

THE UNIVERSITY OF
NEW SOUTH WALES



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Study of Australian Superannuation Fund attitudes to Private Equity investing

Australian study 2005

FOREWORD

In Australia, superannuation funds are a major source of capital for the development of the economy with assets of around AUD700 billion and growing rapidly.

Whilst almost all superannuation funds invest in listed equities either directly or through mandates with investment managers, the exposure to private, or unlisted equity is not universal, and restricted in most instances to the major superannuation funds; even then the exposure is small.

This lack of exposure by most superannuation funds raises several issues:

- Why the exposure is low and what have been the major reasons for this?
- The opportunity cost for fund members lost by excluding private equity as an asset?

This study is aimed at eliciting some of the reasons for the current situation, through establishing what are the attitudes of superannuation funds to private equity investments.

By their nature, surveys sometimes show up not only the views of interviewees, but also that the survey questions may have not been appropriate, and thus further analysis is necessary. This survey is then 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 Germany and Switzerland, together with renowned partners such as the University of St Gallen and the University of Applied Science in Wiesbaden, and is planning further studies in other regions over the next 18 months.

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

Allocation to private equity

- 75% of the respondents of the survey are currently investing in private equity.
- 26% of respondents have an allocation of more than 5% of total assets under management to private equity.
- The allocation to private equity is expected to stay fairly stable at around 4.0% to 4.5% over the next 2-5 years in Australia.
- Australia is and will remain the major focus for private equity investments.
- It is expected the current allocation to Australian investments will decline to be replaced with an increase in investments in Asia, Europe, and other regions.
- Future allocation to fund of funds and single pooled funds is not expected to change but direct investments are expected to decline significantly.

Private equity investment objectives

- The most important objective of private equity investment is the ability to add value relative to benchmarks (usually listed equity indices), followed in importance by risk management objectives.
- The institutions surveyed expect an average absolute return of 16.5% and an outperformance over listed equity of 4.5% p.a.

Investment selection criteria

- The study indicates that issues relating to the technical skills of the manager are the most important criteria in selection either a single purpose pooled fund or a fund of funds.

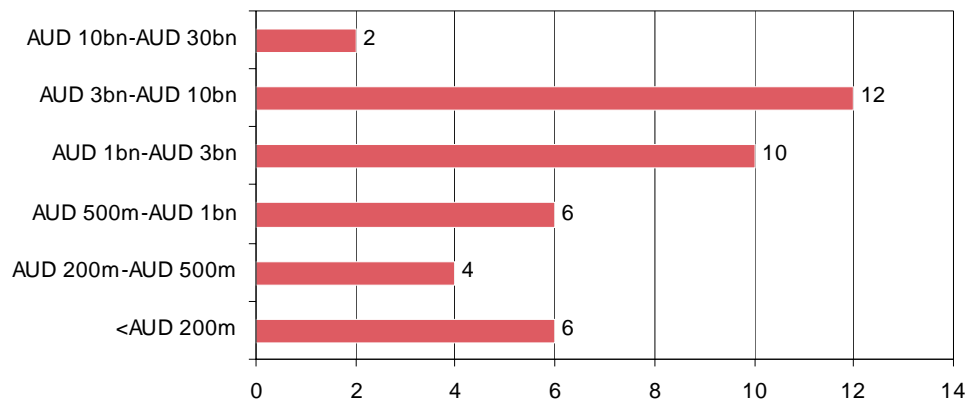
2. STUDIED SAMPLE

The findings of this survey are based on a survey of Australian superannuation funds conducted during January 2005 with 40 respondents.

The total funds under management of the respondents were in excess of AUD 120 billion, with an average of AUD 3 billion, against the industry average based on APRA data at September 2004 of around AUD 2 million. The sample we have used for analysis is therefore heavily biased to the very large superannuation funds.

