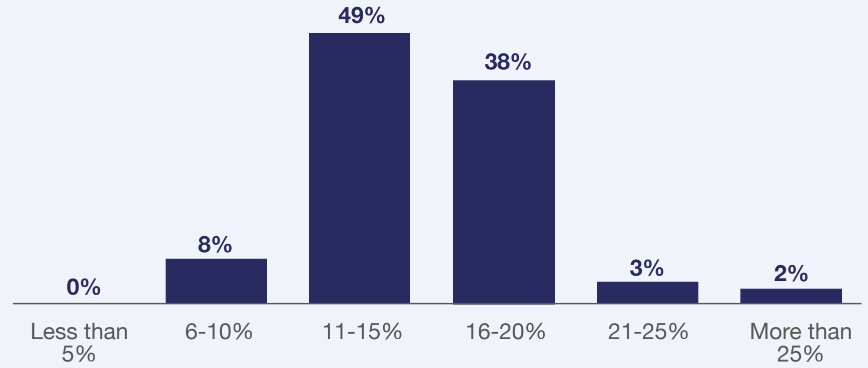



Figure 9b

### Return expectation for secondary funds

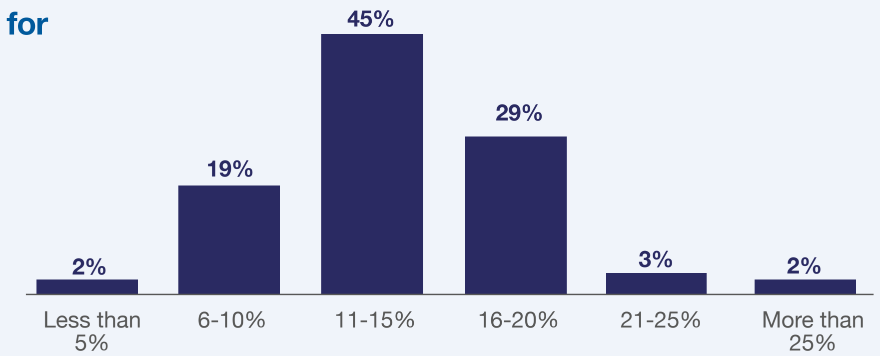
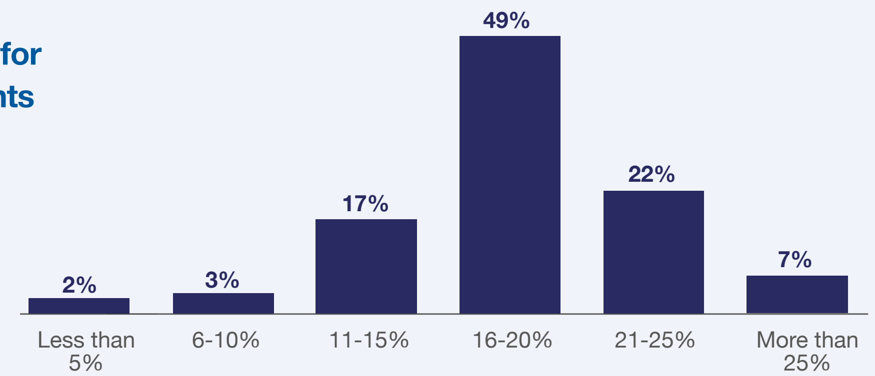



Figure 9c

### Return expectation for direct/co-investments



# Market trends and performance

**Since the beginning of 2022 and at the time of writing this report, the S&P 500 has lost almost 17% of its value year-to-date and the Nasdaq 100 almost 28%[4]. Many European and Asian indexes have not fared better. The annual inflation rate, measured as the year-over-year change in the consumer price index, reached 10.1% in the European Union and 8.3% in the USA in August 2022[5], raising fears that central banks will have to increase interest rates faster than previously announced and maintain tight financial conditions for longer than expected. Despite these economic headwinds, private equity portfolios have remained resilient year-to-date, and respondents seem optimistic about performance in the mid-to-long term.**

