2019-2020

Australian Institutional Investor Survey of Private Equity & Venture Capital Investing

Private Equity Media

Authors: Alistair McCreadie, Simon Uzcilas, Adrian Herbert

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Executive Summary

Key findings

Post-survey developments

This survey was completed before the effects of COVID-19 became apparent. Consequently, the responses reflect a very different landscape to that of today. We have outlined the responses first and discuss in our conclusions the expected impacts of the virus. This report reflects our perspective as of 31 March, 2020.

Allocation levels reduced

At an average of 4.14% of total portfolios, private equity and venture capital allocations are down from 5.55% in the prior year. This can primarily be explained by the denominator effect between asset classes across a total portfolio; a substantial rise in the valuations of listed equities resulting in a proportionate reduction in the exposure to private equity and venture capital.

Interest continues to grow

Fifty per cent of respondents said they planned to increase their allocations to the sector – up from 27% the previous year – whilst 83% planned to make new allocations.

Return expectations also up

Return expectations are up with 66% of respondents now targeting 15% returns, or listed market returns plus 5%. A year earlier, only 33% of respondents expected returns that high.

Private equity almost on par with infrastructure

While infrastructure remains the most attractive of the private asset classes, private equity made gains over the previous year to be almost on par.

Disappointment with future returns may be inevitable

Lower than targeted private equity returns of a decade ago are now apparently disregarded suggesting disappointment may be inevitable in the future. Clearly there will be challenges for private equity to maintain average returns as high as the expected 15 per cent over the longer-term.

Direct and co-investing interest up

Interest in direct or co-investment opportunities is high and increasing. This is being driven by a strong desire to reduce the overall level of fees for the asset class.

Increased interest in local managers

Most LPs expressed increased interest in investing in Australian private equity and venture capital managers.

This does not reflect a move away from the long-term trend for local LPs to prefer global over local private equity programs, rather it appears to be a growing realisation that investing in global investment managers does not achieve optimal local exposure.

Strongest ever interest in venture funds

Interest in investing specifically in Australian venture capital funds has, however, reached a high point. Half of the respondents expressed positive interest.

Size of sector teams

The size of sector teams reported for this survey was generally unchanged from the prior two years which suggests they may be under-resourced for increased activity.

Conclusions

The effects of COVID-19 will clearly extensively alter the intentions revealed by this survey. Direct effects on the superannuation sector will be of primary importance as most LPs are large industry superannuation funds.

Falls in listed markets have resulted in unlisted exposures rising to, or exceeding, internal limits and thus reducing capacity for funds to maintain intended allocations to private equity and venture capital.

The federal government's decision to allow eligible members early access to up to $20,000 from superannuation accounts is expected to create challenges for some super funds and will further diminish the capacity of funds to maintain or grow private equity investment programs.

Other more liquid assets are now offering attractive risk/return profiles and relatively better value than private equity or venture capital. Super funds can be expected to display a preference for these investment opportunities over private equity and venture capital. Some super funds may, however, opportunistically and selectively build exposure in private equity and venture capital.

Overall, allocations to private equity and venture capital are expected to fall and, in some cases, cease altogether.
How long this will remain the case is uncertain, but generally it takes time for confidence to return after a major economic downturn.

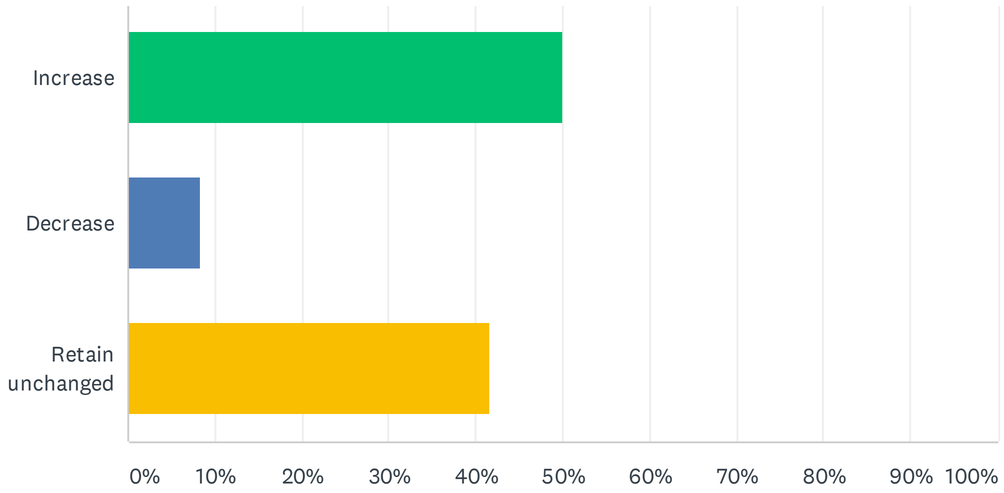
Consolidated Survey Responses

Q1. Percentage of portfolio allocated to private equity and venture capital as at 1 July 2019?

