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mcp

Annual Investor Survey 2020

How leading investors approach private equity during and after Covid

montana capital partners

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Summary

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

In a market environment characterized by a high level of uncertainty caused by the Covid crisis, our research report explores the allocations, appetites, and concerns of investors in private equity. It highlights some of the key changes compared to last year, with the aim of understanding the impact of Covid on the private equity market and the challenges and opportunities that investors are facing.

KEY FINDINGS

- The appeal of private equity to investors has increased further throughout the Covid crisis, with now almost half of family offices and foundations allocating more than 20% of their portfolio to the asset class, and slightly over three quarters of institutional investors allocating between 1% and 10% of their portfolio. 48% of respondents from both categories plan to increase their allocation further next year

- Almost a third of institutional investors will not invest unless a comprehensive ESG policy exists, a sharp step up from last year's 16%. An ESG policy is considered as important or essential for 91% of institutional investors and for more than 50% of family offices and foundations

- 72% of family offices and foundations and 67% of institutional investors invest in secondaries funds, evidencing how important the secondaries market has become for private equity investors. Complex and small secondaries, as well as GP-led transactions, are considered the most attractive strategies

- The top two key concerns of investors regarding the market activity over the next 12 to 24 months are a lack of economic recovery and GPs buying into new companies at too high EBITDA multiples. Investors are divided about the future development of stock markets, with 36% expecting a major correction in the next 12 months and 45% believing that the stock markets will remain at or above current levels. Private equity EBITDA multiples are expected to remain at the current level by almost half of respondents, and 40% expect they will decrease by 1-2 multiple turns only

- For 48% of investors the most attractive theme in the secondaries market over the next 12 months will be the opportunity to buy into fundamentally sound companies that are temporarily underperforming due to Covid. GP-led preferred equity solutions to support portfolio companies is the second most attractive theme, selected by 40% of respondents

- Overall, 63% of investors expect capital calls to exceed distributions in their portfolio in 2021, which could lead to liquidity issues in case the Covid crisis persists

ABOUT MCP

mcp has 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.

We create innovative liquidity solutions that enable secondary sellers and GPs to actively manage their private equity portfolios by selling both funds and fund-of-funds interests as well as direct company stakes.

mcp focuses on directly sourced transactions to create 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.

We hope that the mcp Annual Investor Survey 2020 offers you many valuable insights. Should you have any questions or comments, please do not hesitate to get in touch.

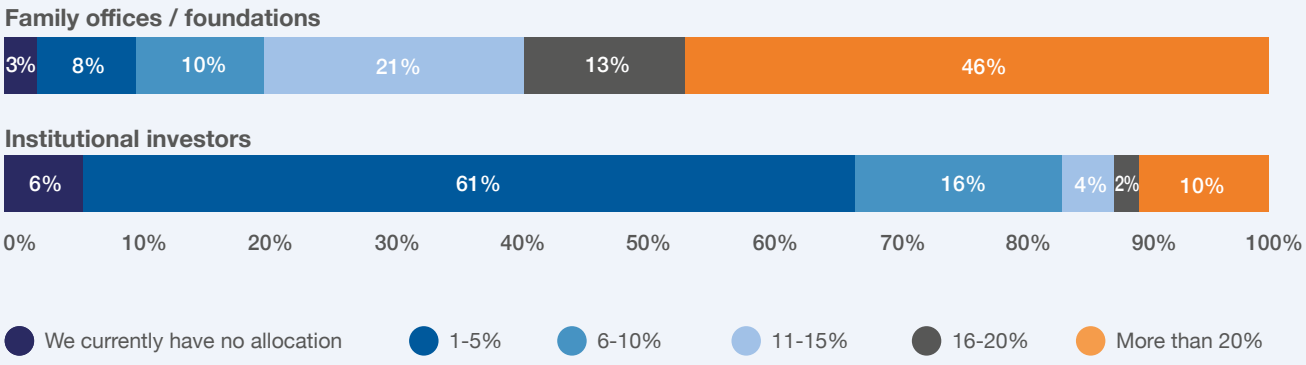
Investor allocations to private equity

At the time of last year's survey, the first signs were emerging that one of the longest bull markets on record could be coming to an end. What we could not foresee, however, is that markets would be shaken by a virus that has taken the world by surprise and led to increased market volatility, fears of a global, long-lasting economic recession, and unprecedented stimulus programs from governments and central banks. This year's survey therefore investigates how some of the leading investors in private equity have adapted to this new environment and how their views and allocations have evolved since the onset of the Covid crisis.

Private equity remains a very attractive asset class for family offices and foundations, with almost half of respondents from this category allocating more than 20% of their portfolio to the asset class (see Figure 1). This represents a sharp increase from last year's 34%, suggesting that an ever-increasing number of family offices and foundations turn to private equity to boost their returns.

Figure 1

What is your current allocation to private equity?



Meanwhile, institutional investors such as pension funds, asset managers, insurance companies, and banks, display a more measured approach, with slightly over three quarters of respondents from this category allocating between 1 and 10% of their portfolio to the asset class. 10% of institutional investors report an allocation of more than 20%.

This strong appetite for private equity is also evidenced by Figures 2 and 3, which show that 43% of all respondents increased their allocation to the asset class in the last 12 months and an even higher number, 48%, expect to increase it again in the next 12 months. This figure is the highest since we first started asking this question

Figure 2

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

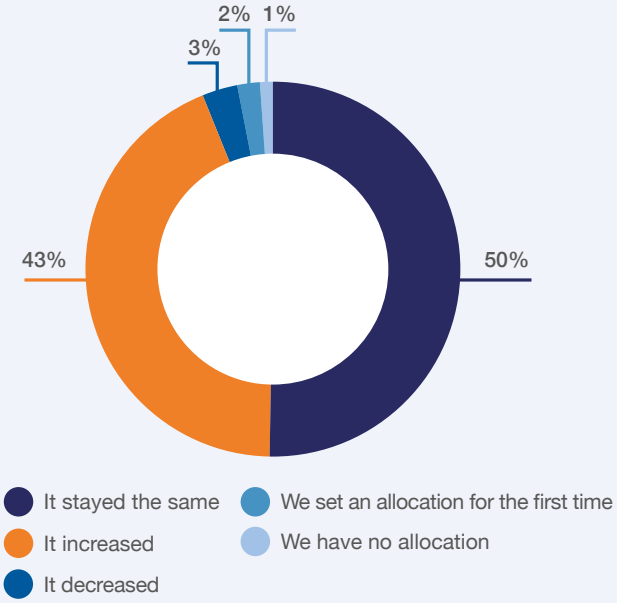
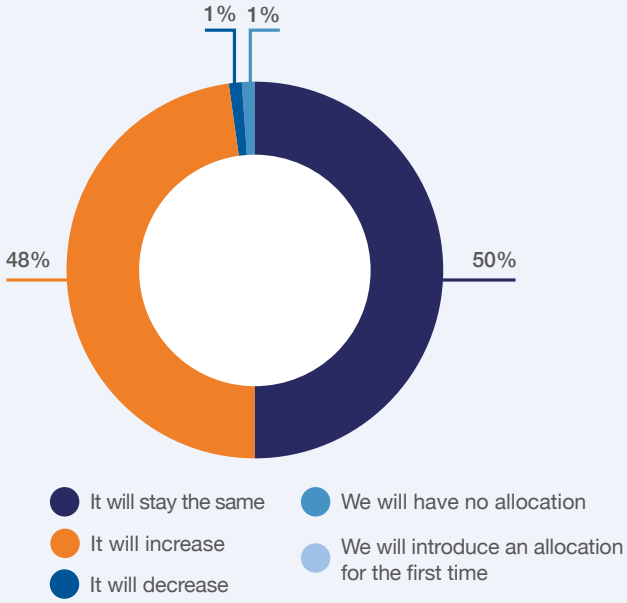


Figure 3

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



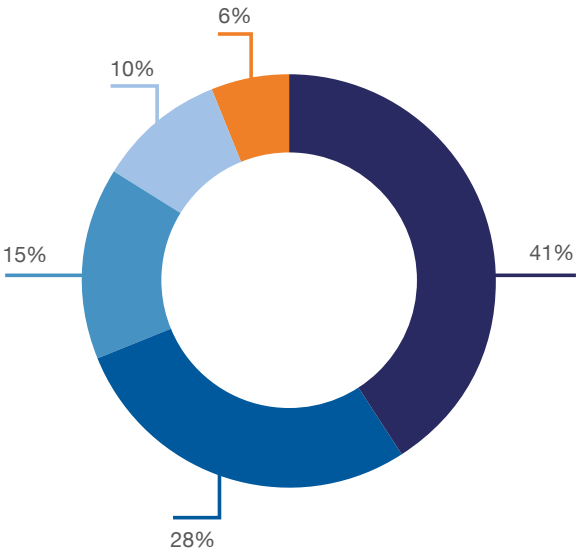
back in 2013, suggesting that investors find private equity particularly attractive in the current market environment.

