



Private Equity:
Primary Investment Opportunities and Considerations

Callan Private Equity Consulting
Presented by Jay Nayak

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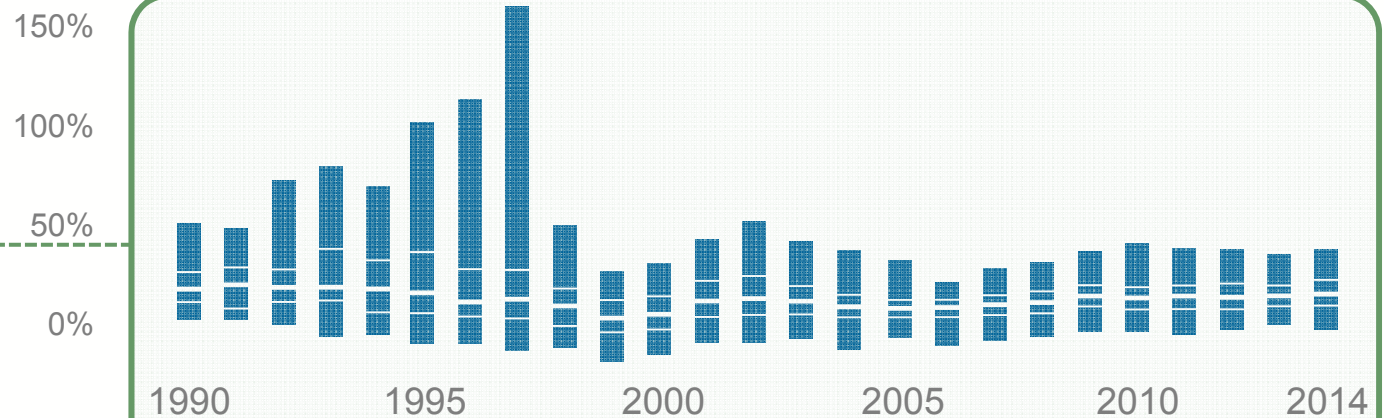


5,154

Funds (1990-2014)

Distribution of Returns by Vintage Year

Net Internal Rates of Return for All Strategy Types – As of June 30, 2018



Industry Message:
"Access to Top Managers" = Private Equity-Like Returns

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5,154

Funds (1990-2014)

27%

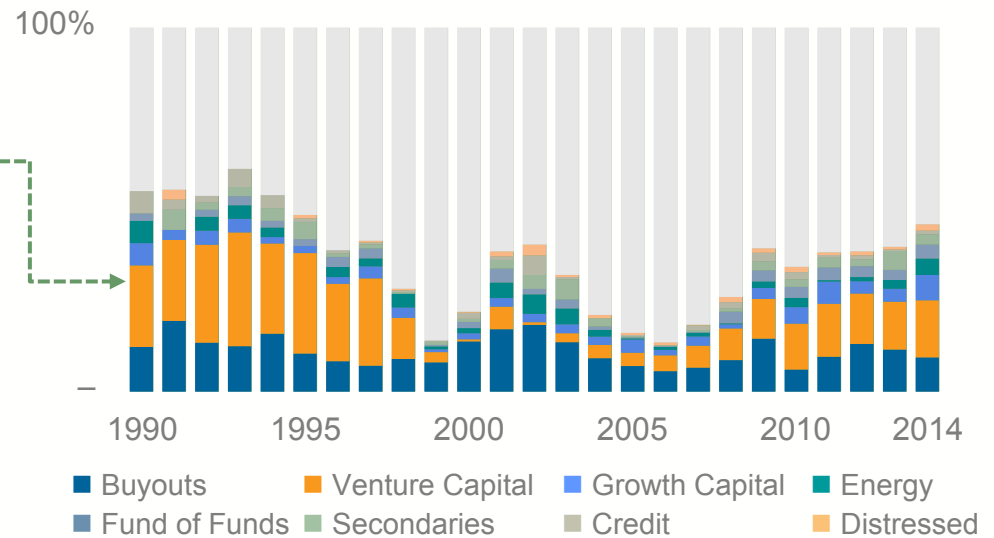
Above 15% Net IRR

73%

Net IRR Below 15%

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Funds Exceeding a 15% Return by Vintage Year Net Internal Rates of Return – As of June 30, 2018





Takeaways

- “Access” is not the only solution for investors to achieve private equity-like returns
- Portfolio construction fundamentals and careful manager selection are key drivers of success

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Goal of this Session

- Illustrate how investors' portfolio construction decisions impact the private equity program
 - Program Design
 - Commitment Pacing
 - Strategy Selection
 - Manager Selection

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Program Design
How an institutional program operates

Strategic Planning
How the program is meant to be invested



Manager Selection
How the program is invested

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PROGRAM DESIGN

The most important decisions are made before the first investment.

