AUSTRALIAN INVESTMENT COUNCIL
The voice of private capital

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# Will the rise of private capital tip the balance of investment power?

Australia PE & VC market: Key trends

**August 2019**

The better the question. The better the answer.
The better the world works.

> The rise of private capital indicates a new era for Australia's investment market, characterised by increasingly influential investors along with new investment models. Importantly, the emergence of private capital in Australia comes at a time when public markets are increasingly focused on short-term investor expectations at the expense of long-term growth initiatives.

**Milan Milosevic**
EY Oceania Private Equity Leader

> As our industry continues to grow, we're well positioned to reap the opportunities presented to us by a changing private capital landscape. More engagement from institutional investors, solid and consistent returns and more focus on responsible investing lay the foundations for private capital to have an even more prominent impact on our economy and communities well into the future.

**Yasser El-Ansary**
Australian Investment Council Chief Executive

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# Executive summary

## Will the rise of private capital tip the balance of investment power?

**As private capital matures and broadens and institutional capital fragments (both international and domestic), local institutions will need to be more active to better align their investment criteria and ensure optimal performance. This global trend, coupled with increasing shareholder activism, will be a key influence in the Australian market, providing institutional funders with greater opportunities and more control.**

Australia's focus on the ASX and listed equities continues to be a key theme for Australian retail and institutional investors. However, underlying the heavy weighting to the listed market is a growing and increasingly material private capital market, looking to target consistent, and repeatable net returns more than listed market references. The rise of private capital and deep pools of alternative capital are creating opportunities where major institutional banks are narrowing their investment horizons.

The view of Australian institutional investors is changing in relation to Australian listed investments. This is evident in increasing influence and proactive strategies that target improvement in financial performance, management incentives, governance and transparency, and building better alignment with members on community expectations and each business's social licence and purpose statement.

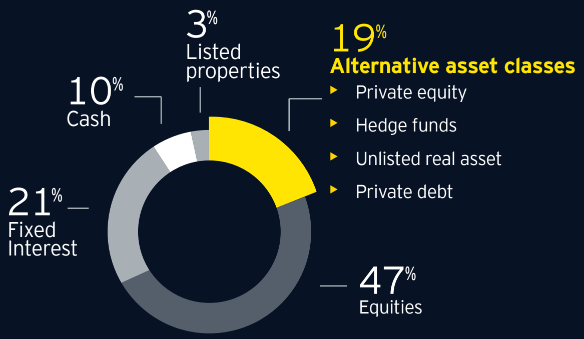
This maturing, re-defining and broadening of the private capital asset class, together with comparable returns and a sustainable impact on economic drivers such as growth, employment, and M&A activity, are enticing more institutional investors to above market returns (alpha).

Private Capital's "secret sauce" is active management and a laser-like focus on business strategy and execution. This includes a model of concentrated ownership, alignment of stakeholders' interests and increasingly the ability to fund businesses during the various stages of maturity delivering a valuable and critical role in the future of the Australian and global economies.

### What will this mean for Australia's investment market?

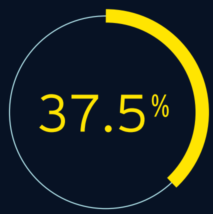
Traditionally, super funds have made substantially larger allocations to real assets and domestic listed equities than their global peers. But now, local trustees are increasing allocations into alternatives. This will both reshape the listed market and require super funds and other institutions to take a new and more assertive role in ensuring their investments deliver.

### Superannuation Scheme Allocation




### Superannuation funds invest cautiously in PE

Across Australia, superannuation funds have been cautious while investing in PE funds. This is primarily due to the costs associated with fees caused by concerns over the timely exits and expensive nature of PE returns. According to the Association of Superannuation Funds of Australia (ASFA), superannuation schemes allocate 47% of total assets to Australian and international equities, 21% to fixed interest, 10% to cash and 3% to listed property. This leaves only 19% to be allocated across various alternative asset classes, such as private equity, hedge funds, unlisted real assets and private debt.

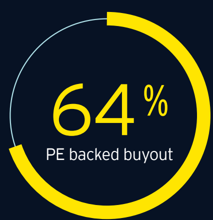



Limited partners co-investing with GPs

### The role of Limited Partners in Australia is evolving

Since the requirement for greater transparency into fee structures is growing around the globe, Limited Partners (LPs) in Australia are also pushing for an increased involvement in investing to better track performance. This has seen a steady progression of the LP role from an investor in funds, to becoming a partner with GPs in deals. According to Preqin, out of the total LPs based in Australia and having Australasia as an investment focus, 37.5% are already co-investing with GPs and 22.5% of them are considering co-investing in the near future.

### Increase in deal value




**200%**

VC Deals

### Australia's environment ripe for investment

Despite questions over asset pricing and political uncertainty in mid-2018, foreign investors with a war-chest of dry powder are attracted to Australia's low-risk environment and rapid adoption of latest technologies by its corporates. Consequently, in 2018 PE-backed buyouts and VC deals in

Australia recorded an increase of 64% and 200% respectively in aggregate deal value compared to the previous year.