A senior banker from a German bank mentioned: ***"We have been and remain very positive about private equity. Interest rates are low, there is a lot of liquidity available in the market, and no other asset class offers similar returns. In the next 12 months, we plan to increase our private equity offering."***

For 41% of respondents, this increase will be accompanied by an increase in the number of managers they invest with, as shown in Figure 4.

Figure 4

The number of managers you invest with:



Investment preferences

In this section we explore the strategic and geographic preferences of investors, as well as their return expectations.

We first asked investors to indicate their long-term strategic preferences in the current market environment. Mid-market buyout is the most attractive strategy for family offices and foundations as well as institutional investors, with 77% and 82% selecting it as a long-term strategic preference (see Figure 5). It is followed by secondaries, with 69% and 57% respectively. Secondaries have become more attractive for investors this year compared to last year, when it was selected as a long-term strategic preference by 66% of family offices and foundations and 51% of institutional investors. This is not surprising as secondaries tend to perform well in moments of uncertainty and increased volatility, when buyers can benefit from higher discounts and attractive portfolios are available for sale from motivated sellers seeking liquidity.

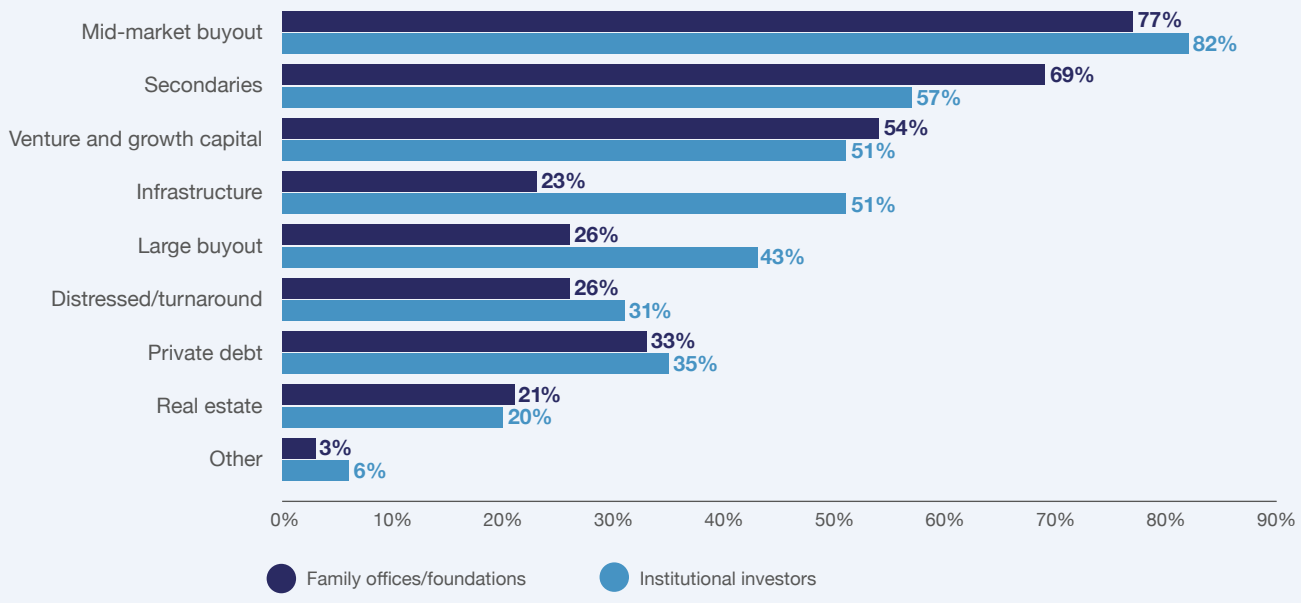
An investor, for instance, is indicating an increased interest in secondaries:

"Within the private equity market, we currently find mid-market buyouts and secondaries most attractive. We are, in particular, increasingly investigating secondaries strategies, principally due to the lack of J-curve effect. We also like niche strategies, in comparison to large funds that are too broadly diversified."

Venture and growth capital is also attractive for investors in the current environment, with about half of them selecting it as a strategic preference. Infrastructure seems to have become this year an attractive strategy for institutional investors, with 51% selecting it as a long-term preference, compared to only 36% last year.

Figure 5

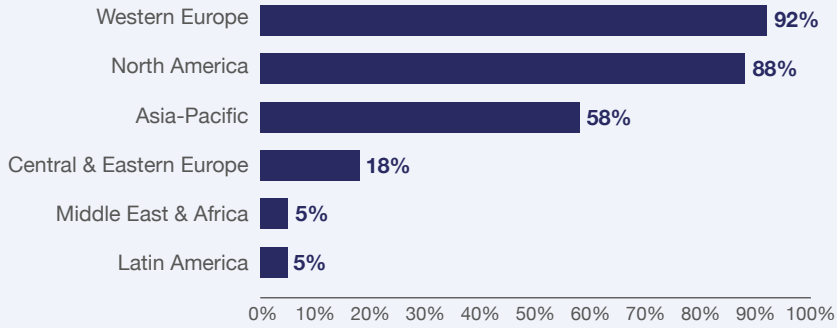
What are your long-term strategic preferences in the current market environment?



Despite the strong preference from all types of investors for investing in Western Europe and North America (see Figure 6), we note a significant increase in appetite for Asia-Pacific, with 58% of investors selecting it as a geographic preference this year, up from 41% last year.

Figure 6

What are your geographic preferences?

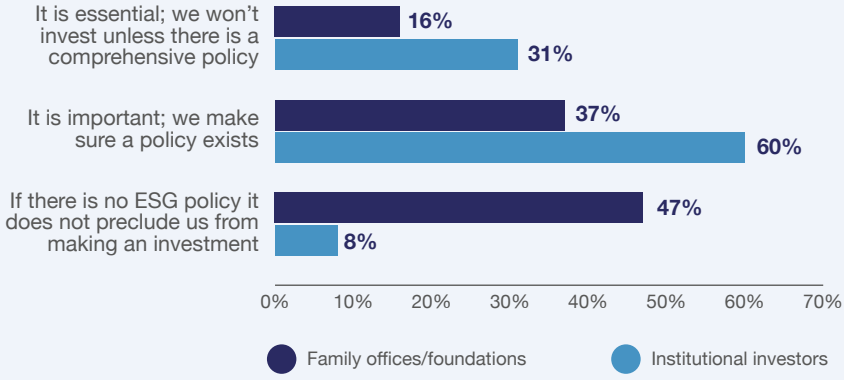


The importance of ESG for investors continues to increase. This year, almost a third of institutional investors will not invest unless a comprehensive ESG policy exists (see Figure 7), compared to only 16% last year. Overall, an ESG policy is important or essential for 91% of institutional investors and for more than 50% of family offices and foundations, which should be seen as a strong incentive for managers to include ESG considerations in their activities.