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

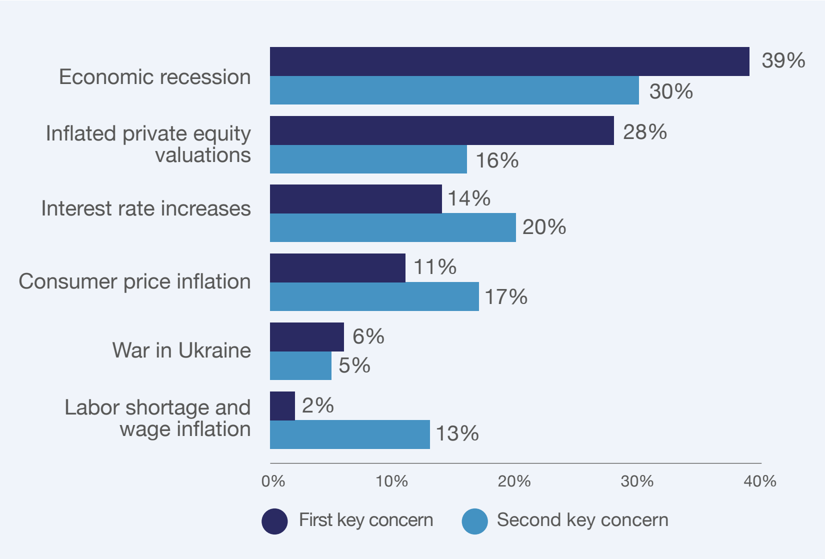



**Figure 10**

With the prospect of a global recession looming, it is no surprise that an economic recession was selected as the highest concern of respondents for the next 12 to 24 months. At the same time, almost 30% selected inflated private equity valuations as their key concern, as valuations in the asset class remain high despite the recent stock market corrections.

## Median private equity buyout multiples reached record-high levels in 2021. Do you expect that over the next 24 months, average multiples:

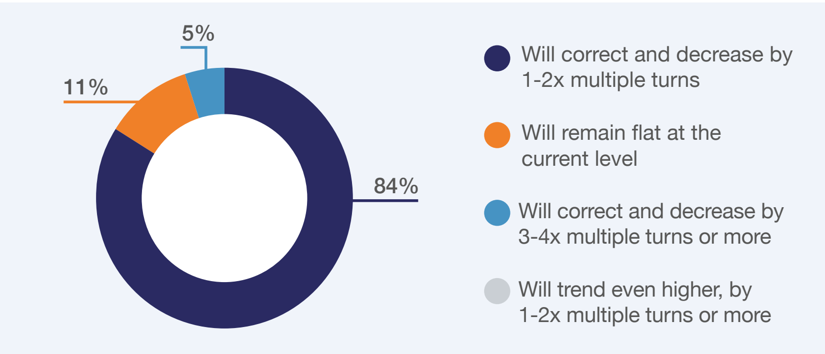



**Figure 11**

The current valuation levels are not expected to be sustainable, and 84% of respondents see private equity buyout multiples decreasing by 1-2x multiple turns, up from 35% in 2021. Interestingly, only 5% expect a sharper correction with multiples decreasing by 3x multiple turns or more.

Generally, respondents expect private equity to outperform public markets over time. For instance, an investor indicated that **"there are fundamental reasons why private equity should outperform: GPs have control over management, there is potential for operational improvements, and bad managers naturally go out of business, leaving the space to those that are actually able to create value."**

[4] *Source: Capital IQ, data as of November 11, 2022*
[5] *Source: Eurostat flash estimate - August 2022 and U.S. Labor Department data published September 13, 2022*





## How has your private equity portfolio performed in 2022 to date?

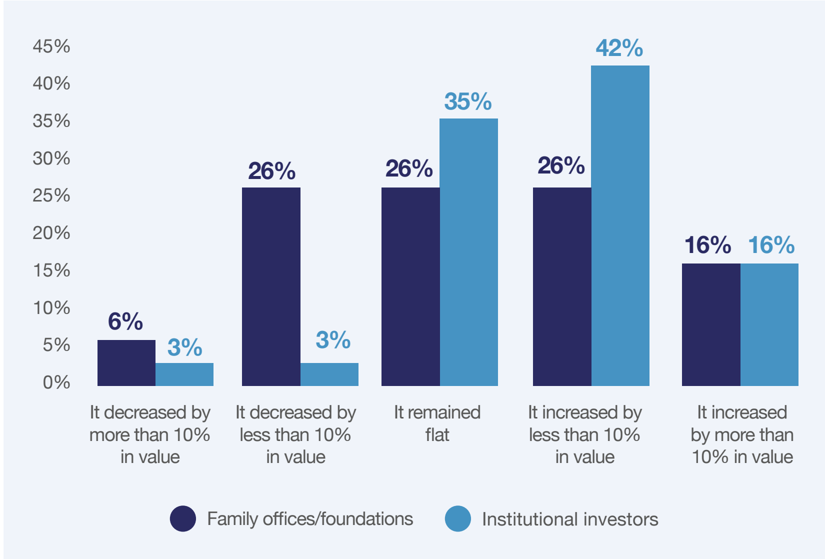



**Figure 12**

Performance at the time of our survey remained strong, with 50% of respondents indicating that their private equity portfolio increased in value and only 20% reporting negative year-to-date performance. Family offices and foundations have experienced a broader range of outcomes, potentially driven by a higher risk appetite.

