

THE UNIVERSITY OF
NEW SOUTH WALES



STUDY OF AUSTRALIAN SUPERANNUATION FUND ATTITUDES TO PRIVATE EQUITY INVESTING

April 2008

FOREWORD

In Australia, superannuation funds are a major source of capital for the development of the economy with assets of around AUD 1 trillion and growing rapidly.

This study is aimed at establishing what are the attitudes of the major superannuation funds to private equity investments and is a follow up to an initial study conducted in 2005.

This survey is one in an on-going series of studies, which Adveq is sponsoring with a view to improving the level of information regarding the attitudes of institutional investors to private equity investing around the world. Adveq has already engaged in similar studies in several countries, with partners such as the Kyoto University, the Stockholm School of Economics, the University of St Gallen, Nottingham University Business School, and the University of Applied Science in Wiesbaden.

I wish to acknowledge the support of Adveq and Shed Enterprises (Adveq's representative in Australia) to undertake this survey.

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1. EXECUTIVE SUMMARY

1.1. Allocation to private equity

- 94% of participants in the survey are already invested in private equity
- The committed allocation to private equity is expected to remain around 6% of total assets
- Fund of funds is the major investment vehicle used, and this is expected to remain so
- Assets are mainly allocated to Australia and the US, but the allocation to these regions is expected to decline, with an increase to other regions, and a significant change in the allocation to global strategies

1.2. Private equity investment objectives

- Return and diversification benefits are the major desired objectives for private equity investment
- Respondents are looking for a 11.6% p.a. nominal return from private equity investments and an out-performance of publicly listed equity of 3.4% p.a.

1.3. Private equity investment selection criteria

- The technical skills of the manager are the most important selection criteria and consistent with this, the major risks of investing in private equity were seen to be performance related
- Lack of transparency was also seen as a risk in this sector

1.4. Changes from 2005 to 2008

- The proportion of respondents with existing allocations to private equity has risen significantly, but this may just be a sampling problem
- The committed allocation has risen to around 6% of total assets and is not expected to change significantly
- The use of fund of funds has increased significantly
- The allocation to Australia has dropped significantly
- The return expectation for private equity has been reduced from a nominal 16.5% p.a. in 2005 to 11.6% p.a. in 2008

2. STUDIED SAMPLE

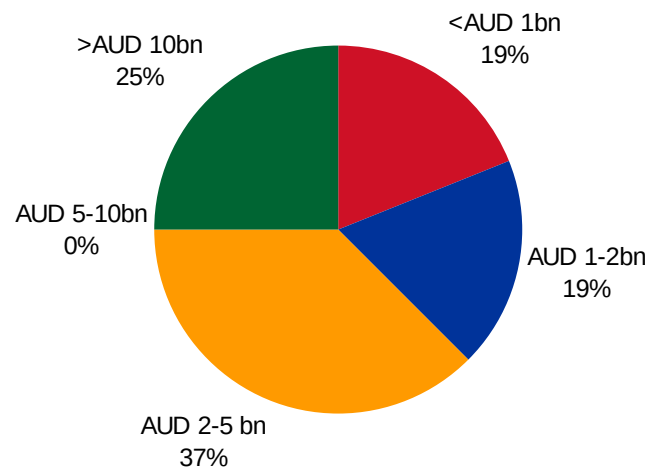
The findings of this survey are based on a survey of major Australian superannuation funds and comparable institutions offering superannuation products.

The survey was conducted during March 2008.

The total funds under management of the respondents were in excess of AUD 250 billion, with an average of AUD 15 billion. The survey includes one very large institution, and had this respondent not been included, the average funds under management would have been closer to AUD 10 billion. The sample we have used for analysis is therefore heavily biased to the very large superannuation funds, but the analysis has, as far as possible, used techniques that do not allow one institution to heavily bias the results.

The funds under management of the respondents were distributed as follows:

Figure 1: Distribution of funds under management

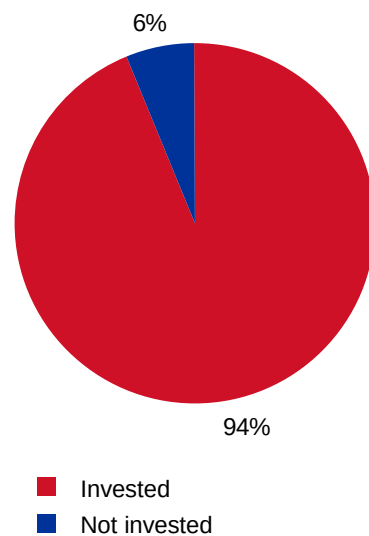


3. THE RESULTS

3.1. Current allocation to private equity

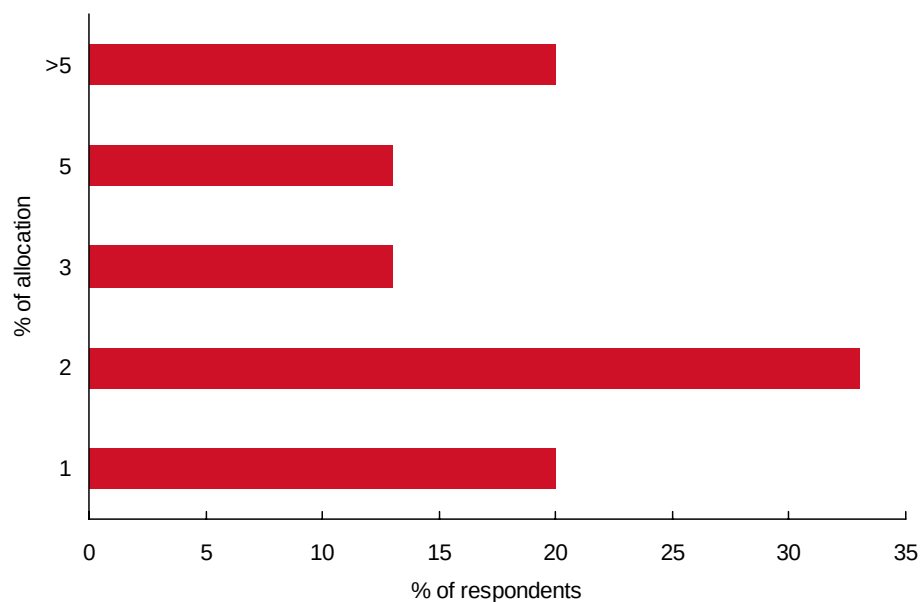
- 94% of the respondents of the survey are currently investing in private equity.

Figure 2: Share of respondents currently investing in private equity



- Of those that already invest in private equity, 20% currently have over 5% of total assets invested in the asset class
- The average current investment level of respondents was 3.7%
- The average commitment level was 6%

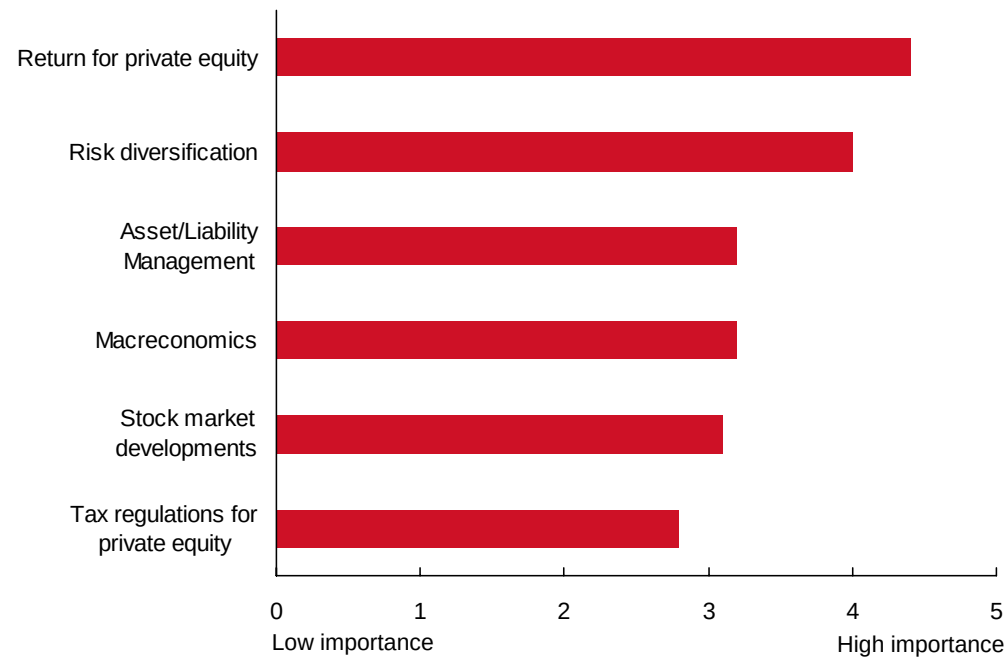
Figure 3: Current allocation to private equity by percent of total assets under management



3.2. Drivers for private equity investment

- The major drivers for investing in private equity are the return and diversification benefits.