An investor commented: ***"ESG has to be an important component of our managers' strategy; they have to demonstrate real steps taken towards compliance with ESG standards. While ESG standards come at a cost, we believe that they are essential, not only from an ethical standpoint, but also to improve returns."***

Figure 7

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



We asked respondents for their return expectation for primary funds, secondaries funds and direct private equity/co-investments (see Figure 8). Return expectations reflect the risks associated with these strategies: a majority of investors expect returns above 15% for direct private equity/co-investments, between 11 and 20% for primary funds and between 11 and 15% for secondaries funds.

Figure 8a

Return expectation for primary funds

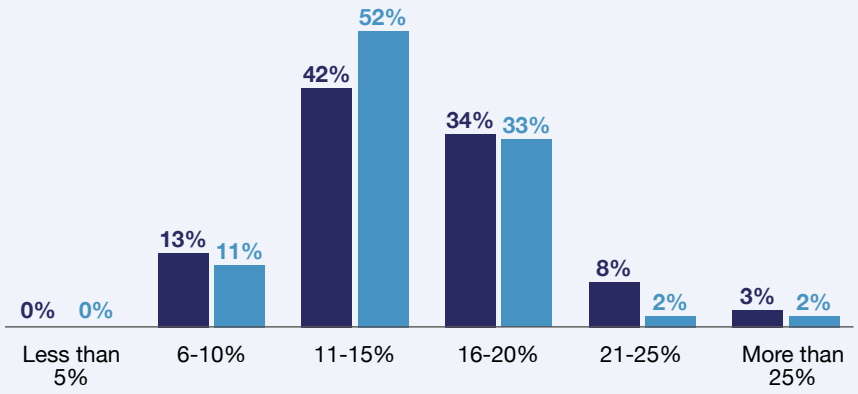


Figure 8b

Return expectation for secondaries funds

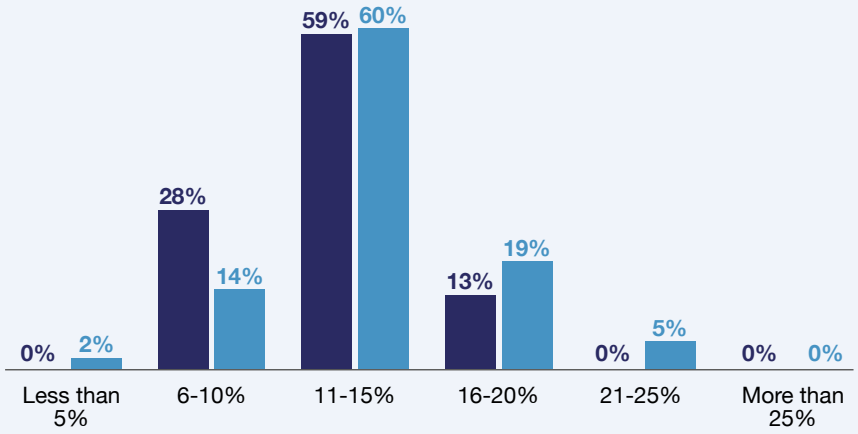
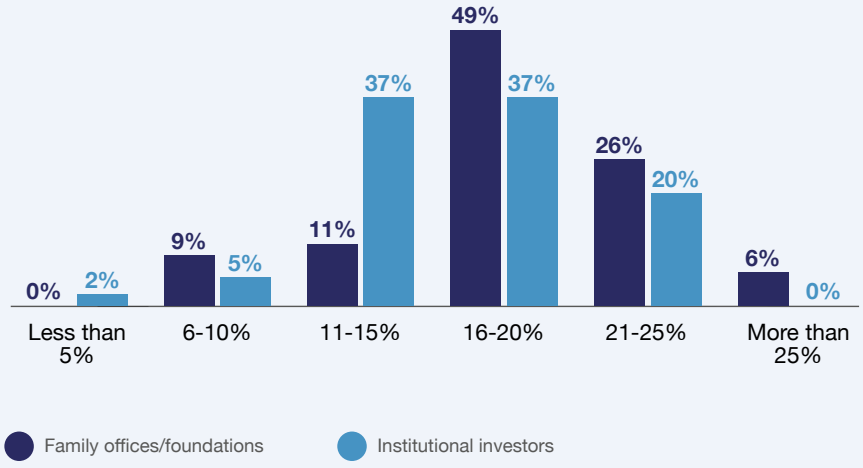


Figure 8c

Return expectation for direct/co-investments



Secondaries

A core focus of our mcp Annual Investor Survey is the private equity secondaries market and how investors use it to improve their returns and manage their portfolios.

According to this year's survey, 72% of family offices and foundations and 67% of institutional investors invest in secondaries funds (see Figure 9). This shows just how important the secondaries market has become for private equity investors. A smaller number of respondents has sold or plans to sell positions, suggesting that there may be further room for growth for the secondaries market, as investors become more familiar with the portfolio management tools available to them.

An investor from a Swiss foundation commented: ***"We started increasing our private equity allocation a few years ago, as we wanted to improve the risk/return profile of our overall portfolio. We particularly like investing in secondaries funds, they allow us to obtain a faster and more diversified exposure to the private equity market."***

Figure 9

How would you describe your relationship with secondaries?

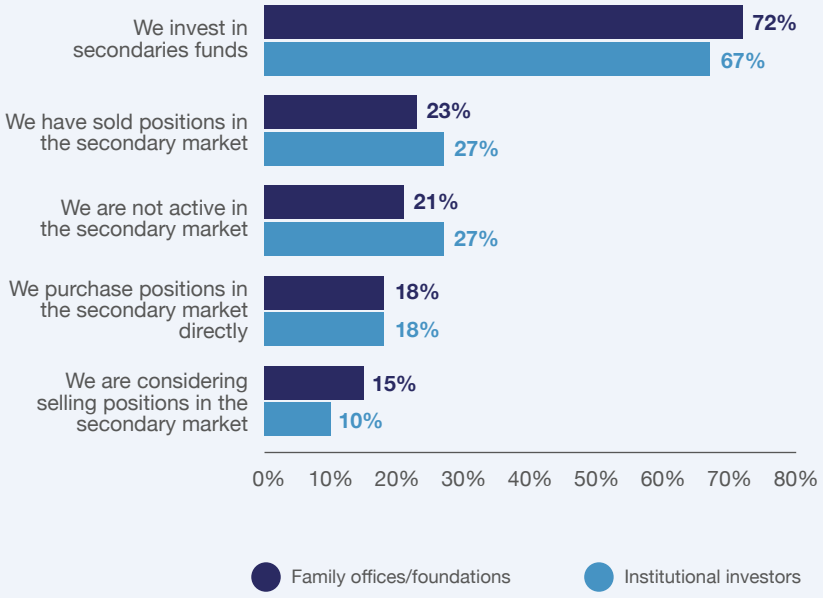
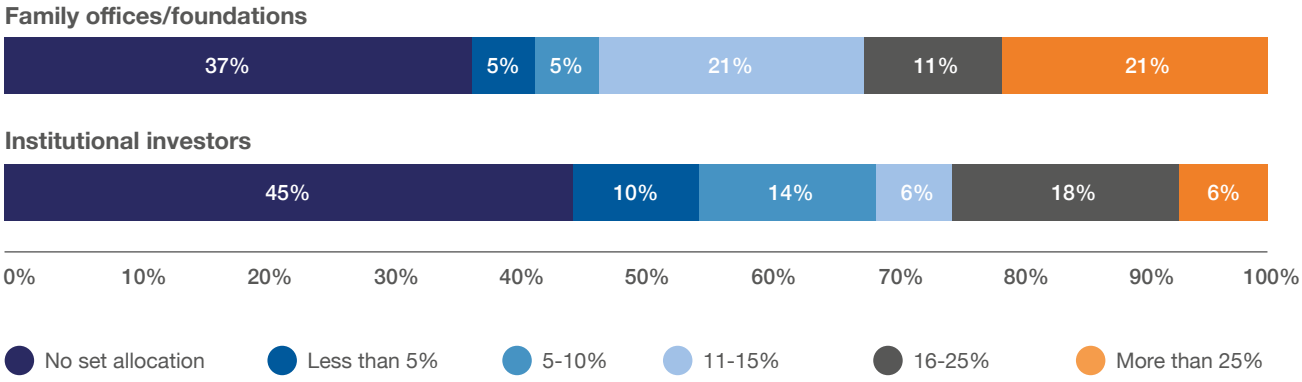


Figure 10 shows that 44% of institutional investors and 58% of family offices and foundations dedicate at least 5% of their private equity allocation to secondaries. Interestingly, we note that more than half of family offices and foundations allocate more than 10% of their private equity allocation to secondaries this year, a large increase to last year's 38%. The allocation of institutional investors has remained largely unchanged this year compared to last year.

