

Australian Business Economists



CHAMP Private Equity

TRENDS IN PRIVATE EQUITY

AUSTRALIAN BUSINESS ECONOMISTS

17 April 2007

Radisson Plaza Hotel

Joseph Skrzynski, AM

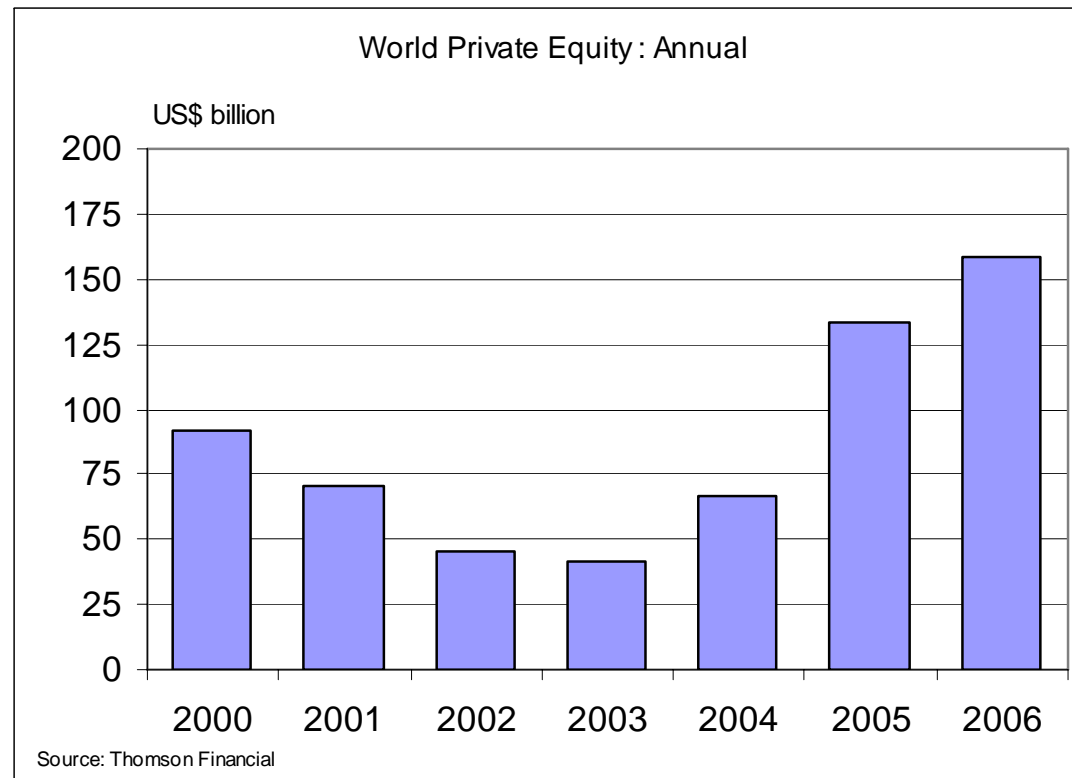
CHAMP
PRIVATE EQUITY

AGENDA

- ❑ CAPITAL FORMATION
- ❑ DEBT TRENDS
- ❑ VALUATION TRENDS
- ❑ MEDIA MYTHS

Trends : Capital Formation / Allocation

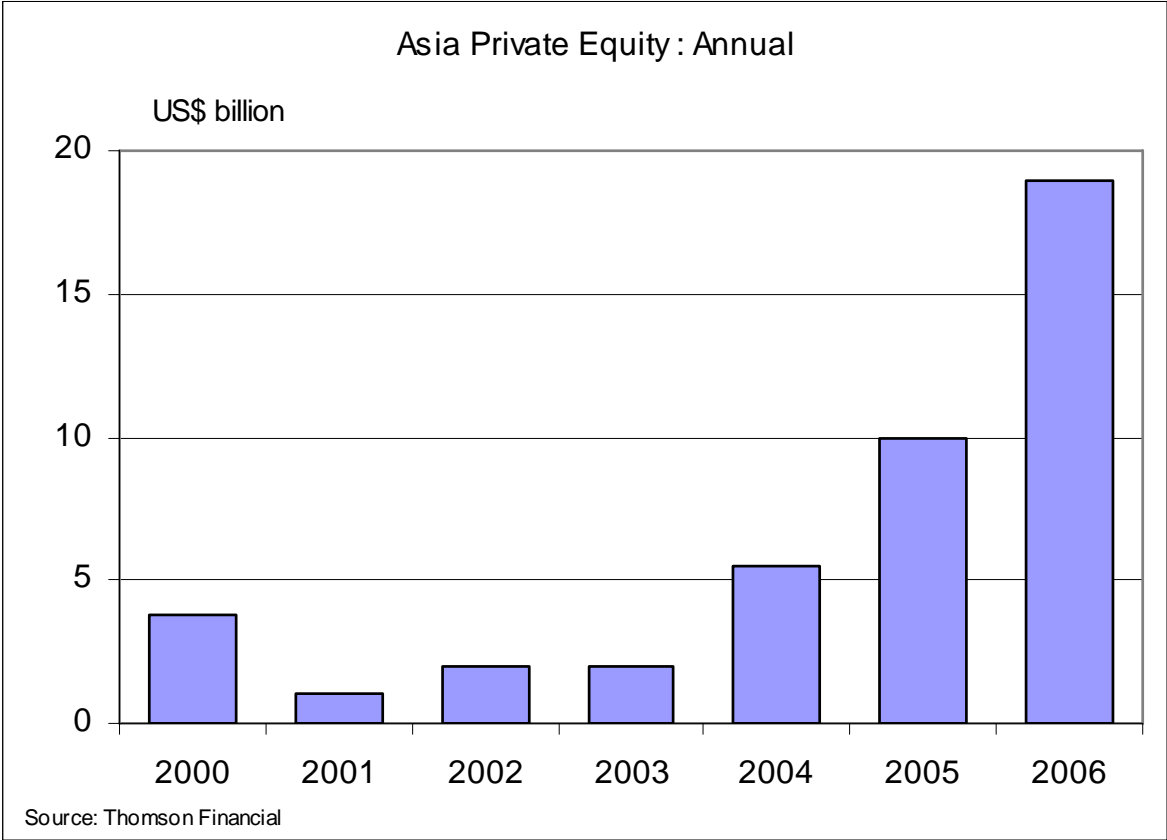
Higher allocations to alternative asset drives higher PE allocations....



