Preqin Australian Investor Outlook: Private Equity

Opinions of Leading Australian Institutional Investors on Private Equity and Plans for 2011 and Beyond – in Association with AVCAL

AVCAL

The AUSTRALIAN PRIVATE EQUITY & VENTURE CAPITAL ASSOCIATION Limited

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Methodology:

Preqin welcomes you to our first Preqin Australian Investor Outlook: Private Equity; a unique look at Australian investors in private equity, their opinions of the market and the outlook for fundraising in the year ahead and beyond.

Preqin Australian Investor Outlook draws on the results of detailed interviews conducted with 33 institutional investors from across Australia during February and March 2011. The sample of LPs was selected from Preqin's Investor Intelligence database. With offices in London, New York and now Singapore, we are able to carry out extensive interviews with LPs from all corners of the globe.

Speaking directly to institutions located across Australia has enabled us not only to provide in-depth analysis of their current views and opinions, but to accompany this with comments from key investment professionals in their own words, providing readers with a unique insight into the attitudes of leading Australian investors in private equity.

We hope that you find the information included within this report useful and interesting and, as always, we welcome any feedback and suggestions you may have for future editions.

www.preqin.com/privateequity

Contents:

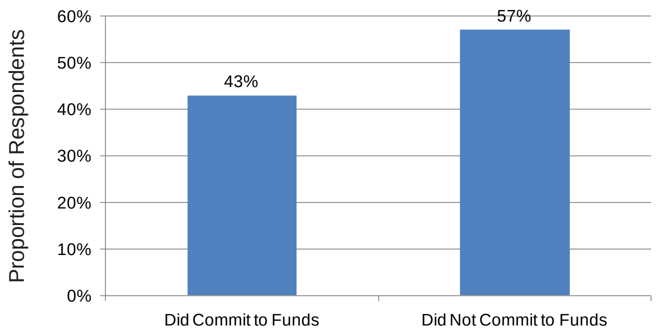
Fundraising in 2010

Globally, fundraising remained challenging in 2010, with the lowest amount of capital received by private equity fund managers since 2004. We talked to Australian LPs to assess their current attitudes to the market and their plans for future investments in the asset class.

Fig. 1 shows that 43% of Australia-based investors that have historically committed to the private equity asset class made a fresh commitment in 2010. This is reflective of an investor market that continues to see private equity in a favourable light, but concurrently needs to be cautious with committing to the illiquid asset class at a time when global markets are still recovering and uncertainty is rife. With deal flow also slow in 2010, many LPs are likely waiting for capital commitments to be called on their existing commitments before investing additional capital to new vehicles.

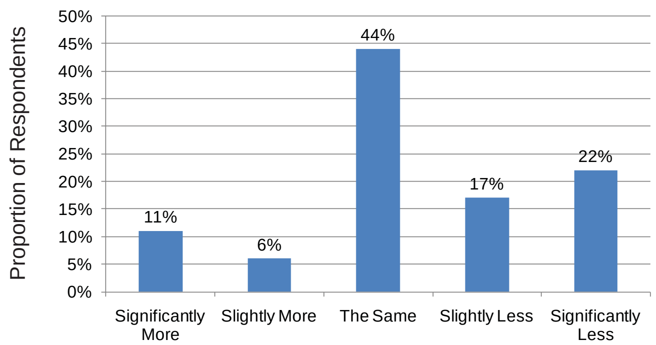
17% of investors committed more capital to private equity funds in 2010 than they did in the preceding year, with 11% allocating significantly more. 39% of Australian LPs committed less to funds than they did in 2009, with 22% committing significantly less. 44% of investors committed the same amount in both years.