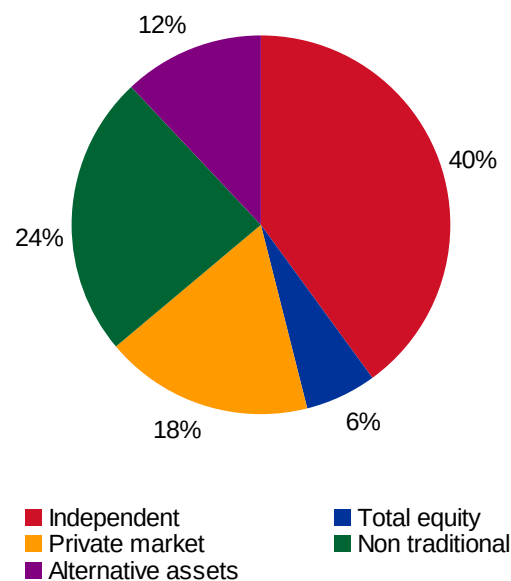
Figure 4: Drivers for investing in private equity (by average ranking)



3.3. Categorisation of private equity investment

- 94% of respondents treat private equity as a separate asset group, although with differing names

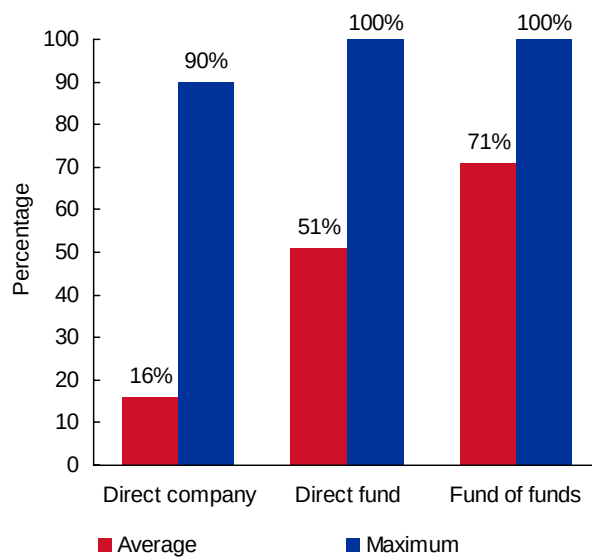
Figure 5: Categorisation of private equity



3.4. Current allocation by type of investment

- “Fund of funds” investment is the most popular type of private equity investment with an average allocation of 71% of current private equity allocations within each respondent’s portfolio, but this varies significantly from 0% through 100%
- Direct investment is currently the least favoured route to private equity investing, accounting for, on average, only 16% of current allocation to the asset class, but again there is a very wide range amongst the superannuation funds surveyed, from 0% though to 90%. The typical allocation to direct investments is nil.

Figure 6: Current private equity allocation by type of investment

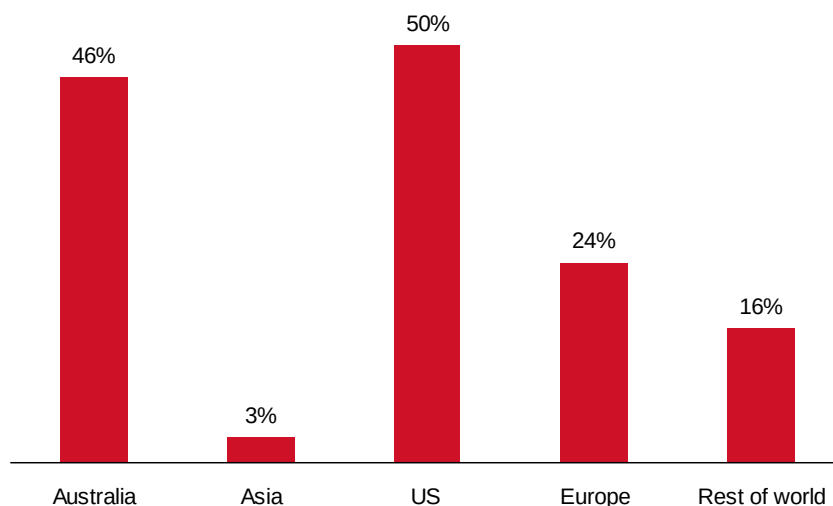


The percentages are the arithmetic average for each criterion and do not therefore sum to 100%

3.5. Current allocation by region

- The superannuation funds included in the survey have a global perspective, with less than half their private equity assets invested in Australia. The US is the other major place for investments, with a marginally greater allocation than to Australia.

Figure 7: Average respondent allocation to each region



The percentages are the arithmetic average for each criterion and do not therefore sum to 100%

3.6. Current allocation by type of investment and region

- Within Australia and global allocations, respondents indicated on average an almost equal use of fund of funds, and direct funds, but with a much lower use of direct investments
- Within Asia, Europe and the US the survey indicated a similar allocation to all three types of investment strategies, but this is biased by one respondent result
- The significant differences across respondents would suggest this result be treated with some caution