Figure 10

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

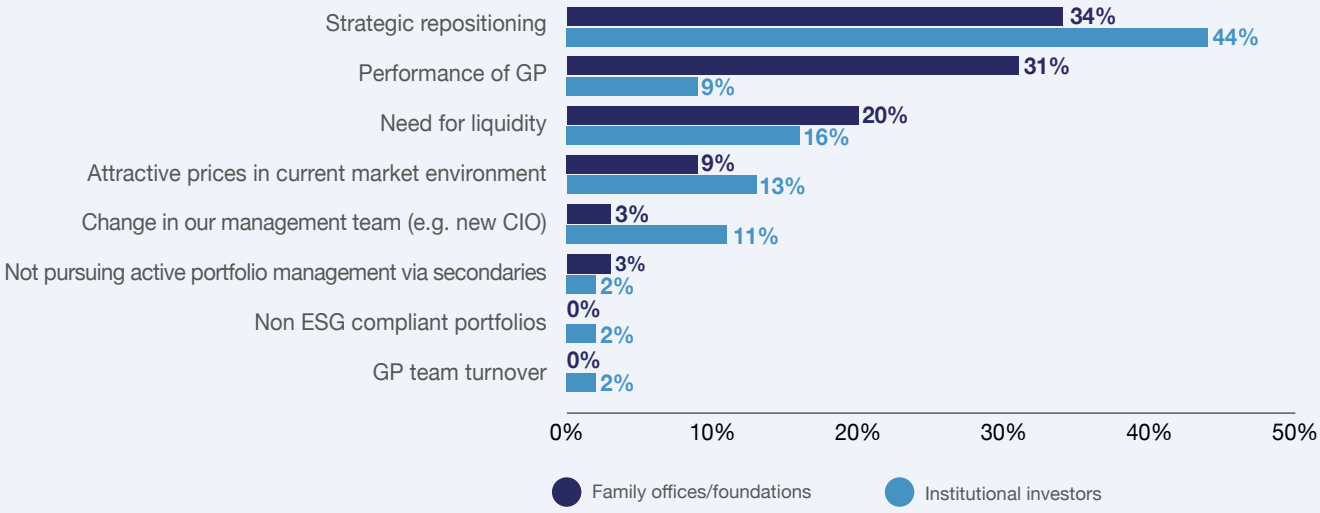


commitments to secondaries funds and/or direct secondaries purchases

Among those investors doing active portfolio management via secondaries, about 40% do so for the purpose of a strategic repositioning (see figure 11). The GP's performance comes as the second most likely reason for family offices and foundations, but only as the fourth for institutional investors. Instead, the need for liquidity is institutional investors' second most likely reason for doing active portfolio management via secondaries, with 16% selecting it, compared to only 8% last year. Fewer respondents mentioned "attractive prices" in the current environment. Last year, it was selected by 20% of both family offices and foundations and institutional investors, compared to 9% and 13%, respectively, this year.

Figure 11

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



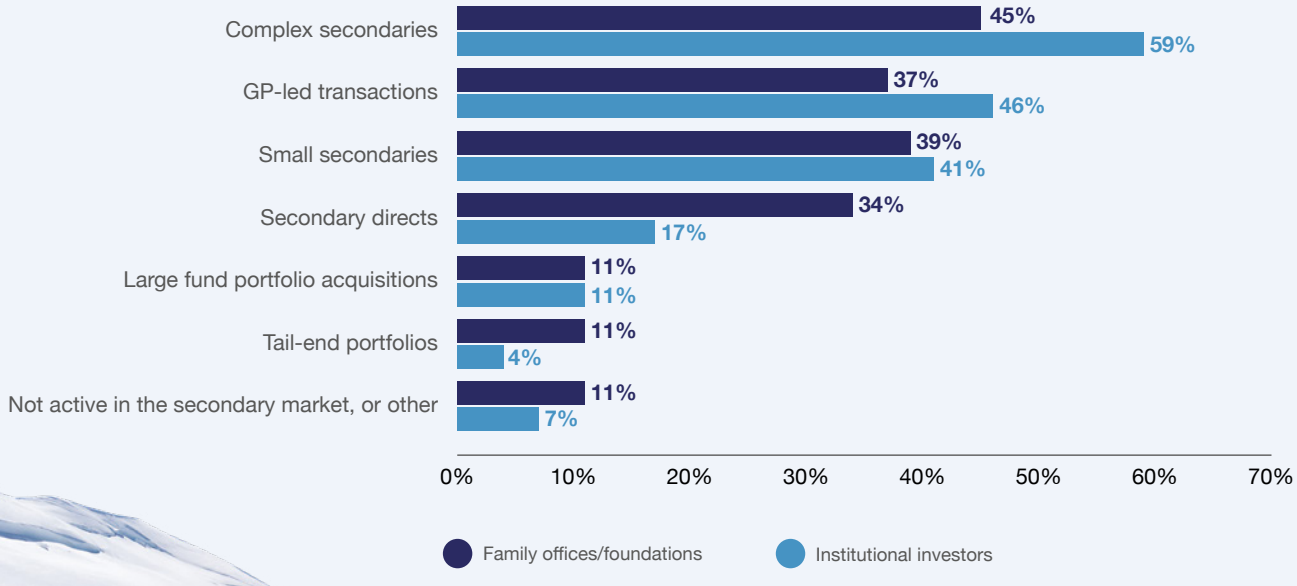
We asked investors which two secondaries strategies they would prioritize over the next 12 months. Both groups of respondents ranked complex secondaries first, followed by GP-led transactions for 46% of institutional investors, and small secondaries for 39% of family offices and foundations (see Figure 12). While GP-led transactions have gained in popularity over the last couple of years, small and complex secondaries consistently rank among the two most preferred strategies, which would suggest that the risk/return profile they offer is particularly attractive for investors.

