

The Actuarial Profession

making financial sense of the future

Private Equity

The Proposition and Practical Considerations

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In general, alternative investments such as private equity involve a high degree of risk, including potential loss of principal invested. Private equity investments can be highly illiquid, charge higher fees than other investments, and typically do not grow at an even rate of return and may experience negative growth. Private equity investments are not subject to the same regulatory requirements as registered investment products. In addition, past performance is not necessarily indicative of future results.

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Private Equity

A Broad Investment Spectrum

Start-up
No revenue

Profitable
company

Lower Middle
Market

Middle Market

Large
Companies

Venture Capital:
Early and Late Stage

Leveraged Buyouts
Distressed
Mezzanine

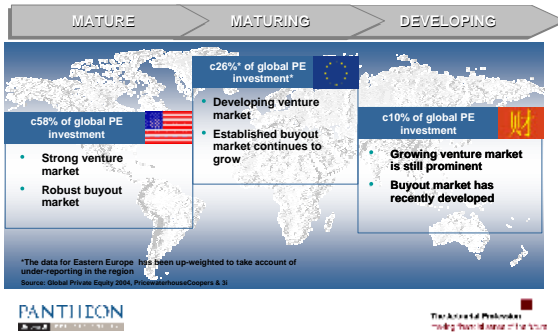
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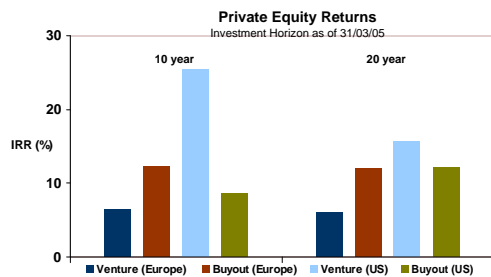
Global Overview of Private Equity Market



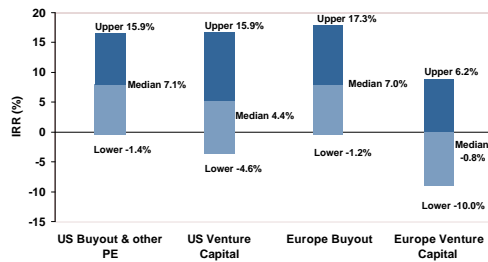
Differentiated Market Exposure

- Private equity is active in parts of the market that are otherwise difficult to access
- Deal structures align interests of managers and investors
- Investments that need time to incubate are sheltered from quarterly reporting requirement
- Private positions benefit from active management skill

Returns in Private Equity Have Been Attractive



Choice of Managers is Critical



As at 31st March 2005
Source: Venture Economics - VentureExpert Web

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Private Equity Research

The Annual Performance
Review of the Private Equity Industry

Differentiators and Drivers

Why private equity SHOULD outperform

- Active management and value creation
- Tailored timetable for performance
- Inefficient market
- Access to proprietary information and deal flow

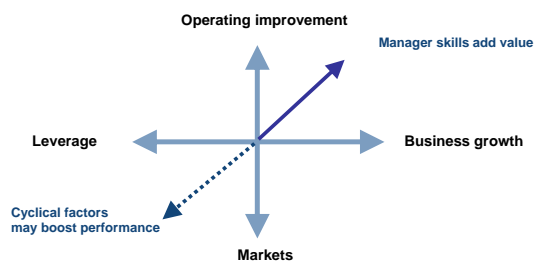
Why private equity NEEDS to outperform

- Long-term, illiquid investment
- Early-stage risk
- Organisational risk – companies and managers
- Costs

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Value Creation in Private Equity Ownership



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How are the Risks Managed?

At the Manager Level

- Skills and experience
- Added value
- Discipline
- Use of leverage to de-risk
- Portfolio construction
- Franchises – virtuous circle of opportunity

In Funds-of-Funds

- Selection skills
- Portfolio construction
- Strategic discipline
- Alignment of interests
- Constructive engagement
- Diversification

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The Annual Fund Review
Holding Your Head Above the Crowd

A Strategic Framework is Crucial



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How to Access Private Equity

	Private Companies	Funds	Funds-of-funds
Probability of TOTAL loss	30%	1%	0%
Probability of ANY loss	42%	30%	1%
AVERAGE loss	- 85%	- 29%	- 4%

Source: Wedig, Tom and Mathonet, Pierre-Yves, "The Risk Profile of Private Equity" (January 2004).

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How Can a Fund-of-Funds Outperform?

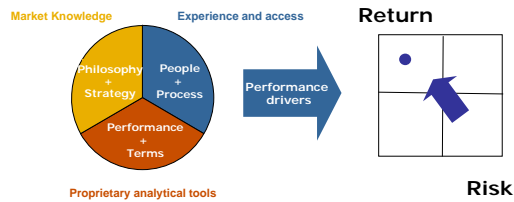
- **No place for indexing**
 - Impossible to buy private equity “index”; if one DID exist, it would be unattractive
- **Manager selection matters**
 - Long-term outperformance of public equities can be achieved in the first and second quartile

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The Annual Pitchbook
Helping You Measure the Value of Your Fund

Picking the Right Managers...