Investors remain generally optimistic about the long-term performance of private equity, as one respondent from a bank mentioned: **"While performance over the next 12-24 months might be softer, we are convinced that private equity will continue to outperform in the mid-to-long-term."**

## Following record-high valuations in 2021, stock markets have corrected significantly in 2022. How do you expect them to perform over the next 24 months?

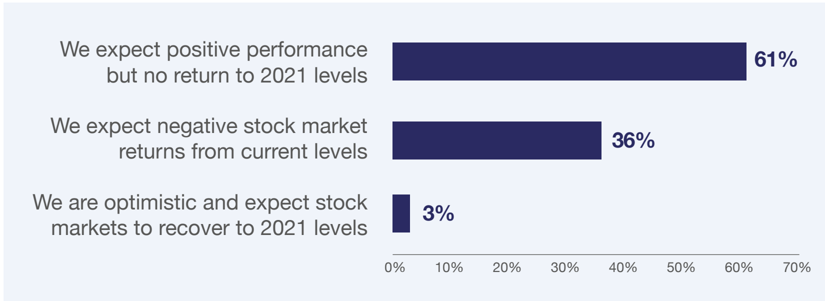



**Figure 13**

Respondents remain optimistic about stock market performance over the next 24 months, with about two-thirds expecting positive performance, and only one-third forecasting negative returns from current levels.

## How concerned are you about the impact of consumer price and wage inflation on your private equity portfolio?

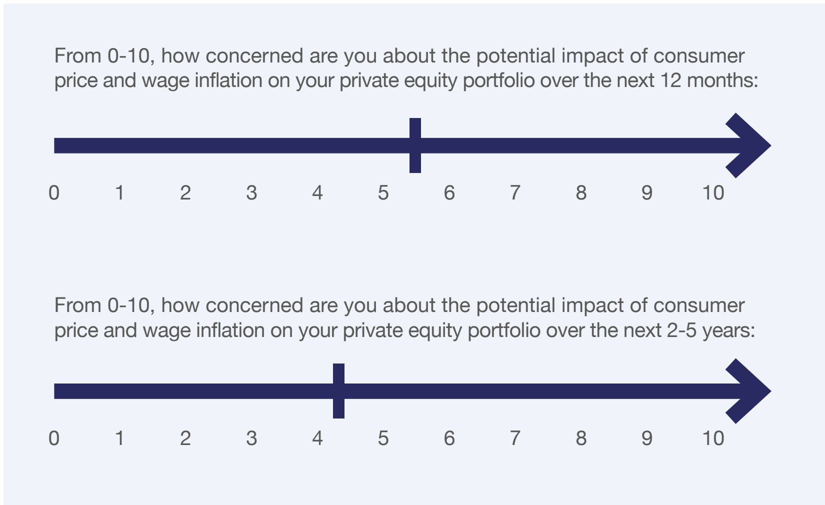



**Figure 14 & 15**

Concerns about the short-term impact of inflation on private equity portfolios have increased compared to last year but have remained stable when looking at the mid-term (2-5 years). This could indicate that private equity investors remain confident in the asset class and the ability of private equity portfolios to withstand the currently high levels of inflation.

An investor commented: **"We are confident that inflation will come down and that portfolio companies with solid pricing power will be able to cope with a 3-4% long-term inflation rate."**

# Secondaries

**Secondary funds are typically well diversified, offer an attractive cash flow profile, and reduce the blind pool risk associated with primary strategies. In addition, secondary strategies are expected to perform well in a downturn, as buyers can take advantage of the pricing inefficiencies and offer a solution to investors looking for immediate liquidity. It is, therefore, no surprise that respondents indicated a strong appetite for the strategy, with a clear preference for complex and diversified transactions.**

## How would you describe your relationship with secondaries?

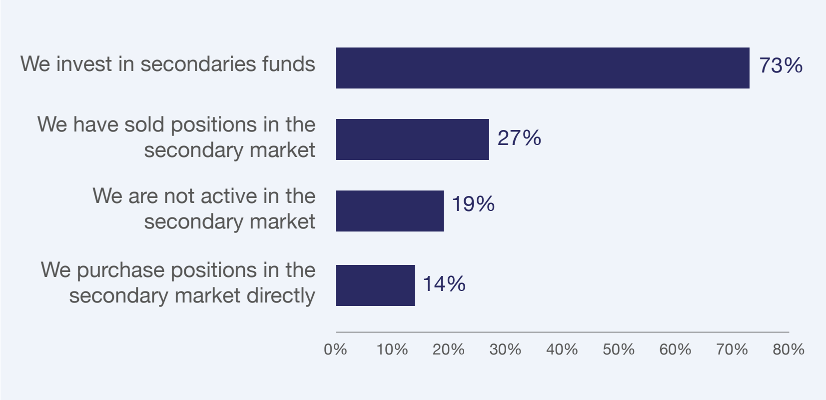



Figure 16

Almost three-quarters of respondents invest in secondary funds, and over a quarter have made use of the secondary market to sell positions.