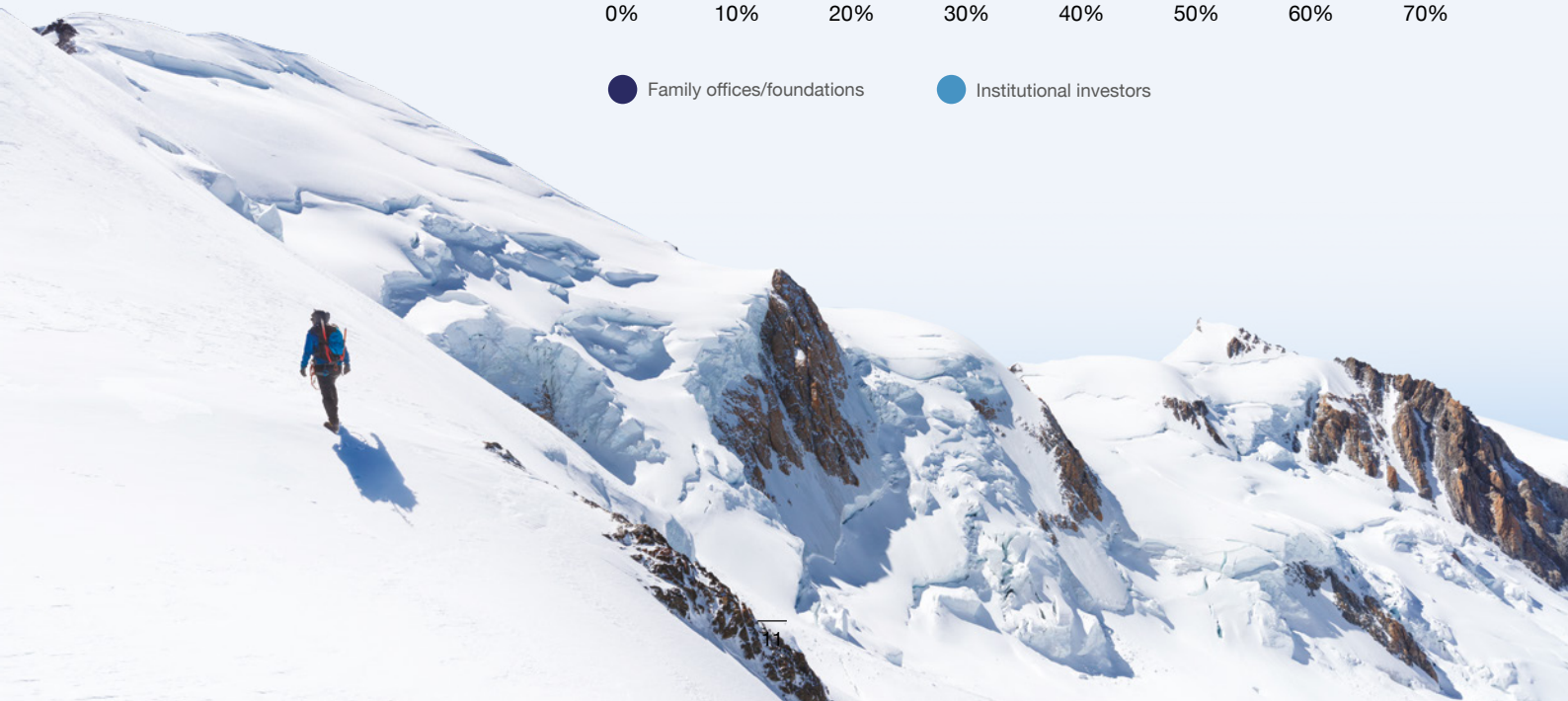
This view was shared by an institutional investor, who indicated:

"We find small and complex secondaries particularly attractive. Complex deals are more difficult to structure, while small deals are on nobody's radar. This leads to less competition and more attractive prices. In comparison, large cap secondaries have become less attractive."

Figure 12

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





Market trends

The current market environment is characterized by a high level of uncertainty, which is reflected in the answers of investors surveyed.

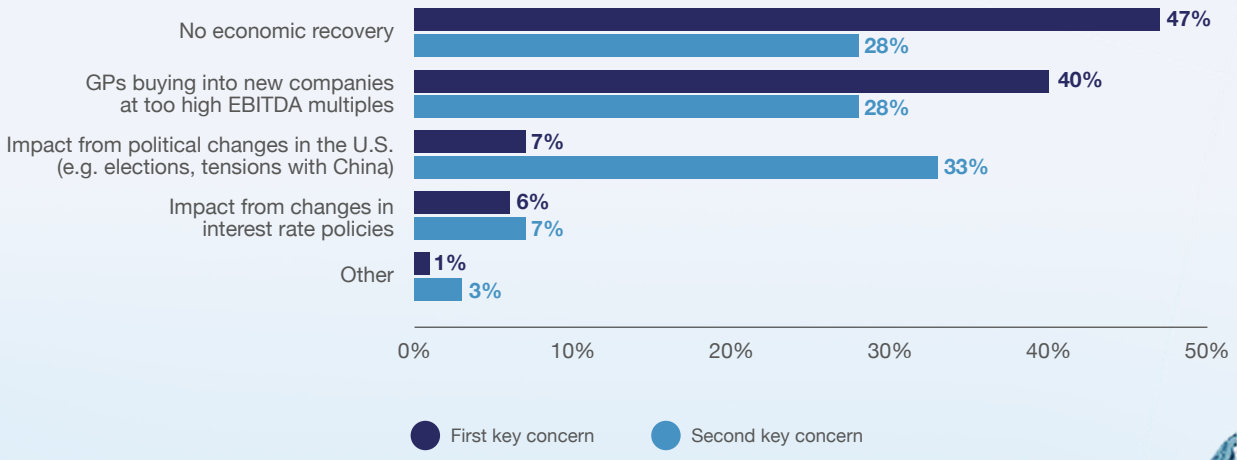
47% of respondents across investor types indicated "no economic recovery" as their first key concern regarding the expected market activity over the next 12 to 24 months, and 28% as their second key concern (see Figure 13).

With 40% of respondents selecting "GPs buying into new companies at too high EBITDA multiples" as their first key concern and 28% as their second, we can also sense the uncertainty of investors with regard to asset prices, which have remained high on average during the Covid crisis.

In an environment characterized by record low interest rates and a pandemic accompanied by an economic

Figure 13

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



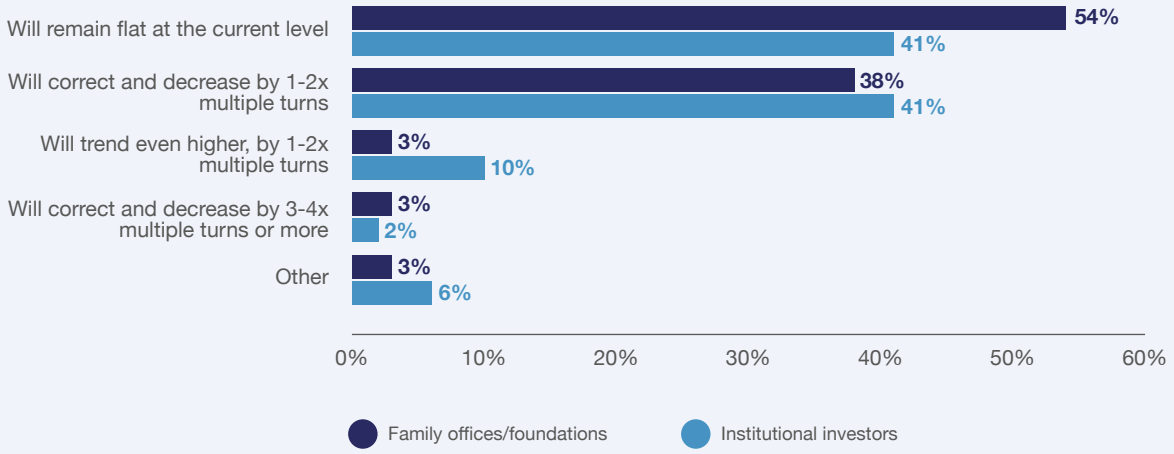
recession, investors believe that private asset prices have peaked (see Figure 14).

Very few investors believe that private equity buyout EBITDA multiples will increase even further from current levels in the next 24 months, while 41% of institutional investors and 54% of family offices and foundations expect them to remain flat, and 41% and 38%, respectively, expect them to decrease by 1-2 EBITDA multiple turns. Interestingly, 10% of institutional investors expect a severe contraction of 3-4 EBITDA multiple turns, while very few family offices and foundation expect this.