Fig. 1: Proportion of LPs That Committed to Private Equity Funds in 2010



Source: Preqin

Fig. 2: Amount of Capital Committed by Investors to Private Equity Funds in 2010 Compared to 2009



Source: Preqin

Attitudes Towards GP/LP Alignment of Interests

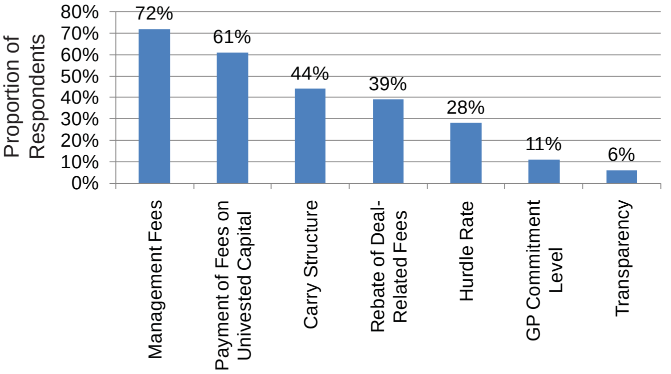
With regulatory developments and strong global competition for capital resulting in increased scrutiny of management fees, it was to be expected that institutional investors worldwide would focus closely on this area in the months ahead. We spoke to Australian investors on their views on how the alignment of interests between GPs and LPs could be further improved.

In terms of the alignment of interests between GPs and LPs, it was acknowledged that there was quite a wide range in the terms offered by different funds. One superannuation scheme commented that the situation was a 'mix and match'.

When questioned on areas where they felt that alignment could be most improved, a significant proportion of LPs (72%) felt that management fees were too high. The second biggest concern, cited by 61% of investors, was the issue of having to pay fees on committed capital that was sitting uninvested. 44% stated that carry structure could be further improved and 39% of investors said that the proportion of rebates on deal-related fees should increase.

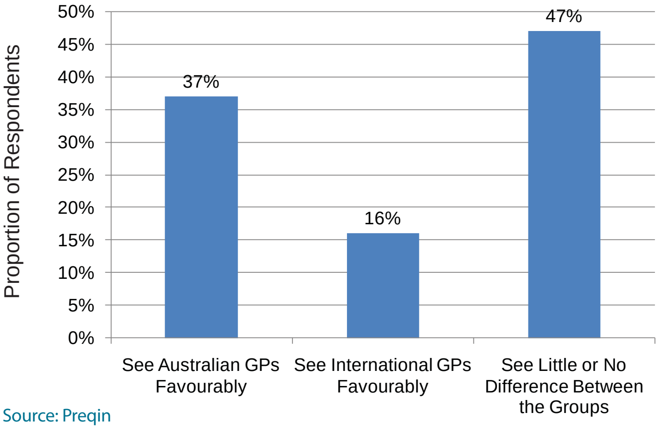
In the context of alignment, almost half of Australian investors believed there to be little to no discernible difference between Australian and foreign GPs. Only 16% of LPs declared that they were better aligned with international GPs while 37% said that Australian GPs offered better alignment with LP interests compared to offshore managers.

Fig. 3: Areas Where LPs Believe That Alignment Needs to Be Improved



Source: Preqin

Fig. 4: LPs' Views of Australian GPs Compared to International GPs in Meeting Their Requirements



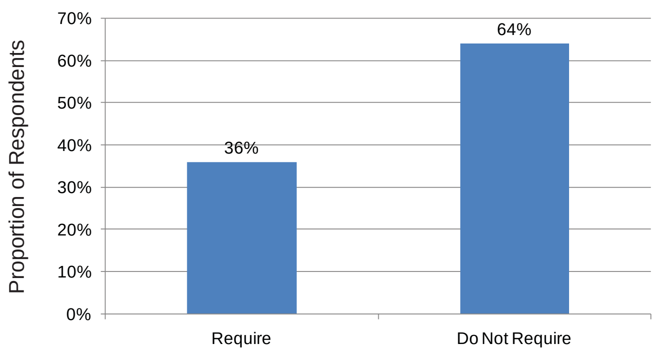
Source: Preqin

Views on Environment, Social and Governance Considerations

With increasing awareness of the need to embed Environment, Social and Governance (ESG) considerations into the investment process, we looked into what investors expect of their fund managers with regard to ESG.