Percentage of portfolio allocated to private equity and venture capitalas at 1 July 2018
2.0%
7.0%
2.2%
3.0%
6.0%
2.5%
3.0%
<1.0%
8.0%
5.0%
5.0%
5.0%
Average: 4.14%

(Answered: 12 Skipped: 0)

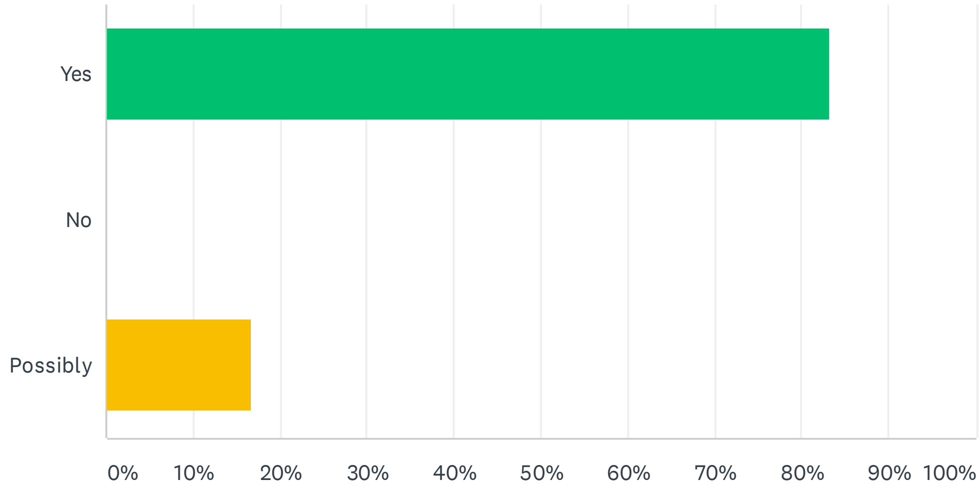
Q2. Do you plan to change your total allocation to private equity and venture capital investments in the 12 months started 1 July 2019?



Answer Choices	Responses	
Increase	50.00%	6
Decrease	8.33%	1
Retain unchanged	41.67%	5
TOTAL		12

(Answered: 12 Skipped: 0)

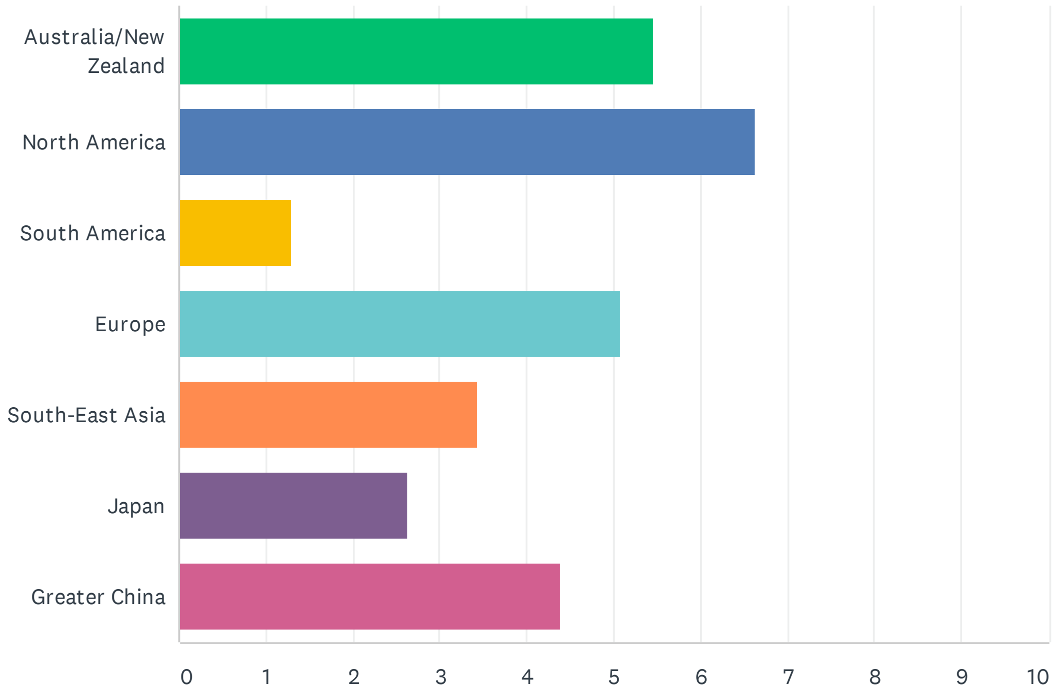
Q3. Do you anticipate making fresh commitments to private equity or venture capital investing in the 12 months started 1 July 2019?



Answer Choices	Responses	
Yes	83.33%	10
No	0.00%	0
Possibly	16.67%	2
TOTAL		12

(Answered: 12 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	2	3	4	5	6	7	Total	Average Ranking
Australia/New Zealand	27.27% 3	27.27% 3	27.27% 3	0.00% 0	18.18% 2	0.00% 0	0.00% 0	11	5.45
North America	81.82% 9	9.09% 1	0.00% 0	9.09% 1	0.00% 0	0.00% 0	0.00% 0	11	6.64
South America	0.00% 0	0.00% 0	0.00% 0	0.00% 0	0.00% 0	28.57% 2	71.43% 5	7	1.29
Europe	0.00% 0	36.36% 4	45.45% 5	9.09% 1	9.09% 1	0.00% 0	0.00% 0	11	5.09
South-East Asia	0.00% 0	0.00% 0	28.57% 2	14.29% 1	28.57% 2	28.57% 2	0.00% 0	7	3.43
Japan	0.00% 0	0.00% 0	0.00% 0	25.00% 2	25.00% 2	37.50% 3	12.50% 1	8	2.63
Greater China	0.00% 0	30.00% 3	10.00% 1	50.00% 5	0.00% 0	0.00% 0	10.00% 1	10	4.40