An investor noted: **"Secondaries are increasingly sophisticated, and GPs create value not only through discounts but also through asset selection and structuring. For institutions, secondaries have become an important portfolio management and rebalancing tool.**

## Do you expect to be selling positions in the secondary market in the next 12 months?

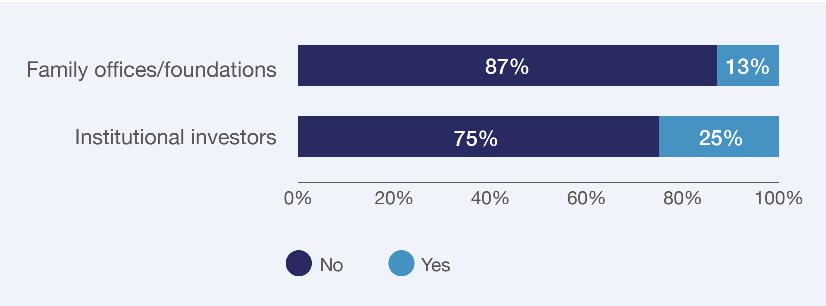



Figure 17

While a majority of respondents do not expect to be selling positions in the next 12 months, the 25% of institutional investors and 13% of family offices and foundations that indicated they would do so represent a significant amount of AuM and, therefore, an attractive opportunity for potential secondary buyers in the upcoming months.

## What proportion of your private equity allocation is dedicated to secondary strategies?[6]

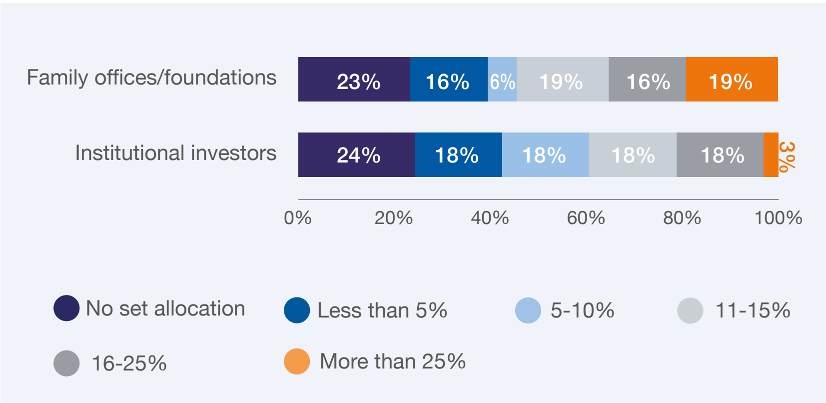



Figure 18

Over half of family offices and foundations and almost 40% of institutional investors allocate more than 10% of their portfolio to secondaries (vs. 43% and 30% last year), which is also in line with investors' strategic preferences (see also Figure 4).

An investor from a large endowment mentioned: **"Secondaries play a critical role in our PE allocation, as they offer an attractive mix of broad diversification and earlier cash flows."**