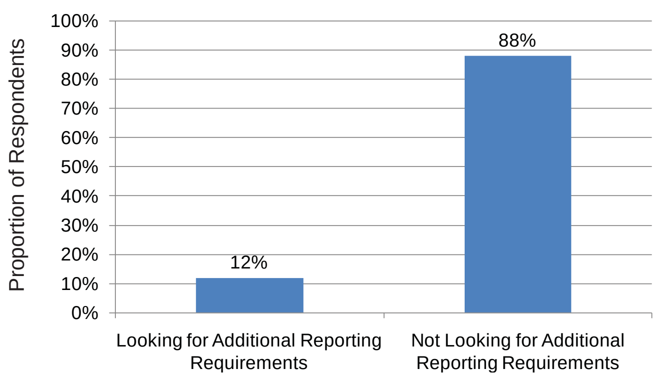
While 64% of Australian LPs stated that they did not currently require ESG reporting of their GPs, over two-thirds of these LPs are either looking to introduce, or considering introducing, ESG reporting requirements in the future. Accordingly, GPs will have to be more conscious of ESG reporting as they seek capital commitments this year and beyond. Of those that did require ESG accounting, 88% were satisfied with the current level of reporting, with only 12% seeking additional reporting requirements.

Fig. 5: Proportion of LPs That Require Formal Reporting on Environmental, Social and Governance (ESG)



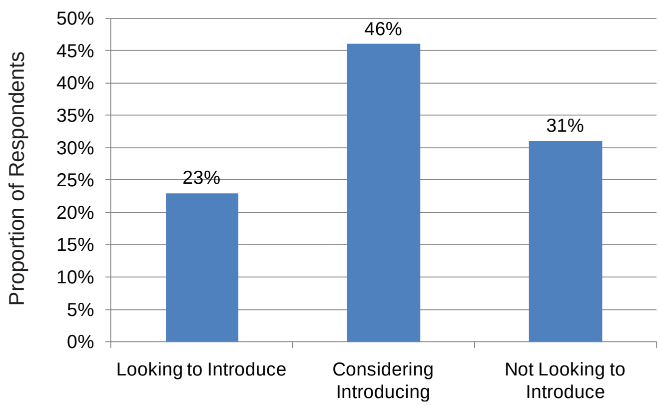
Source: Preqin

Fig. 6: Proportion of LPs That Require ESG Reporting Looking for Additional Reporting Requirements



Source: Preqin

Fig. 7: Proportion of LPs That Do Not Currently Require ESG Reporting Looking to Introduce ESG



Source: Preqin

Key Geographies in 2011

As Australian LPs look to the year ahead, many will be planning where to best place their capital. We spoke to these investors about which regions they are seeking exposure to both in terms of underlying markets and fund manager location.

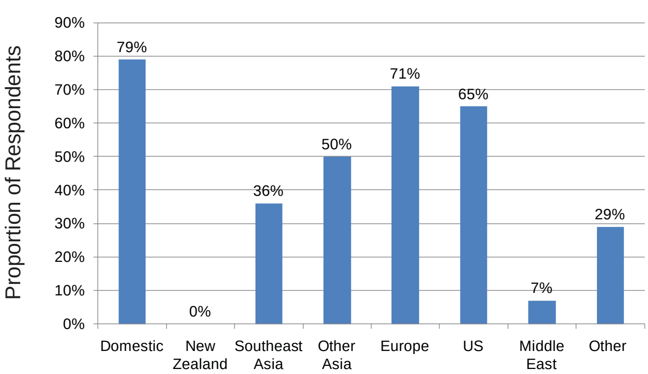
Fig. 8 and Fig. 9 show that many of the Australian LPs looking to invest in private equity funds in 2011 will do so in domestic markets, with 79% likely or considering to do so before the end of the year. In terms of GP location, Australian fund managers remain at the centre of investment plans for a large percentage of Australian LPs. 75% of those investing in 2011 intend to use domestic fund managers.