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Program Design
How an institutional program operates



Strategic Planning

Manager Selection

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Governance & Oversight

The structure and process by which the private equity program is governed

Objectives/Risk Specifications

How investment policies, procedures, strategy, and risk are defined and reviewed

Staffing & Resources

Internal and external resources to administer the private equity program

Roles & Responsibilities

How internal and external resources are organized and work together

- Each of these elements must be deliberately aligned to empower manager selection

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Governance & Oversight

The structure and process by which the private equity program is governed

- Involvement of fiduciary board in program
- Familiarity with private equity topics

Objectives/Risk Specifications

How investment policies, procedures, strategy, and risk are defined and reviewed

- Investment objectives, strategy and risk budget
- Monitoring process

Staffing & Resources

Internal and external resources to administer the private equity program

- Strategy and investment parameters
- Sourcing, screening and diligence process

Roles & Responsibilities

How internal and external resources are organized and work together

- Headcount and organization structure
- Use of external resources

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Program Design – Case Study

Governance & Oversight

- Clearly-articulated role and strategy of private equity
- Manager selection-driven investment philosophy

Objectives/Risk Specifications

- Procedural flexibility to empower manager selection
- Investment flexibility aligning with philosophy

Staffing & Resources

- Gradual headcount growth, linked to gradual direct portfolio investment
- Specific use of Callan to assist staff in their investment process

Roles & Responsibilities

- Staff specifically focused on idea generation & GP relationship management
- Callan's process and role aligned to support staff

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Program Design – Takeaways

- Proactively manage program design elements
- Align these elements within the organization to empower manager selection
- Deliberately establish and maintain the roles of staff and external resources

The most important decisions are made before the first investment.

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STRATEGIC PLANNING

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Program Design



Strategic Planning

How the program is meant to be invested

- Commitment Pacing
- Strategy Selection

Manager Selection

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COMMITMENT PACING

Budget capital with purpose;
avoid chasing a private equity target allocation.

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Commitment Pacing – Overview

- Commitment pacing is foremost a risk management exercise
- Investors focus on commitment pacing to:
 - Budget capital for future investment needs
 - Adjust investment activity to the cash flow profile of the private equity program
- Strategic decisions can improve private equity returns and reduce operational challenges

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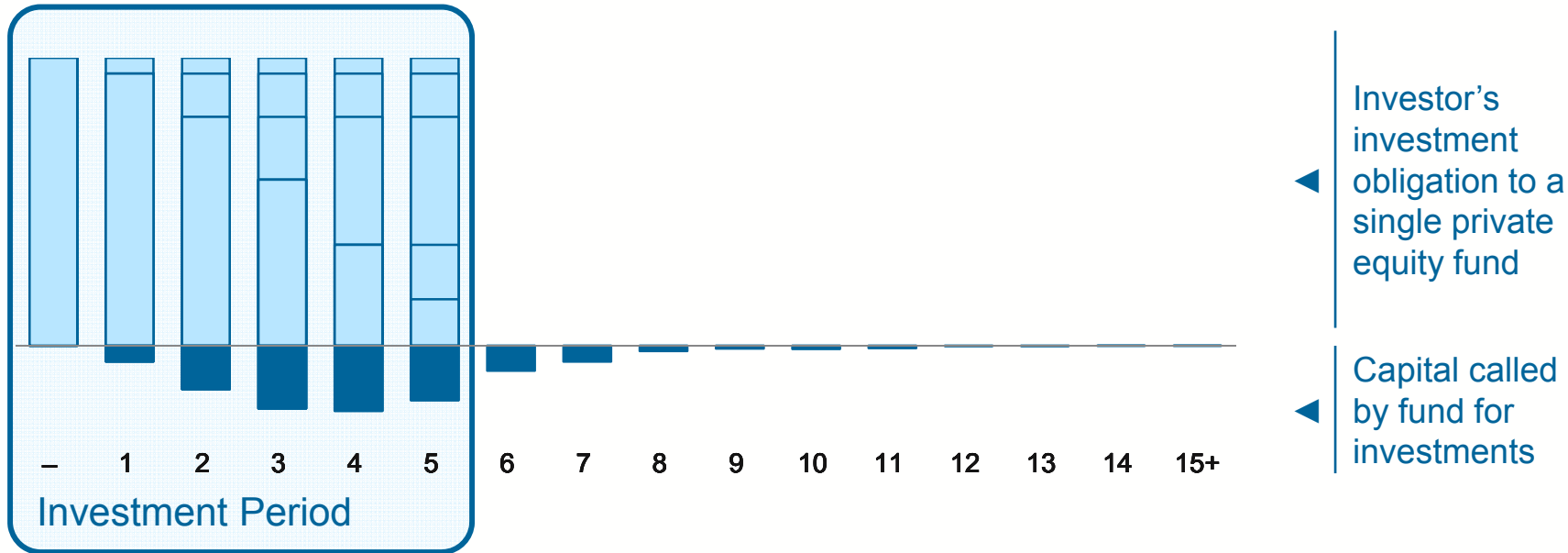
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Lifecycle of a Single Private Equity Fund Investment