One investor argued: ***"Private equity prices will remain high for the same reasons that make the asset class attractive at the moment: lots of liquidity available in the market and no convincing investment alternative. In this context, I don't see why prices should come down."***

Figure 14

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



After a sharp drop at the beginning of the Covid crisis, stock markets have rapidly regained pre-Covid levels. Respondents are however divided about the likelihood of a major correction from here on. 45% of them expect that there will be no major correction in the next 24 months, while 36% expect a major correction to take place in the next 12 months (see Figure 15). 19% foresee a major correction in 12 to 24 months. Institutional investors are more optimistic than family offices and foundations, with more than half of respondents from this category expecting stock markets to remain at or above current levels in the next 24 months.

An investor from a U.S. endowment commented: ***"We are closely following the Fed to predict future valuations, and we expect massive interventions to keep interest rates low in the next two years; as a result, we believe valuations will remain high."***

In the current market environment, characterized by high stock prices despite economic recessions looming all around the world, we were curious to find out whether private equity investors had a different view than usual on private equity valuations. This does not seem to be the case, as 70% of respondents still consider that private market valuations follow public market valuations with a time lag (see Figure 16). However, 43% of respondents also believe that GPs value their portfolios in a more rational manner than stock market investors and only 21% think that GPs have not decreased their portfolio valuations enough due to fundraising considerations.

Interestingly, another institutional investor pointed out: ***"Private equity will follow the public markets with a certain beta; if public markets go down, private equity will not be exempt from it."***

Figure 15

Stock markets have rapidly regained pre-Covid levels. Do you expect a major correction to eventually take place and if so, when?

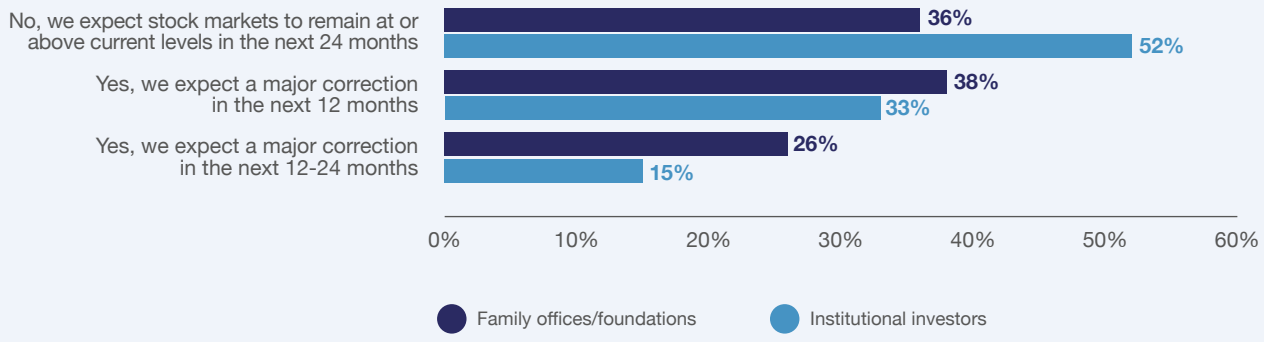
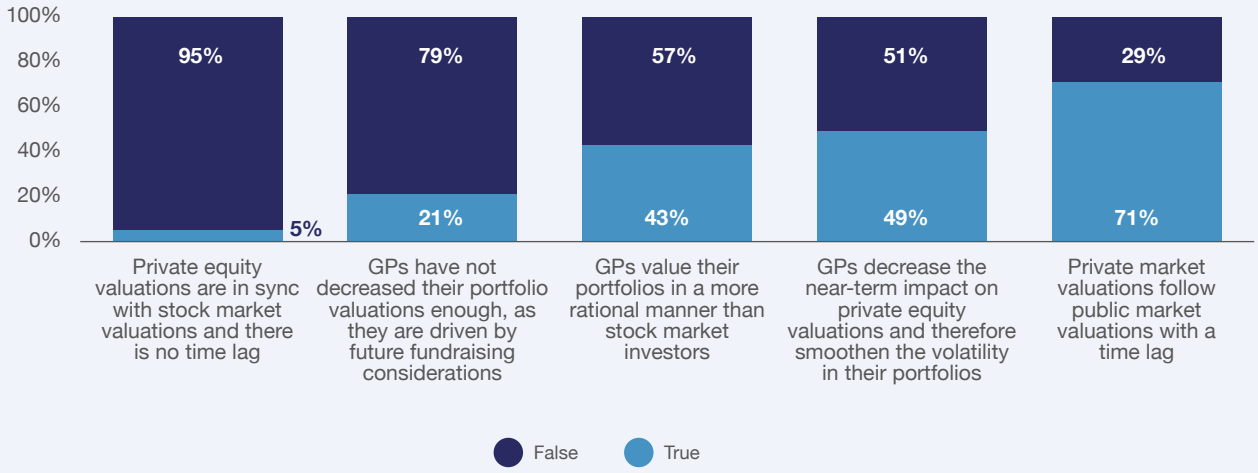


Figure 16

Which of the following do you believe is true for private market valuations in the current market environment?



Capitalizing on opportunities in a post-Covid environment

At the time of writing this report, Covid cases are on the rise again in Europe and elsewhere. A large number of industries and companies have been severely hit by the first wave and approach a second wave with concerns. Some sectors and investment strategies have however benefited from the current situation, and so have private equity funds investing in them. In what follows, we take a closer look at investors' expectations and strategic preferences for the next 12 to 18 months, how they expect to react to the current situation and what consequences it has for their portfolios.

We asked respondents to select the two industry sectors they found most attractive in a post-Covid environment. Software and information technology rank first, selected by 84% of respondents, followed by healthcare with 63% and business services with 34% (see Figure 17). Financials is the least attractive industry sector for respondents, selected by only 8% of them.

To quote one investor who volunteered to be interviewed following the survey:

"We find healthcare very attractive at the moment. There is an increasing awareness for health, and telemedicine is a huge opportunity. The same applies to the technology sector, which is supported by a shift in people's habits: they work from home, shop from home."

On the other hand, some investors are wary of the high valuations in some sectors that have been most resilient during the Covid crisis. One investor indicated that ***"business services and technology have been doing well during the crisis. We are however cautious because of the very high valuations in these sectors".***

Almost a quarter of investors plan to increase their allocation to secondaries funds to take advantage of opportunities arising from the current environment (see Figure 18), ahead of distressed/turnaround funds with just 16%. At the same time, around two thirds are relying on their regular private equity GPs to find the right post-Covid opportunities for them.

Figure 17

Which two industry sectors would you consider to be most attractive in a post-Covid environment ?