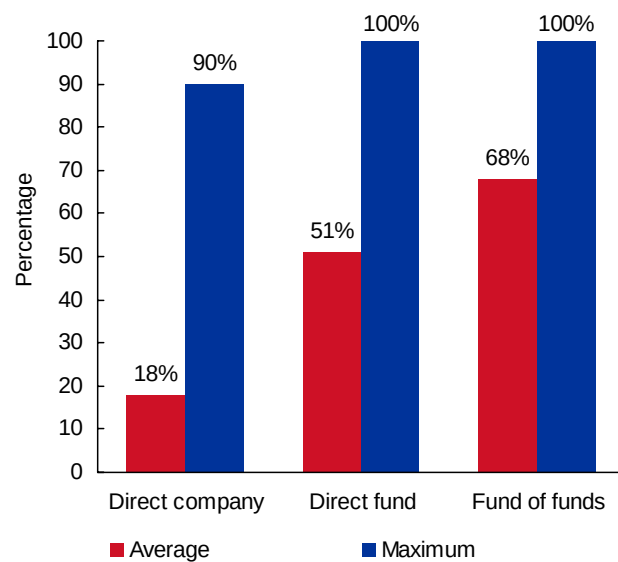
3.7. Future allocation to private equity

- Survey respondents expect the percentage of total assets under management committed to private equity to remain fairly stable over the next 2 to 5 years (slight decrease from an average of 6% to an average of 5.7% in the next two to five years, but this is affected by two respondents, with the remainder either keeping their allocation stable, or increasing marginally)

3.8. Future allocation by type of investment

- Overall, respondents indicated they would not shift their allocations much from their current position, with a marginal decline in their average allocation to fund of funds investment from 70% to 68%, and a similar decline in direct investments, balanced by an insignificant increase in the average allocation to direct funds
- There remains a very wide difference between respondents as to their allocation to the alternative types of investment

Figure 8: Future private equity allocation by type of investment

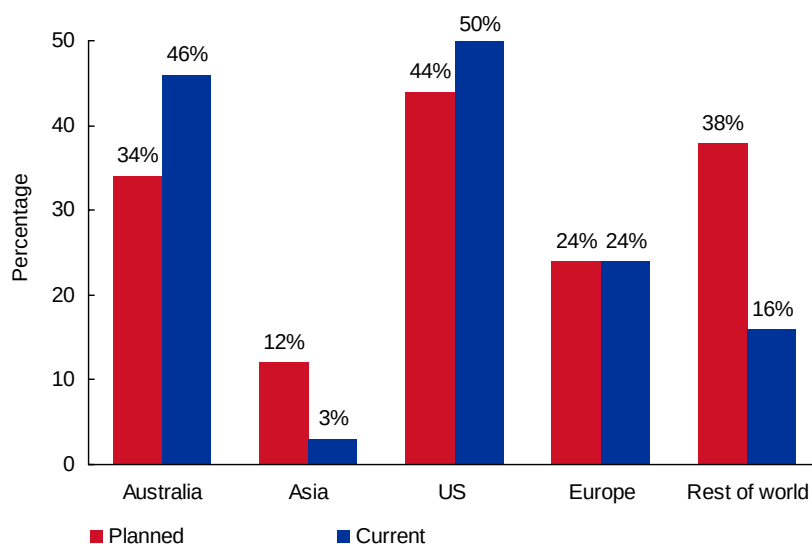


The percentages are the arithmetic average for each criterion and do not therefore sum to 100%

3.9. Future allocation by region

- The survey indicates a shift in allocation by region over the next 2-5 years
- The allocation to Australia and the US will be decreased, with an increased allocation to Asia, and a significant change to a more global approach rather than geographic specific occurring

Figure 9: Future private equity allocation by region of investment



The percentages are the arithmetic average for each criterion and do not therefore sum to 100%

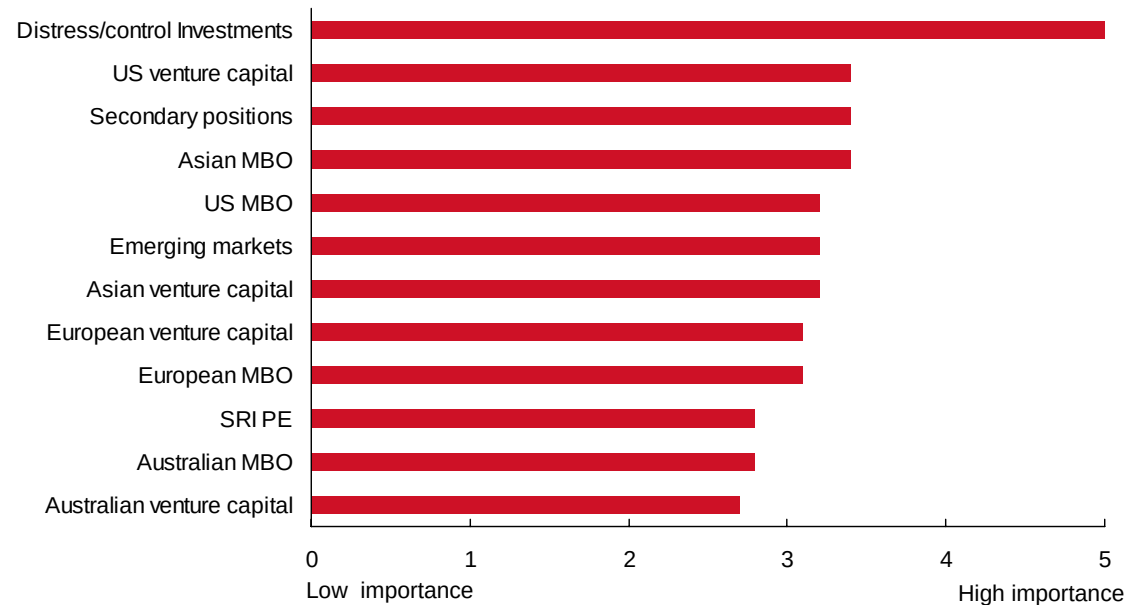
3.10. Future allocation by type of investment and region