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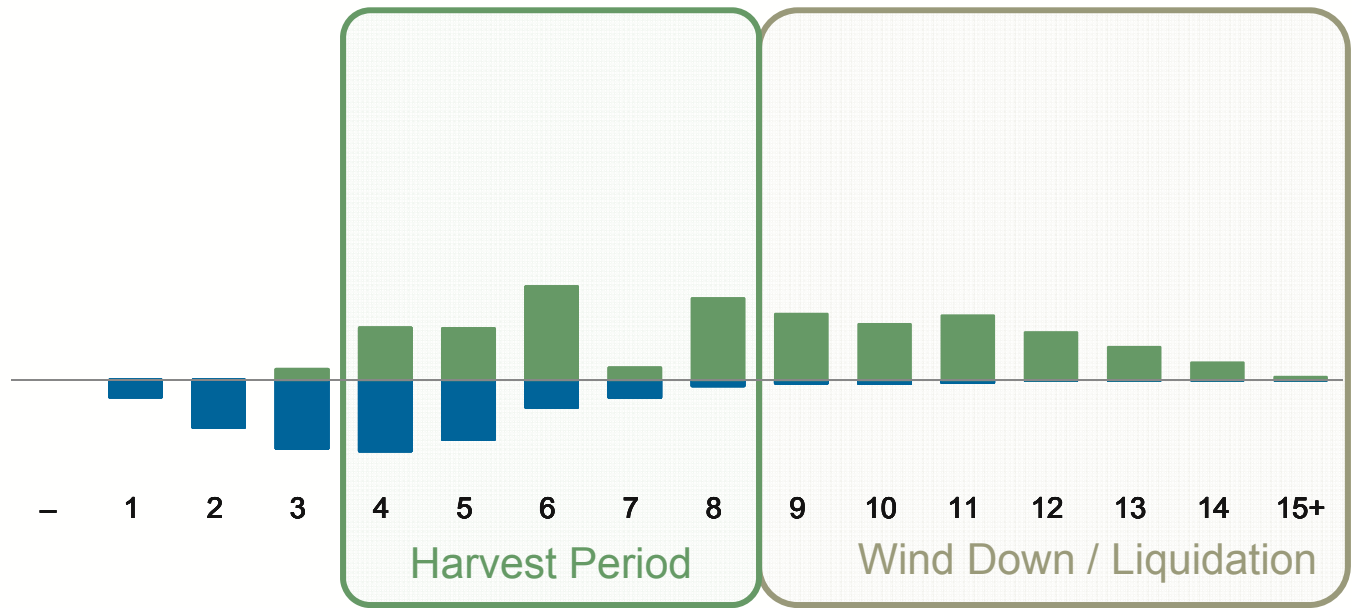
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Lifecycle of a Single Private Equity Fund Investment



Investor receives distributions as companies are sold by the manager

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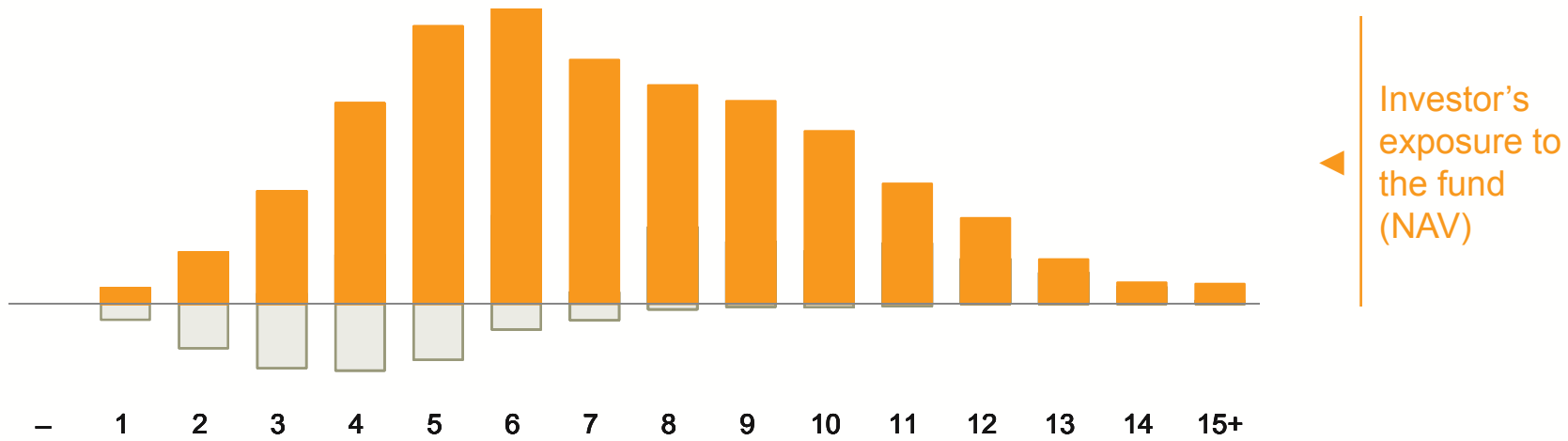


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Lifecycle of a Single Private Equity Fund Investment



