2018

Australian Institutional Investor Survey of Private Equity & Venture Capital Investing

Private Equity Media

Authors: Simon Uzcilas, Alistair McCreadie, Adrian Herbert

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Executive Summary

Key findings

Allocations generally being maintained

Australian institutional investors are generally maintaining their allocations to private equity and venture capital at current levels.

Average allocations 4% – 6%

While some large superannuation funds are now allocating 6% or more of their funds under management to private equity and venture capital, most allocate in the range 4% – 6%.

Fresh commitments planned

Most institutional investors are planning to make fresh commitments to private equity managers in the current year.

China interest increases

Australian investors are still giving priority to allocating to the North American market, as has been the case for some years, but Greater China now ranks second overtaking Europe. Greater China's increased share comes from small reductions of interest in other markets except South-East Asia which has also attracted increased interest.

Investor satisfaction at high point

Overall satisfaction with private equity investment is at the highest level since the survey was started in 2013.

Interest in local venture capital remains low

Interest in investing in Australian and New Zealand venture capital remains low although it has continued the modest increase of the last few years.

Strong interest in direct investing and co-investing

Strong interest continues in direct private equity investing or co-investing alongside private equity fund managers.

Less external advice

The influence of external private equity and venture capital advisers has reduced.

Investment team levels largely unchanged

The average number of equivalent full-time professionals in investors' private equity and venture capital teams remains largely unchanged.

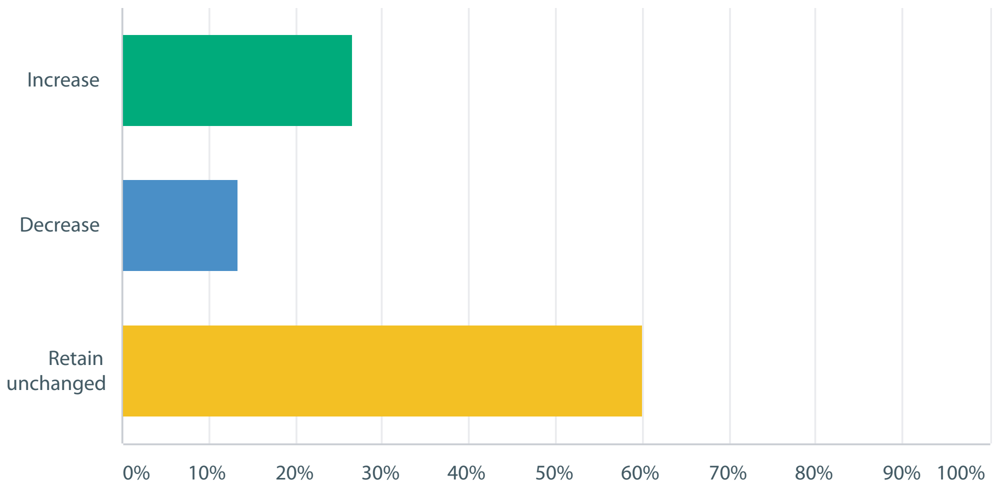
Consolidated Survey Responses

Q1. Percentage of portfolio allocated to private equity and venture capital as at 1 July 2018?

Percentage of portfolio allocated to private equity and venture capitalas at 1 July 2018
6.0%
2.26%
3.5%
4.0%
8.0%
5.0%
4.0%
7.5%
14.0%
20.0%
7.0%
2.04%
4.0%
1.0%
4.0%
Average: 5.55%

(Answered: 15 Skipped: 0)

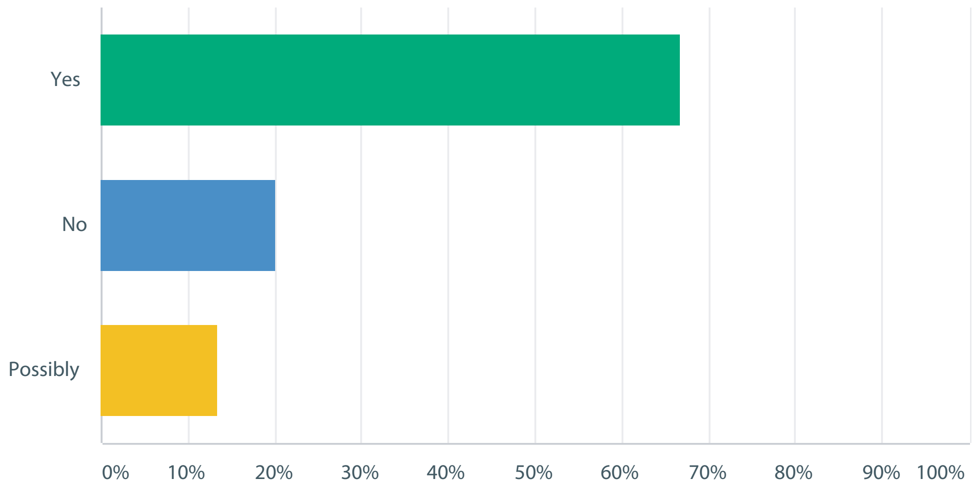
Q2. Do you plan to change your total allocation to private equity and venture capital investments in the 12 months started 1 July 2018?