- Within Australia and global allocations, respondents indicated an intention to continue their current strategy with, on average, an almost equal use of fund of funds, and direct funds, but with a much lower use of direct Investments.
- Within Europe and the US the survey indicated respondents who were invested there intended to change their allocations to a fund of funds bias
- Within Asia, respondents indicated they intended to increase the allocation to direct funds
- The significant differences across respondents would suggest this result be treated with some caution

3.11. Future allocation by investment segment

- According to the study, there is not much difference perceived in the relative attractiveness of private equity segments for investment over the next 2-5 years for Australian superannuation funds, but there is a possible bias against Australian and European assets and a bias to distressed and secondary assets

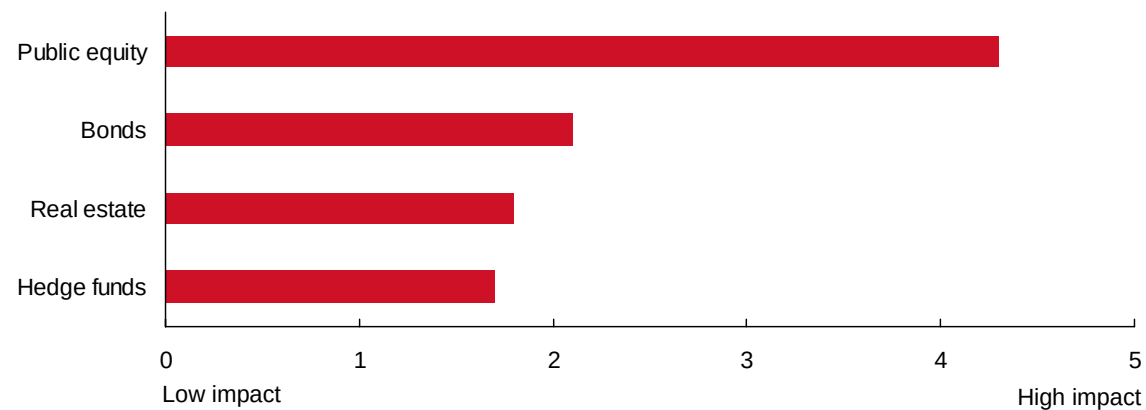
Figure 10: Attractiveness of private equity segments within the next 2-5 years (by average ranking)



3.12. Flow-on effects of changes in private equity allocations

- Respondents indicated that if they were to increase their allocation to private equity, then they would reduce their allocation to public equity markets, and similarly, if the allocation to private equity was decreased, then the funds would be transferred to the public equity markets

Figure 11: Level of negative correlation between allocation to private equity and to other assets classes



3.13. Other considerations when investing in private equity

Objectives for private equity investment

- According to the study, the ability of private equity to increase relative returns is the most important reason for institutions to invest in private equity
- The institutions surveyed expect an average absolute return of 11.6% and an out-performance of public equity of 3.4% p.a.
- Risk reduction and diversification are other key reasons for investing in private equity
- Non-financial objectives are of relatively low importance