Europe is currently viewed as an attractive investment market for Australian LPs, with 71% of investors wanting access to European deals and 83% of investors wanting to commit to a vehicle managed by a European GP. 65% of investors want to commit to funds in 2011 that will give them exposure to US markets and a similar number want to commit to a manager based in the US.

"75% of those investing in 2011 intend to use domestic fund managers..."

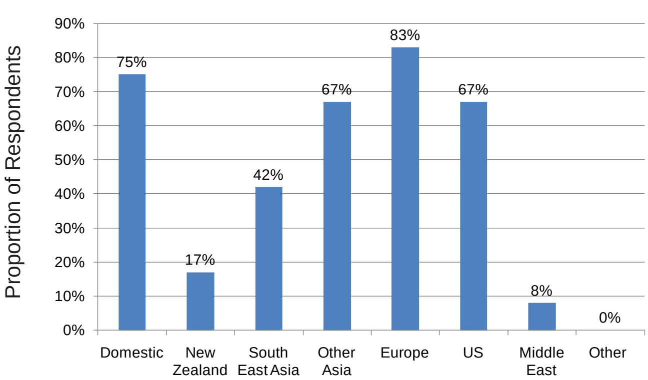
Asian markets are also of interest to many Australian investors. 50% of investors want exposure to Asian markets beyond those of South East Asia. This includes the markets of Japan, China and India. Two-thirds of LPs want to gain access to managers from these 'Other' Asian countries.

Fig. 8: Underlying Regional Markets of Interest to LPs in 2011



Source: Preqin

Fig. 9: Proportion of LPs Interested in Markets by GP Location



Source: Preqin

Views of Key Australian LPs

Given an extremely competitive global fundraising market, it is more important than ever for fund managers to better understand the institutional investor universe and their views on the industry. We gathered the thoughts of some key Australian LPs.

"We believe Australian GPs understand our needs better." A Queensland asset manager

"There is a mix and match in terms of GP and LP interest alignment. Those that differ the most are in fees and carry structure." A Tasmanian superannuation scheme

"LPs have to bargain pretty hard to get more favourable terms." A Victoria asset manager

"GPs should be more transparent in terms of overall fund structure." A Queensland superannuation scheme

"Fees charged by GPs are quite high." A Victoria superannuation scheme

"Private equity funds are an important component of our portfolio. However, the fees charged ... [are] a hindrance for future investments." A Victoria superannuation scheme

"We have seen a massive change in the prevailing terms of funds of funds over the past six months." A significant and influential institutional investor

"We have always preferred Australian funds because of favourable and familiar tax structures. That allows us to save money and hassle when we file tax returns." A New South Wales investment company

"As a public organisation, we are committed to growing Australia's private equity market. That is why we actively seek to invest in domestic funds." A Victoria public pension fund

"There are better opportunities internationally, so we are shifting our focus to places such as Asia, the US and Europe. Especially for emerging Asia, that is where we believe deal flow to be strong and robust in the future." A Western Australia superannuation scheme

"We will continue to invest with Australian GPs this year as we are confident in their abilities." A Victoria asset manager

"We will consider Australian funds this year if suitable opportunities come along. The great thing about Australian funds is we know the tax rules and so we are able to create a more efficient tax structure. As a publicly owned corporation, investing in Australian markets is also in line with our desire to help develop Australia's economy. [Furthermore] we believe Australian GPs understand our needs better." A Queensland asset manager

"We do not expect to commit to domestic funds this year; as the Australian market is quite small, there are not many suitable funds to choose from." A significant and influential institutional investor

"Australian funds give us a sense of familiarity and we are able to monitor deals more effectively." A Victoria superannuation scheme

"Australia is our national economy: we want to contribute to its development. This is especially more so for opportunities within our own state." A Victoria asset manager