[6]Commitments to secondary funds and/or purchasing secondaries directly





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

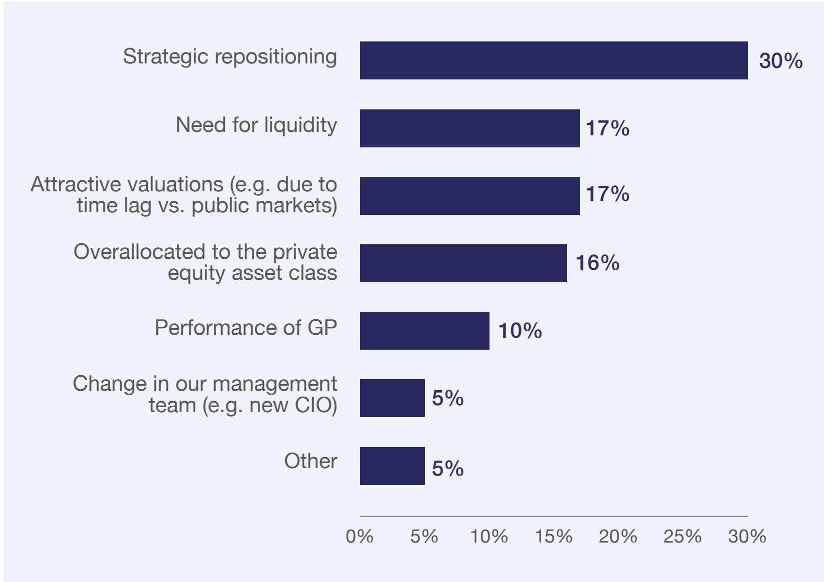



Figure 19

For the fifth consecutive year, investors selected strategic repositioning as the most likely reason to sell positions in the secondary market, highlighting it as the dominant driver for active portfolio management. It is noteworthy that almost a third of investors would consider selling positions either due to a need for liquidity or because they have become over-allocated to the asset class.

For instance, an investor from a pension fund indicated: **"Driven by the strong performance of private equity, our portfolio has reached regulatory allocation limits, which is why we will look at secondaries to reduce our exposure and make room for re-ups and new manager relationships."**

## As an allocator of capital to secondary strategies over the next 12 months, which two would you prioritize?

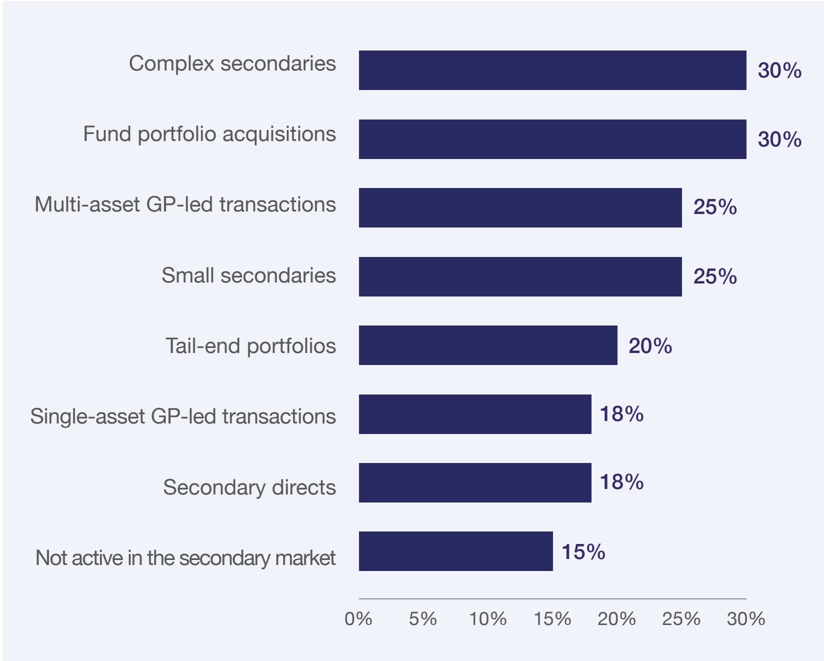



Figure 20

Niche strategies and diversification are top of mind when it comes to investor preferences in the near term, with complex secondaries and fund portfolio acquisitions ranking first, followed by multi-asset GP-led transactions and small secondaries.

## What is your view on single-asset GP-led continuation funds?

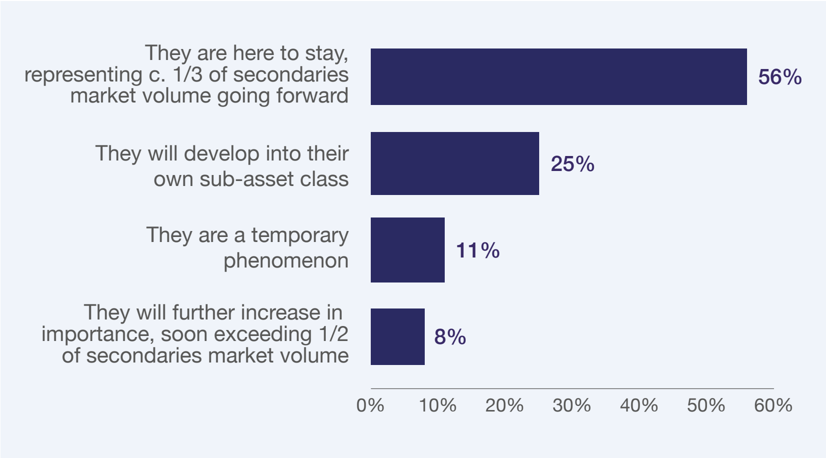



Figure 21

Single-asset GP-led continuation funds have become increasingly important in the past years, representing about half of the GP-led market, and about a quarter of the total secondary market. Respondents agree that this type of transaction is here to stay and not a temporary phenomenon. A quarter of respondents even expect them to develop into their own sub-asset class.