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

Figure 1: Breakdown of the funds under management



3. THE RESULTS

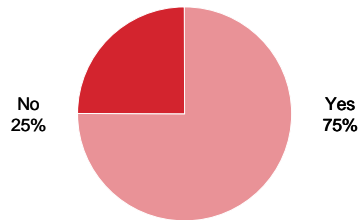
3.1. Current allocation to private equity

3.1.1 Overall

By total allocation

- 75% of the respondents of the survey are currently investing in private equity.

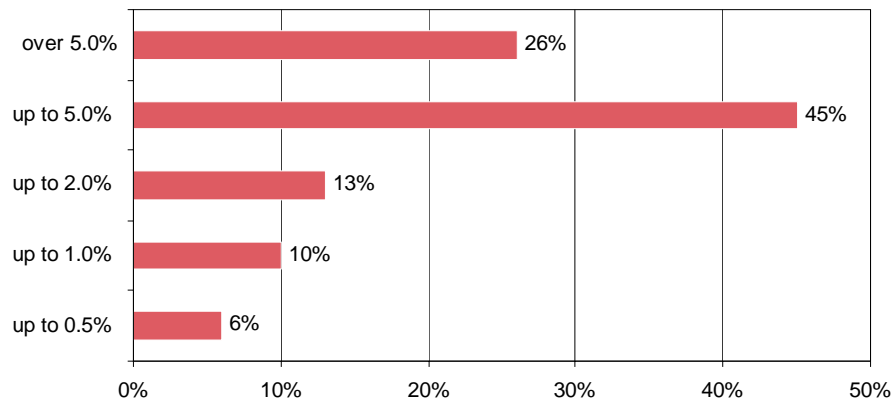
Figure 2: Current allocation to private equity



By assets under management

- Of those that already invest in private equity, 26% currently allocate over 5% of total assets under management to the asset class.
- The average allocation of respondents was 4.5%.
- The average current allocation achieved was 2.6% and almost all respondents indicated they had not achieved their targeted allocation.

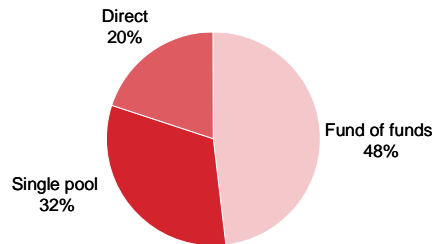
Figure 3: Current allocation to private equity by percent of total assets under management



By type of investment

- “Fund of Funds” investment is the most popular type of private equity investment accounting for 48% of current private equity allocations.
- Direct investment are currently the least favoured route to private equity investing, accounting for only 20% of current allocation to the asset class.

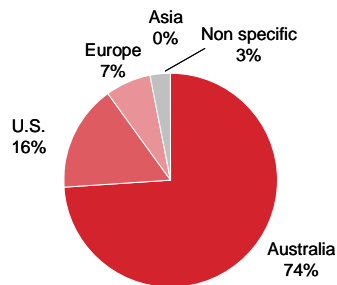
Figure 4: Current private equity allocation by type of investment



By region of investment

- Australia is the most important region for private equity investments of Australian superannuation funds, accounting for 74% of private equity allocations by region. The next most important region is the U.S., which accounts for 16% of current private equity investment.

Figure 5: Current private equity allocation by region of investment



3.2. Future allocation to private equity

3.2.1 Overall

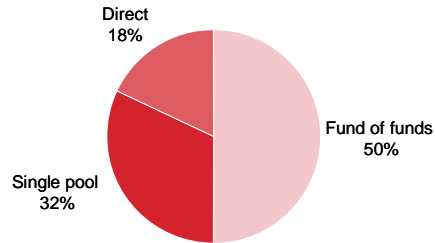
By assets under management

- 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 4.5% to an average of 4% in the next two to five years).
- This slight decrease is explained by a few funds not intending to invest further in private equity, and the remainder not increasing their allocations significantly.

By type of investment

- Fund of funds investment: Fund of funds will continue to account for half of the total allocation.
- Direct fund investment: Fund investments will continue to account for a third of the total allocation.
- Direct company investment: This type of investment is expected to decline shifting from an average of 20% of assets invested in private equity to 18%.

