# Global private equity strategy

*Investment update to 30 June 2021*[1]

MLC gives investors access to private equity (also known as private assets) all around the world. Private equity isn't traded on listed exchanges and involve buying shares in private companies.

The strategy is managed by MLC's Private Equity team, which uses a combined multi-manager and co-investment approach to investing. This means they invest into a range of external private equity fund managers, as well as alongside these managers, investing directly into some of their most attractive private companies. MLC has managed the private equity strategy through different market conditions, since 1997.

The following multi-asset portfolios invest in MLC's global private equity strategy:

- MLC Horizon portfolios (MLC MasterKey superannuation and pension products)
- MLC Inflation Plus portfolios (MLC MasterKey superannuation and pension products), and
- MySuper in MLC MasterKey Business Super.

Each fund's allocation to global private equity is shown in Table 1.

**Table 1: Target allocations to global private equity as at 30 June 2021**

| MLC MasterKey superannuation and pension products | % of portfolio invested in global private equity |
|---|---|
| MLC Horizon 2 Capital Stable Portfolio | 2 |
| MLC Horizon 3 Conservative Growth Portfolio | 4 |
| MLC Horizon 4 Balanced Portfolio | 6 |
| MLC Horizon 5 Growth Portfolio | 6 |
| MLC Horizon 6 Share Portfolio | 7 |
| MLC Horizon 7 Accelerated Growth Portfolio | 8 |
| MLC Inflation Plus Conservative Portfolio | 2 |
| MLC Inflation Plus Moderate Portfolio | 4 |
| MLC Inflation Plus Assertive Portfolio | 7 |
| MySuper Conservative Growth Portfolio | 4 |
| MySuper Growth Portfolio | 5 |

**Source:** MLC Asset Management Services Limited. Based on the portfolios' target allocations.

**An explanation of how fees are deducted from returns is in Appendix 1.**

This investment update provides performance, exposures and commentary for the private equity strategy used in the MLC Horizon portfolios and MLC Inflation Plus Assertive portfolio in MLC MasterKey superannuation products. This strategy has been in place since 1997.

## What is private equity?

Private equity involves the purchase of securities in private companies. Companies may be:

- businesses – at any stage of the business lifecycle, from start-ups to mature businesses – that are able to benefit from the infusion of capital or expertise to grow, merge or restructure, and

1. This investment update provides performance, exposures and commentary for the private equity strategy used in the MLC Horizon portfolios and MLC Inflation Plus Assertive portfolio in MLC MasterKey superannuation products.

- public companies which are taken private by private equity firms.

Many of these investments can't be accessed directly by investors because they are often open only to select institutions or because the average investor simply doesn't have the amount of money or expertise needed to invest directly in them.

While there's no denying private equity is a risky asset class, its benefits are well known and widely proven. When managed well, it can provide excellent diversification and return potential for investors because returns aren't directly linked with the performance of listed global shares or fixed income.

A good way of looking at the private equity investment universe is by breaking it into four categories: venture capital, growth, buy-outs, and rescue/turn-arounds/distressed companies. This is illustrated in Chart 1.

### Chart 1: The private equity investment spectrum


**Source:** MLC Asset Management Services Limited. These companies have been chosen for illustrative purposes only. MLC may not invest in any of these companies.

## Venture capital

These are companies in their early stages – they're looking for seed capital and they're in the start-up phase. You're investing in an idea or a business plan, for example, the early days of Mark Zuckerberg demonstrating his first prototype of Facebook, with a few parties willing to invest and provide advice to help the company expand and grow.

It's an exciting investment category with lots of buzz, especially in places like Silicon Valley. But while the potential rewards can be huge, it's important to remember it's very easy to lose out. Harvard Business School lecturer Shikhar Ghosh's research indicates 70% to 80% of venture-backed companies fail to see projected return on investment.[2]

## Growth

Growth investing is similar to venture capital, but it's investing at a later stage. The company will tend to have revenue streams and profits, but needs finance to help grow further.