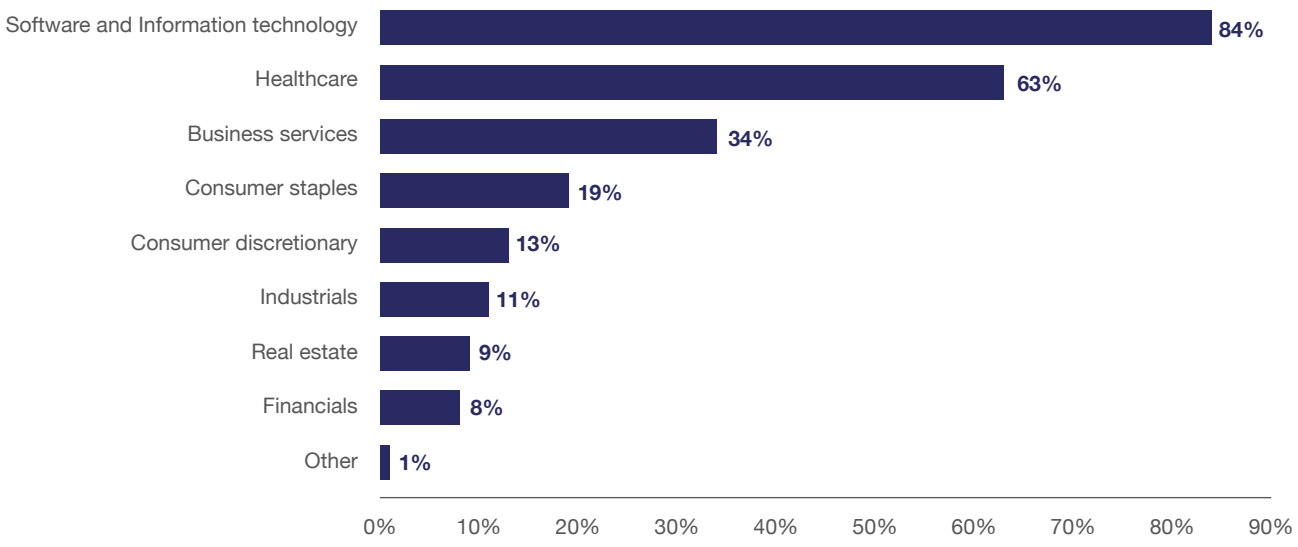
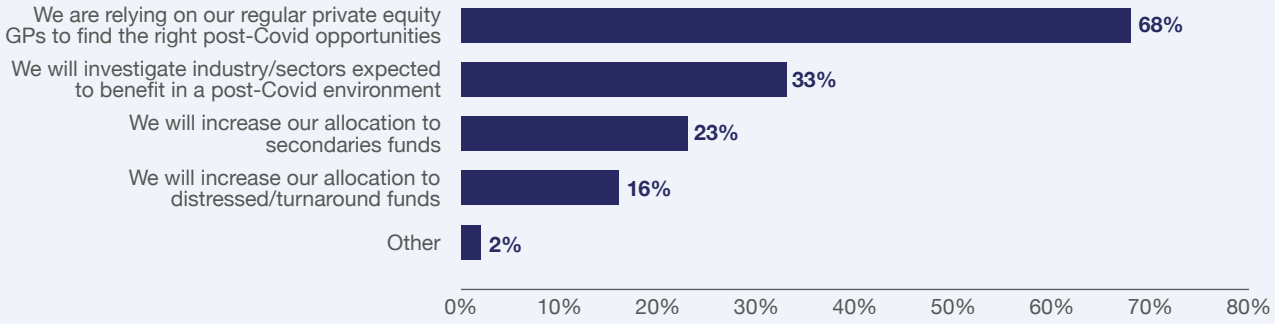


Figure 18

How do you plan to take advantage of opportunities arising from the current Covid environment?

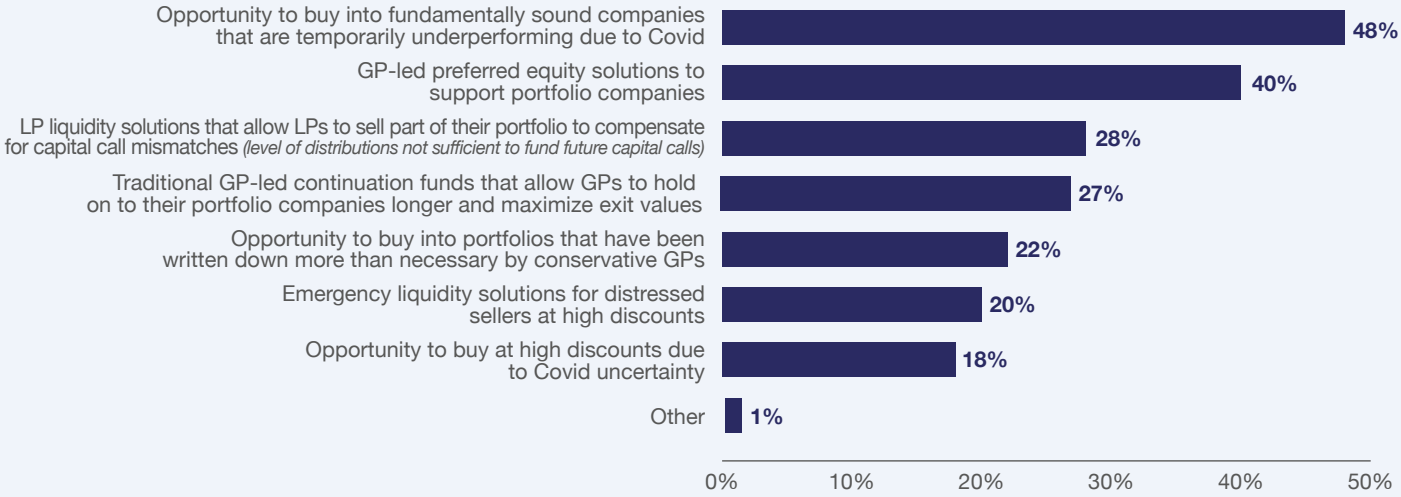


Secondaries benefited from the global financial crisis of 2008, as some investors in need of liquidity had to sell large portions of their portfolios, sometimes at very high discounts. In the current environment, we asked respondents to select the two most attractive themes in the secondaries market over the next 12 months.

As figure 19 shows, about half of investors expect secondaries funds to benefit from the opportunity to buy into fundamentally sound companies that are temporarily underperforming due to Covid. More innovative solutions

Figure 19

What do you think will be the two most attractive themes in the secondaries market over the next 12 months?



such as GP-led preferred equity solutions to support portfolio companies and LP liquidity solutions that allow LPs to sell part of their portfolio to compensate for capital call mismatches are also considered among the most attractive themes for secondaries.

An investor mentioned:
"The full impact of the pandemic is not yet priced in; when looking at GDP evolution, we believe that valuations are too high and will likely decrease. This will create opportunities, especially for secondaries buyers who will be able to acquire assets at attractive discounts from sellers in need of liquidity due to a decrease in the value of their stock market portfolio."

Figure 20

How have cash flows in your portfolio changed since the start of Covid, compared to last year?

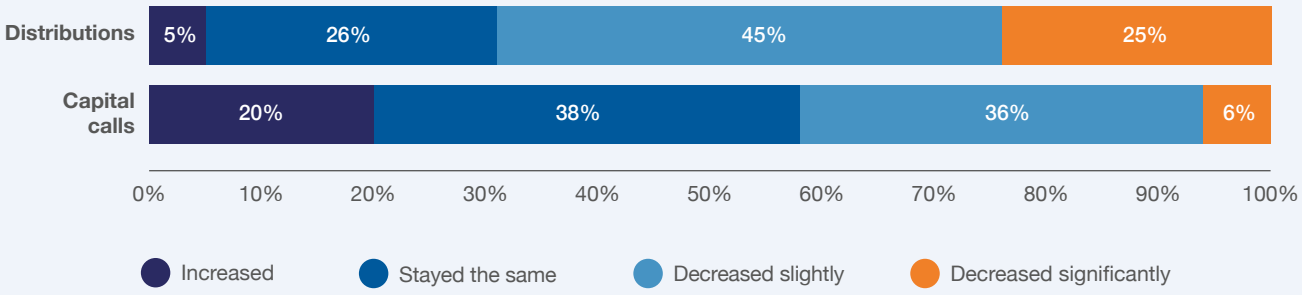
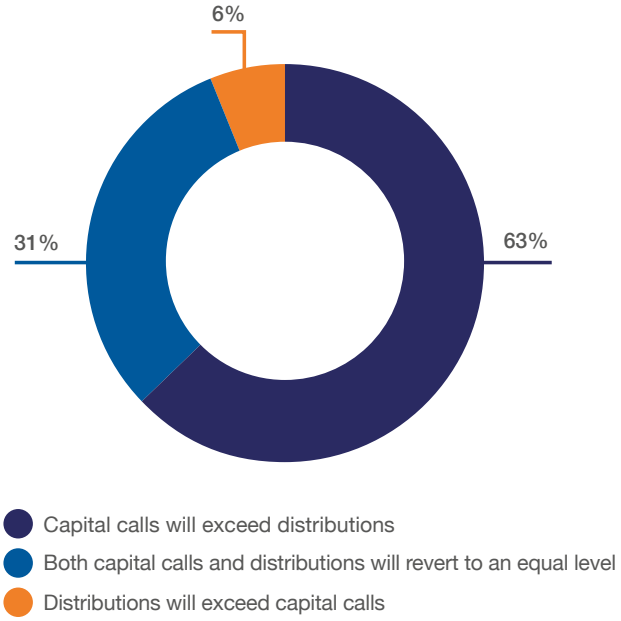


Figure 21

How do you expect capital calls and distributions in your portfolio to develop in 2021?