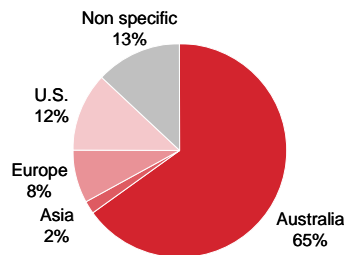
Figure 6: Future private equity allocation by type of investment



By region of investment

- According to this study, it would appear that there will be a decrease in the allocation to Australia of the current 74% to 65%.
- This will result in an increase in private equity allocations to other regions. The next 2-5 years will see an increasing commitment to Asia (from a current zero base to around 2%), an increase to Europe (from 7% to 8%), and the rest of the world from a current 3% base to around 13% of assets invested in private equity.

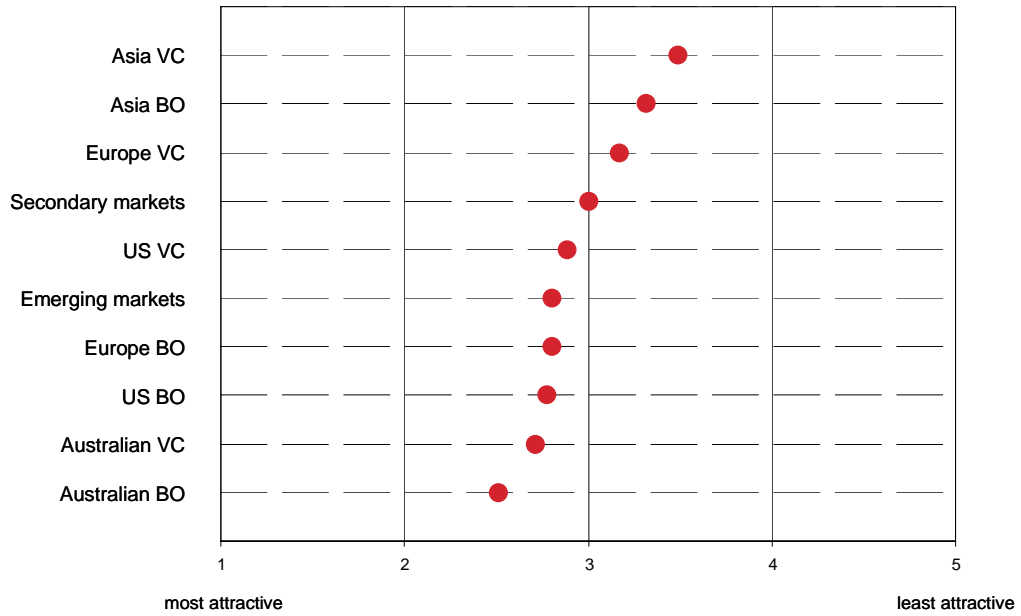
Figure 7: Future private equity allocation by region of investment



By private equity segment

- According to the study, the most attractive private equity segments for investment over the next 2-5 years for Australian superannuation funds will be Australian buyouts (BO) and venture capital (VC).

Figure 8: Attractiveness of private equity segments within the next 2-5 years



3.3. Other considerations when investing in private equity

3.3.1 Objectives for private equity investment

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 investing in private equity.
- The institutions surveyed expect an average absolute return of 16.5% and an outperformance of public equity of 4.5% p.a.
- Risk reduction and diversification are other key reasons for investing in private equity.
- Non-financial objectives are of relatively low importance.