With both venture capital and growth investments, you tend to take a minority stake in the business. An important role of private equity managers is to provide advice and guidance to help the company grow, navigate new markets or create new product lines. The best managers tend to be entrepreneurs themselves; they're people who accept failure, understand risk, and want to be alongside the company for the ride and help them make good decisions. For example, private equity managers including Silver Lake Partners and General Atlantic helped founder Jack Ma grow Alibaba into one of the largest e-commerce companies globally and guided the company to a successful US initial public offering (IPO).

## Buy-outs

Unlike venture capital and growth, with buy-outs investments are in a controlling stake of the company. The private equity fund managers will run the business plan. They'll usually have an idea about how they can optimise the business and make back a

[2] 'The Venture Capital Secret: 3 out of 4 Start-Ups Fail', Gage, D, The Wall Street Journal: US Edition, 19 September 2012.

significant return on their investment in a short period of time (three to five years). These managers will tend to use debt and leverage to optimise the business and capital structure. For example, Australian buy-out manager Pacific Equity Partners acquired cinema group Hoyts. They transformed the business through fully digitising the cinema network, entering out-of-home advertising and expanding into adjacent vertical businesses, such as Hoyts DVD kiosks and streaming, before exiting the buy-out by successfully selling Hoyts to another company in the industry.

### Rescues or turn-arounds

These are investments in a failing company or a complex transaction that a regular investor would avoid. The private equity fund manager often needs to take control, roll-up their sleeves and really help the company transform. Like venture capital, the potential loss rates are high. There are only a handful of private equity fund managers who have proven they can invest successfully in this field. For example, TPG acquired power generation company Alinta in 2010 in the largest debt-for-control restructuring in the Australian market at the time. They recruited a new CEO from AGL Energy and successfully completed the operational turnaround of the company in conjunction with their in-house operations team. However, these are also the types of transactions which tend to hit the headlines when things go badly, eg Dick Smith Electronics.

## How are returns generated?

Private equity returns are based on valuations of the companies, returns of capital from the private equity managers, and realisation of the investment when the remaining capital (and profit) is paid to investors.

Valuing private companies is difficult and, unlike listed companies, it isn't done frequently. As a result, valuations of private equity investments may involve a considerable time lag.

We usually expect to realise the final return on our investments after a period of at least three to seven years, when we exit from the private company and the remaining investment capital and profit is returned to our funds. When we're considering making private equity investments, potential exit strategies is one of the aspects we research carefully, as we aim to maximise the return for investors in MLC funds.

Common strategies for exiting private equity investments are:

- **Initial public offering** – the private equity manager floats or lists the company on the share market.
- **Trade sale** – the private equity manager sells its shares in a company to a trade buyer that operates in the same industry as the company.
- **Secondary buy-out** – the private equity manager sells the company to another private equity manager.
- **Leveraged recapitalisation** – the company borrows funds to pay out equity in the company to the private equity investor ie substitutes some of the company's equity with debt.

## Investment objectives

The private equity strategy aims to provide MLC's multi-asset portfolios with:

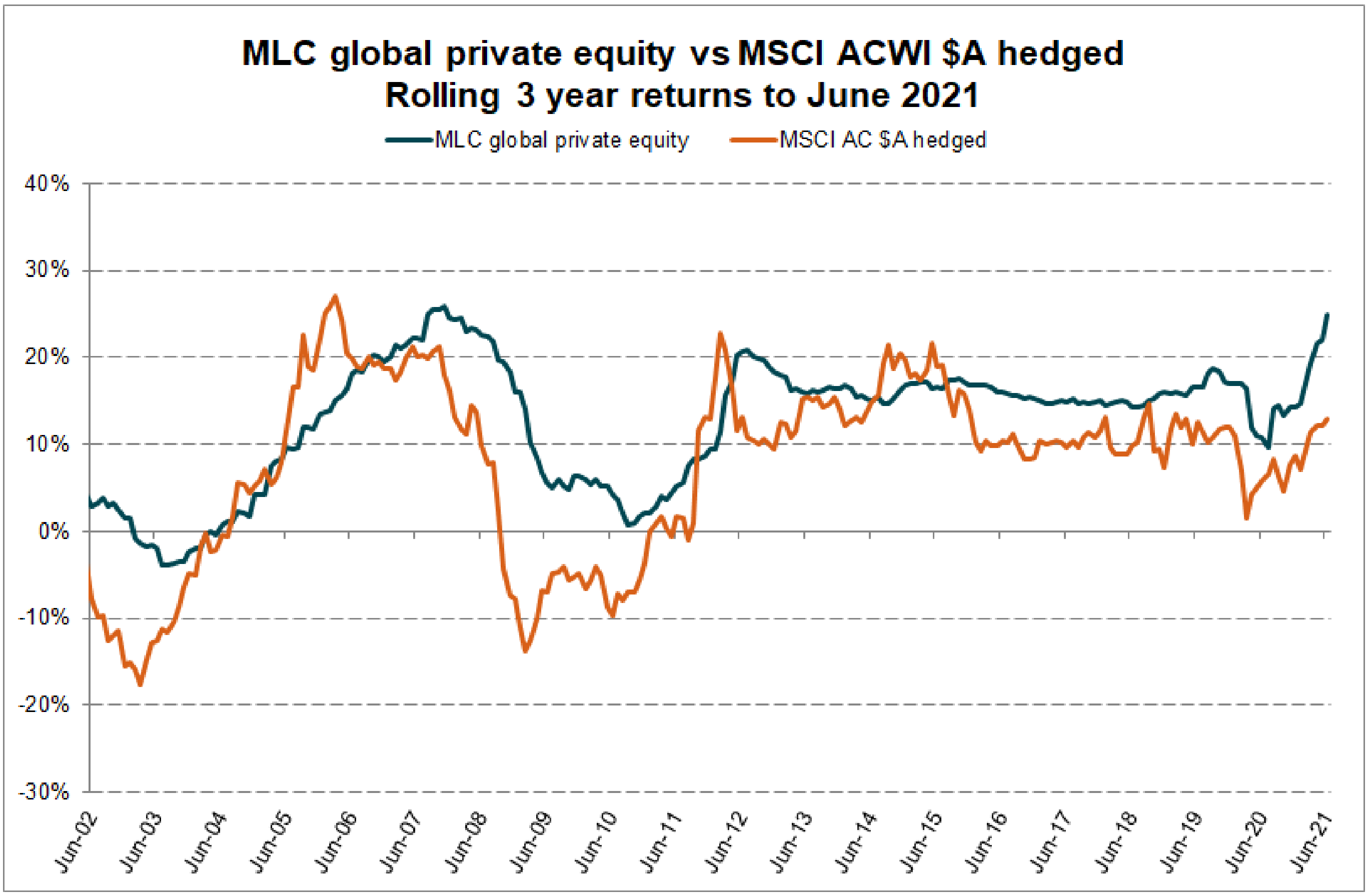
- outperformance of the global listed share market over seven year periods
- consistent returns through normal economic cycles, and
- preservation of capital through abnormal events (eg the GFC).

Since most private equity investment opportunities lie outside Australia, the strategy seeks to access the benefits of the greater range and quality of opportunities available in the global market. While return, rather than diversification, is the primary driver of MLC's private equities portfolio construction, the outcome is a very well diversified strategy - one that is diversified by managers and regions and across the spectrum of private equity investments.

## Performance

Chart 2 demonstrates the performance of the private equities strategy (hedged to the Australian dollar) compared to the performance of the listed global share market (hedged to the Australian dollar). It shows that it is a particularly helpful strategy in weak share markets. For example, private equity provided a significant cushion to performance during the GFC. It continued to offer returns significantly higher than listed markets for nearly five years, until the rally in global shares, as private equity may underperform listed markets if share markets are rising strongly. Similarly, over the March 2020 quarter where global share markets experienced extreme volatility due to the COVID-19 pandemic, the strategy outperformed. Chart 2 also shows significant swings in returns from private equity, and their returns tend to have a time lag behind listed share markets.