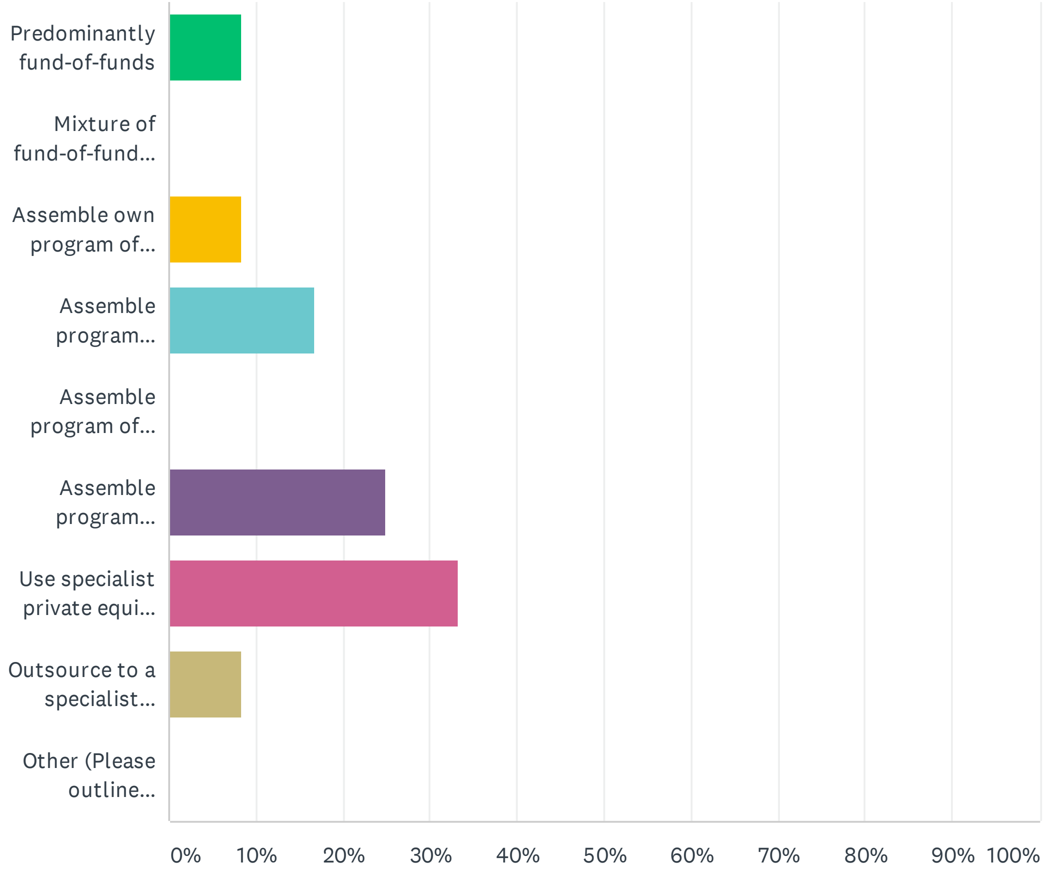
(Answered: 12 Skipped: 0)

Q5. Number of equivalent full time professionals in your private equity and venture capital team as at 1 July 2019?

Number of equivalent full time professionals in your private equity andventure capital team as at 1 July 2018
0.5
2.0
2.0
1.0
0.0
1.0
0.5
Skipped
2.0
7.0
4.0
20
Average: 3.35

(Answered: 11 Skipped: 1)

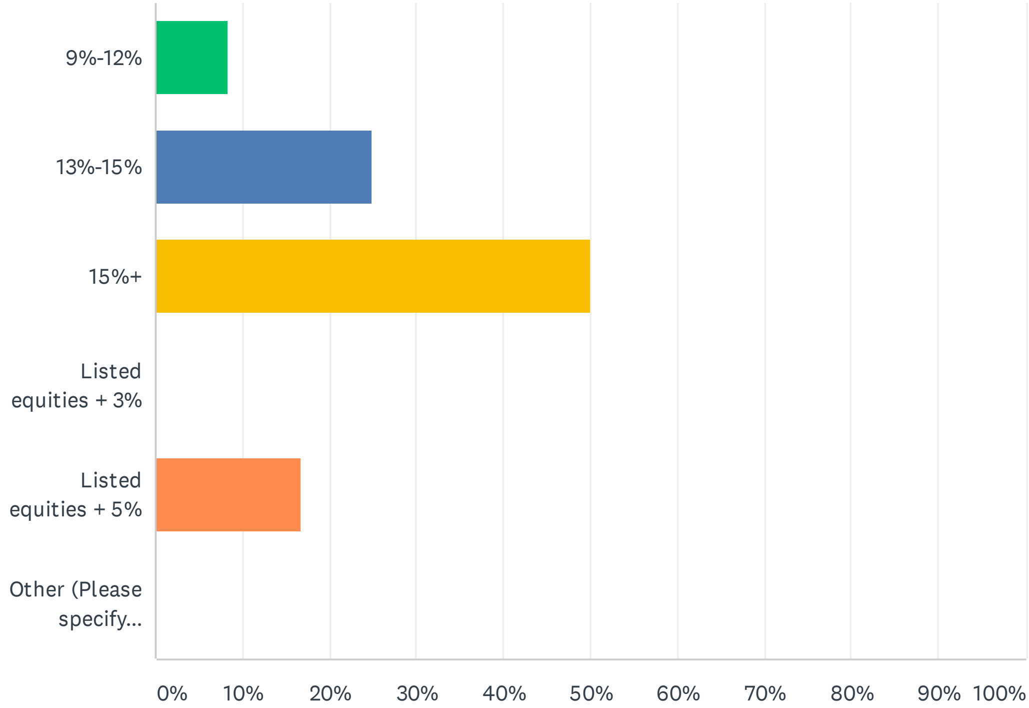
Q6. What is your preferred execution/implementation approach for your private equity and venture capital allocation?