Figure 9: Return expectations of private equity investments

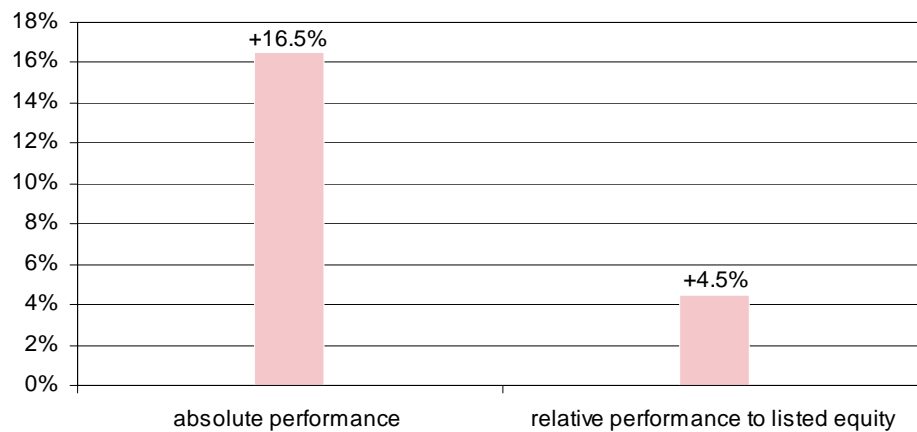
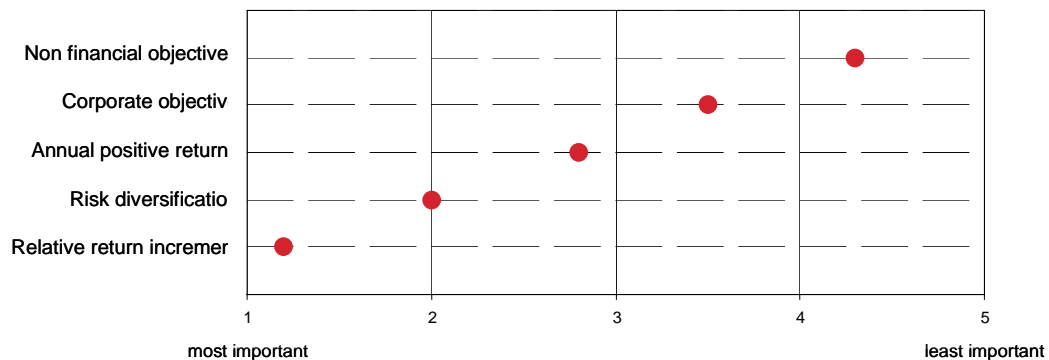


Figure 10: Objectives for private equity investments within the next 2-5 years

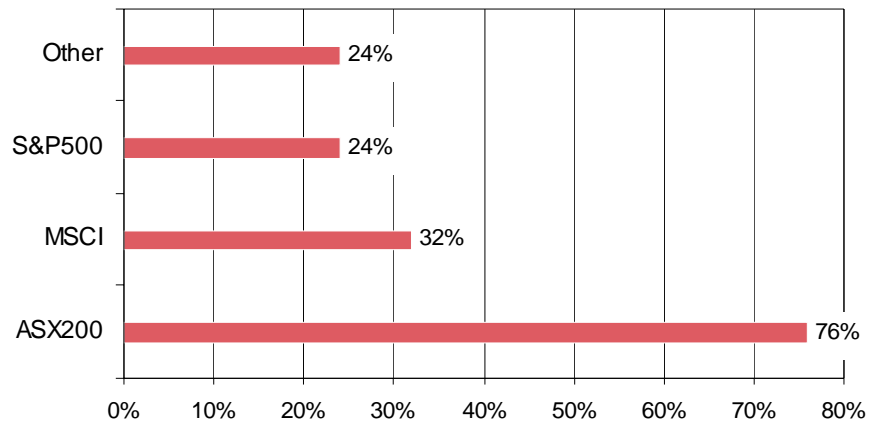


3.3.2 Benchmarks for private equity investment

Benchmarks for private equity investment

- When it comes to measuring returns, most of the superannuation funds surveyed preferred to use the ASX200/300 index which is consistent with the majority of the assets being within Australia and their objective being to increase relative return.
- Quite a few respondents used multiple benchmarks, which may reflect their allocation policy by region.