Another investor added:
"GP-led solutions will drive attractive deal flow, as GPs will increasingly use the secondaries market to support portfolio companies and return capital to LPs. Given their need for capital, we expect them to do so at investor-friendly terms."

We also asked respondents how cash flows in their portfolios have changed since the start of the pandemic, and what their expectations for 2021 are. For 70% of respondents, distributions decreased slightly or significantly, while capital calls stayed the same or increased for 58% of them (see Figure 20). This cash flow mismatch is expected to continue in 2021, with 63% of respondents indicating that they expect capital calls to exceed distributions (see Figure 21).

Participant information

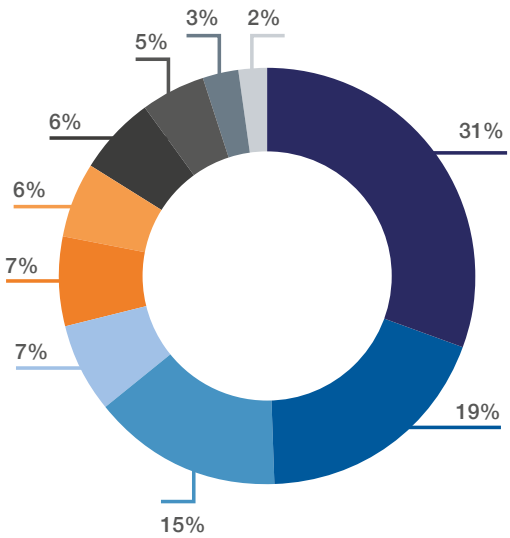
Our eighth Annual Investor Survey collected 101 responses from many of the world's leading investors in private equity, representing more than EUR 500 billion in assets under management. The survey results were then complemented by a number of one-to-one virtual interviews with investors who indicated their availability to discuss their responses in greater detail.

Responses this year again came from a wide range of investor types. Single family offices, multi-family offices and foundation/endowments, classified in our report as "family offices and foundations", represent 43% of all respondents. Insurance companies, pension funds, asset managers and banks, together 57% of respondents, are classified as "institutional investors".

Figure 22

What is your institution type?

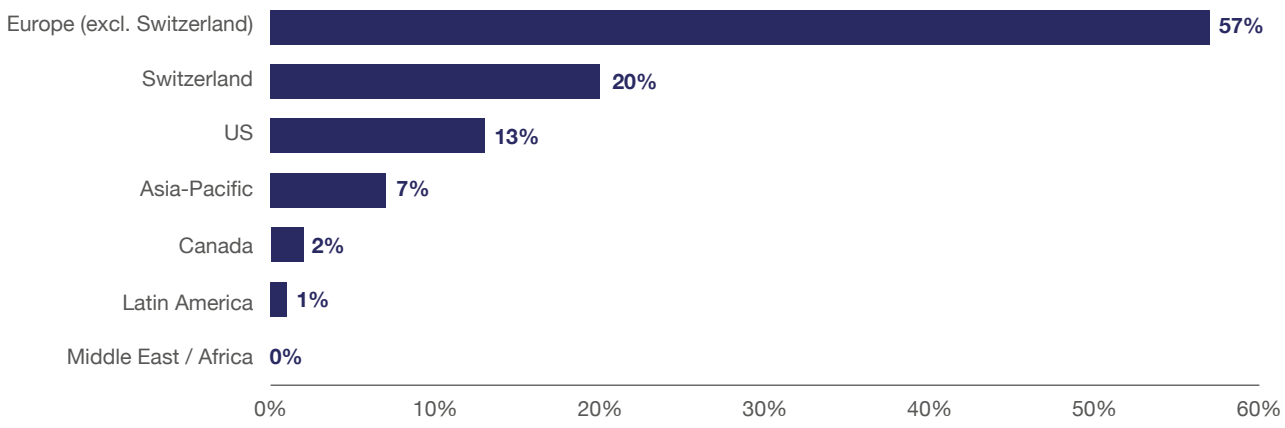
Figure 22 shows the split of respondents by investor type.



Single family office
Insurance company
Pension fund
Asset manager
Other
Multi-family office (>5 families)
Corporate pension fund
Foundation/endowment
Bank
Multi-family office (2-5 families)

Figure 23

Where is your institution located?



The majority of respondents are located in Europe, followed by the U.S., Asia-Pacific, Canada and Latin America, as shown in Figure 23.

Almost half of respondents have been operating for more than 20 years and 75% for more than 10 years (see Figure 24), and 45% manage more than 10 billion in assets (see Figure 25), evidencing the quality and experience of our respondent base.

Figure 24

How long have you been operating?

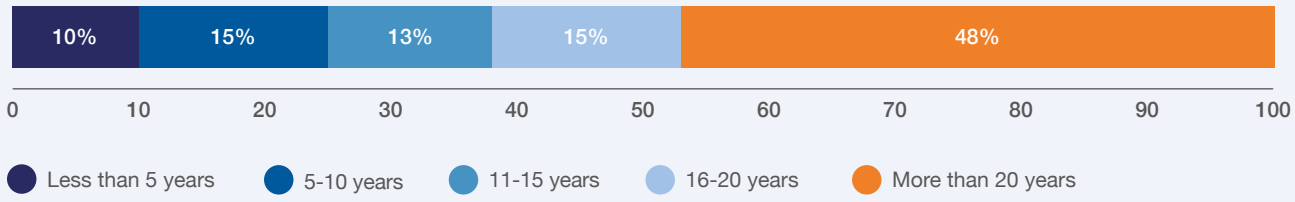
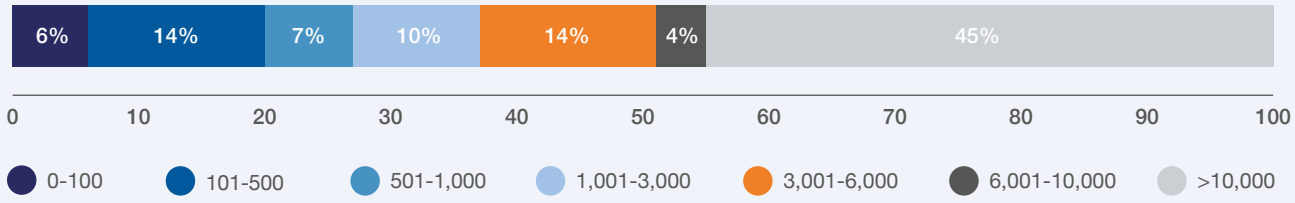


Figure 25

What is your total AUM (USD million)?



montana capital partners

About us

Montana Capital Partners (mcp) is a Swiss-based private equity investment firm focused on attractive niches of the secondaries market globally. The firm has raised four funds so far, each closed at the hard cap with a total AuM of EUR 1.5 billion, and is currently raising its fifth fund with a hard cap of EUR 1.3 billion.

mcp provides a wide range of liquidity solutions from straight sales to more innovative structures such as non-traditional secondaries (co-investments and fund-of-funds) and structured transactions. In addition to its secondaries activities, mcp offers high-quality advisory services for investment and risk management.

mcp focuses on attractive niches of the secondaries market such as customized and more complex transactions in the small to mid-sized segment usually directly sourced from sellers and GPs. mcp's close relationship with secondary sellers and GPs allows for customized solutions that take into account their specific requirements, in order to create mutually beneficial outcomes.

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 tailored 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. Through our investment management services, we assist investors in finding attractive primary investment opportunities and support them in implementing high-quality risk management systems.

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

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