Growth from 2003 nearly fourfold

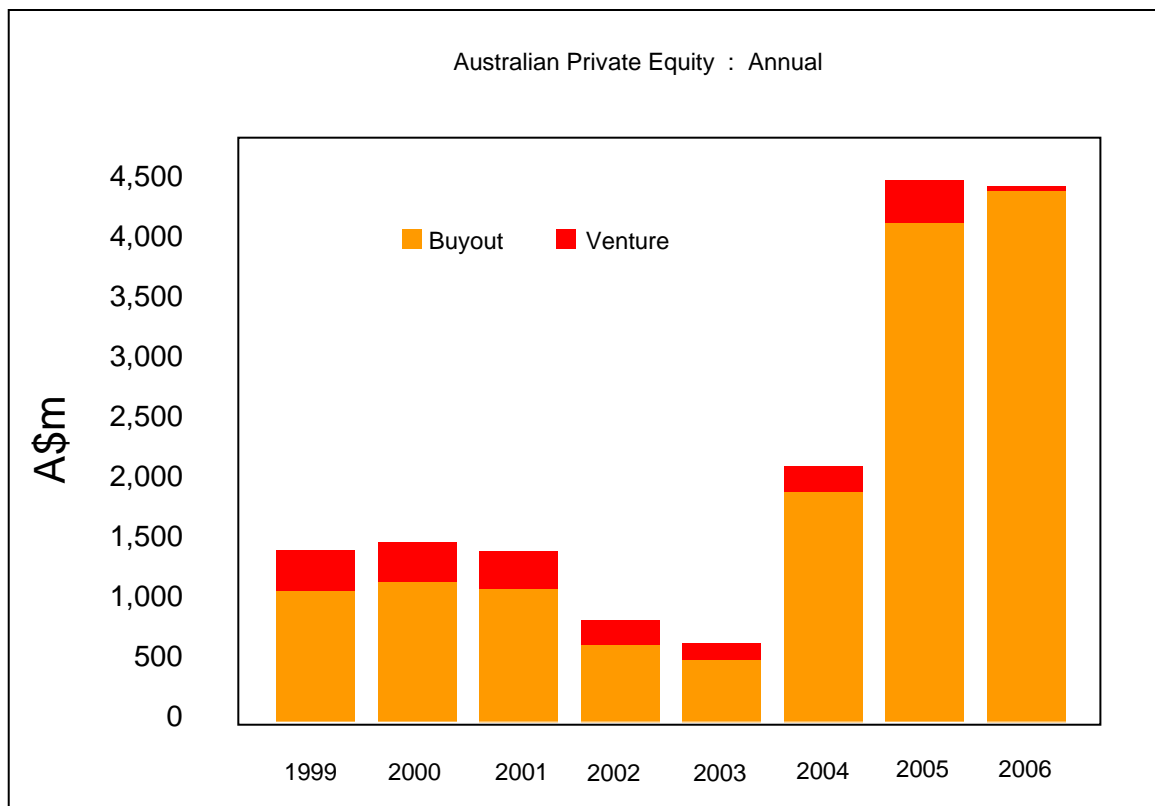
Trends : Capital Formation / Allocation

China interest drives higher Asian allocations....



Trends : Capital Formation / Allocation