Answer Choices	Responses	
Predominantly fund-of-funds	8.33%	1
Mixture of fund-of-funds and individual funds	0.00%	0
Assemble own program of diverse individual fund relationships	8.33%	1
Assemble program including some co-investments	16.67%	2
Assemble program of predominantly direct investments	0.00%	0
Assemble program including co-investments and direct holdings in managers' investee companies	25.00%	3
Use specialist private equity adviser for research and advice but make final investment decisions	33.33%	4
Outsource to a specialist adviser/manager to implement on discretionary basis	8.33%	1
Other (Please outline briefly)	0.00%	0
TOTAL		12

(Answered: 12 Skipped: 0)

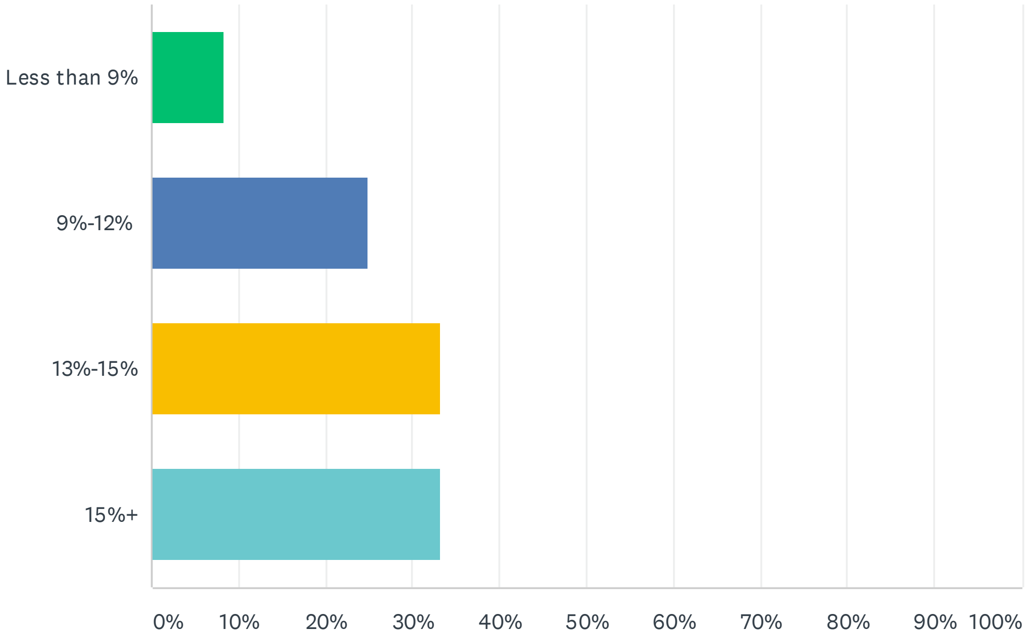
Q7. What net rates of return are you targeting for your private equity and venture capital investments for the 12 months started 1 July 2019?



Answer Choices	Responses	
9%-12%	8.33%	1
13%-15%	25.00%	3
15%+	50.00%	6
Listed equities + 3%	0.00%	0
Listed equities + 5%	16.67%	2
Other (Please outline briefly)	0.00%	0
TOTAL		12

(Answered: 12 Skipped: 0)

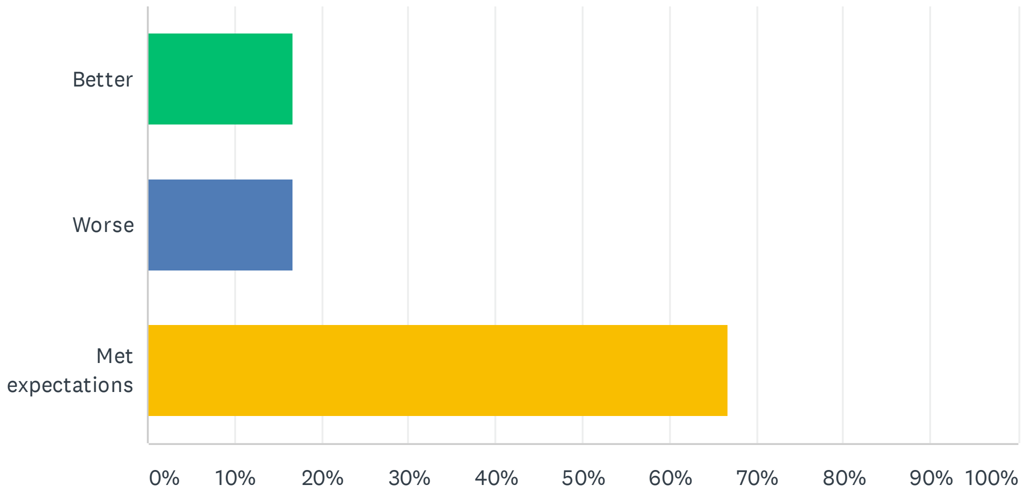
Q8. Historically, what net rates of return have you typically realised from investments in private equity and venture capital?