**Chart 2: Rolling three year returns compared to global share markets to 30 June 2021**

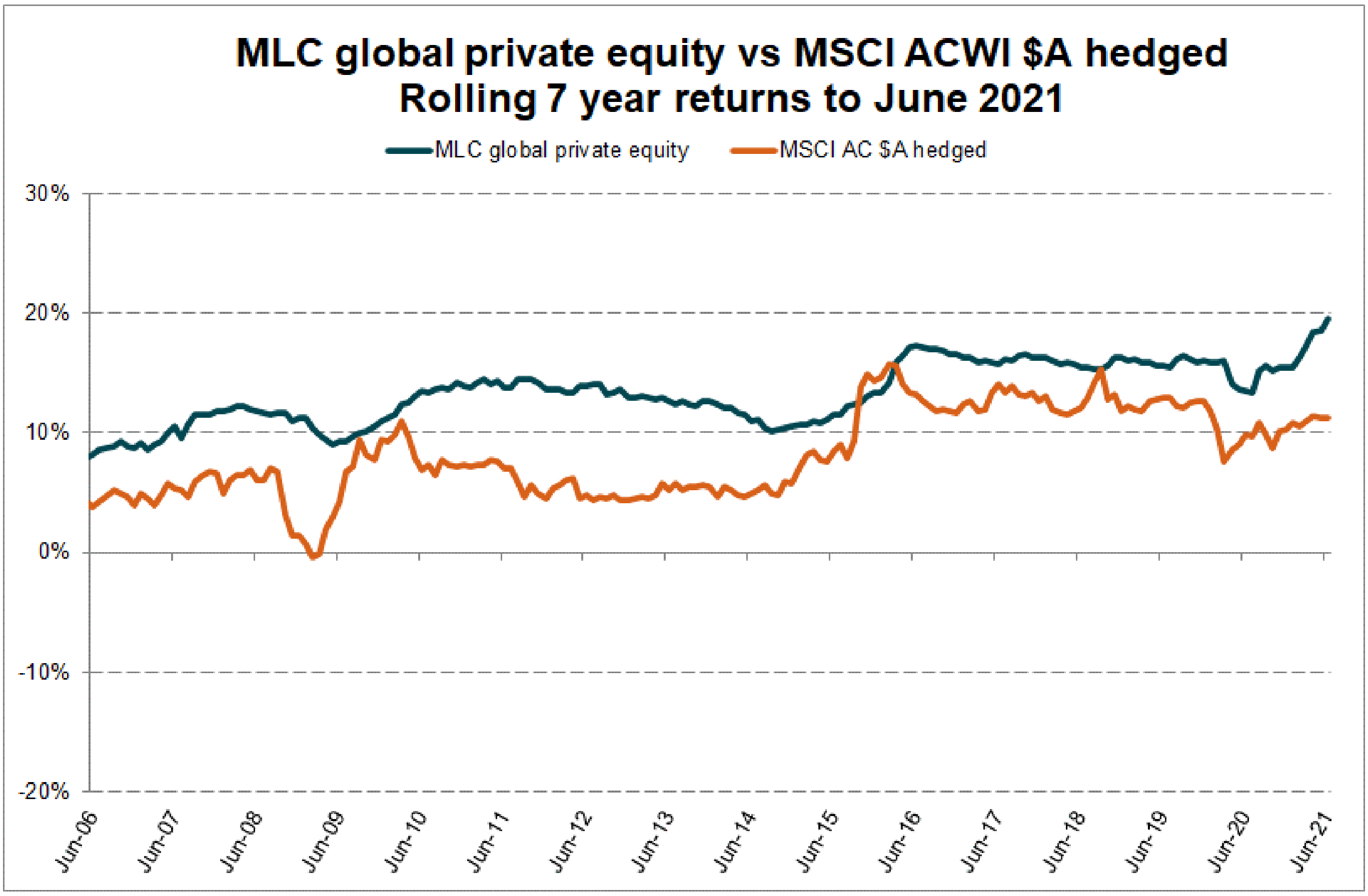



**Source:** MLC Asset Management Services Limited. Private equity returns are net of indirect costs[3].Past performance is not a reliable indicator of future performance.