Australia benefits from Asia interest.... 60% offshore LPs

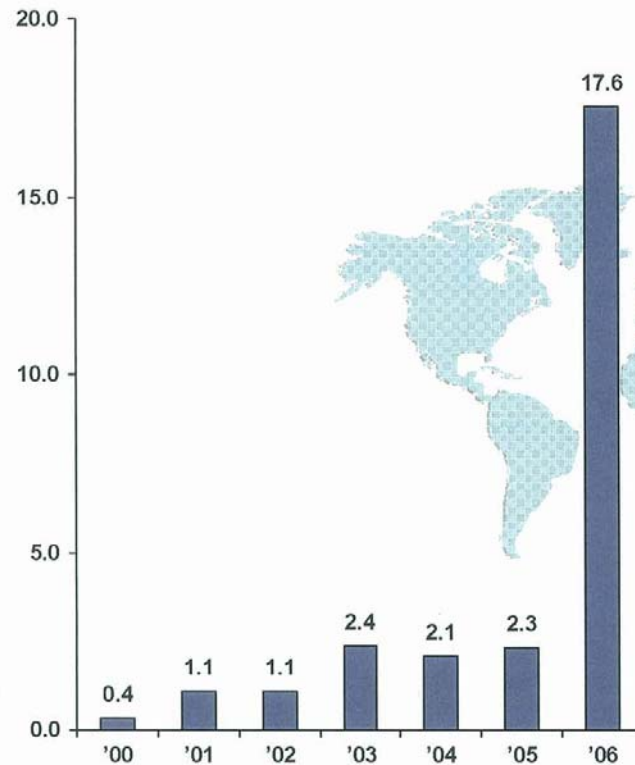


Source: Thomson Financial

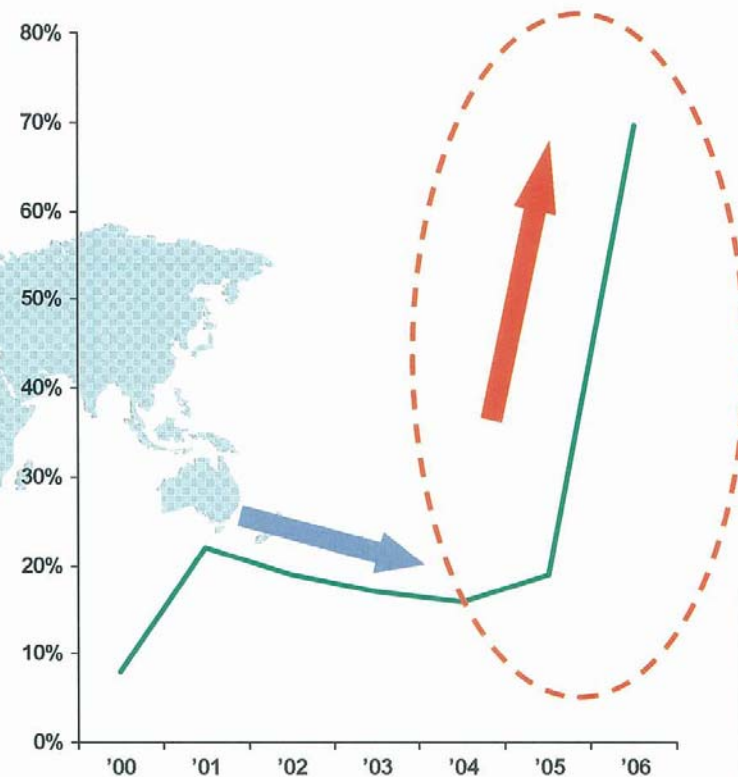
Trends : Capital Formation / Allocation

Spill over investment from Asia to Australia....