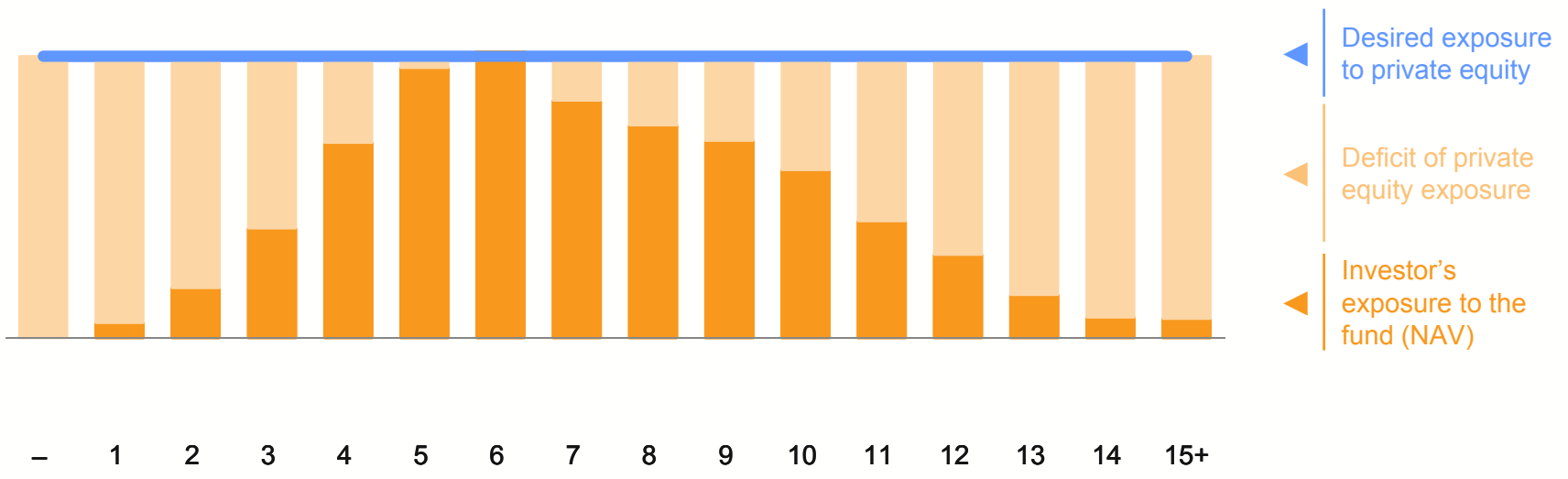
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Lifecycle of a Single Private Equity Fund Investment



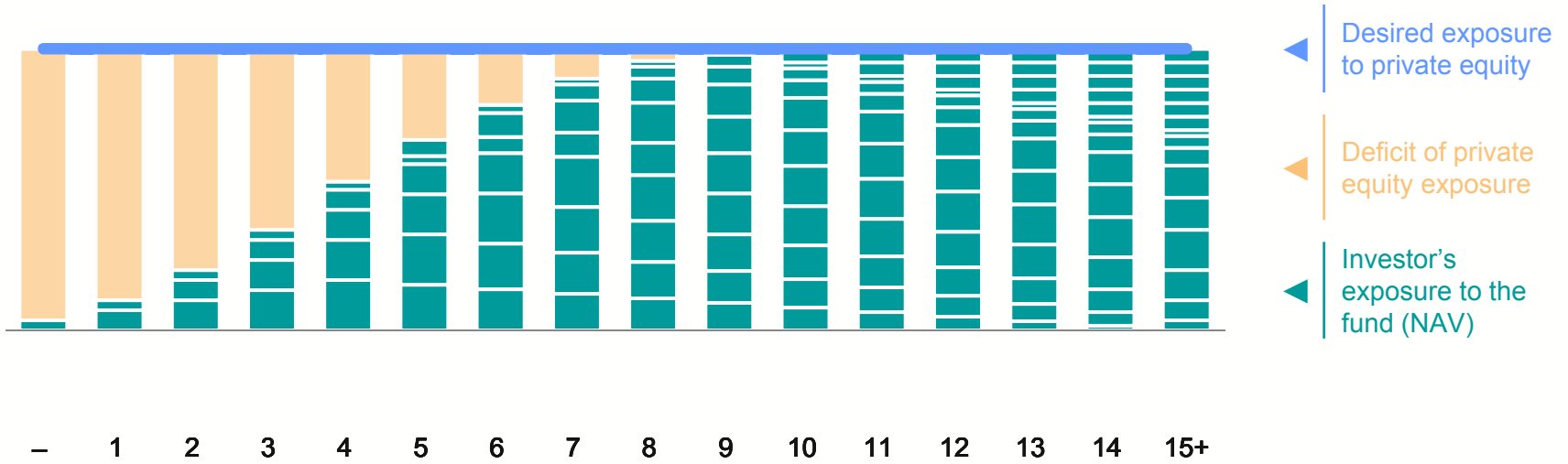
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Lifecycle of a Private Equity Portfolio