Figure 12: Return expectations of private equity investments

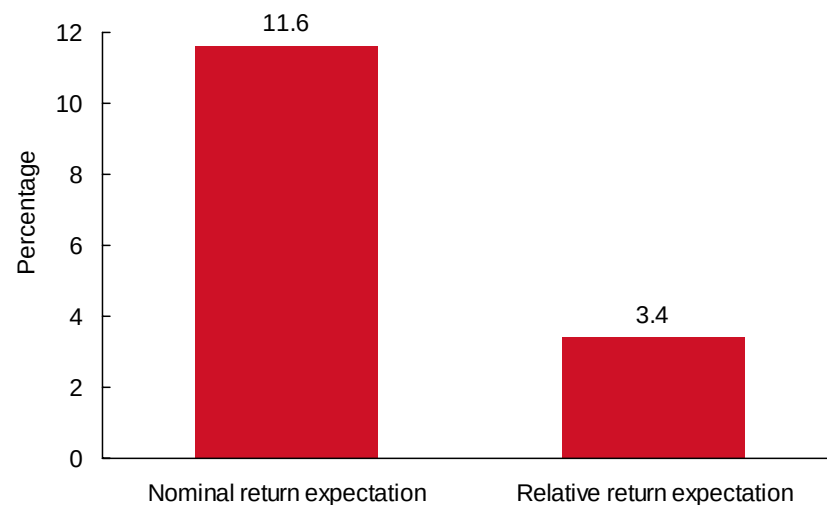
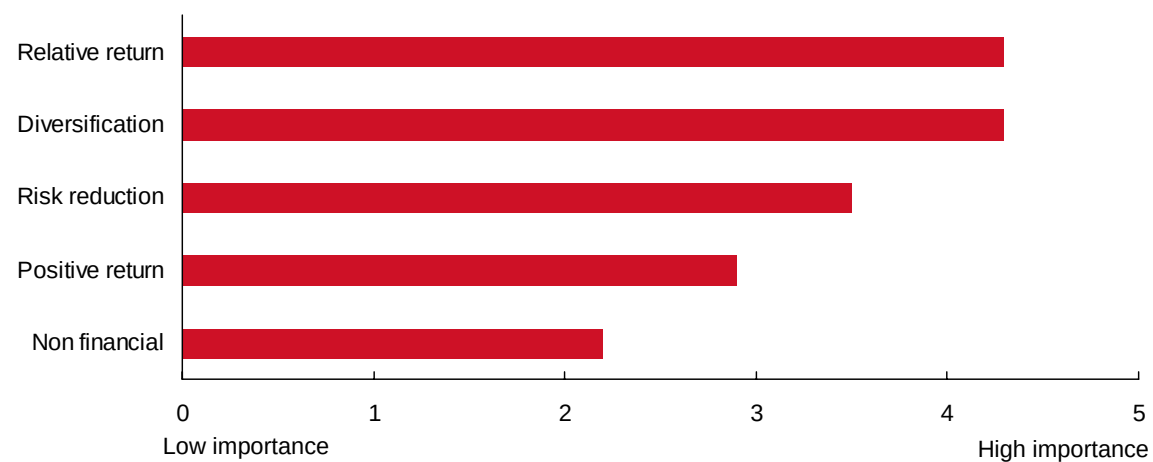


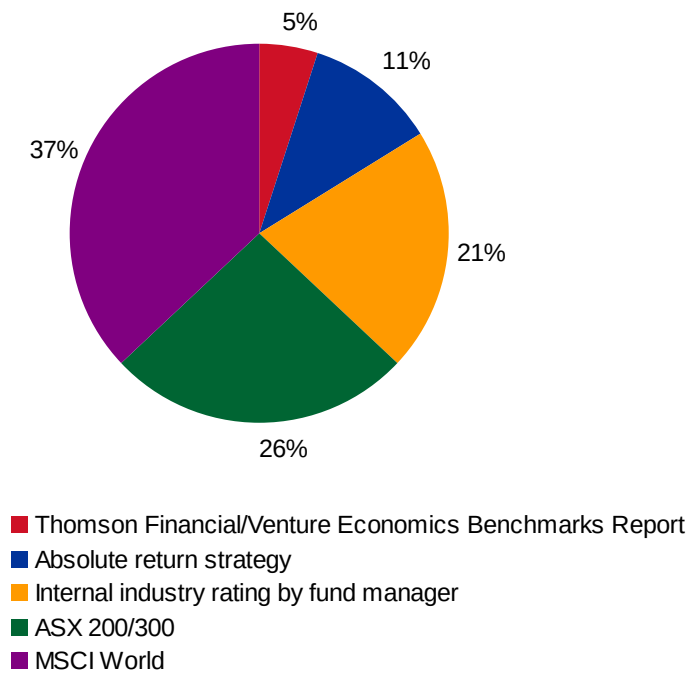
Figure 13: Objectives for private equity investments within the next 2-5 years (by average ranking)



Benchmarks for private equity investment

- When it comes to measuring returns, most of the superannuation funds surveyed preferred to use the MSCI World or ASX200/300 index.
- The current benchmarks used were broadly consistent with what respondents considered appropriate going forward