Answer Choices	Responses	
Increase	26.67%	4
Decrease	13.33%	2
Retain unchanged	60.00%	9
TOTAL		15

(Answered: 15 Skipped: 0)

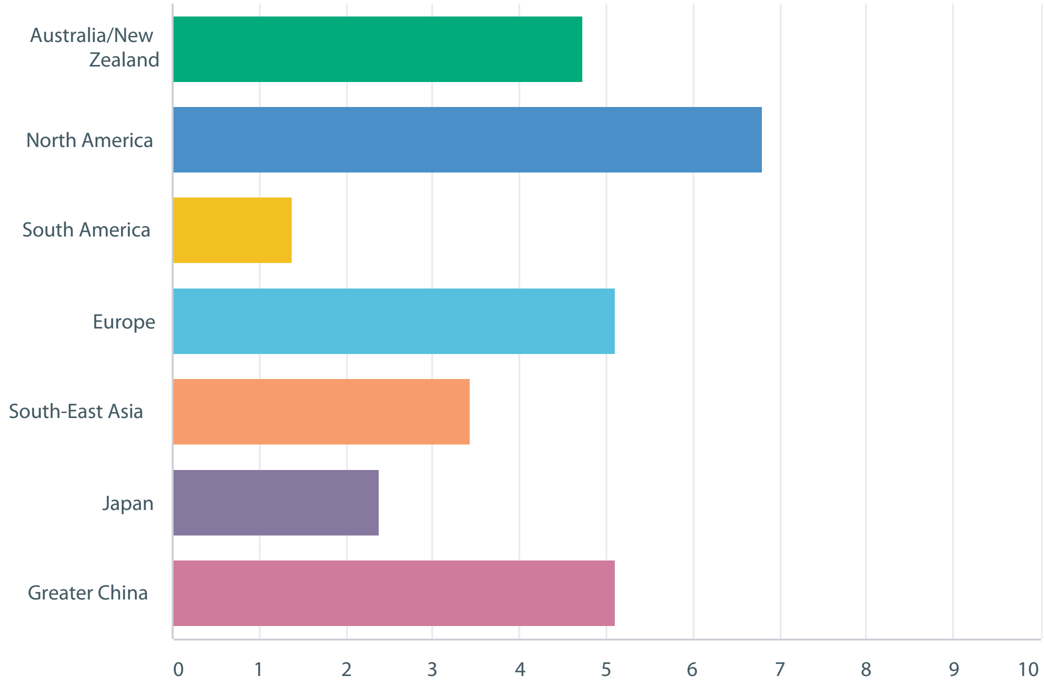
Q3. Do you anticipate making fresh commitments to private equity or venture capital investing in the 12 months started 1 July 2018?



Answer Choices	Responses	
Yes	66.67%	10
No	20.00%	3
Possibly	13.33%	2
TOTAL		15

(Answered: 15 Skipped: 0)

Q4. Rank in order the geographic regions in which you anticipate your fund will invest in private equity and venture capital over the 12 months started 1 July 2018.



	1	2	3	4	5	6	7	Total	Average Ranking
Australia/New Zealand	18.18% 2	0.00% 0	45.45% 5	27.27% 3	0.00% 0	0.00% 0	9.09% 1	11	4.73
North America	90.00%	0.00% 0	10.00% 1	0.00% 0	0.00% 0	0.00% 0	0.00% 0	10	6.80
South America	0.00% 0	0.00% 0	0.00% 0	0.00% 0	12.50% 1	12.50% 1	75.00% 6	8	1.38
Europe	0.00% 0	50.00% 5	10.00% 1	10.00% 4	0.00% 0	0.00% 0	0.00% 0	10	5.10
South-East Asia	11.11 1	0.00% 0	11.11 1	0.00% 0	55.56% 5	22.22% 2	0.00% 0	9	3.44
Japan	0.00% 0	0.00% 0	0.00% 0	12.50% 1	25.00% 2	50.00% 4	12.50% 1	8	2.38
Greater China	0.00% 0	55.56% 5	22.22% 2	11.11% 1	0.00% 0	11.11% 1	0.00% 0	9	5.11