An investor commented: **"We believe that GP-leds provide a clear value-add by allowing GPs more time to create value, which is especially important since Covid significantly delayed value creation initiatives in many sectors."**

## Do you want your secondary GPs to actively invest in single-asset GP-led transactions?

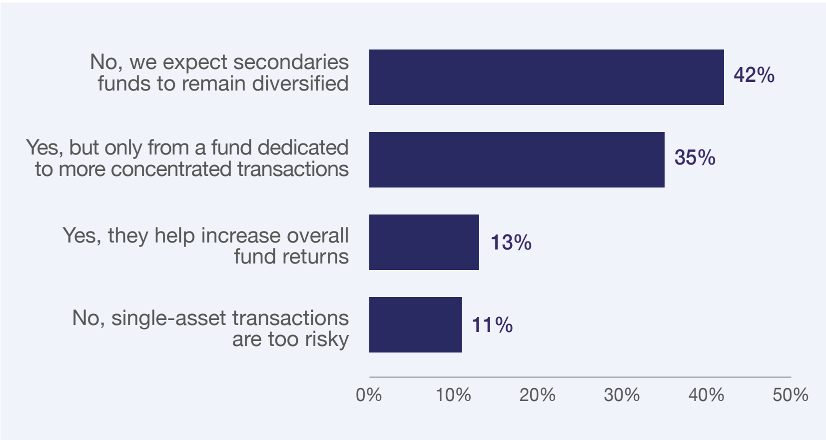



Figure 22

While single-asset GP-led transactions are often considered an attractive tool to increase returns, investors also believe that secondary funds should remain sufficiently diversified and/or that secondary GPs should invest in such transactions from a dedicated fund.

An investor from a private bank commented: **"We believe that GP-led transactions can provide attractive returns. However, alignment with the manager and detailed due diligence on the assets are essential to identify the right opportunities."**

*[7]Based on H1 2022 market volume. Source: Evercore H1 2022 Secondary Market*



# Portfolio management – coping with the fundraising frenzy

**At the end of July 2022, there were 4,055 funds in the market, up from 3,801 at the end of Q1, which were collectively seeking USD 1.23 trillion of capital. 2021 was a record year for fundraising, but the first half of 2022 already saw a decline, with only USD 337 billion of capital raised, down from USD 459 billion during the same period in 2021.[8] The last 12 months have seen many GPs returning to the market, and LPs have adopted various strategies to cope with re-ups. Still, the fundraising environment is generally expected to slow down in 2023.**

## The number of private equity managers you invest with:

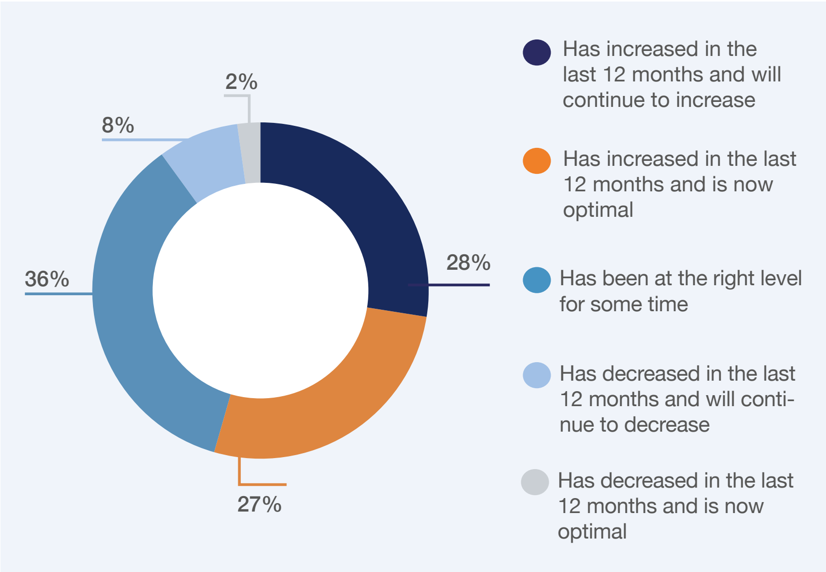



Figure 23

For 55% of respondents, the number of active GP relationships has increased over the last 12 months. However, that figure is expected to stabilize, as 64% of respondents now consider their number of relationships to be optimal.

## Despite a slowdown in H1, 2022 is on track for another strong year of private equity fundraising. Do you believe fundraising volumes will remain as strong in 2023?