**48** Funds Closed | **$12.7b** Aggregate capital raised

Australia closed 48 funds in 2018 with US$12.7b of Aggregate capital raised across private equity, venture capital, real estate, natural resources, infrastructure, special situations, etc. Industry-wide dry powder for Australasia stood at US$14.8b, up by 6% from US$14b in 2017. The growth in dry powder reflects a consistent theme of higher levels of allocated capital towards private markets across global developed economies. Dry powder for North America and Europe increased by 12.2% and 11.8%, respectively in 2018 as compared to the previous year.

## Expected increases in infrastructure assets

Expected increases in 'core-plus' assets

Land titles registries

Data centres

Smart metering

**Continued focus on infrastructure**

The majority of global investors consider Australian infrastructure assets to be stable, significantly lower in risks, and offering attractive returns compared to other asset classes. With ever-increasing funds under management, institutional investors will continue to invest significantly in infrastructure assets. Interest from institutional investors in 'core-plus' assets such as land titles registries, data centres and smart metering assets is expected to increase.

**After a bullish run until 2018, the Australian IPO market is likely to face challenges in 2019**

Driven by uncertainty in macroeconomic and political conditions in global markets, and with fund managers and institutions pushing hard on pricing, likely challenges are ahead. The PE industry is expected to witness limited sell-side opportunities and a continued trend towards trade sales as the favoured exit path.

EY's Global IPO trends report published in December 2018, highlighted that investors in Australia will continue to be selective in which larger IPOs (by deal size) they invest in, restricting IPO volumes at the top end of the market in 2019. IPO activity will instead focus on small cap issuers, especially technology, and metals and mining companies.

## Forecast of increasing IPO Activity

Small cap issuers

Technology

Mining & Metals

**Active management becomes the key to maintaining returns**

Increasing competition from offshore investors, the increasing public to private (P2P) push by private equity, the search for continuing return performance and investment alignment is impacting the way institutional investors are influencing their invested capital. It's going to be a material change for listed equity executives, who are used to receiving institutional support.

Super funds have already articulated higher expectations of their listed investment performance. The partnership between AustralianSuper and BGH could be the first of many such P2P arrangements. The discussion amongst sophisticated institutional investors is turning towards how they can utilise the influence of their capital base to bring about positive economic, financial and societal change, while delivering strong after-fee returns to their members.

**The relationship with listed Australian equities will change**

The trend in the US is for companies to stay private for longer. This has resulted in the number of listed companies falling by 50% over the past 20 years. Whilst in Australia the data is yet to demonstrate the same dramatic shift taking place, anecdotal evidence is pointing to the same outcome. As deeper pools of capital become available for businesses to access, the conceptual arguments around the need to take companies into public markets to raise capital will diminish.