Figure 14: Benchmarks for private equity investments



4. SECONDARY FINDINGS

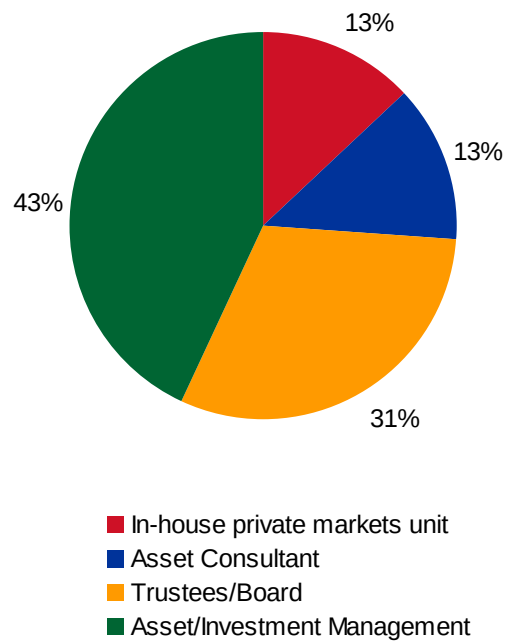
4.1. Internal resourcing

- Respondents indicated they had around 5 full time (or equivalent) personnel involved in the management of their private equity investments.

4.2. The investment decision

- Most investment decisions are made by an asset consultant or investment manager
- Most funds have a high level of trustee involvement in the investment decision

Figure 15: Responsibility for private equity investment decisions

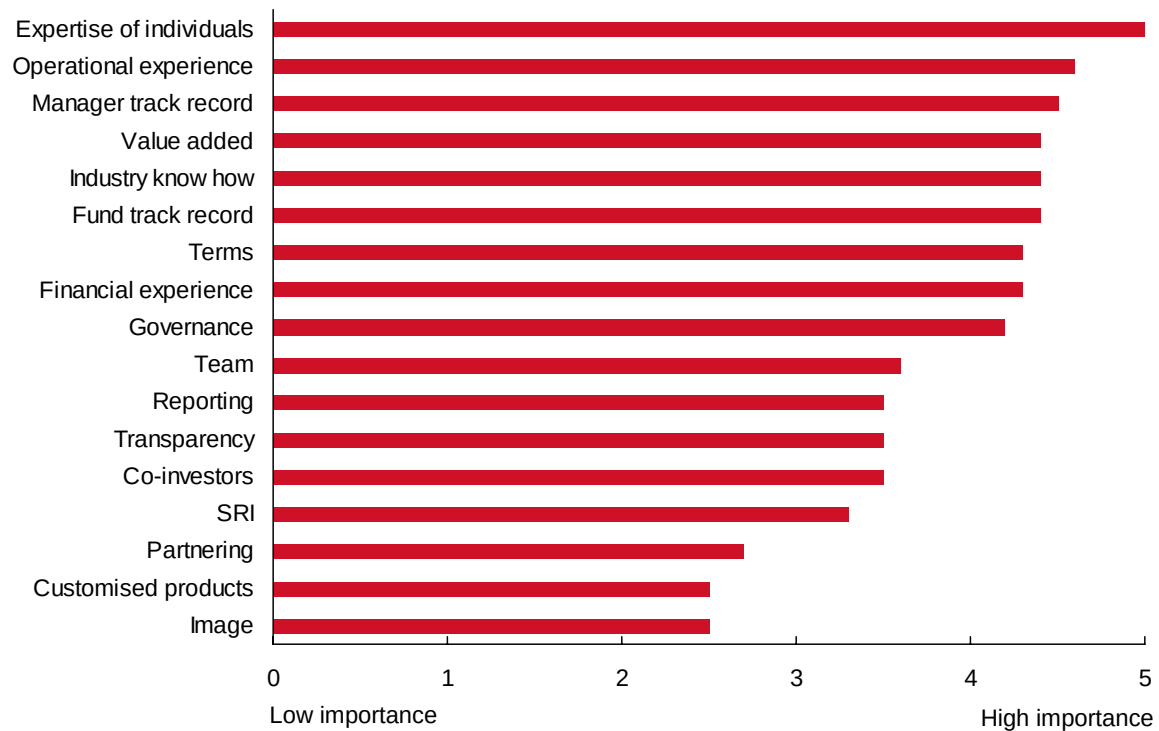


4.3. Key criteria for private equity investment

Investing through a single pooled fund

- For superannuation funds investing through pooled funds that were not a fund of funds, the most important criteria for selecting a fund manager relates to their technical skills as managers (previous experience, track record and industry experience).