Answer Choices	Responses	
Less than 9%	8.33%	1
9%-12%	25.00%	3
13%-15%	33.33%	4
15%+	33.33%	4
TOTAL		12

(Answered: 12 Skipped: 0)

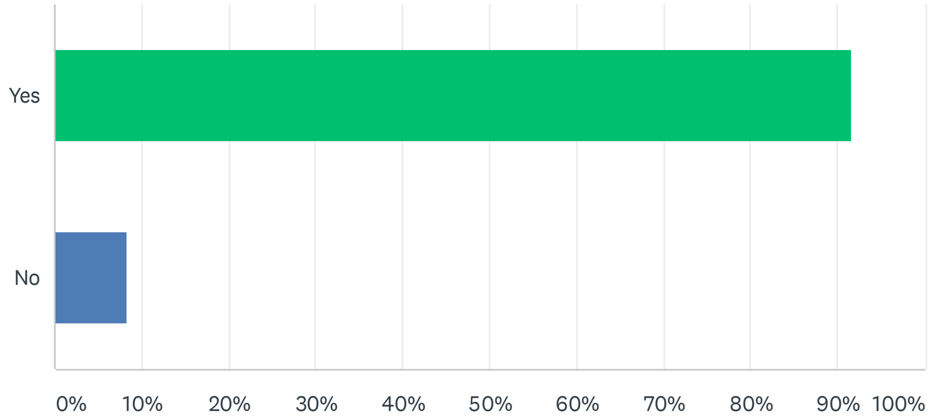
Q9. How have your private equity and venture capital investments performed relative to your expectations for this asset class?



Answer Choices	Responses	
Better	16.67%	2
Worse	16.67%	2
Met expectations	66.67%	8
TOTAL		12

(Answered: 12 Skipped: 0)

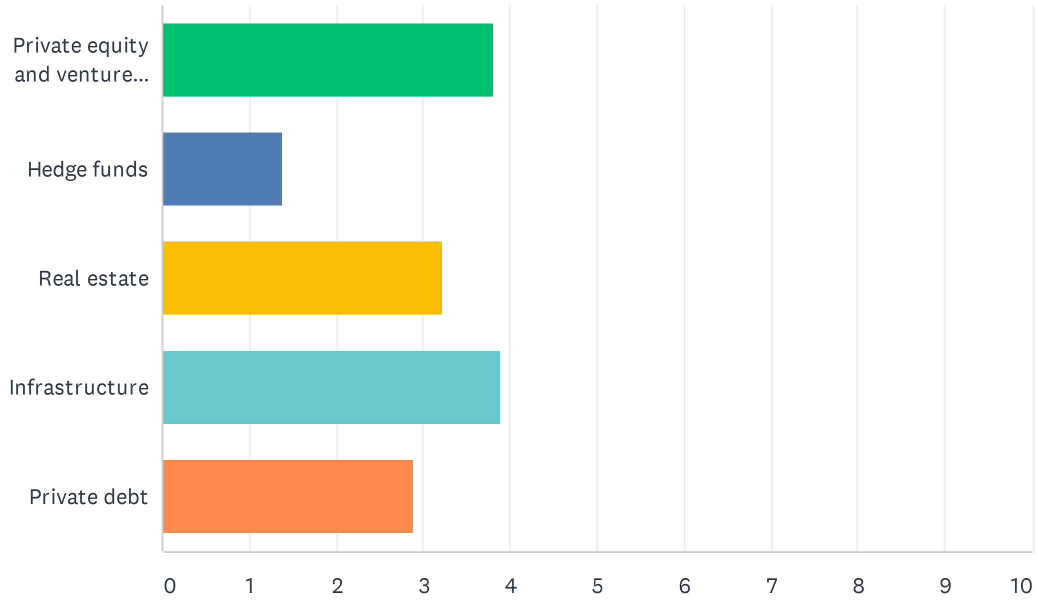
Q10. On a risk adjusted basis, do your current private equity and venture capital investments offer value for money?



Answer Choices	Responses	
Yes	91.67%	11
No	8.33%	1
TOTAL		12

(Answered: 12 Skipped: 0)

Q11. Of the alternative asset classes listed below, rank in order your preference to allocate funds in the 12 months started 1 July 2019 (1 being of greatest interest and 5 being of least interest):



	1	2	3	4	5	Total	Score
Private equity and venture capital	40.00% 4	20.00% 2	20.00% 2	20.00% 2	0.00% 0	10	3.80
Hedge funds	0.00% 0	12.50% 1	0.00% 0	0.00% 0	87.50% 7	8	1.38
Real estate	11.11% 1	44.44% 4	11.11% 1	22.22% 2	11.11% 1	9	3.22
Infrastructure	44.44% 4	11.11% 1	33.33% 3	11.11% 1	0.00% 0	9	3.89
Private debt	11.11% 1	11.11% 1	33.33% 3	44.44% 4	0.00% 0	9	2.89

(Answered: 10 Skipped: 2)

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 1 July 2019? (0 indicating no interest and 10 indicating strong interest.)

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.)
6
10
5
9
Skipped
8
10
6
10
10
10
10
Average: 8.54

(Answered: 11 Skipped: 1)

Q13. What is your level of interest in allocating to Australian private equity and venture capital GPs over the 12 months started 1 July 2019? (0 indicating no interest and 10 indicating strong interest.)