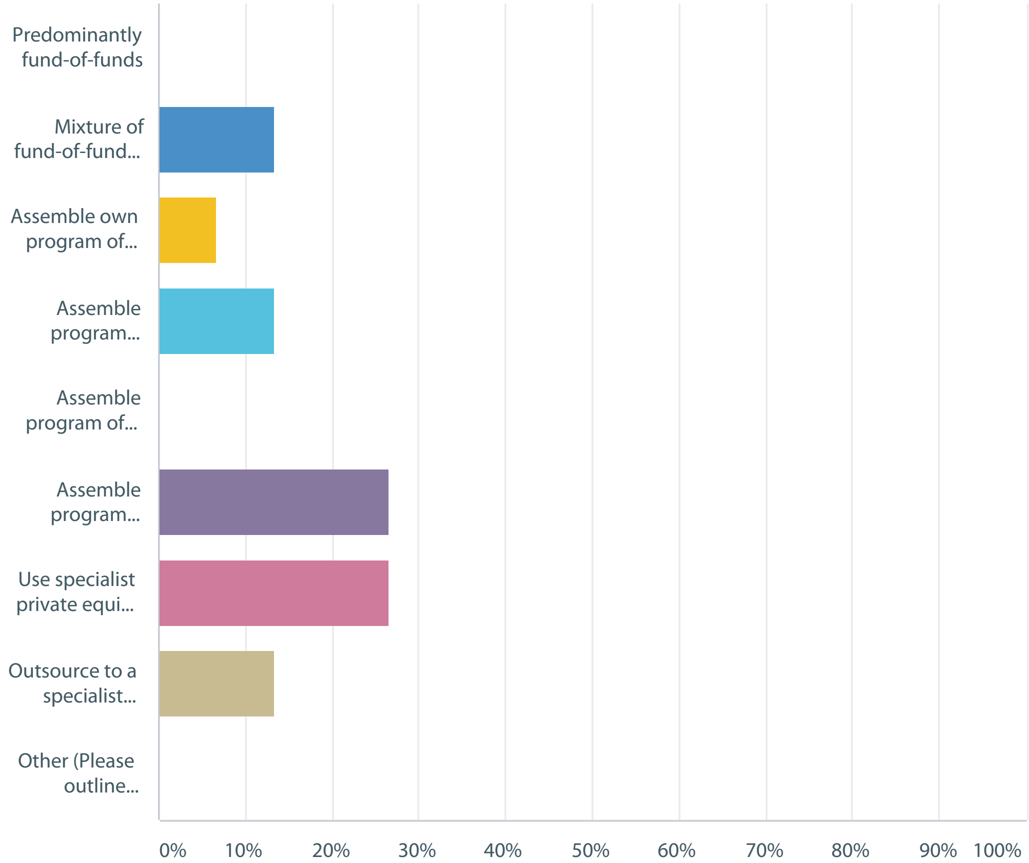
(Answered: 12 Skipped: 3)

Q5. Number of equivalent full time professionals in your private equity and venture capital team as at 1 July 2018?

Number of equivalent full time professionals in your private equity and venture capital team as at 1 July 2018
11.0
1.5
0.5
1.0
2.0
2.0
0.5
1.0
7.0
0.0
2.0
0.3
2.0
0.0
1.0
Average: 2.12

(Answered: 15 Skipped: 0)

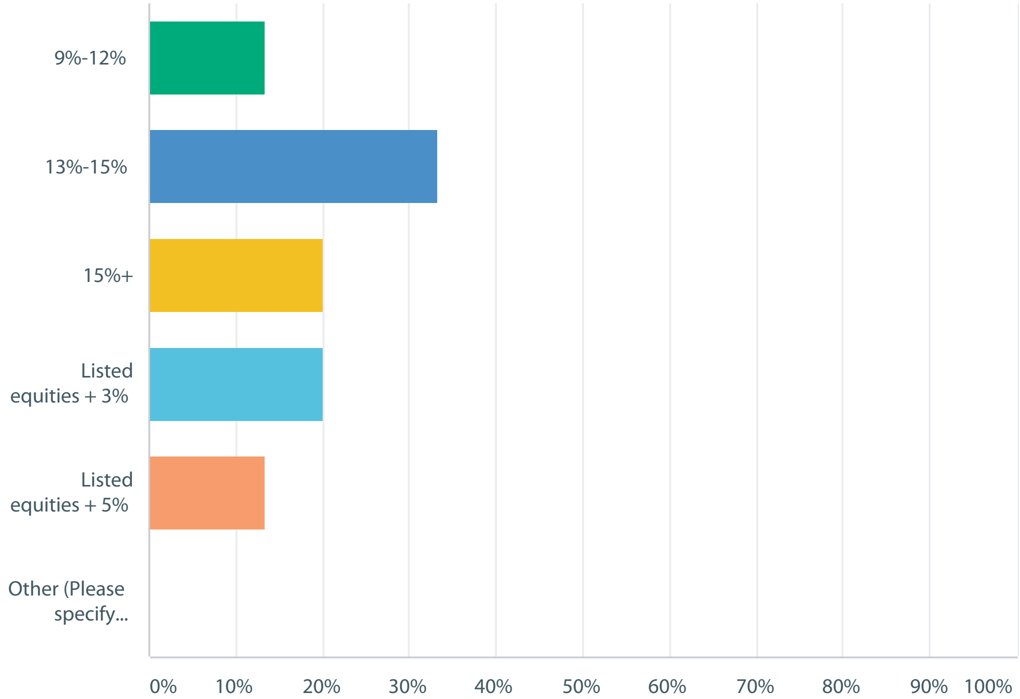
Q6. What is your preferred execution/implementation approach for your private equity and venture capital allocation?