Australian PE Investments (US\$Bn) ⁽¹⁾



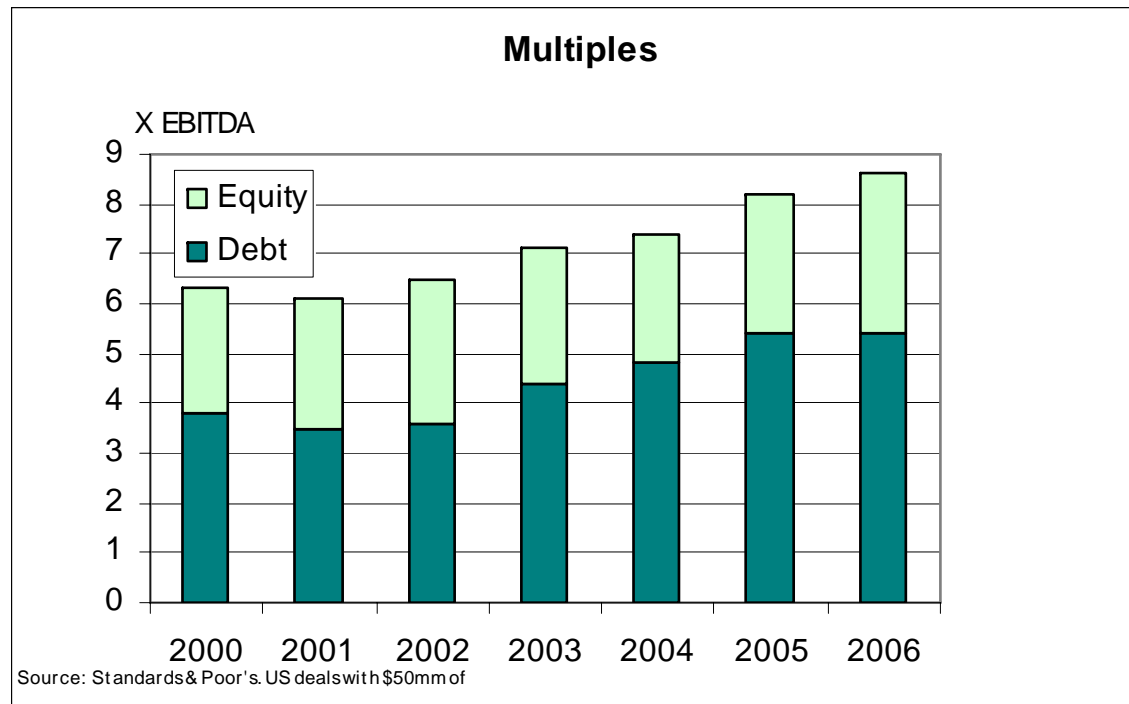
Australian PE Investments (% Asia) ⁽¹⁾



Source: AVCJ, HarbourVest estimates
Note: (1) Transaction value includes equity and debt values