Figure 11: Benchmarks for private equity investments

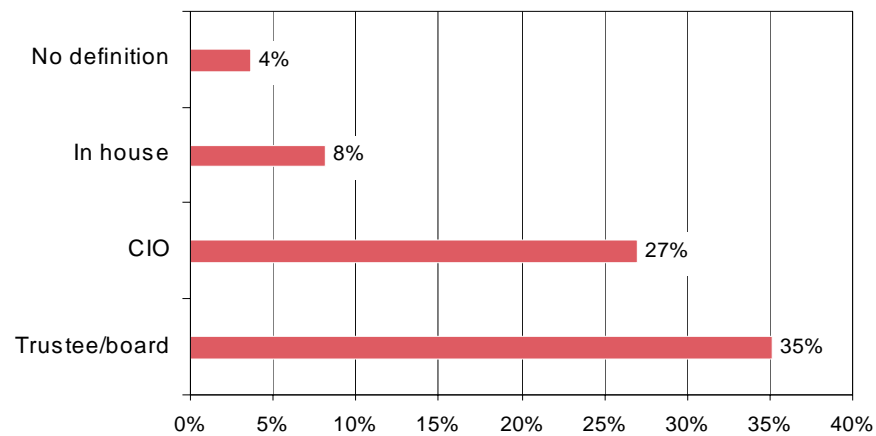


4. SECONDARY FINDINGS

4.1. The investment decision

- 35% of respondents indicate their trustee board was the primary party responsible for the management of private equity investments.
- 27% of respondents indicated that they had a CIO, who was the primary responsibility for management of private equity investments.
- However, as many as 8% of the companies contacted do not have a dedicated private equity specialist and the responsibility for private equity investment tends to lie with a generalist fund manager.

