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# Private Equity and the Allocation Gap

## Investment White Paper

**February 2022**

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Private equity (PE) investments are simply investments in private companies. There is a broad spectrum of private equity investment structures but typically it involves the PE manager (also known as a General Partner (GP) or sponsor) acquiring a controlling stake in a business. The asset class has grown tremendously over the past 10 years as investors are increasingly attracted to its long-term nature and historic outperformance against public equity market benchmarks.

PE funds are typically structured as progressively called, locked-up, 10+ year life, offshore investment partnerships with high minimum investment thresholds. There is a high level of administrative complexity and illiquidity compared to traditional public equity and fixed income assets. Accessing the best PE managers and building diversification are additional challenges for investors.

As a result, institutional investors have allocated far more capital to private equity than have private individuals and retail investors.

A sample of the largest Australian superannuation funds shows a typical 3-5% allocation to private equity in their balanced strategy. American public pension funds have increased their target PE allocations on average 50% over the past decade to 9%. This is not unusual, with leading pension funds, sovereign wealth funds, family offices and UHNWIs all allocating an increasingly substantial portion of their portfolio to the asset class.

Private equity is a sector that has seen strong growth on the back of higher investor demand, structural changes to public and private capital markets, and strong long term investment performance.

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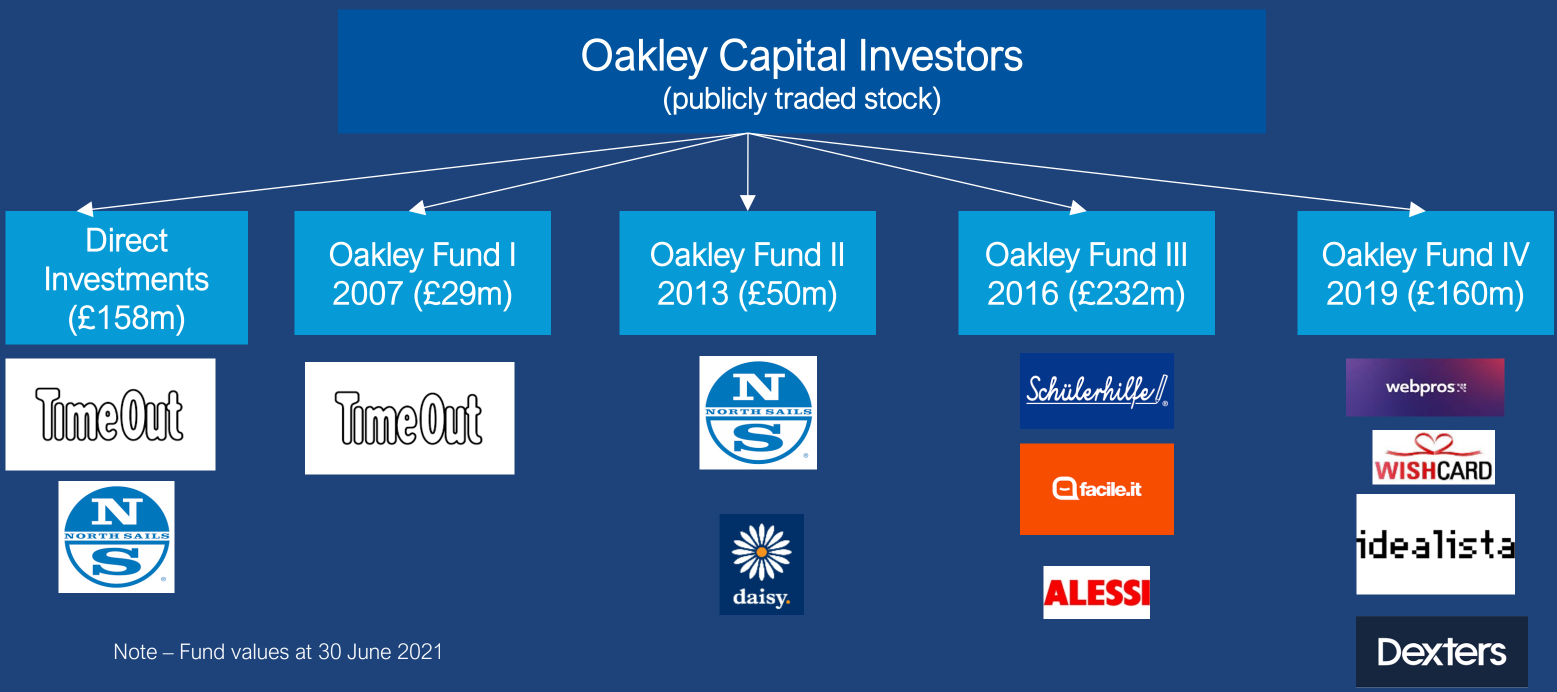
# The Listed Private Equity Solution

