FEATURE ARTICLE

PRIVATE EQUITY

OVERVIEW

GIC deploys capital in areas where we can utilise our comparative advantages, in particular, a long investment horizon, global presence, as well as skilled and experienced teams. Private Equity (PE) exemplifies an asset class where we tap our advantages to reap excess returns from investments that require longer gestation periods to realise their potential.

WHAT IS PRIVATE EQUITY

Unlike public equities, PE entails investing in equity or equity-like instruments in companies which are not traded via organized exchanges. It also includes investments in publicly traded securities through privately structured deals. PE investments provide capital to companies at all stages of their life cycle, from start-ups through to mature companies, and in a range of situations such as corporate spin-outs, management buyouts and turnarounds. Well-known companies that have been financed by PE include Google, Facebook, Dell and Hilton Hotels.

The key drivers of PE performance include:

- Strong alignment of interest between investors and company management
- Operational improvements to add value to companies
- Ability to make strategic decisions without pressure of short-term share price concerns
- Appropriate use of leverage to increase Return on Equity

WHY GIC INVESTS IN PE

GIC's asset allocation strategy is based on a trade-off between expected return and risk, with the goal of building a diversified portfolio to deliver good overall long-term real returns. PE offers diversification benefits to GIC as its return drivers are somewhat different from those of traditional asset classes. Consequently, PE occupies a distinct and important role in GIC's portfolio.

Investing in PE enables better long-term returns on our portfolio. PE offers the highest expected return, albeit with the highest risk, among the major asset classes (Chart 1). In part, this is to compensate investors for assuming illiquidity risk – the holding period of PE investments is typically three years or longer, and it is difficult to divest at short notice.

The performance of PE deals can vary greatly, as the chart on industry returns (Chart 2) shows. Similar to other asset classes, performance can be impacted by global conditions such as the 2008-2009 financial crisis, although even in challenging years some investments still do well, compensating for those that underperform. A long-term investor like GIC can afford to ride through the higher volatility of PE in return for a higher expected long-term return.

Investing in PE is therefore a higher-risk activity, but the strategy has worked well for GIC so far. Returns from the PE asset class since its introduction into the GIC Portfolio have exceeded returns from public equities.

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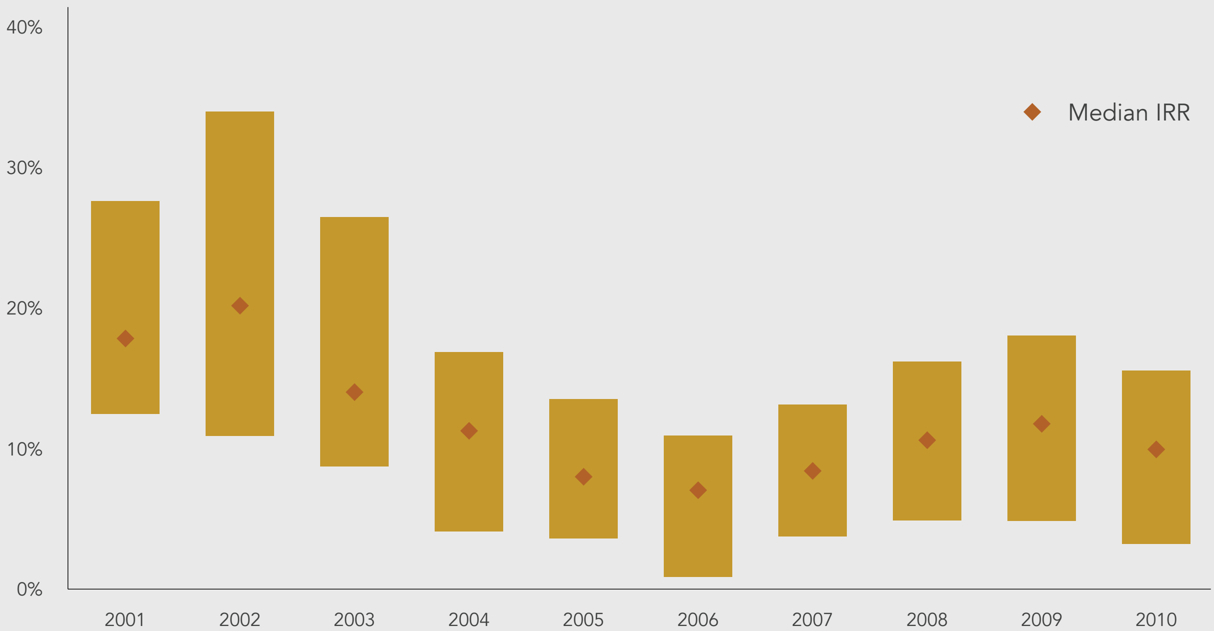
Chart 1: 20-Year Expected Real Return and Volatility Assumptions of Asset Classes

Chart 2: Internal Rate of Return of the Private Equity Industry for the Period 2001-2010



Top of bar represents 75th percentile
Bottom of bar represents 25th percentile

Source: Private iQ Global PE benchmark by Burgiss
Note: Recent years are excluded as it is too early to tell their performance

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HOW WE INVEST IN PRIVATE EQUITY

GIC began investing in PE in 1982, and is one of the largest and most established PE investors in the world today. While the bulk of our investments are in developed markets, particularly in North America and Europe, we have a substantial presence in emerging markets (Chart 3). Through local teams spread over seven offices on four continents, GIC has built a PE portfolio that includes investments in well-known global and local companies and PE funds.