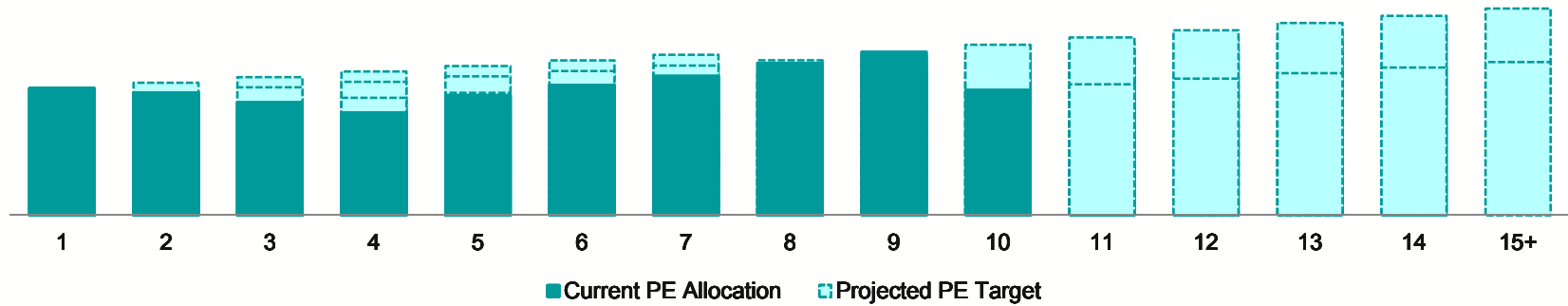
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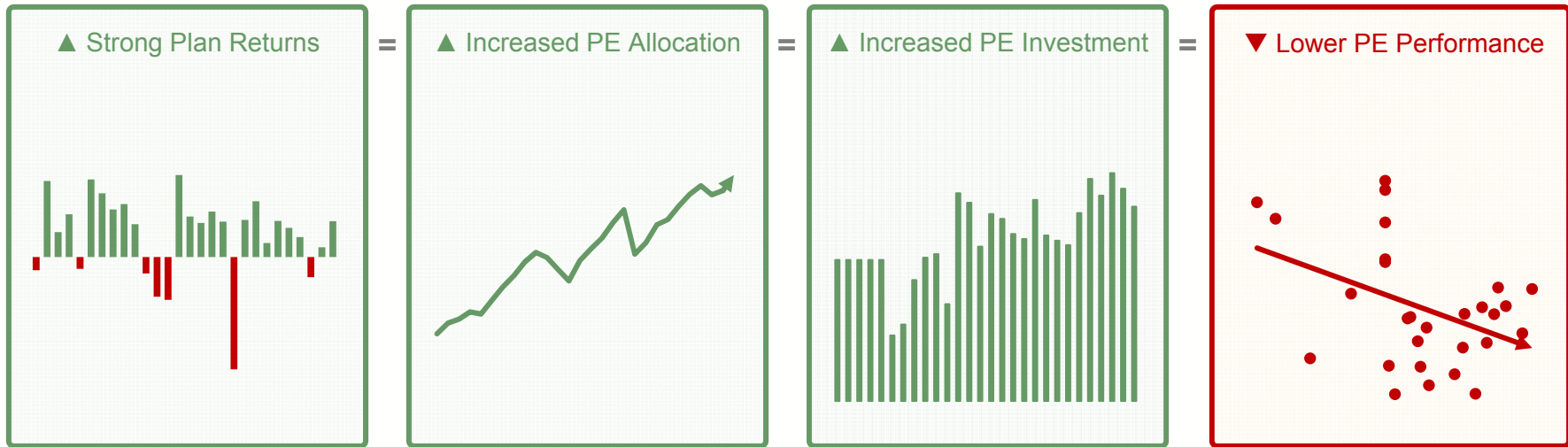


Illustrative Capital Pacing Projection





- There is a tendency to “chase” the private equity target allocation at the wrong time



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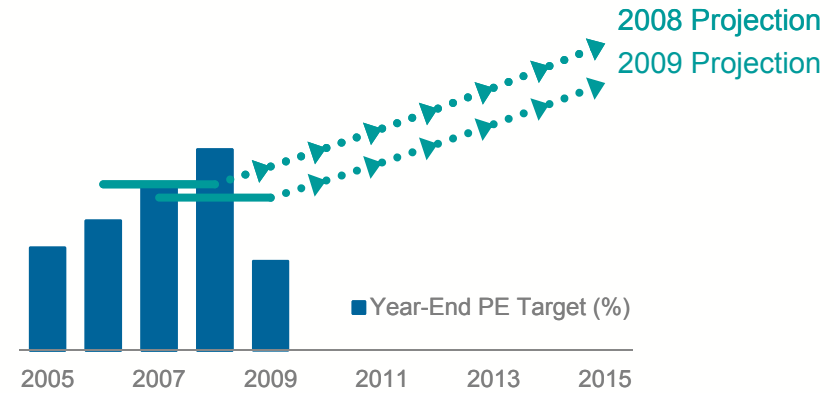
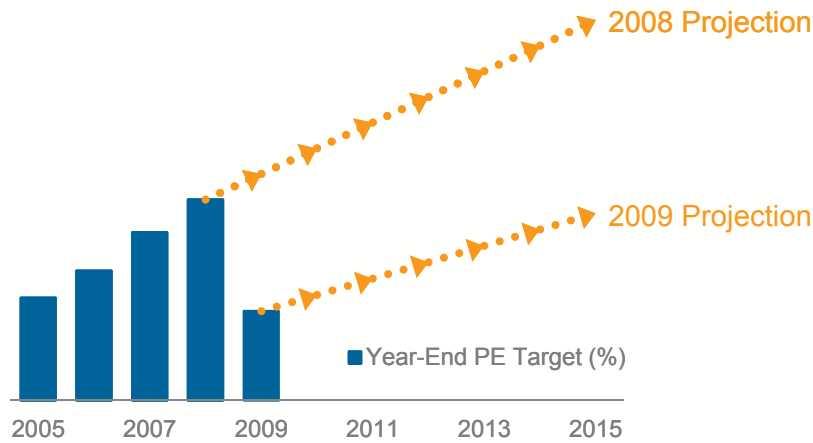
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Alternative Commitment Pacing Approaches