Answer Choices	Responses	
Predominantly fund-of-funds	0.00%	0
Mixture of fund-of-funds and individual funds	13.33%	2
Assemble own program of diverse individual fund relationships	6.67%	1
Assemble program including some co-investments	13.33%	2
Assemble program of predominantly direct investments	0.00%	0
Assemble program including co-investments and direct holdings in managers' investee companies	26.67%	4
Use specialist private equity adviser for research and advice but make final investment decisions	26.67%	4
Outsource to a specialist adviser/manager to implement on discretionary basis	13.33%	2
Other (Please outline briefly)	0.00%	0
TOTAL		15

(Answered: 15 Skipped: 0)

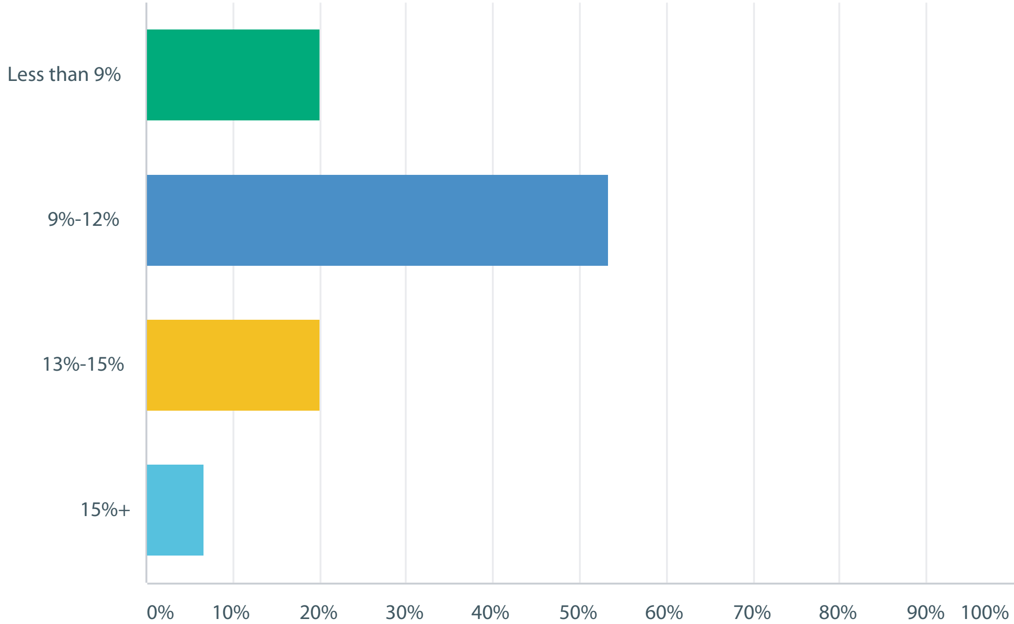
Q7. What net rates of return are you targeting for your private equity and venture capital investments for the 12 months started 1 July 2018?



Answer Choices	Responses	
9%-12%	13.33%	2
13%-15%	33.33%	5
15%+	20.00%	3
Listed equities + 3%	20.00%	3
Listed equities + 5%	13.33%	2
Other (Please outline briefly)	0.00%	0
TOTAL		15

(Answered: 15 Skipped: 0)

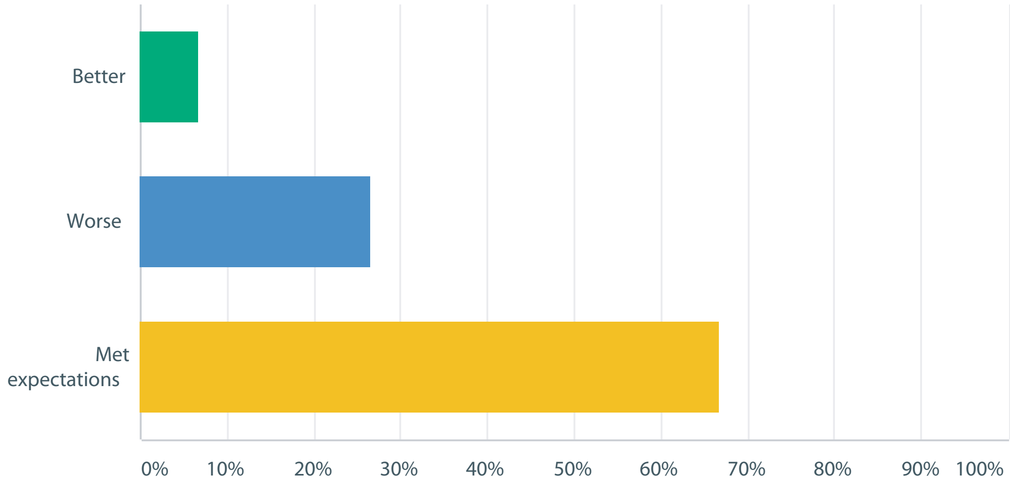
Q8. Historically, what net rates of return have you typically realised from investments in private equity and venture capital?



Answer Choices	Responses	
Less than 9%	20.00%	3
9%-12%	53.33%	8
13%-15%	20.00%	3
15%+	6.67%	1
TOTAL		15

(Answered: 15 Skipped: 0)

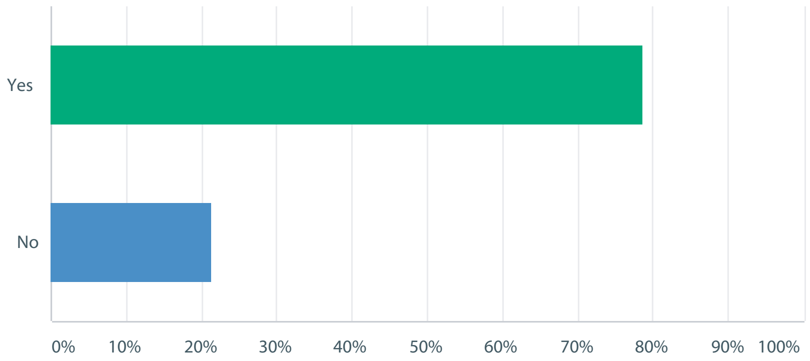
Q9. How have your private equity and venture capital investments performed relative to your expectations for this asset class?