Figure 16: Important selection criteria for single pooled fund investments (by average ranking)



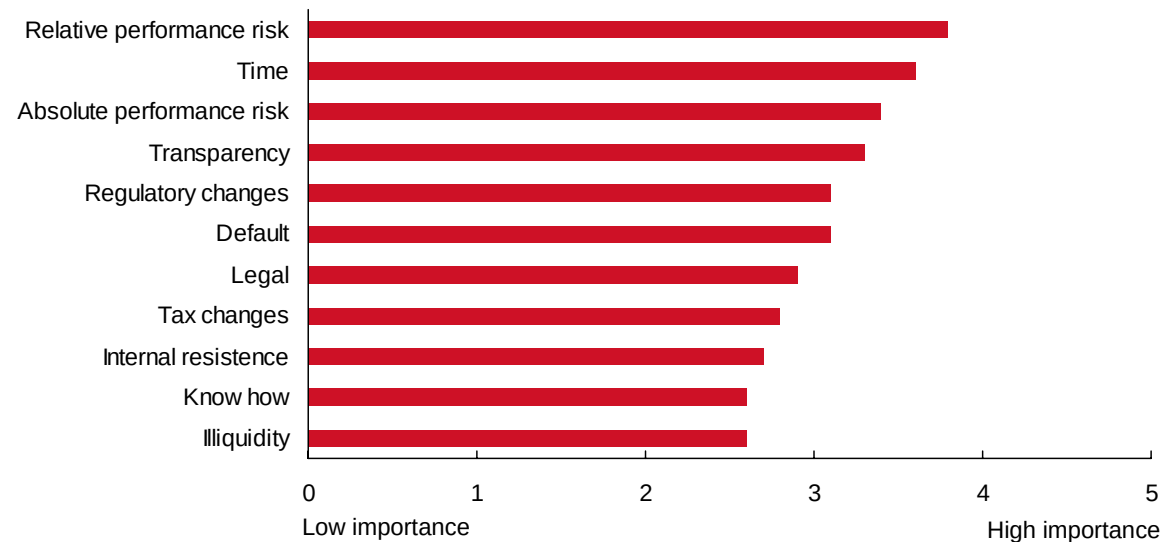
Fund of funds investments

- When it comes to selecting fund of funds, the same criteria generally apply, although, in addition, the network of fund of funds managers to gain access to premier funds is an important aspect

4.4. Barriers to investing in private equity

- For respondents, the main risks seen in investing in private equity were performance related and lack of transparency, although none of these were regarded as extreme

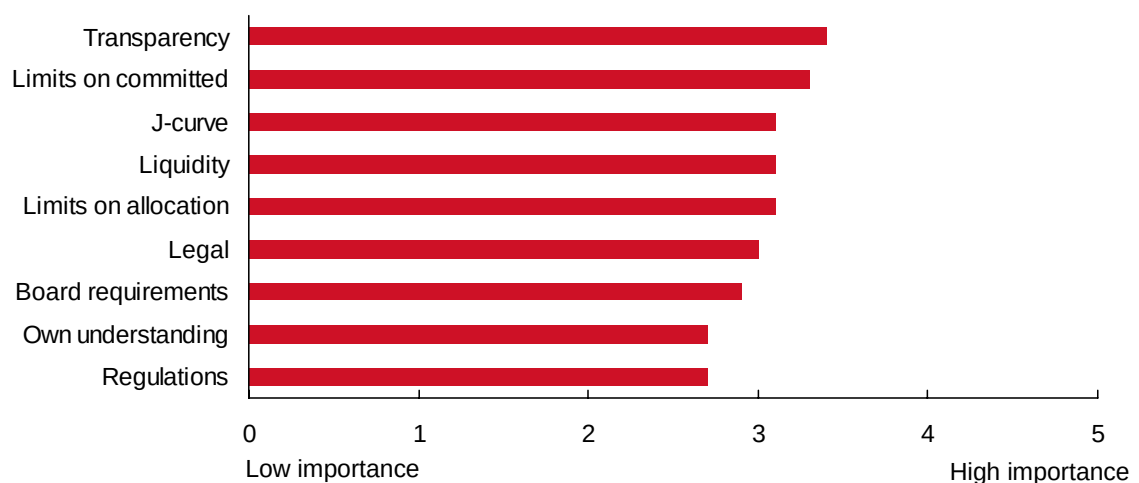
Figure 17: Risks associated with private equity investments (by average ranking)



4.5. Obstacles to investing in private equity

- None of the issues raised with respondents appeared to be extreme obstacles, but transparency, the “J-curve” effect and liquidity were the most important

Figure 18: Obstacles associated with private equity investments (by average ranking)



5. COMPARISON OF 2005 AND 2008 RESULTS

- The 2008 sample indicates that a much larger proportion of respondents have investments in private equity already and this has affected some of the results, which may not be strictly comparable
- The average commitment level has increased from 4.5% in 2005 to 6% in 2008, and is expected to remain close to this
- The proportion of respondents in 2008 that used fund of funds has significantly increased from around 50% to around 75%, and not much change to this is expected in the future
- The allocation to Australia has dropped significantly, from an average of 74% in 2005 to just under 50% in 2008, with allocations to all other zones increasing
- The return expectation for private equity has been reduced from a nominal 16.5%pa in 2005 to 11.6%pa in 2008
- Return and diversification benefits remain the major objectives for private equity investment
- The criteria for investing in the various types of investment vehicles available has not changed significantly
- The perceived risks of investing in private equity have not changed significantly

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