Conventional Approach

Alternative Approach – Uses 3 Year Average

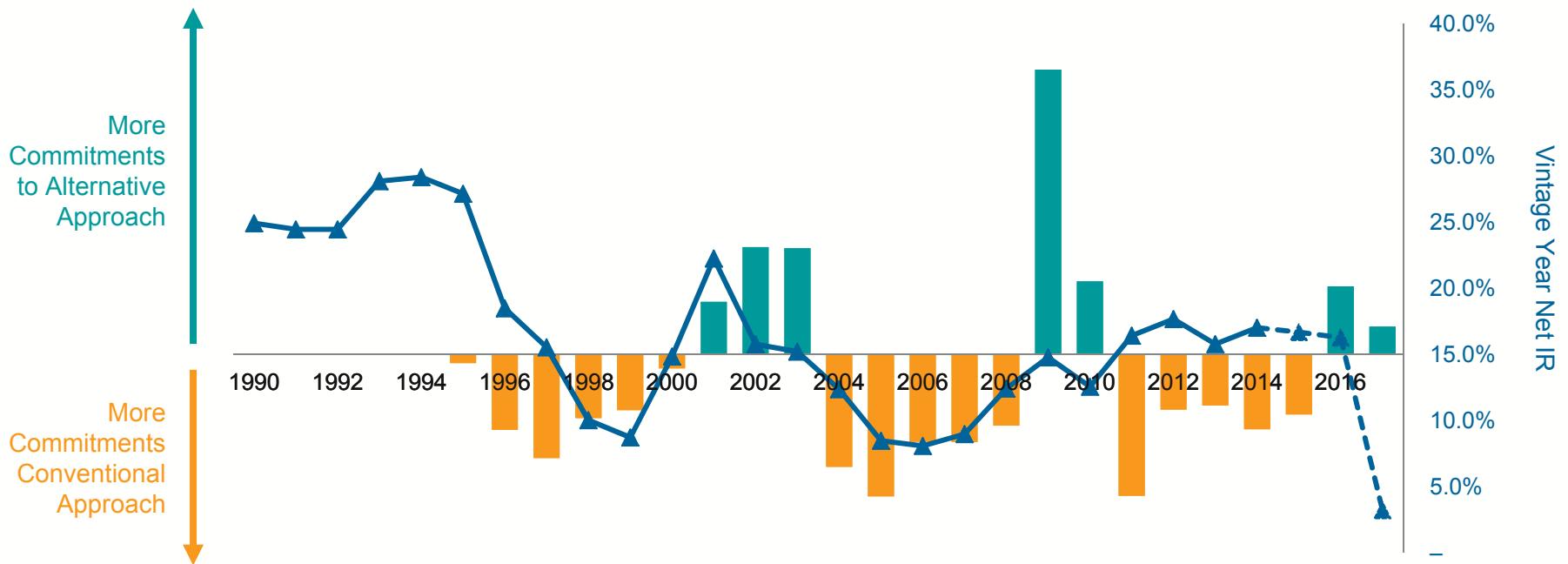


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Commitment Pacing – Takeaways

- Develop and regularly review the commitment pacing analysis
- Adjust expectations to focus squarely on investment quality and merits
 - There is a cascading effect of performance on investment needs, program liquidity, and administration requirements

Budget capital with purpose; avoid chasing a private equity target allocation.

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STRATEGY SELECTION

Private equity returns are fungible;
focus on strong and consistent results.

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Strategy Selection Overview

- Strategy Selection focuses on how LPs invest in different private equity strategy types
 - Ex. Buyouts, venture capital, growth capital, distressed, etc.
- Evaluating the strategy mix is another way investors can impact private equity performance