Debt Trends : Debt Equity Mix

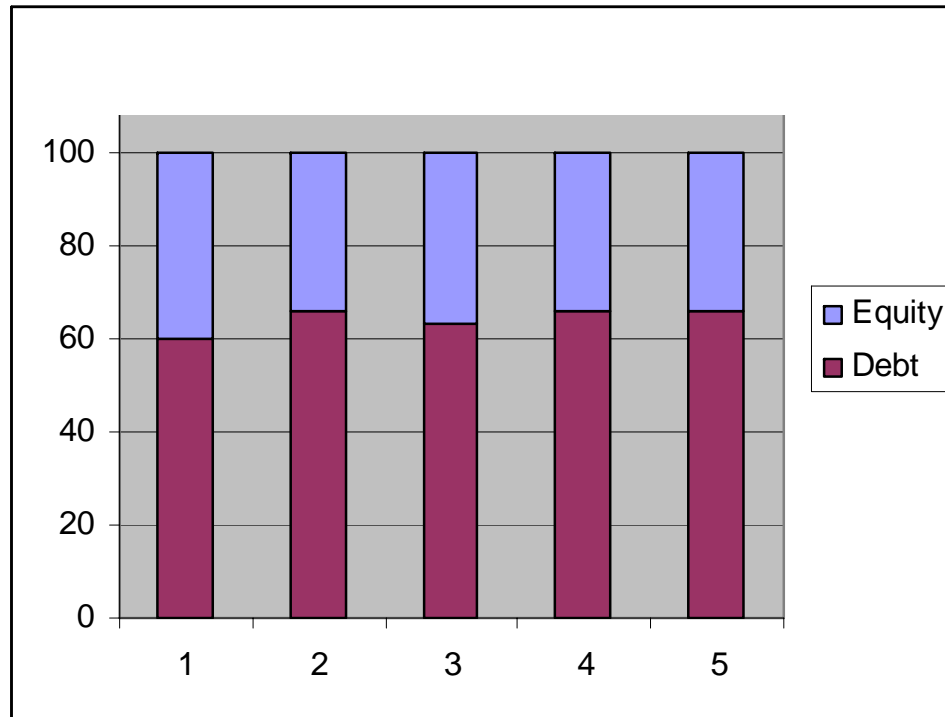
USA : Debt up, but Debt / Equity mix steady....



Unlike the 1980s, debt has not substituted for equity in the capital structures

Debt Trends : Debt Equity Mix

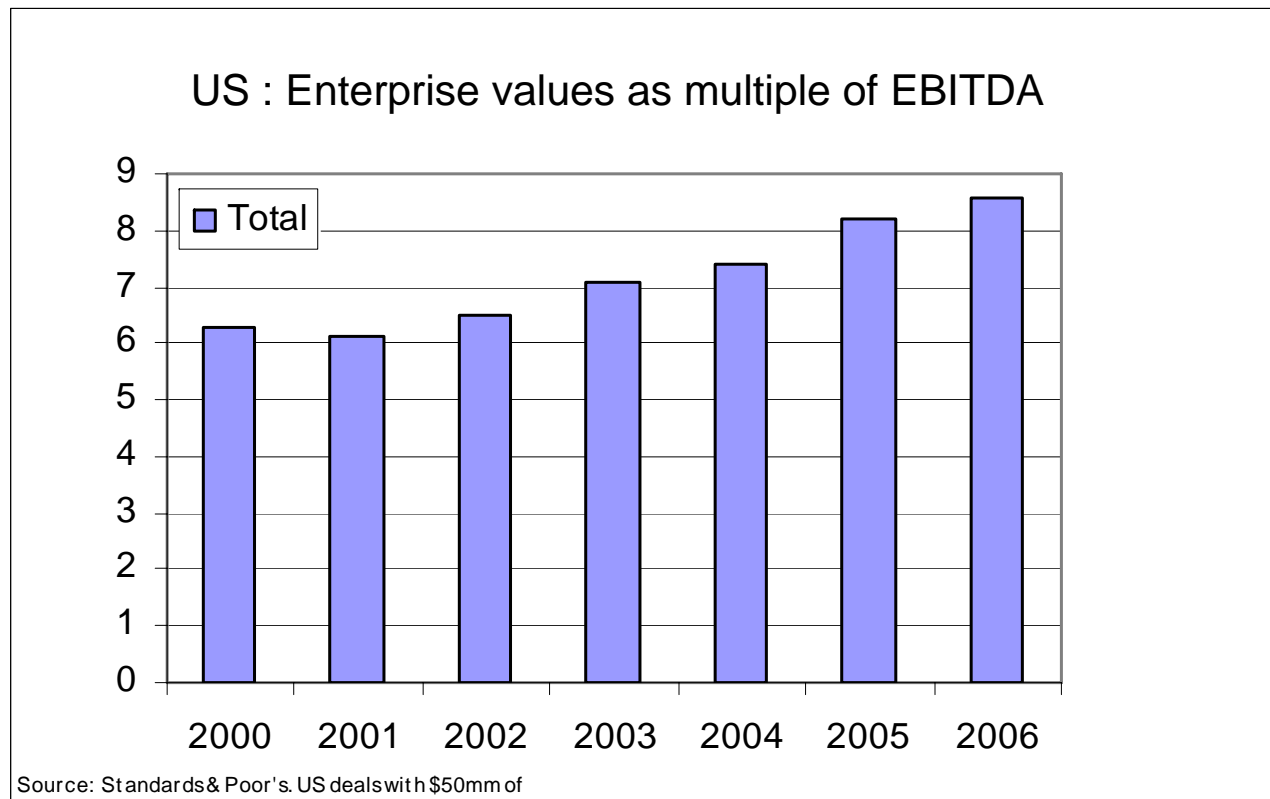
Australian Deals : Equity Steady at 33-40%....