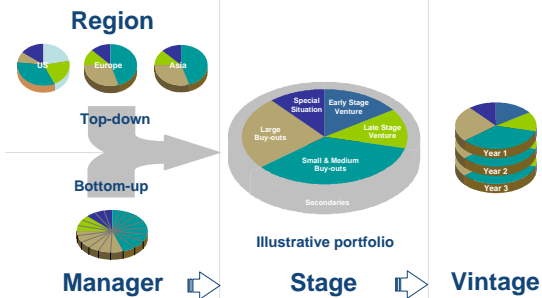
Qualitative and Quantitative Factors



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Constructing a Programme



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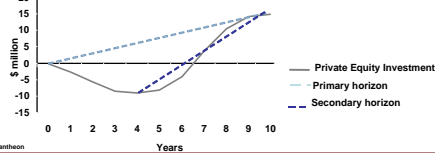
The Annual Pitchbook
Helping You Measure the Value of Your Fund

Benefits of Secondaries

- Investing in funds that are at least 50% invested
- Asset value is the driver, not investing in a blind pool
- Typically purchased at a discount to Net Asset Value
- Diversifying into prior vintage years
- Shorter time to distributions, smoother cash flow profile

Secondaries return capital earlier

(Illustrative cash flows)

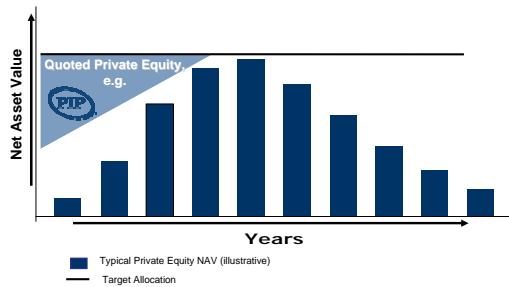


Source: Pantheon

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Holding Your Investment in the Future

Managed Exposure



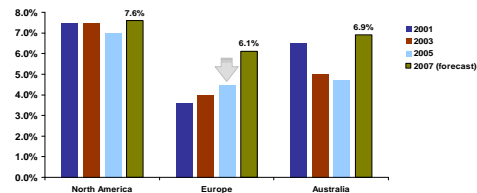
Source: Pantheon

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Trends in Pension Fund Investment

Current & Forecast Strategic Allocations to PE

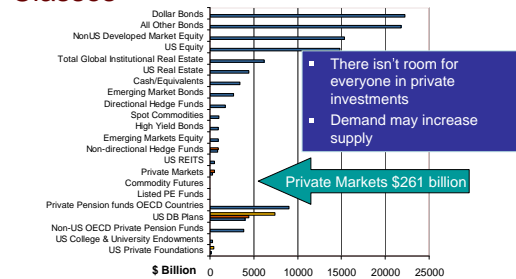


Source: Russell Survey on Alternative Investing 2005

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Market Capitalisation of Major Asset Classes



Sources: Commonfund 2004 Foundations Benchmark Study; WS 501 Bulletin, 2001; NACUBO Endowment Study, 2004; P&I, Jan. 24, 2005; EBR, Dec. 2002; ABP Investments, Dec. 2003; P&I, Dec. 2004, preliminary data via email communication; "REITs 101: The History of REITs" www.REITnet.com

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Other Trends in Private Equity

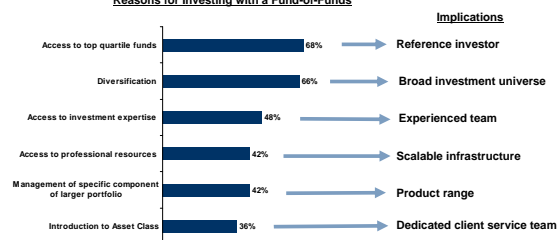
- Globalisation of markets and managers
- European and Asian markets investing at a faster pace than U.S. markets
- Growth of Mega Firms
- Emergence of new strategies
 - Emerging managers
 - Undervalued managers
 - European and Asian venture
 - Emerging markets

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What does a Fund-of-Funds Need?

Survey of 50 Limited Partners on
Reasons for Investing with a Fund-of-Funds

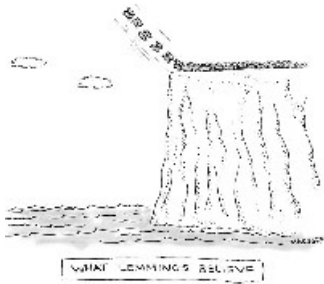


Source: Alameda Capital, April 2005

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The Path of the Inexperienced...



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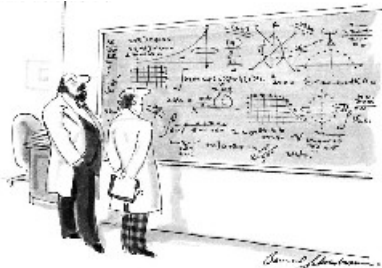
Private Equity - Conclusions

- Less an 'alternative', more a 'super' equity
- Returns can be compelling for investors with long horizons
- Selectivity and appropriate diversification mitigate risks
- Cannot be market timed
- Requires long-term, strategic approach and...

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