Investments are made both indirectly via funds and directly into companies. GIC currently has over 100 active relationships with PE fund managers in all regions of the world. We invest directly in companies, either alongside our fund managers or independently, and we have investments in well over 100 companies globally. GIC's PE direct investments cut across multiple industry sectors, with a focus on financial services, business services, consumer, healthcare, technology / media / telecommunications (TMT) and natural resources (Chart 4).

Our PE investments span a wide range of sub-asset classes within the industry. The largest proportion of the portfolio is invested in buyouts, which is broadly consistent with the rest of the PE industry (Chart 5).

GIC'S PRIVATE EQUITY INVESTMENT STRATEGY

Since returns from PE are volatile, superior returns are available only to the best PE fund managers and investors. GIC seeks top-quartile fund managers across the world to invest in and co-invest with, and has built relationships with a number of established managers. At the same time, we have been, and continue seeding promising new funds.

While GIC works alongside knowledgeable investment partners, we have also built the capabilities to source and lead deals independently through our global network, supported by our local investment teams around the world. Having patient capital, cross-asset class capabilities, and a global presence with experienced local teams have set GIC apart from other institutional investors and helped us to gain preferred access to good investment opportunities.

We follow a robust and rigorous investment process throughout the life of our investments, from deal origination, due diligence, investment decision-making, deal execution, monitoring, through to exit.

RISK MANAGEMENT

PE investments share risks with their public market counterparts, but are also exposed to risks specific to the asset class. For instance, PE can carry high concentration and idiosyncratic risk. Investments also often involve more financial leverage. Our PE teams therefore pay close attention to risk control and exercise discipline in portfolio construction. The aim is to construct a non-cyclical portfolio that is diversified by type of investments, geographical regions, industries, as well as time (vintage year[1] diversification). Time-diversification is especially important to avoid pro-cyclical investing and over-exposure to periods where market valuations may be high.

[1] Vintage year is the year in which an investment is made.

Chart 3: Last 10 Years' Private Equity Investments by Region

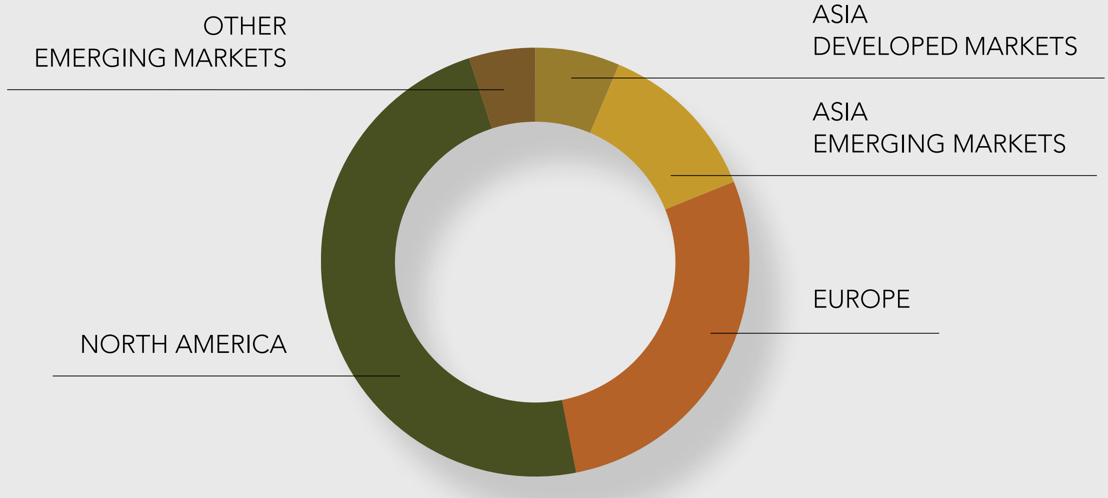

Chart 4: Last 10 Years' Direct Investments by Sector

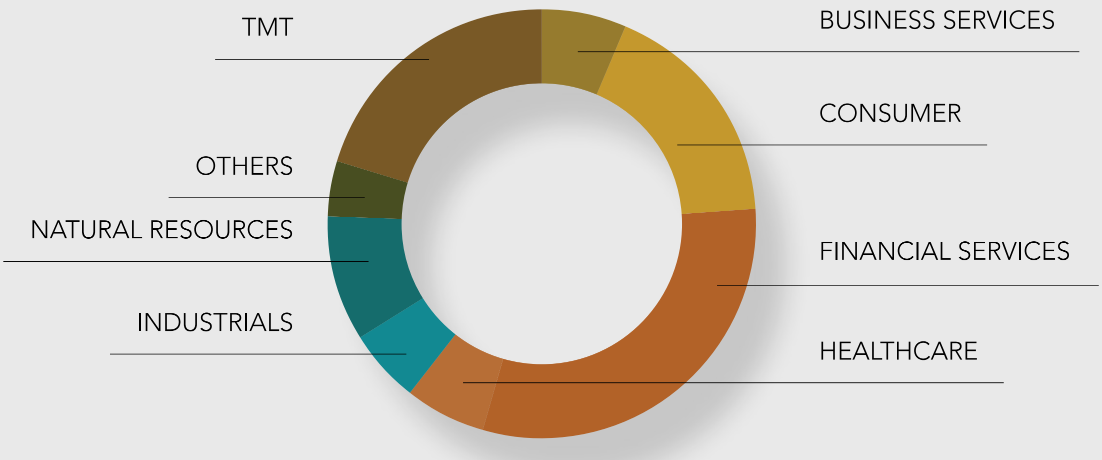

Chart 5: Last 10 Years' Private Equity Investments by Sub-Asset Class