Listed private equity stocks trade on major international exchanges around the world. By placing illiquid private equity investments within a closed-end, publicly traded structure – it effectively enables investors to buy and sell private equity investments like any other listed equity. We like to think of it as "democratizing" access to private equity for all investors whilst providing transparency in pricing.

The illustration below depicts the structure of Oakley Capital Investments, a typical listed PE fund which trades on the London Stock Exchange.




Note – Fund values at 30 June 2021

There are some distinct advantages to investing in listed PE:

- Daily liquidity subject to exchange volumes for underlying investments. The Barwon Global Listed Private Equity Fund accepts daily applications and redemptions, based on market prices of holdings.
- The ability to actively construct and manage a global PE portfolio diversified by geography, vintage, and deal stage (buyouts, growth equity, VC).
- Ease of administration and liquidity management.

# The Listed Private Equity Universe

The listed PE universe is comprised of 250 listed PE stocks and 500 listed PE backed companies. The combined market capitalisation is $2,750 billion.

We categorise the universe into four types of listed PE, which are exposed to different economics within the private equity ecosystem.

| Type | Underlying asset | Economic drivers |
|---|---|---|
| Buyouts | Leveraged buyouts (directly or through PE funds) | Return on private equity investment |
| PE Backed listed companies | Publicly listed companies controlled by PE managers. | Return on private equity investment |
| Alternative Asset Managers | Financial services company + balance sheet of own investments | Fees from managing alternative assets, return on private equity investment |
| Private debt funds | Direct loans to private equity companies | Return on private debt investment – loans to PE backed companies |

Examples of each listed private equity manager type:

| Buyouts | PE Backed Listed Companies | Alternative Asset Managers | Private Debt |
|---|---|---|---|
| Oakley Capital | PowerSchool / ONEX | Blackstone | GOLUB CAPITAL |
| Partners Group | solarwinds / SILVERLAKE | APOLLO | ARES |
| Apax Partners | INSTRUCTURE / THOMABRAVO | Brookfield | Goldman Sachs Asset Management |
| PANTHEON | ADT / APOLLO | THE CARLYLE GROUP | OWL ROCK |
| ONEX | | ICG | BainCapital Credit |
| Hg | | KKR | |
| | | EQT | |

# Where's the Catch?

## Volatility

Private equity assets, including the underlying portfolios of listed PE stocks, are typically valued only quarterly. Moreover, they are valued using approaches such as a multiple of earnings that can include a level of subjectivity and introduce a systematic smoothing of returns.

In contrast, the daily share price of listed PE stocks are actual transaction prices, not an estimate of intrinsic value. Therefore, they are subject to the randomness and vagaries of daily market pricing. Listed PE stocks can exhibit public market volatility and over a short horizon may not reflect the smoothed valuations of their underlying portfolio. This creates an inefficient market in which we believe an actively managed portfolio makes sense.

## Premiums and Discounts

As a consequence of daily price movements, there are LPEs that may trade, sometimes persistently, at a discount or a premium to their reported NAV. However, shareholder returns in the long term are ultimately driven by underlying NAV growth – i.e., the value created by its private equity portfolio. We believe the vagaries of random swings in sentiment and inefficient pricing are a source of alpha for the active investor.

Note that transactions in our Fund occur at NAV which is based on the stock price of its holdings.

## Conclusion

Private equity has been an outsized contributor to the returns of large institutional investors around the world. The increasing allocation gap to private equity between institutional and individual investor portfolios has been growing. Accessing private equity via listed PE can provide the global asset class exposure, daily liquidity and pricing, and ease of access demanded by managed account providers, individuals and private investors.

**Listed private equity provides investors with PE returns, but with public market liquidity. It is an inefficient market, so alpha can be generated through active management.**

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