Figure 12: Responsibility for private equity investment decisions

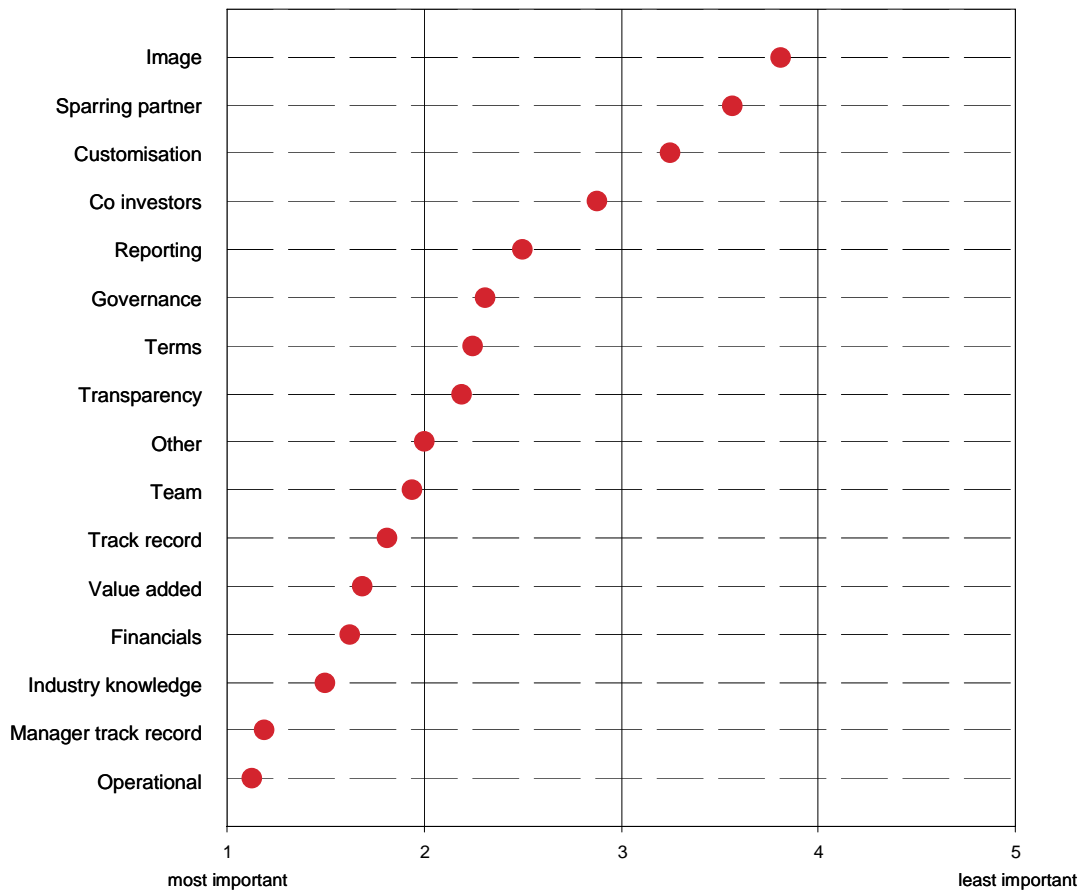


4.2. Key criteria for private equity investment

4.2.1 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 ranking the most important on average).
- Customization, image, and brand recognition as well as co-investment opportunities are not seen as important.

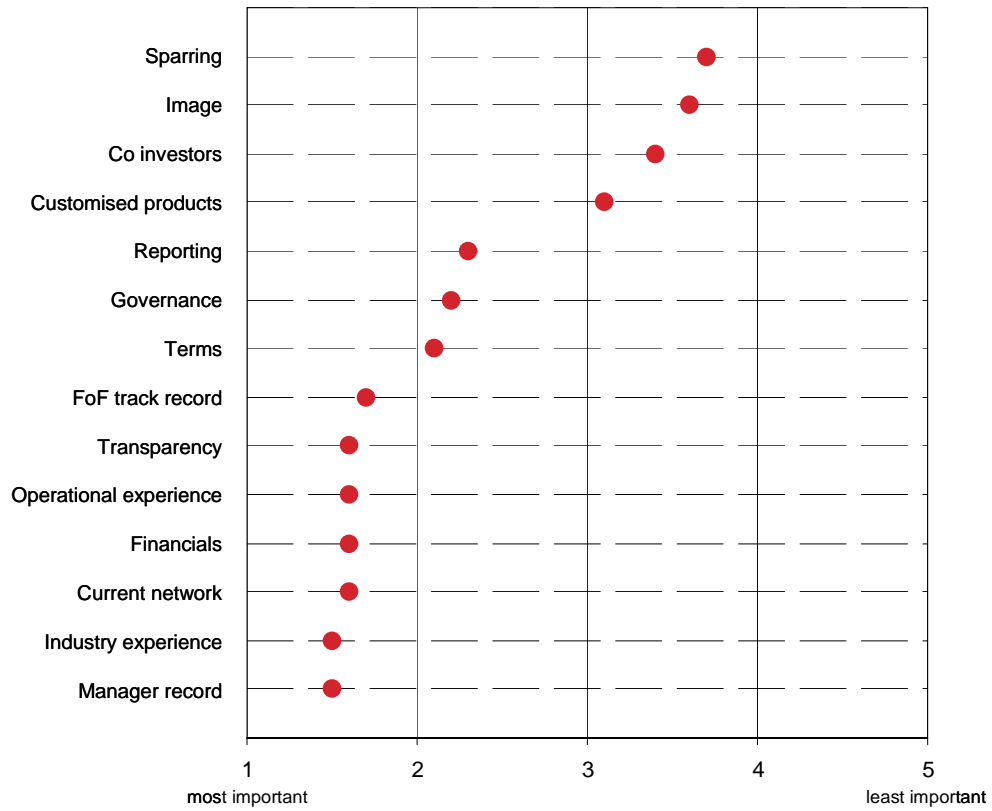
Figure 13: Important selection criteria for single pooled fund investments in private equity funds