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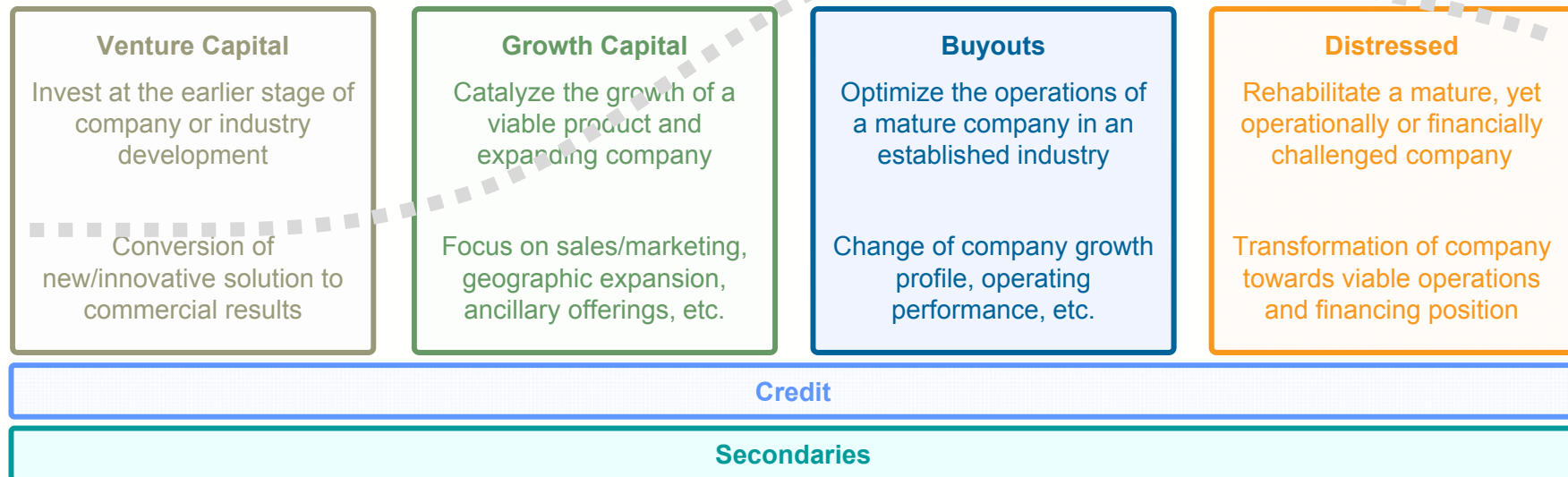
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Stages of Private Equity Investment



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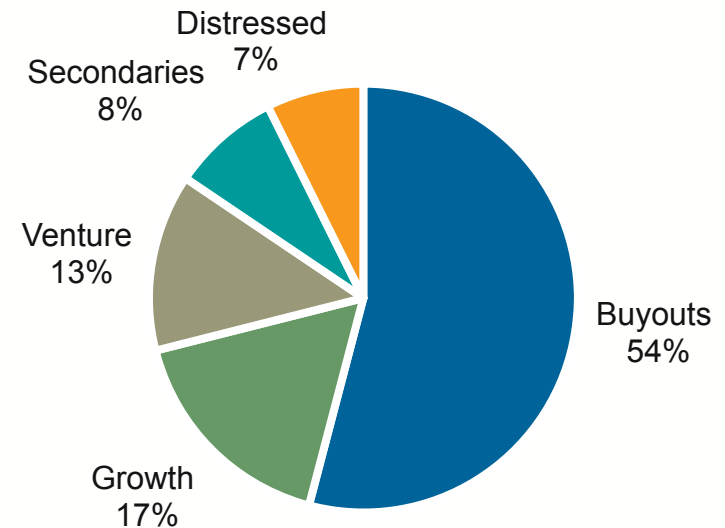
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Typical Private Equity Strategy Allocations

- Strategy allocations often resemble the broader private equity market
- Each strategy type has unique characteristics and investment profiles
- Investors must develop expectations for each and decide how to allocate across strategies

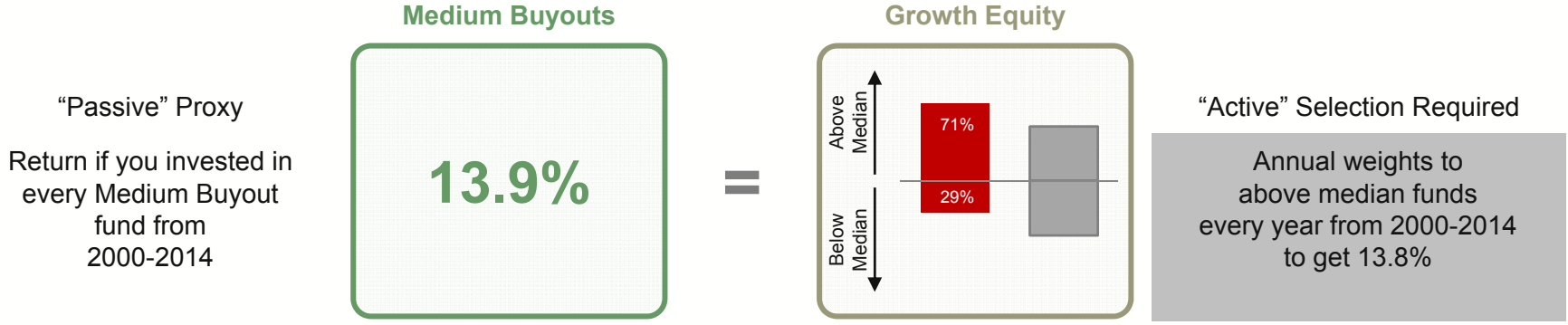


Source: Refinitiv/Cambridge, as of September 30, 2018.
Sum of capital raised by strategy type, last 10 vintage years.



- To effectively determine strategy allocations it is critical to compare strategy types relative to one another

Comparative Review Example



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Source: Refinitiv/Cambridge, as of September 30, 2018.