Answer Choices	Responses	
Better	6.67%	1
Worse	26.67%	4
Met expectations	66.67%	10
TOTAL		15

(Answered: 15 Skipped: 0)

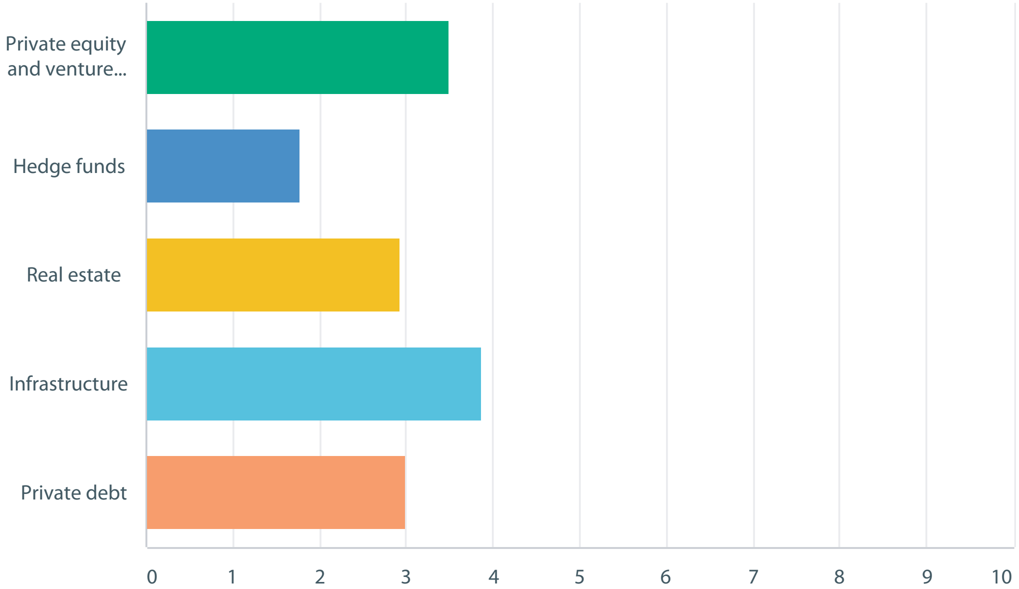
Q10. On a risk adjusted basis, do your current private equity and venture capital investments offer value for money?



Answer Choices	Responses	
Yes	78.57%	11
No	21.43%	3
TOTAL		11

(Answered: 14 Skipped: 1)

Q11. *Of the alternative asset classes listed below, rank in order your preference to allocate funds in the 12 months started 1 July 2018.*



	1	2	3	4	5	Total	Score
Private equity and venture capital	35.71% 5	21.43% 3	14.29% 2	14.29% 2	14.29% 2	14	3.50
Hedge funds	7.69% 1	0.00% 0	7.69% 1	30.77% 4	53.85% 7	13	1.77
Real estate	7.14% 1	28.57% 4	21.43% 3	35.71% 5	7.14% 1	14	2.93
Infrastructure	28.57% 4	42.86% 6	14.29% 2	14.29% 2	0.00% 0	14	3.86
Private debt	21.43% 3	7.14% 1	42.86% 6	7.14% 1	21.43% 3	14	3.00

(Answered: 14 Skipped: 1)

Q12. What is your level of interest in allocating to direct or co-investment private equity or venture capital investments over the 12 months started 1July 2018?

What is your level of interest in allocating to direct or co-investment private equity or venture capital investments over the 12 months started 1July 2018? (0 indicating no interest and 10 indicating strong interest.)
10
5
10
1
10
10
10
10
10
0
10
3
0
4
8
Average: 6.7

(Answered: 15 Skipped: 0)

Q13. What is your level of interest in allocating to Australian private equity and venture capital GPs over the 12 months started 1 July 2018?

What is your level of interest in allocating to Australian private equity and venture capital GPs over the 12 months started 1 July 2018? (0 indicating no interest and 10 indicating strong interest.)
7
5
2
1
10
10
7
10
9
0
5
0
3
0
2
Average: 4.7