Key Fund Types in 2011

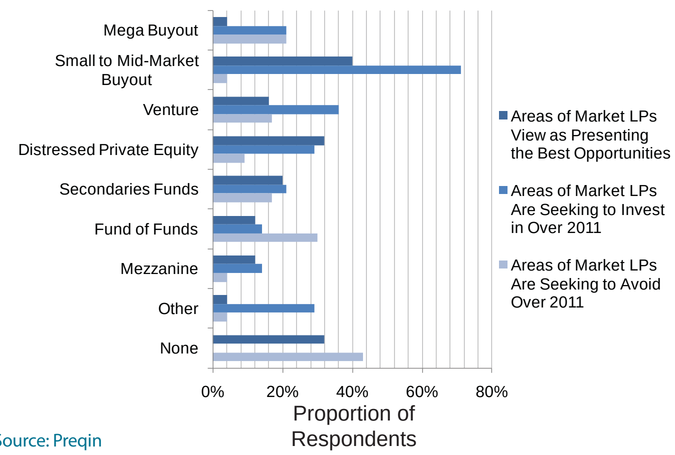
Australian LPs were asked about their views on varying fund types including buyout and venture capital funds. We discovered what fund types they believed presented the best opportunities in the current climate and what markets they would actually look to invest in this year.

Small to mid-market buyout funds featured strongly in Australian investors' preferred fund types with 40% believing that they presented the best opportunities in the current market. The next fund type that investors believed would yield positive opportunities was the distressed private equity market, with 32% of investors viewing this as an attractive fund type to invest in given the current climate. 32% of investors could not identify any particular fund type that stood out in terms of investment attractiveness. Only 12% felt that funds of funds presented good opportunities, which is particularly interesting as many Australian LPs have traditionally used funds of funds to tap into the markets.

"...funds of funds were stated by 30% of investors as an area to avoid in 2011..."

In terms of where Australian LPs are looking to commit to in 2011, small to mid-market buyout funds again topped the list with 71% of respondents stating an interest in investing in these vehicles in 2011. Venture funds came in second with 36% of investors interested, followed by distressed private equity (29%) and then mega buyouts and secondaries funds (both 21%). 14% indicated that they were interested in committing to funds of funds in 2011.

Fig. 10: LP Attitudes to Different Fund Types



Source: Preqin

Funds of funds were stated by 30% of investors as an area to avoid in 2011. 21% of investors wanted to stay clear of mega buyout markets, believing that deals were too difficult to come by in the current market environment. 43% of investors were more relaxed with their market overview, explaining that there was no particular area of the market they were determined to avoid.

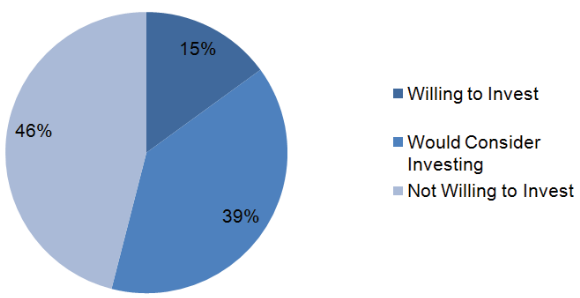
First-Time Funds and Co-investing

With fundraising conditions remaining challenging and extremely competitive, we spoke to LPs about whether they would invest with newly established managers over the next year. We also looked into whether they would be looking to co-invest alongside GPs in 2011.

Unlike in the private equity boom years when many managers were coming to the market for the first time and successfully raising vehicles, fundraising is now highly testing for new managers. This was reflected in our conversations with Australian LPs. As Fig. 11 shows, 46% of investors would not invest in first-time funds, with only 15% confirming that they were willing to commit to such vehicles. 39% of investors were unsure of whether they would commit to new managers, but would not rule out doing so.