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Strategy-by-Strategy Comparative Review

"Passive" returns by strategy		Small Buyouts	Medium Buyouts	Large/Mega Buyouts	Secondary PE	Growth Equity	Distressed	Venture Capital
		15.9%	13.9%	12.8%	12.3%	11.7%	10.9%	8.6%
Small Buyouts	"Active" above median selection required	-	31%	26%	23%	20%	16%	6%
Medium Buyouts		-	-	38%	36%	32%	28%	15%
Large/Mega Buyouts		38%	18%	-	4%	0%	0%	0%
Secondary PE		89%	65%	-	-	35%	24%	0%
Growth Equity		87%	71%	63%	-	-	-	31%
Distressed		82%	70%	62%	-	-	-	32%
Venture Capital		- NM -	87%	78%	74%	68%	62%	-

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Source: Refinitiv/Cambridge, as of September 30, 2018.



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Strategy Selection – Takeaways

- Each strategy type has a unique return and risk profile
 - Adjust the strategy weights based on your ability to capture above-average performers within each
- Maintain a long-term strategic view and retain flexibility where the advantage of superior manager selection is greatest

Private equity returns are fungible; focus on strong and consistent results.

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MANAGER SELECTION

Manager selection begins long before sponsors start fundraising.

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Program Design

Strategic Planning



Manager Selection

How the program is invested

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- Manager Selection contributes to Private Equity Program performance through:

Proactive Identification

- ✓ Focused and consistent investment strategy
- ✓ Clear and relevant angle to the prevailing market
- ✓ Well-developed organizational infrastructure
- ✓ Stable, investor-centric operating philosophy

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Manager Avoidance

- ✗ Material shifts in investment strategy or markets
- ✗ Decoupling of investment philosophy and deal types
- ✗ Weak investment processes and risk controls
- ✗ Asset growth-oriented operating philosophy

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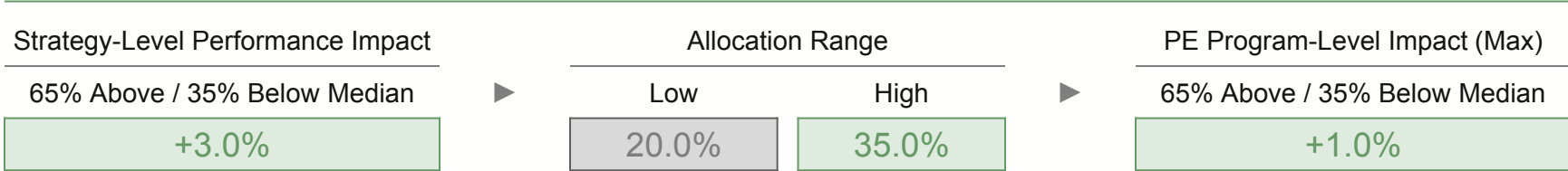


- Manager Selection contributes to Private Equity Program performance through:

Illustrative impact of proactive manager selection at the Strategy- and Private Equity Program-levels



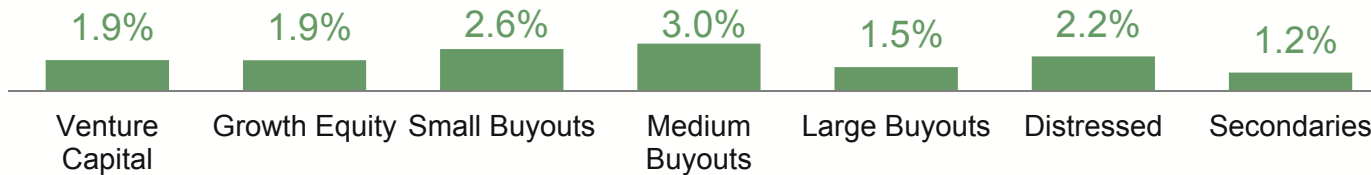
Medium Buyouts



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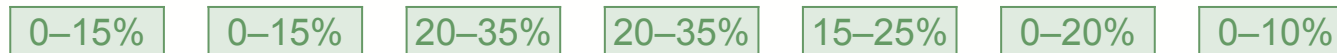
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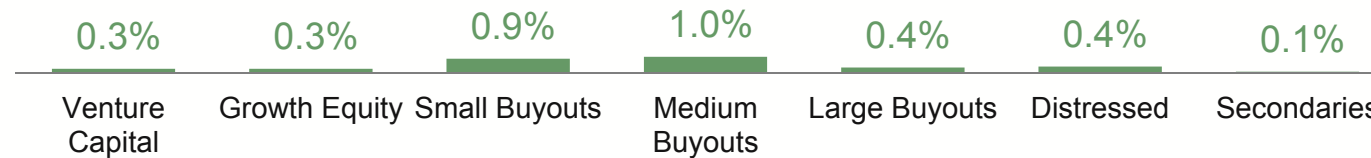
Manager Selection Contribution (Strategy-Level)

X



"Market" Strategy Allocations

=



Weighted PE Program-Level Contribution

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Session Takeaways

- Investors have many levers to improve their PE performance
 - Manager selection is critical, but “access” is not the sole determinant of private equity program success
- A long-term, strategic and holistic perspective is necessary
 - Success is driven by effectively weaving together Program Design, Strategic Planning, and Manager Selection

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