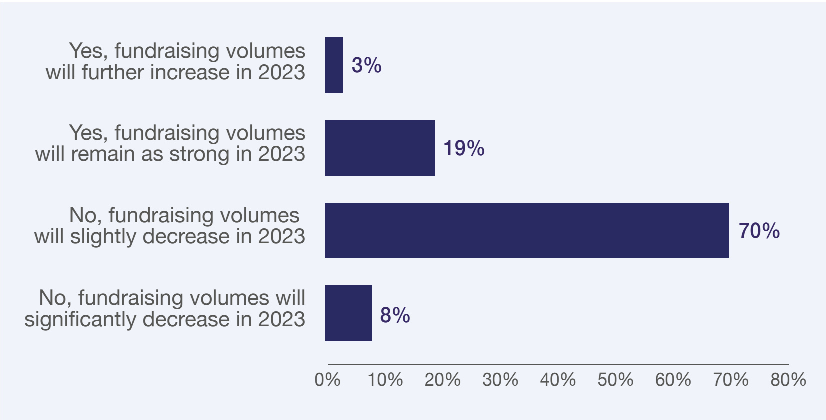



Figure 24

Respondents expect the fundraising environment to slow down in 2023 and volumes to slightly decrease.

[8]*Source: PEI Fundraising Report H1 2022*





## How do you approach re-ups in the current fundraising environment?

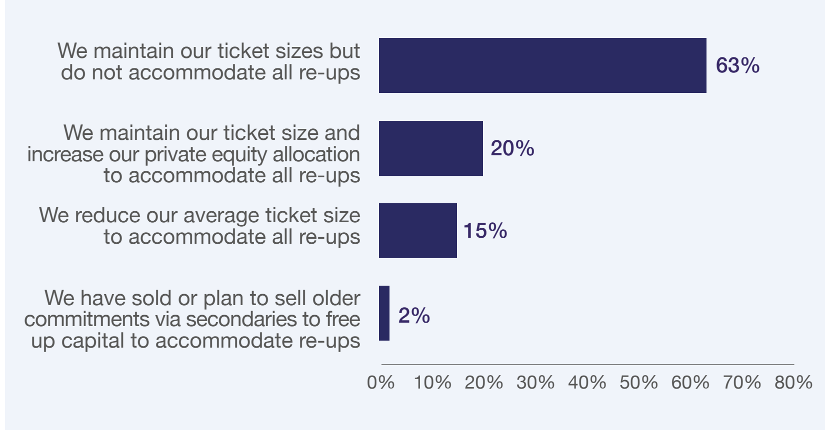



Figure 25

Not all re-ups could find a home, as most respondents indicated that their strategy to cope with the frenetic fundraising pace was to maintain their ticket size but be selective when deciding which GPs to re-invest with. Family offices and foundations tend to have a more flexible investment program and 27% of those investors could increase their private equity allocation to accommodate all re-ups (vs. 13% of institutional investors).

An investor added: **"We see unprecedented fundraising volume and GPs coming back to market faster than ever. We still try to evaluate each manager on their own merit and will accommodate most re-ups, however, we will reduce our average commitment size."**

## How much visibility do you already have on your private equity allocations for 2023?

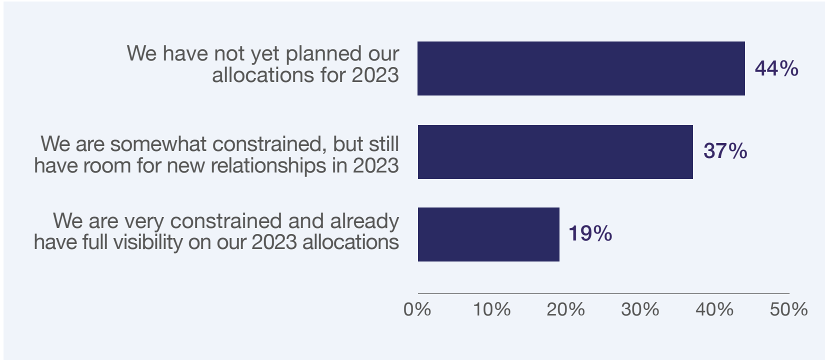



Figure 26

Good news for GPs planning to go back to the market in 2023, as 44% of respondents have not yet planned their allocation for 2023, and 37% of them still have room for new relationships in 2023 in spite of being constrained.