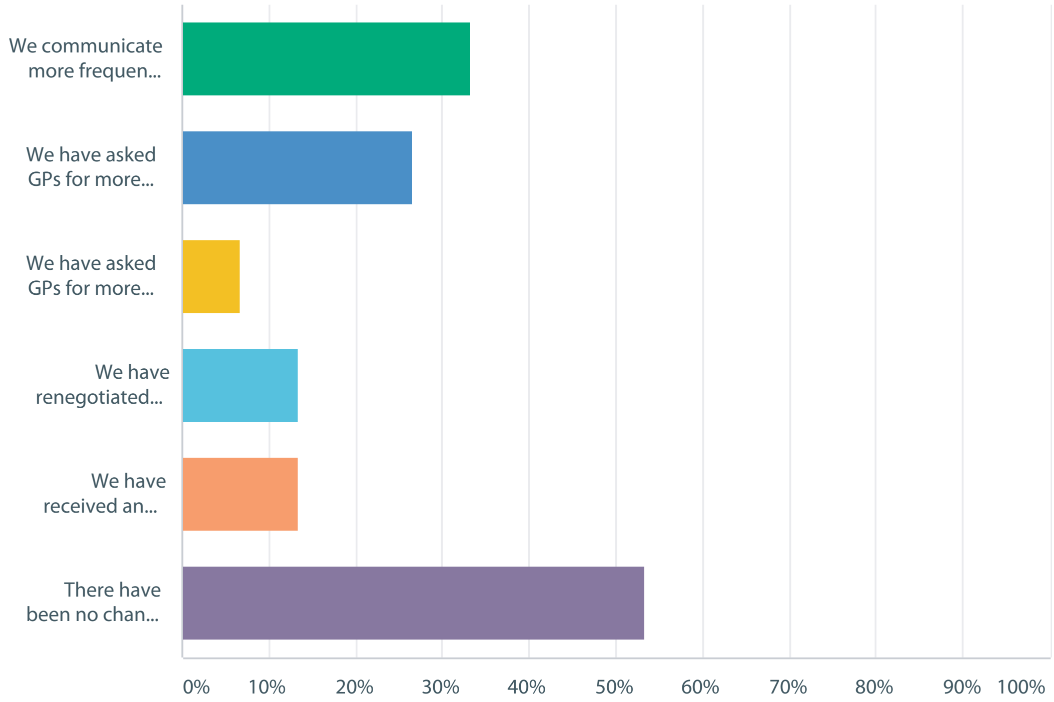
(Answered: 15 Skipped: 0)

Q14. What is your level of interest in allocating specifically to Australian venture capital (as opposed to private equity) GPs over the 12 months started 1 July 2018?

What is your level of interest in allocating specifically to Australian venture capital (as opposed to private equity) GPs over the 12 months started 1 July 2018? (0 indicating no interest and 10 indicating strong interest.)
5
5
2
2
0
5
2
10
9
0
3
0
0
3
2
Average: 3.3

(Answered: 15 Skipped: 0)

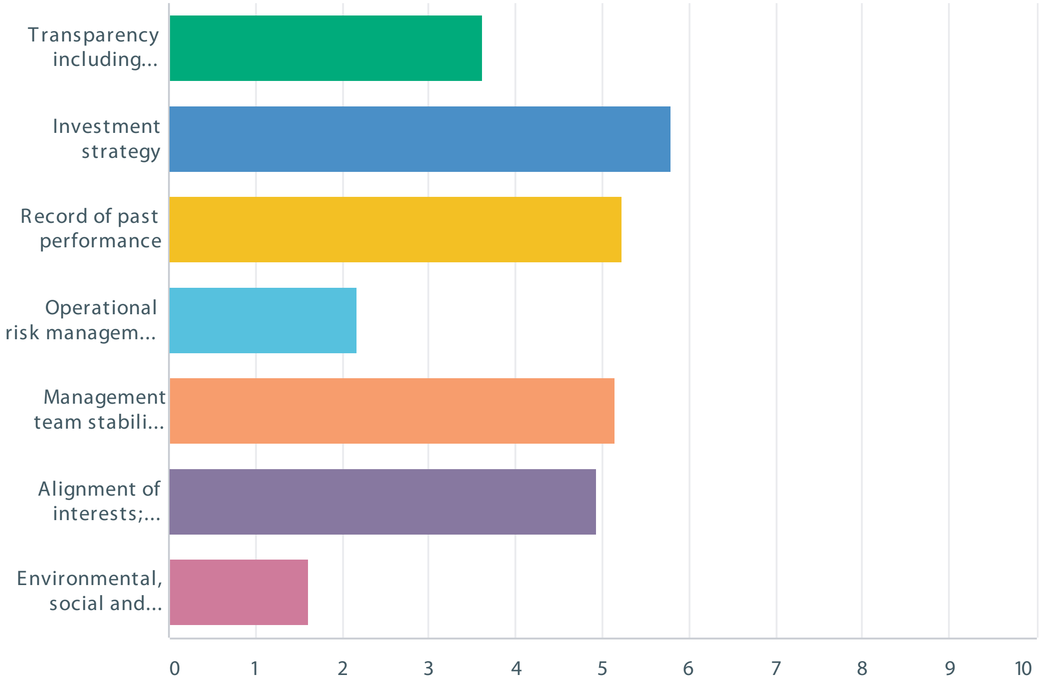
Q15. Reflecting on your relationships with GPs over the last 12 months, which of the following are true?