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.)
6
6
8
3
Skipped
10
6
1
10
8
6
10
Average: 6.72

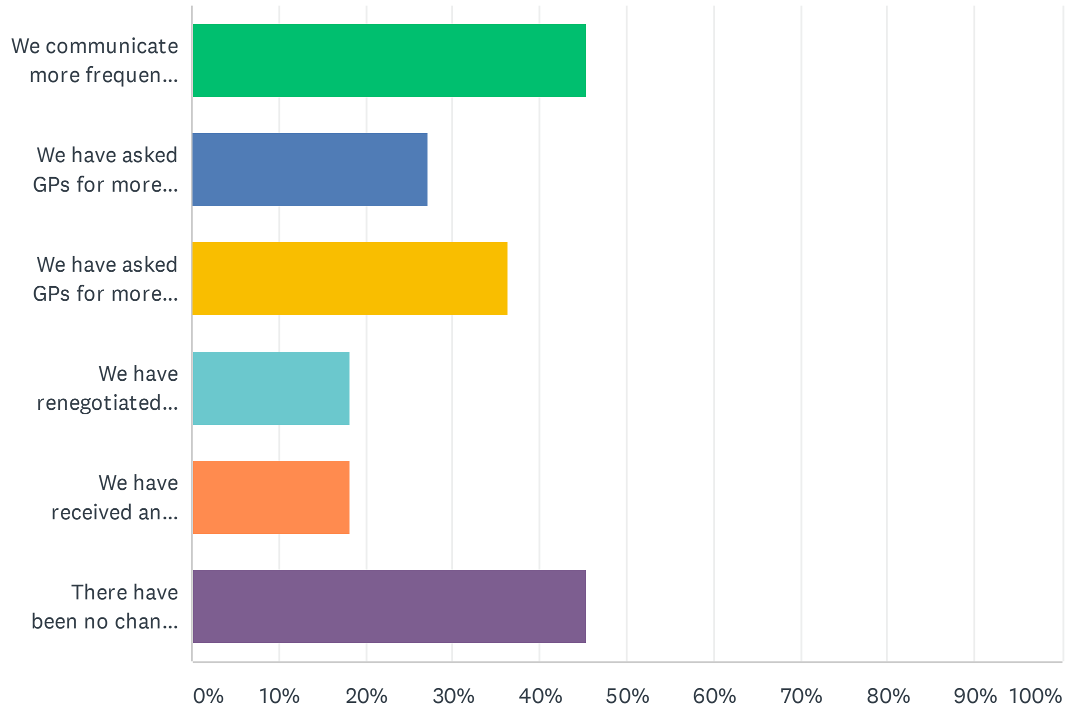
(Answered: 11 Skipped: 1)

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 2019? (0 indicating no interest and 10 indicating strong interest.)

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.)
7
10
8
1
Skipped
3
2
1
10
5
7
0
Average: 4.90

(Answered: 11 Skipped: 1)

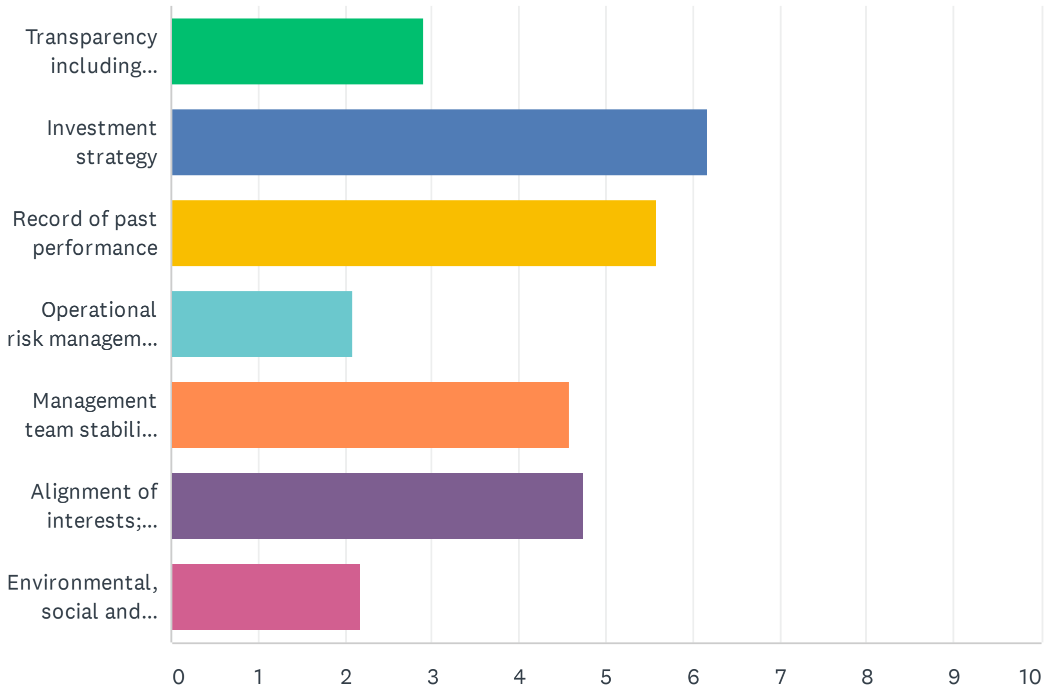
Q15. Reflecting on your relationships with GPs over the last 12 months, which of the following are true? (Select one or more than one.)