An investor from a large public pension fund however mentioned: **"We expect the 2023 fundraising environment to be very competitive and we will carefully assess the pricing discipline of GPs over the last years to decide on re-ups and new commitments."**

# Participant information

### What is your institution type?

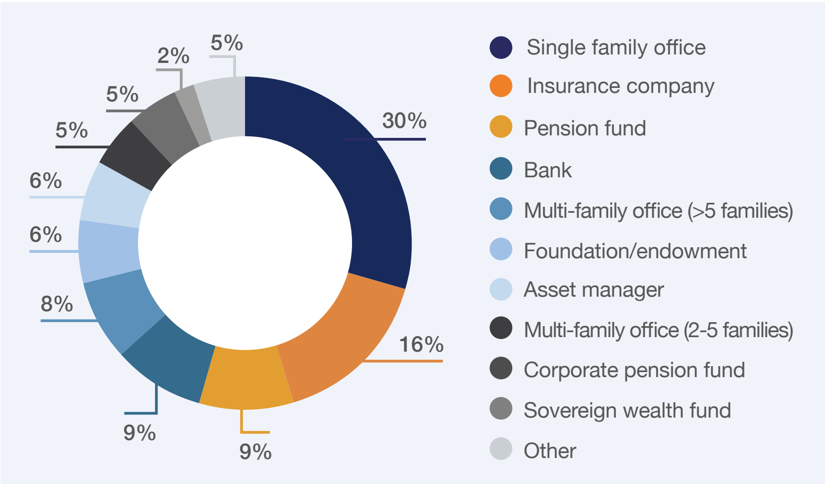



**Figure 27**

48% of respondents this year were family offices (single or multi-families) and foundations/endowments. 52% were institutional investors, ranging from sovereign wealth funds to pension funds.

### Where is your institution located?

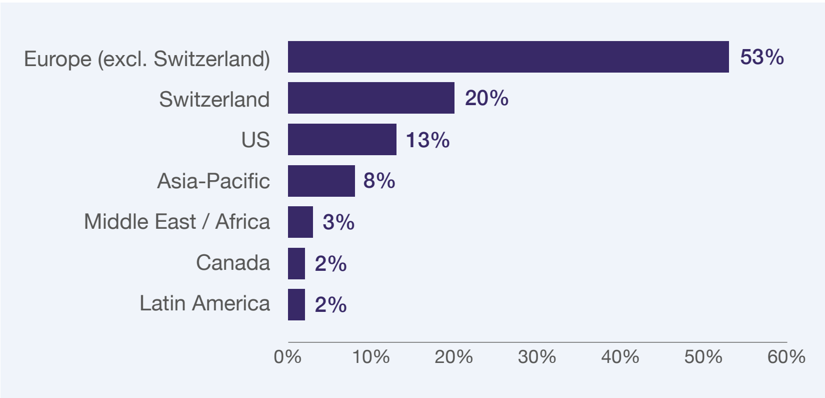



**Figure 28**

Most respondents are based in Europe, with 15% in the US and Canada and the remainder in APAC, MENA, and Latin America.

### How long have you been operating? What is your AuM?

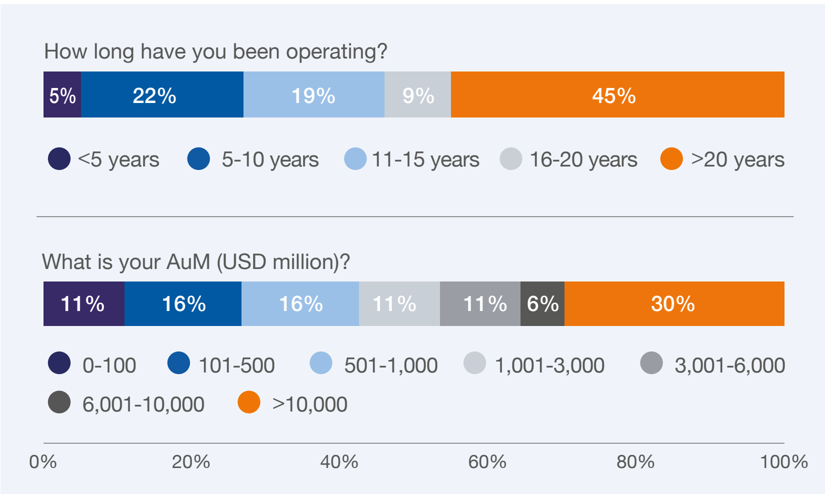



**Figure 29 & 30**

Respondents are well-established private equity investors, and almost half of them have been operating for more than 20 years. They also represent a significant amount of AuM.



# About us

mcp is a Swiss-based private equity investment firm focused on attractive niches of the secondary market globally. The firm has acted as an investment advisor for five funds so far, each closed at the hard cap with total AuM of more than EUR 3.4 billion (USD 3.5 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 1.3 trillion global investment management business of Prudential Financial, Inc. mcp has retained its investment autonomy and independence, and benefits 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