Answer Choices	Responses	
We communicate more frequently than previously	33.33%	5
We have asked GPs for more transparency in new investments	26.67%	4
We have asked GPs for more transparency in valuations	6.67%	1
We have renegotiated fees with our existing GPs for their new funds	13.33%	2
We have received an increase in GP extension requests regarding investment periods for the life of funds	13.33%	2
There have been no changes in our relationships with GPs	53.33%	8
TOTAL		15

(Answered: 15 Skipped: 0)

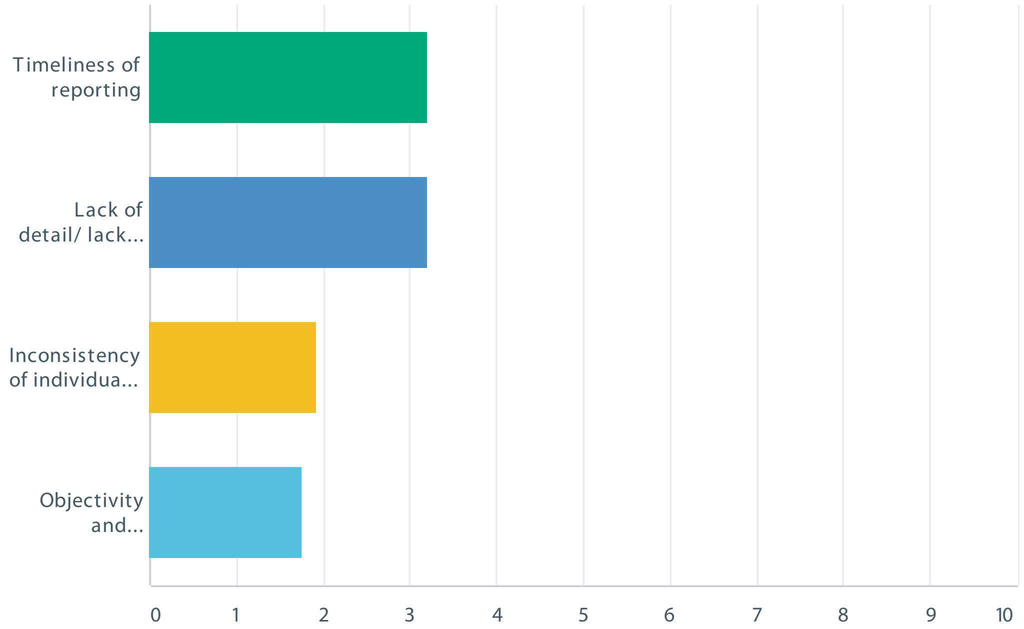
Q16. When allocating to a GP the most important factors are: (Rank in importance with 1 indicating greatest importance.)



	1	2	3	4	5	6	7	Total	Score
Transparency including robust valuation process	15.38% 2	0.00% 0	0.00% 0	15.38% 2	53.85% 7	15.38% 6	0.00% 0	13	3.62
Investment strategy	28.57% 4	42.86% 6	7.14%% 1	21.43% 3	0.00% 0	0.00% 0	0.00% 0	14	5.79
Record of past performance	23.08% 3	23.08% 3	38.46% 5	0.00% 0	7.69% 1	0.00% 0	7.69% 1	13	5.23
Operational risk management	0.00% 0	0.00% 0	0.00% 0	8.33% 1	25.00% 3	41.67% 5	25.00% 3	12	2.17
Management team stability and retention strategies	23.08% 3	15.38% 2	38.46% 5	7.69% 1	7.69% 1	7.69% 1	0.00% 0	13	5.15
Alignment of interests; fees, carried interest and GP investment	14.29% 2	21.43% 3	21.43% 3	35.71% 5	0.00% 0	7.14% 1	0.00% 0	14	4.93
Environmental, social and governance (ESG) issues	0.00% 0	0.00% 0	0.00% 0	7.69% 1	7.69% 1	23.08% 3	61.54% 8	13	1.62

(Answered: 14 Skipped: 1)

Q17. Regarding valuation and reporting, the most common problems with information received, ranked in importance from the most important are:



	1	2	3	4	Total	Score
Timeliness of reporting	50.00% 7	35.71% 5	0.00% 0	14.29% 2	14	3.21
Lack of detail/ lack of transparency	50.00% 7	21.43% 3	28.57% 4	0.00% 0	14	3.21
Inconsistency of individual GPs in their reporting from period to period	0.00% 0	33.33% 4	25.00% 3	41.67% 5	12	1.92
Objectivity and independence of those who prepare reports	0.00% 0	16.67% 2	41.67% 5	41.67% 5	12	1.75

(Answered: 14 Skipped: 1)

Observations:

Allocations generally being maintained

Australian institutional investors' average allocations to private equity and venture capital modestly increased in the year to the end of June 2018 with most Australian institutional investors allocating 4% – 6% of total investment portfolios.

That increase could be interpreted as indicating improving positive sentiment toward private equity investment but increases in allocations are not necessarily entirely the result of active decisions. Rising valuations of existing private equity investments and lower valuations in other asset classes, most notably listed equities late in the survey period, are likely to have helped increase the proportionate size of allocations. Therefore, the increase more likely represents most institutions seeking to maintain their current allocation levels. In fact, 60% of respondents said they planned to retain their allocations at around current levels while 27% planned increases.

Most of the investors with high current allocations to private equity and venture capital are industry superannuation funds and some of the largest of these funds have led the trend to higher allocations.