4.2.2 Fund of funds investments

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

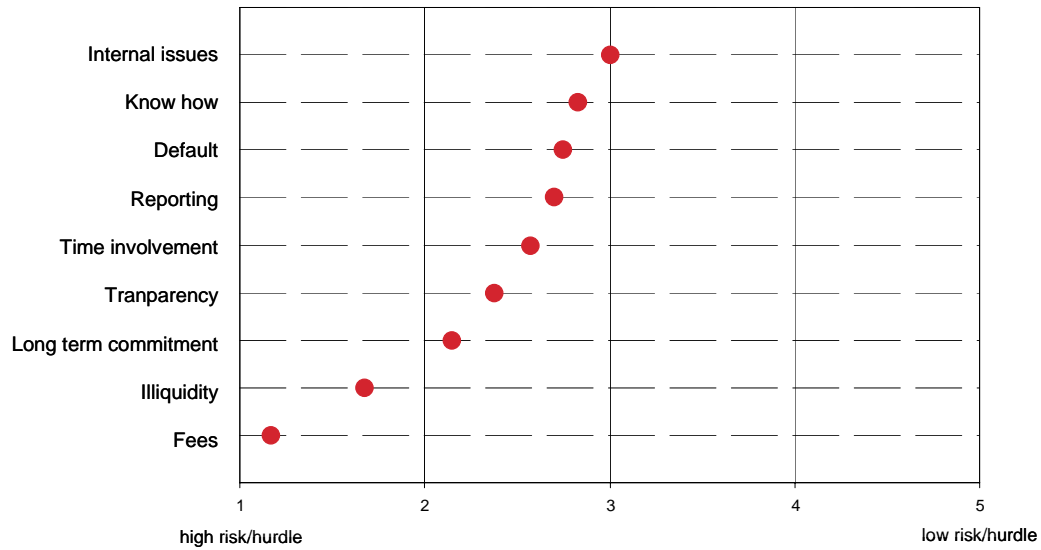
Figure 14: Important selection criteria for investments in fund of funds



4.3. Barriers to investing in private equity

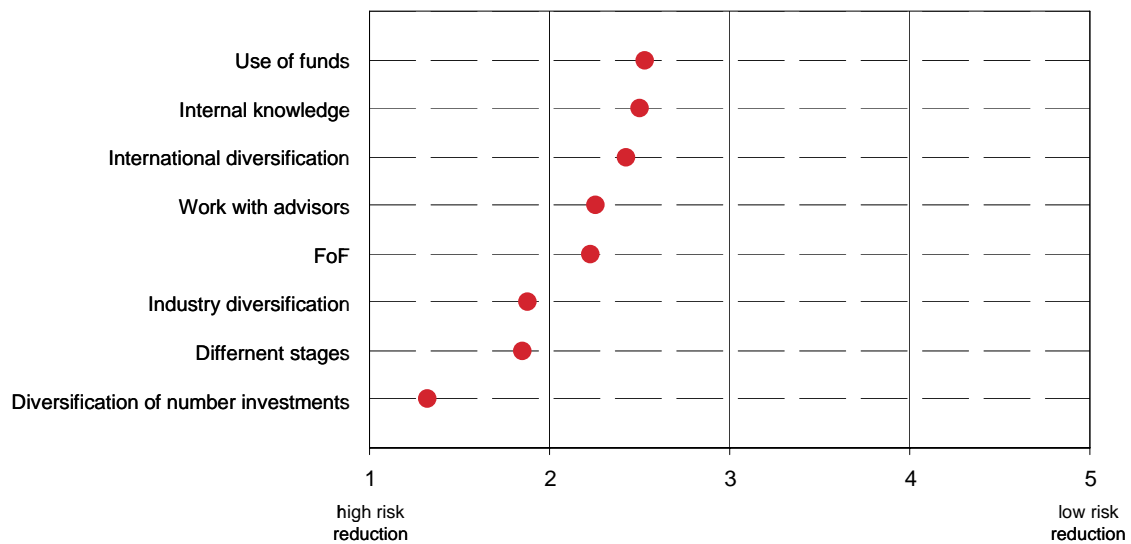
- For respondents, the main barriers to private equity investing were fees charged and are illiquidity.

Figure 15: Risks and hurdles associated with private equity investments



- The respondents believed that they could reduce the risks associated with private equity investing by achieving diversification through an increased number of investments and investing across different stages of private equity investment cycles.

Figure 16: Risks reduction associated with private equity investments



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