Answer Choices	Responses	
We communicate more frequently than previously	45.45%	5
We have asked GPs for more transparency in new investments	27.27%	3
We have asked GPs for more transparency in valuations	36.36%	4
We have renegotiated fees with our existing GPs for their new funds	18.18%	2
We have received an increase in GP extension requests regarding investment periods for the life of funds	18.18%	2
There have been no changes in our relationships with GPs	45.45%	5
TOTAL		11

(Answered: 11 Skipped: 1)

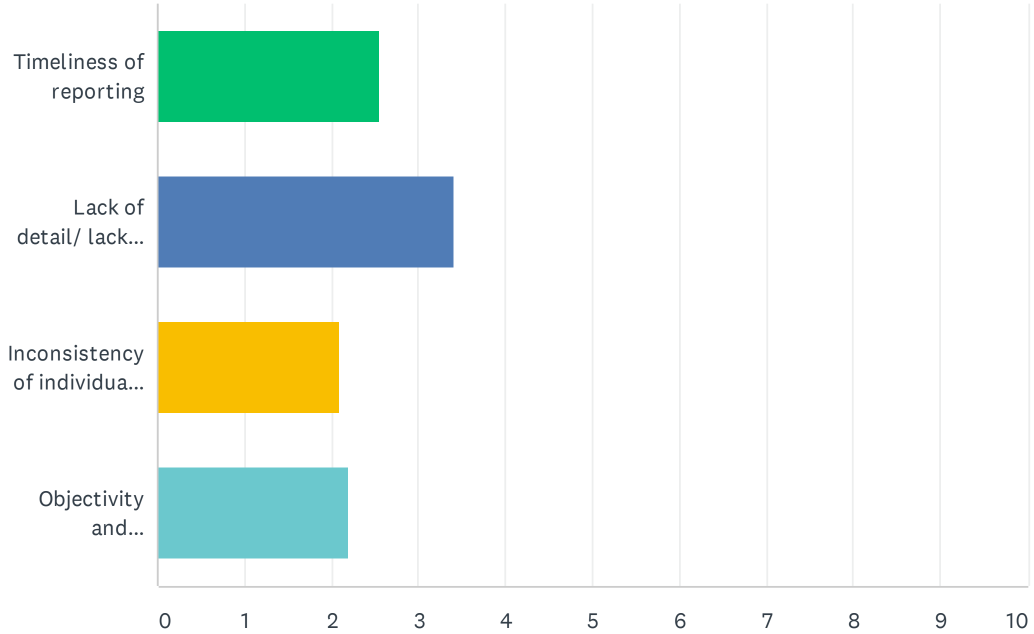
Q16. When allocating to a GP the most important factors are: (Rank in importance with 1 indicating greatest importance.)



	1	2	3	4	5	6	7	Total	Score
Transparency including robust valuation process	0.00% 0	0.00% 0	20.00% 2	10.00% 1	30.00% 3	20.00% 2	20.00% 2	10	2.90
Investment strategy	33.33% 4	58.33% 7	0.00% 0	8.33% 1	0.00% 0	0.00% 0	0.00% 0	12	6.17
Record of past performance	41.67% 5	16.67% 2	25.00% 3	0.00% 0	8.33% 1	8.33% 1	0.00% 0	12	5.58
Operational risk management	0.00% 0	0.00% 0	0.00% 0	9.09% 1	18.18% 2	45.45% 5	27.27% 3	11	2.09
Management team stability and retention strategies	8.33% 1	16.67% 2	25.00% 3	41.67% 5	0.00% 0	0.00% 0	8.33% 1	12	4.58
Alignment of interests; fees, carried interest and GP investment	16.67% 2	8.33% 1	33.33% 4	25.00% 3	8.33% 1	8.33% 1	0.00% 0	12	4.75
Environmental, social and governance (ESG) issues	0.00% 0	0.00% 0	0.00% 0	9.09% 1	36.36% 4	18.18% 2	36.36% 4	11	2.18

(Answered: 12 Skipped: 0)

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	36.36% 4	18.18% 2	9.09% 1	36.36% 4	11	2.55
Lack of detail/ lack of transparency	50.00% 6	41.67% 5	8.33% 1	0.00% 0	12	3.42
Inconsistency of individual GPs in their reporting from period to period	18.18% 2	9.09% 1	36.36% 4	36.36% 4	11	2.09
Objectivity and independence of those who prepare reports	0.00% 0	40.00% 4	40.00% 4	20.00% 2	10	2.20

(Answered: 12 Skipped: 0)

Observations:

This survey was completed before the effects of COVID-19 became apparent. Consequently, the responses reflect a very different landscape to that of today. We have outlined the responses first and discuss in our conclusions the likely impact of the virus on these responses. This report reflects our perspective as of 31 March, 2020.

Allocation levels reduced by equities boom

At an average of 4.14% of total portfolios, private equity and venture capital allocations for the 2019-20 financial year are lower than the survey historical high 5.5% of the prior year. This might appear at odds with other responses which indicate continuing and growing interest in the sector, but the reduction can primarily be explained by the denominator effect between asset classes across a total portfolio; a substantial rise in the valuations of listed equities resulting in a proportionate reduction in the exposure to private equity and venture capital. The dollar value of allocations to private equity and venture capital would, however, have risen in almost all cases. Most of the limited partner (LP) investors surveyed are superannuation funds and their assets under management would have risen significantly over the year since the prior survey.