Chart 3 and Table 2 demonstrates the success of MLC's private equity strategy in meeting its seven-year outperformance objective. The strategy has generally provided substantial benefits to our multi-asset portfolios, even after taking into account the costs involved in investing in private equities.

[3] Indirect costs are incurred when a portfolio invests in external investment funds. They aren't additional fees retained by MLC. Indirect costs are in addition to investment fees and are reflected in the unit price of the multi-asset portfolios.

**Chart 3: Rolling seven year returns compared to its objective to 30 June 2021**




**Source:** MLC Asset Management Services Limited. Private equity returns are net of indirect costs. Past performance is not a reliable indicator of future performance.

**Table 2: Returns to 30 June 2021 (before fees and tax)**

| | 1 year % | 2 years % pa | 3 years % pa | 5 years % pa | 7 years %pa | 10 years %pa | 15 years %pa |
|---|---|---|---|---|---|---|---|
| **MLC global private equity strategy (hedged)** | 69.9 | 29.2 | 24.9 | 21.5 | 19.6 | 18.2 | 16.2 |
| **MSCI All Country World Index (hedged)** | 35.3 | 16.8 | 13.0 | 14.2 | 11.3 | 12.4 | 9.2 |
| **Excess return** | 34.6 | 12.4 | 11.9 | 7.3 | 8.3 | 5.9 | 7.0 |

**Source:** MLC Asset Management Services Limited. Private equity returns are net of indirect costs. Past performance is not a reliable indicator of future performance. The value of an investment may rise or fall with the changes in the market. Figures are rounded to one decimal place.

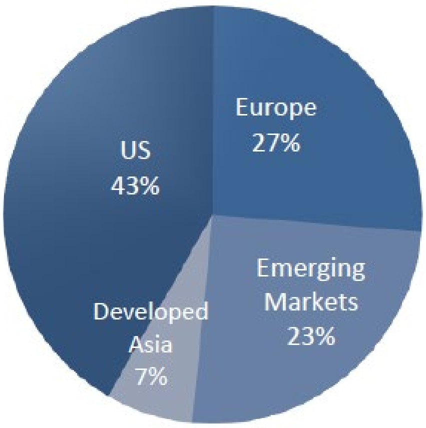
MLC's global private equity strategy aims to identify and access the best private equity funds globally. As these investments require MLC to invest in external funds, indirect costs are incurred. However, even after taking into account the higher costs involved with these investments, the long-term excess return from MLC's private equity strategy has exceeded that of listed share markets.

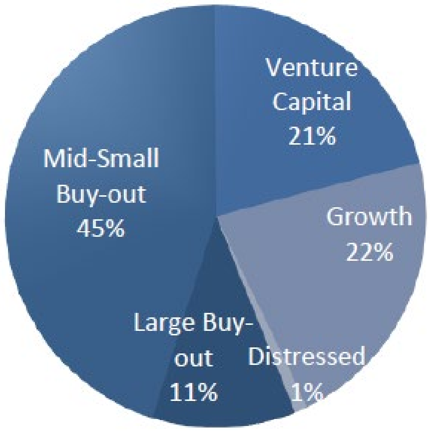
The strategy won't always achieve its objective of outperforming listed share markets over seven year periods. Most of our investments in private equity have a very long tenure and even over a period as long as seven years, conditions for private equity may not be as favourable as those for listed markets.

## Portfolio diversification

This unique strategy is diversified over buy-out, venture capital, growth and distressed sub-sectors, investing in both specialist managers and co-investments.  Chart 4 provides more detail on the portfolio exposures.

**Chart 4: Regional exposures and investments across the private equity spectrum as at 30 June 2021**




**Source:** MLC Asset Management Pty Limited, based on net asset value and undrawn commitments, excluding fund of fund investments.

**Notes:** We haven't provided the names of the private equity funds and investments as private equities aren't listed securities, and transactions in them are infrequent compared with listed investments. Contractual terms for private equity normally prohibits investors, such as MLC, from disclosing any information relating to the private equity or any transactions in relation to them.

## Portfolio activity for the quarter

During the quarter, MLC made 10 new commitments, comprising of:

- six new fund commitments, including four US and one European venture capital managers, and a European buy-out manager,  and
- four new co-investments, being an Emerging Markets growth manager, a US buy-out manager, a US growth manager, and a European buy-out manager.

