

# Public Pension Funds Should Consider Listed Private Equity

by Ian Armitage, Chairman, HgCapital

Local Authority pension funds have been investors in private equity for many decades. I can remember seeing the names of many county and metropolitan schemes on lists of investors in the early funds of the 1980s, names that continue to commit to funds today. These leaders have brought in others.

That said, as a proportion of all investment by local authorities, the allocation to private equity is still small. Moreover, it tends to be committed to those fund managers with long and successful track records across the full economic cycle. These investors understand that private equity has generated good returns over entire cycles and that the private equity model possesses inherent advantages over public equity investment.

Last year, as part of a continuing research programme, LPEQ (Listed Private Equity), commissioned Preqin to conduct a survey of the attitudes of users and potential users of listed private equity among 100 institutional investors across Europe. All the sample invested in private equity Limited Partnership (LP) funds and included 16 UK local authority pension funds, four of whom also invested in listed private equity.

LPEQ, a group of 14 UK and continental European listed private equity firms, was formed – originally as iPEIT – in 2006 to increase understanding and raise awareness of the listed private equity sector among investors, financial advisers, brokers and commentators.

With some 80 tradable private equity vehicles in Europe, we never cease to be amazed at how many investors and advisers are unaware that they can access private equity for the price of a share. Or that institutions can use listed private

equity, not only as a relatively liquid route into this asset class, but also as a means of managing their allocation alongside investment in ten-year LP funds.

The Preqin study \* was our fifth research survey among groups that use private equity in their or their clients' portfolios.

61% of all those surveyed thought that listed private equity should be considered by those institutions not already invested in the asset class, particularly those too small or unwilling to commit to ten-year LP funds. As if to bear this out, the four UK pension funds invested in listed private equity managed small to medium sized funds.

But the overwhelming conclusion of the survey was that remarkably few institutions knew about or considered listed private equity investment as part of their allocation to the sector, in spite of consistent and strong long term NAV outperformance. 53% of those surveyed did not even have a mandate to invest in listed private equity stocks.

Lack of information was seen as the main barrier to investment. External sources of information on listed private equity are disparate, ranging from LPEQ itself to indices and trackers, like LPX, and share information providers, like Fundamental Data (Morningstar). Surprisingly, only 24% of those invested in listed private equity received broker information and only 9% of the total sample had ever had a consultant discuss listed private equity opportunities with them. This was a surprise to us. 51% of those with consultants surveyed felt it would be useful for consultants to provide information on the sector. We agree.

A disadvantage of listed private equity cited by local authorities not invested in

listed private equity was the correlation with listed equities. This perception was aggravated by recent market turmoil, as shown in responses between a pilot for the study conducted three months before the main survey and the main survey completed towards the end of last year. The pilot suggested that investors thought private equity offered investors the benefit of uncorrelated returns. However, as we know, when confidence hits the public markets as it has in the past few months, virtually all stocks suffer. And financial stocks have taken a particular beating.

But a glance of share price performance over time of the 20 or so listed private equity stocks on the London Stock Exchange shows considerable variation between these stocks alone. Differences arise, inter alia, based on how much cash each holds, on recent distributions and commitments and on the portfolio performance of each. Worthy of note is the statistic that 70% of the whole sample and 82% of those invested in listed private equity saw today's large discounts to NAV in listed private equity stocks as a buying opportunity.

Key advantages of listed stocks over ten-year LP funds were seen as greater liquidity (86%), and reduced administration and better cash management (77%). 47% of investors tended to hold their stocks for five years and more, confirming conclusions from other surveys that most investors hold these stocks for long term capital appreciation.

The members of LPEQ, which range from single manager funds to global funds-of-funds, all found the results of this survey interesting and useful. It will no doubt inform their investor relations activity.

\*available at [www.LPEQ.com](http://www.LPEQ.com)

Private equity attracted considerable comment as an industry in 2007, much of it ill-informed. The industry has taken action to become more transparent and now operates under enhanced reporting guidelines. As we address our communication challenges, I am confident that the investing public will become better informed and as a result will allocate more capital to listed private equity vehicles.

With the economy deteriorating rapidly, our portfolios will undoubtedly take a hit. Conversely, the opportunity to buy at very attractive prices will increase. We are not alone in facing these problems – companies of all types, regardless of how they are funded, will find 2009 and 2010 very challenging indeed.

As a believer in the propositions that the quality of management and alignment of interests have a huge bearing on corporate performance, I take comfort from the

increasingly accepted fact that the private equity model is best placed to recruit and reward the best management talent available.

Timing plays a part too. We all know that the best returns come from investments made at the bottom of the cycle; private equity is no exception. So, once company valuations come down (and they still, in or view, have a way to go), there will be good investments made from the current vintage of funds.

We are most grateful to those local authorities who took part in this survey and to those of you who contribute funds to our efforts to support developing businesses and improve the efficiency of more mature ones. The current crisis will produce change in the financial and corporate worlds, but private equity is still open for business – indeed, we are currently one of the few sources of capital available at all.

---

*“ the best returns come from investments made at the bottom of the cycle; private equity is no exception ”*

---



**Ian Armitage**  
HgCapital