Interest in private equity and venture capital continues to grow

The growing interest of LPs in allocating to private equity and venture capital is illustrated by the fact that 50 per cent of respondents said they planned to increase their allocations to the sector – up from 27% the previous year – whilst 83% – up from 66% the previous year – planned to make fresh allocations to the sector.

Average return expectations increase significantly

Return expectations have also increased with 66% of respondents now targeting 15% or listed market returns plus 5%.

A year earlier, only 33% of respondents expected returns that high. Similarly, 66% said that in the past they had typically realised returns of above 13% with 33% saying returns had been above 15 per cent.

Almost all LPs (91%) see private equity as offering value for money on a risk-adjusted return basis. This is again an increase from a year earlier and is now the highest in the seven-year history of the survey.

Private equity almost on par with infrastructure

While infrastructure remains the most attractive of the private asset classes, private equity was up from the previous year to be almost on par. As most LPs are superannuation funds, they can be expected to recognise the longer-term returns of infrastructure as better matching their predictions of steeper increases in outgoings in a decade or so as the number of members withdrawing their contributions on retirement sharply increases. Presumably they see higher shorter-term returns from private equity as currently more attractive, most likely against a background of infrastructure assets becoming increasingly expensive. Along with earlier responses, this poses the question: are LPs beginning to expect too much from the private equity asset class?

Interest in direct investing and co-investing continues to grow

Interest in direct and co-investment opportunities is high and is continuing to increase. This reflects a widely observed industry trend which is being driven by a strong desire to reduce the overall level of fees for the asset class, and also to flatten the J-curve effect of investing in funds.

Increased interest in local managers

Most LPs expressed increased interest in investing in Australian private equity and venture capital managers. This does not reflect a move away from the long-term trend for local LPs to prefer global over local private equity programs – North America remained the preferred region for investment, but Australia and New Zealand moved up to second place from fourth a year earlier. This suggests there is growing realisation that investing in global investment managers does not achieve optimal local exposure. Increased interest in allocating to local managers is also probably linked to increased interest in direct investment and co-investment. Most LPs want to make these investments in the local market.

Overall, it seems Australian LPs are now deciding to earmark some of their sector allocation for investing with local managers. This decision is, no doubt, made easier by the fact that many local managers are performing well compared to global standards. Investment scale problems remain, however. As the assets under management of major industry superannuation funds increase, the funds of most local private equity managers (except the largest) would generally be seen as subscale. This also applies to most local venture capital funds.

Strongest ever interest in venture funds

Interest in investing specifically in Australian venture capital funds has, however, reached a high point, no doubt supported by the recent elevation of several relatively young Australian technology start-ups to Unicorn status. Half of the respondents expressed positive interest. However, if the LPs that have already made allocations to the sector are disregarded, interest among the remainder is still just on the negative side of the median.

Size of sector teams

The size of sector teams was generally unchanged from the prior two years, adjusting for changes in sample by comparing the responses of individual LPs with their previous year's responses. However, considering the trends toward larger allocations, direct investments and co-investments along with final investment decisions being made in-house, there would appear to be a risk that teams will be under-resourced to deal with increased activity in the future.

Conclusions

The effects of COVID-19 will clearly extensively alter the intentions revealed by this survey. Direct effects on the superannuation sector will be of primary importance as most LPs are large industry superannuation funds.

The federal government's decision to allow eligible members early access to up to $20,000 from superannuation accounts is expected to create challenges for some super funds. Treasury has estimated that less than 1% of the $2.9 trillion in super – about $27 billion – would be likely to be accessed under these emergency provisions but industry estimates are much higher. Also, these withdrawals will not be made evenly across the superannuation system. Withdrawals would be unlikely to be made from self-managed super funds, defined benefit funds or funds for state government employees. Most of the demand will be on industry super funds and among these effects will be exacerbated for funds in which there is a concentration of members employed in sectors suffering large job losses or stand-downs. The termination or standing down of large numbers of workers in the hospitality, tourism, retail and transportation sectors, for example, is likely to concentrate withdrawals on industry funds.

Clearly super funds will not make new investments until liquidity and portfolio allocation concerns have been resolved. How long this will take, depends on a number of factors, including: confidence; job growth; the extent of portfolio dislocations experienced; and perhaps regulatory pressures related to the level of liquid assets in portfolios. There are no reliable indications for this as recent recessions and downturns have all been economic in origin. One thing is certain; some of the jobs lost as a result of COVID-19 will not be re-created so creation of new jobs and new industries will be crucial to the recovery.

If the federal government recognises the potential of the technology and healthcare sectors to generate new jobs and provides incentives for investment, this could lead to increased support for venture capital. In the near term, however, investments in Australian venture funds from additional LPs suggested by the survey will not now occur. And the small number of Australian LPs that made commitments to the local sector over recent years are now unlikely to re-invest this year despite a couple confirming in the survey that they planned to do so.

Allocations to local private equity funds are also unlikely to be made in the short term with LPs likely to reinstate or increase their allocations to funds with greater liquidity and less volatility first. Although some funds may make opportunistic direct investments in what they see as quality companies.

Global strategies are likely to be the first private equity and venture capital allocations reinstated but some LPs may delay this until performance from the sector is persuasive. If recovery follows the pattern of previous downturns, investors who delay may miss out on investing in some of the most successful fund vintages of the next decade. But, as previously noted, it is difficult to predict what shape recovery from a virus induced economic collapse will take.

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, 12 participated in the survey. The survey was sponsored by global financial services provider Apex Group Ltd: www.theapexgroup.com