Fresh commitments planned

Close to 70% of institutions are this year planning to make fresh commitments to private equity. Whether those commitments will become investments this year is another matter. Only some funds will be raising capital in any year, so investors are likely to be selective and wait for the fund opportunities they wish to target. Gaining access to the funds of leading investment teams is, however, difficult as allocations will go first to prior investors. Maintaining allocations over multi-year periods is increasingly recognised as the best approach.

China interest increases

As our previous surveys have found, Australian institutional investors now prefer to allocate to private equity and venture capital funds globally, with access to the North American market the highest priority. Increasing interest in investing in

Greater China and South-East Asia has, however, brought the ranking of other regions closer to that of North America and closer together. Greater China is now seen as the second most important market just pipping previously second-ranked Europe. The Australia and New Zealand market retains fourth place not far behind Europe although it has lost some ground to Greater China and fifth-ranked South-East Asia. Australian institutional investors, however, continue to be over allocated to Australia and New Zealand.

Interest in local venture capital remains low

Interest in investing in Australian private equity is mixed with half of the respondents having strong interest and half low interest. Interest in investing in Australian venture capital remains low. Most Australian investors that allocate specifically to venture capital (rather than including some venture capital as part of a private equity allocation) prefer to do so solely through US-based venture funds which invest internationally. Investing in Australian venture funds is problematic for large institutional investors such as industry super funds because the funds are too small for them to make their minimum allocations without their stakes in the funds being unacceptably large.

As has been well documented in *Australian Private Equity & Venture Capital Journal* and elsewhere, two large industry super funds have made allocations to Australian venture capital funds over the last few years. Our survey is carried out on the understanding that individual respondents are not identified so we will not identify those funds here. Only about 13% of respondents, however, expressed strong interest in investing in Australian venture capital, a percentage that correlates with two institutions. About 73% of respondents indicated low interest which is roughly in line with a year earlier. There is, therefore, no indication that other investment institutions are planning to materially change their allocations to Australian venture capital funds in the short term.

Strong interest in direct investing and co-investing

The strongest trend revealed by the survey is continued interest in making direct private equity investments or co-investments alongside private equity fund managers. More than half, 53%, of respondents indicated the highest level of interest in these strategies. Most of the remainder indicated low levels of interest. This polarisation had been apparent in the last two surveys and probably reflects those institutions that are strong believers in investing in private equity seeking a way to reduce the impact of management fees and drive greater value for their investors. Direct private equity investing or investing as co-investors alongside private equity fund managers averages down the high management fees of private equity fund investing. It will take many years to determine whether bringing private equity investing "in-house" can generate as strong overall returns as fund investing, but the trend appears to have eased investment institutions' concerns over fund managers' fees.

Less external advice

The influence of external advisers over decision-making has reduced. Little more than 25% of respondents said they would use a specialist private equity adviser for research and advice and then make final investment decisions in-house. A year earlier 50% said they would take this approach. Over 13% of respondents said their preferred execution/implementation strategy was to outsource their private equity investing to a specialist adviser or fund manager, up from under 10%.

These changes probably reflect the polarisation between the strategies of bringing the management of private equity and venture capital investment in-house or rejecting that approach in favour of outsourcing. So, while some investors are now building quite large in-house private equity and venture capital teams others have re-affirmed decisions to outsource mandates to specialist advisors.

Satisfaction reaches high point

Less concern about fees, along with strong capital returns from managers exiting investments over the last few years, has helped lift satisfaction with private equity investment to the highest level since the survey was started in 2013 with nearly 80% saying private equity investments offer value for money on a risk-adjusted basis. Over 60% of respondents said the performance of their private equity and venture capital investments had met their expectations while close to 7% said it had exceeded expectations. A little under 30% said their investments had performed worse than expected. A year earlier, opinions had been fairly equally divided with just over 46% answering in the positive and the same percentage answering in the negative. A little under 8% had said then that their private equity and venture capital investments had performed better than expected.

In parallel with increased satisfaction levels, most respondents (more than 53%), said that historically they had realised net rates of return of 9–12% on their private equity and venture capital investments. The proportion reporting achieving past returns of 13%–15% reduced from more than 33% to 20% while those achieving returns of greater than 15% also reduced a little from over 8% to close to 7%. Those recalling past returns of less than 9% also increased slightly from nearly 17% to 20%. The responses suggest most investment institutions have revised down their overall past returns from private equity and venture capital which has perhaps provided reason for them to be more conservative about the returns they target for the future.

Targets for future returns have reduced a little. Over 13% of respondents said they were targeting 9-12% whereas a year earlier all targets were higher than that. More than 33% are targeting returns of 13-15%, the same as a year earlier.

More investors are now simply setting fixed percentage benchmark returns for the asset class rather than a relative margin over listed equities. Perhaps this suggests investors are expecting the asset class to generate absolute performance (alpha) rather than relative performance.

Between the alternative asset classes of private equity and venture capital, hedge funds, real estate, infrastructure and private debt, infrastructure is marginally favoured for allocations in the current year over private equity and venture capital.

About this survey: Private Equity Media sought responses from more than 50 Australian investment institutions known to have invested in private equity or venture capital. Of those, 15 participated in the survey.