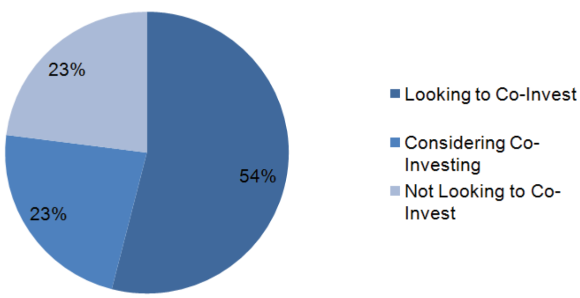
With LPs looking for a competitive edge in obtaining the most positive results from their fund commitments, many LPs are considering co-investing alongside their GPs to gain greater exposure to the underlying portfolio companies. Accordingly, 54% of Australian LPs stated that they would look to co-invest with GPs in 2011, with a further 23% willing to consider co-investment opportunities.

Fig. 11: Proportion of LPs Willing to Invest in First-Time Funds in the Next 12 Months



Source: Preqin

Fig. 12: LP Attitude towards Co-Investing with GPs in 2011



Source: Preqin

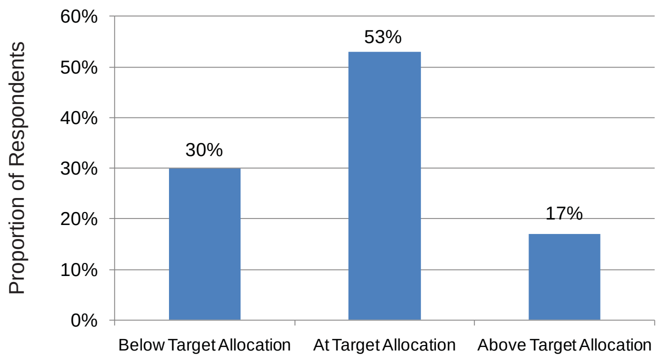
Plans For Allocations to Private Equity

One of the consequences of the global economic downturn is that investors have become more uncertain with how, when and to what degree to invest their capital. We spoke to Australian LPs about these issues, with a very mixed reaction to the topics raised.

Fig. 13 highlights that 17% of LPs were actually above their target allocations. 30% of LPs still needed to invest capital to meet the allocation levels set for private equity, and a number of LPs from the 53% who were at their target said that they might invest further to maintain these allocations.

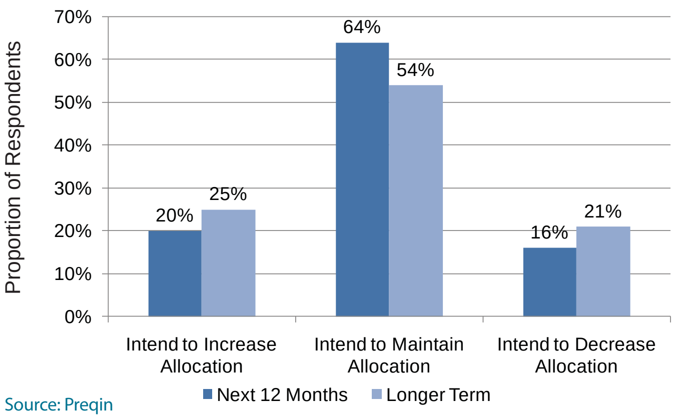
In terms of allocation horizons, most investors expected their target allocations to stay the same over both the next 12 months and the next three to five years, with 64% and 54% respectively stating this. A quarter of investors intended to increase their portfolio allocations to private equity over the longer term, whilst just over a fifth said that they were seeking to reduce the percentage of capital invested.

Fig. 13: Proportion of LPs Currently Below, At or Above Their Target Allocations to Private Equity Funds



Source: Preqin

Fig. 14: LPs' Intentions for Their Private Equity Allocations



Source: Preqin

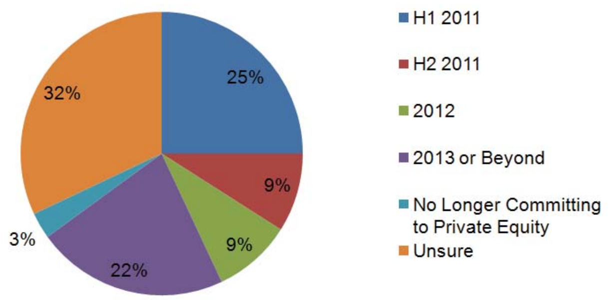
Future Commitment Plans & Returns Expectations

We interviewed Australian LPs to find how their opinions on private equity have changed, when their next commitments to the asset class will take place and what expectations they have regarding future returns.