Whilst debt multiples on two of these deals exceeded x7, a record for Australia, the debt / equity mix is conventional.

Valuation Trends

Av US valuations up 43%.... size mix effect?



Current Controversies

- ❑ **WILL PE BUY EVERYTHING?**
 - ❑ Global PE is <1% of global capital markets
 - ❑ Total US PE < General Electric
 - ❑ Asian /Australian PE <1% ASX
 - ❑ Will be 10/20% M&A activity
 - ❑ Many PE companies will re-list

Current Controversies (cont'd)

- ❑ **“BARBARIANS” STEALING, STRIPPING & FLIPPING?**
 - ❑ Deals : Only proceed if best option for vendors
 - ❑ Majority of PE deals not P2P
 - ❑ PE companies : Higher productivity, growth, jobs creation
 - ❑ IPO record good : CHAMP 10 IPOs ... IRR +30%
 - ❑ Key PE advantage : governance arbitrage

Current Controversies (cont'd)

- ❑ **PE Doesn't Pay Tax?**
 - ❑ Vendors taxed on sale to PE
 - ❑ Interest : tax neutral
 - ❑ Exit profits : LP native tax

Current Controversies (cont'd)

- ❑ **Is the Banking System at Risk?**
 - ❑ Glenn Stephens, Reserve Bank : No
 - ❑ John Laker, APRA : No
 - ❑ Reality, total PE minor % debt pool
 - ❑ Overseas, 50% PE loans non-bank, rising

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THE ROLE OF PRIVATE EQUITY IN THE ECONOMY AND THE INFLUENCE OF SUPERANNUATION FUNDS

John Evans

Faculty of Business,
UNSW

Role of Private Equity

- The major role of private equity is to provide finance for establishment and development of enterprises (medium and large), and in this process private equity also acts as a stimulus to rationalisation of inefficient enterprises and industries

Why Private?

- Less public scrutiny.

Investment Horizon

- Private equity usually has a surprisingly short investment horizon

Financing

- Private equity typically uses a small amount of equity capital and a larger amount of debt capital

The (intended) Result?

- To move the acquired business to a more efficient stage of its evolution by concentrating on shareholder returns and taking the restructured company to public ownership or trade sale

The Risks

- Unable to make intended changes
- Interest rates
- Competitor reactions

The Experience

- Just 9 per cent of European M&As were "completely successful" in achieving their stated objectives. (Hay Group)
- Two-thirds of M&As fail to deliver the expected benefits. (KPMG)

Superannuation Fund Influence

- Superannuation funds with long term objectives see private equity as a source of return and they expect to earn more from this than from exchange traded securities

2005 Australian Survey (Adveq & UNSW)

- Survey of 40 large superannuation funds with \$120 billion assets
- Average allocation of 4.5% of assets to private equity

2005 Nordic Study (Adveq and Stockholm School of Economics)

- Euro 30 billion assets
- Average allocation of 4.5% with not much expected change in 2~5 years
- The “home base” bias is also evident

New Funds

- The Australian Future Fund and the NZ Superannuation Fund are both expected to grow to over \$100 billion each in a few years and both have a high commitment to private equity

The Drivers

- Expected return enhancement and risk management
- Both Australian superannuation funds and the Nordic institutions were looking for a value add relative to exchange traded securities of around 5% pa

The Tears??

- No doubt some high profile disasters will occur
- Modest value add expectation indicates lower risk appetite
- BUT, we have to watch the supply side and it may be that margins will get squeezed, and some managers will take on the higher risk deals, and that could result in tears (for the members of superannuation funds in particular)

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Dr Ken Henry
Secretary to the Treasury
Annual post-Budget Address

Tuesday 15 May '07
Sheraton on the Park Hotel

abe.org.au