## Portfolio case study

One of our managers, **Vitruvian Partners**, provided the following case study for one of its previously held investments, **Unifaun**, which you may find interesting.

"Unifaun makes a significant contribution to enabling carbon emissions reduction through its business model.

Unifaun is a leading cloud delivery orchestration transportation platform. Its customers range from large global carrier brands such as DHL and DSV, to smaller transportation companies (including IKEA, Vestas and Unilever), to small and medium-sized enterprises and the 'recipient' market through participating apps.

Unifaun developed a new environmental emission engine module to support 150 large-scale, multi-site enterprise shippers with carrier selection, with the objective of reducing transport emission. Access to the 'Unifaun Emission Report' empowers customers, giving them an understanding of their total emissions including energy usage, carbon dioxide emissions and particle emissions based on actual shipment data with weight, distance and transport mode. This is done in partnership with The Network for Transport Measure (NTM), a non-profit organisation aimed at establishing a common base of value on how to calculate environmental performance for all various modes of traffic, including goods transport."

Note: As our investment managers are constantly reviewing and making changes to their holdings, these investments may no longer be included in the portfolio.

## Private equity market activity for the quarter

The private equity market continues to exhibit strong momentum going into the second half of 2021. The strength and speed of the rebound suggest resilience and continued confidence as investors increasingly look to private markets for higher potential returns in a sustained low-yield environment. In the June 2021 quarter, an aggregate USD295 billion was raised across 570 funds, led by North America which accounted for 57% of aggregate capital raised, followed by Asia (25%) and Europe (18%). The largest fund closed in the quarter was Hellman & Friedman Capital Partners X at USD23 billion.

There were 1,818 buy-out deals completed in the June 2021 quarter for a combined value of USD215 billion. This is substantially higher than the 1,675 deals completed in the prior quarter for a combined value of USD146 billion. The uplift is primarily driven by an increase in North America and Asia-led deal flow. The latter almost doubling its prior quarter numbers, led by two large public-to-private transactions: the sale of Hitachi Metals to a Bain Capital-led consortium for USD7.5 billion and the sale of 51job Inc. to a consortium of Chinese investors led by DCP Capital Partners for USD5.7 billion.

The largest buy-out transaction of the quarter was the acquisition of leading health care supply manufacturer Medline Industries by an investor consortium comprised of Blackstone Group, Carlyle Group, and Hellman & Friedman for USD34 billion. Separately, the largest buy-out exit of the quarter was the sale of Pharmaceutical Product Development, a clinical research organisation, by Carlyle Group and Hellman & Friedman to Thermo Fisher Scientific Inc. for USD17.4 billion.

In the June 2021 quarter, there were 3,589 venture capital deals completed for a combined value of USD181 billion. Technology cemented its position as the dominant sector, accounting for 41% of total deal value during the quarter, followed by health care and consumer discretionary at 16% and 15%, respectively. The largest venture deal of the quarter was Coinbase's NASDAQ listing, which raised USD 43.8 billion.

With respect to fundraising, the private equity markets in which the strategy operates remain largely unchanged from the March 2021 quarter. There are now 5,311 funds seeking to raise USD887 billion, with an average fund size of USD278 million. In terms of strategies, venture capital accounts for 58% of fund raising and 26% of aggregate capital, while buy-out represents 12% of fund raising and 33% of aggregate capital.

## Appendix 1: Understanding fees that are deducted from returns in this investment update

As MLC Horizon and Inflation Plus portfolios invest in the global private equity strategy and a range of other asset classes and strategies, only some of the fees disclosed in the Product Disclosure Statements (PDSs) relate directly to the management of the global private equity strategy. Therefore, the global private equity strategy's performance is reported before deducting most of the fees and taxes disclosed in the PDSs.

**Important information**

This communication provides performance, exposures and commentary for the private equity strategy used in the MLC Horizon portfolios and MLC Inflation Plus Assertive portfolio in MLC MasterKey superannuation products.

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