A recurring theme arising from our interviews with Australian LPs, consistent with LPs from all over the world, was the uncertain investment outlook on the part of many investors. 34% of Australian LPs said that they planned on investing in private equity funds in 2011, but 32% declared that although they intended to continue committing to private equity, they were uncertain when their next commitment would occur. Only 3% of investors said that they no longer planned to commit to private equity funds. Of those who said they would commit in 2011, 31% indicated they would be committing approximately the same amount of capital as they did in 2010. Another 31% said that they would commit more than they did in 2010, with that figure rising to 44% if including investors that did not invest in 2010 but are planning to in 2011.

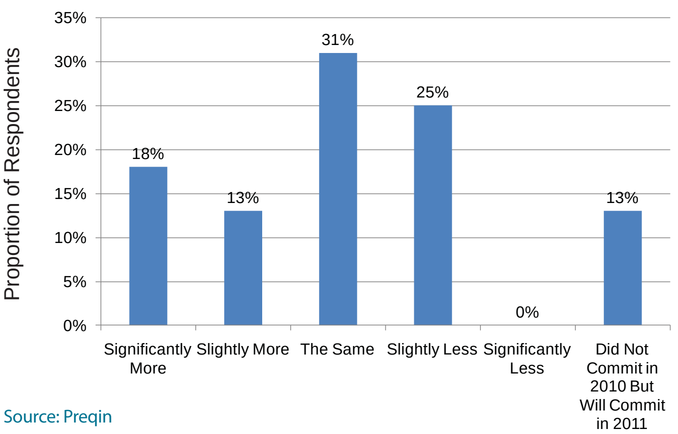
Despite the effects of the global financial crisis on the performance of private equity funds in general, Australian LPs' returns expectations from their private equity investments remain high. As shown in Fig. 17, over two-thirds of investors expected private equity to outperform the public markets by at least 4.1%.

Fig. 15: Breakdown of LPs' Proposed Timing of Next Commitment to Private Equity Funds



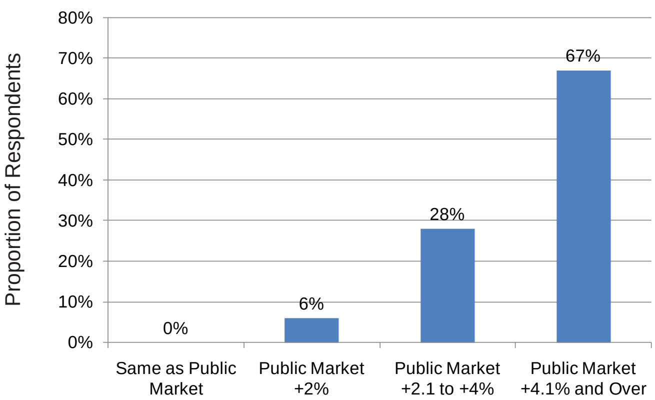
Source: Preqin

Fig. 16: Amount of Capital Investors Are Looking to Commit to Private Equity Funds in 2011 Compared to 2010



Source: Preqin

Fig. 17: LPs' Return Expectations for Their Private Equity Portfolios



Source: Preqin

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Representing Private Equity

The Australian Private Equity & Venture Capital Association Limited (AVCAL) is a national association which represents the private equity and venture capital industries.

AVCAL's members comprise most of the active private equity and venture capital firms in Australia. These firms provide capital for early stage companies, later stage expansion capital, and capital for management buyouts of established companies.

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Information for Private Equity Professionals

Full profiles for all the investors contacted in the process of creating this report are available to view on Preqin's Investor Intelligence database – the private equity industry's leading source of institutional investor profiles. In total, Preqin maintains over 4,000 investor profiles, each containing exclusive information gathered through direct communication with LPs by our international teams of analysts.

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