**Growth in overseas investment**

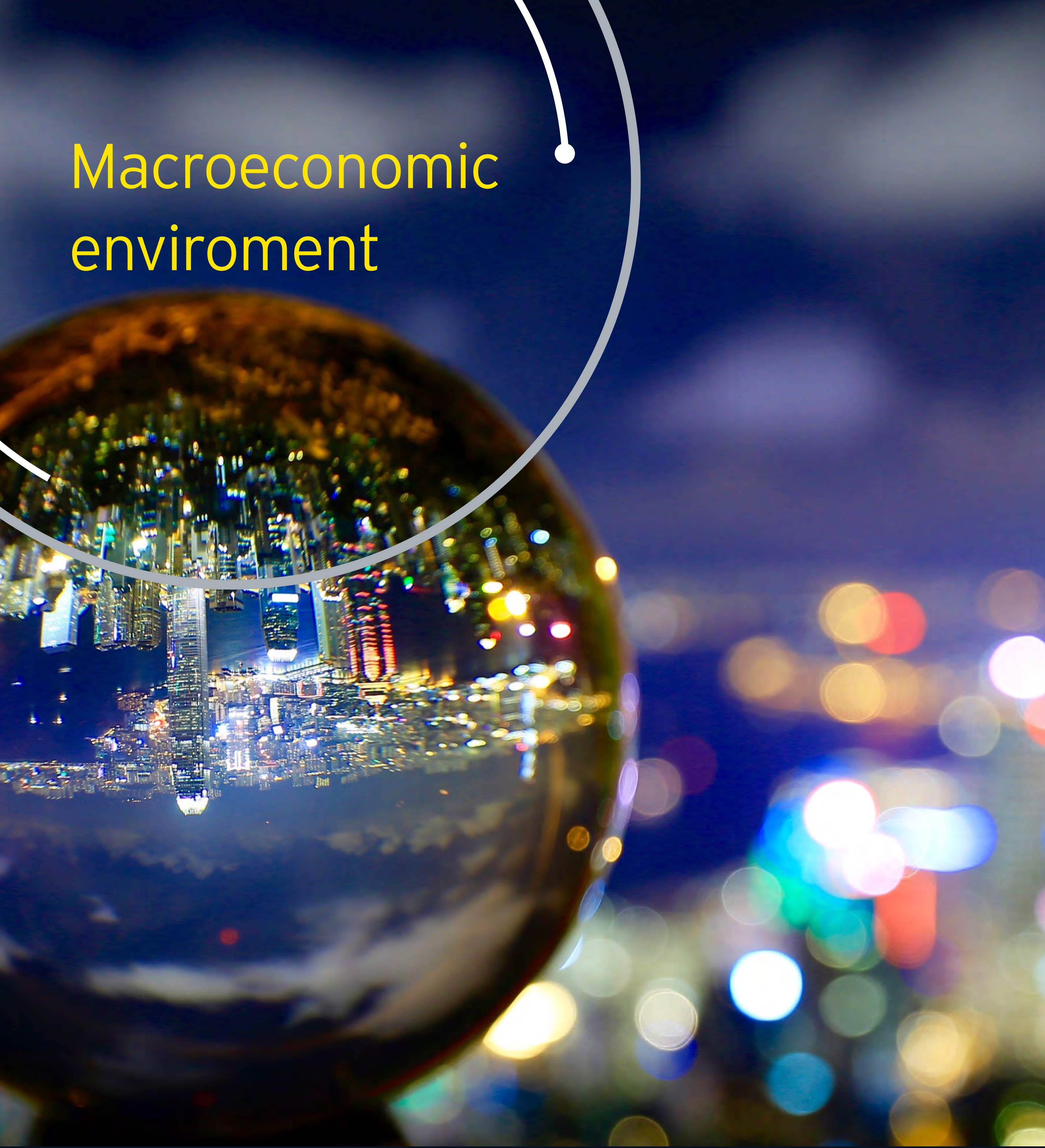
Australia's solid regulatory regime and traditional market have long made us a drawcard for offshore investors. The growth of private capital fund raising, combined with an ability to leverage the US and China, will see the volume of overseas investment continue to increase over the next few years.

With the private capital market gaining momentum, Australia will soon have institutional investors that are much more capable, aware and analytically enabled than ever. The implications for Australia's entire investment market will be profound.

Expanding the private capital reach will provide investors with deeper funding sources to invest and grow opportunities. The trend by Institutional Investors to increase their target allocations to private capital is accelerating. This deepening pool of capital is increasing the ability to fund through the maturity cycle and will enable companies to stay private for longer, creating a scaled and strong market for capital outside the traditional listed markets in Australia.

The changing role of superannuation in Australia, leveraging its strong global position, is key to maximising the opportunity for retiring Australians and drive better, and more sustainable outcomes for Australian businesses.

# Macroeconomic enviroment



Institutions are now increasing their target allocations to a broad range of private capital including credit, senior, special situation and venture funds, and even family offices.

# Australia entered 2019 riding on a wave of positive economic growth with investor confidence intact

**Public and private capital markets have suitably responded to Australia's favourable macroeconomic growth outlook. Generally, global public markets have witnessed a decline in the number of listed entities, whilst the Australian Securities Exchange saw a marginal incline.**

**Notably, with growing household consumption, a rising level of exports and the drag from falling investment in mining, the economic growth prospects for the country are expected to be well on track for at least the foreseeable future.**

### Economic overview

Australia's nominal GDP in 2018 of AU$1.9t (US$1.4t) was a growth of 3.5% in US$ terms over 2017. The country's long span of positive output growth continues, demonstrating the economy's resilience to shocks. Continued robust output growth of around 2.6% is projected in the near future.

Growth in the Australian economy in the last year was broad-based buoyed by household consumption, dwelling investment, public demand and exports.

GDP per capita increased marginally from AU$72.6k (US$55.7k) in 2017 to AU$75.1k (US$56.7k) in 2018.

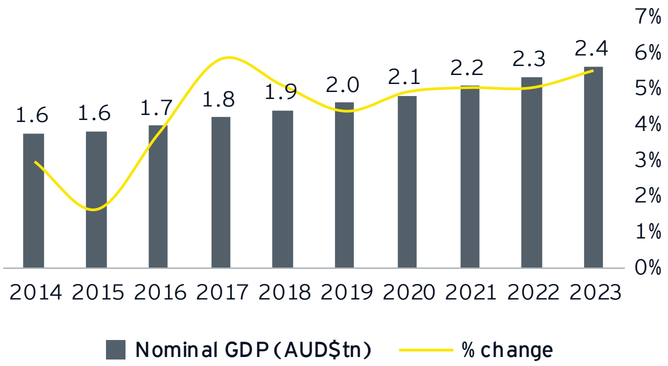
### Declining unemployment

Australia's labour market has been equally resilient, with rising employment and labour force participation, with unemployment declining from 5.6% in 2017 to 5.3% in 2018.

According to a report by the Reserve Bank of Australia, the majority of employment growth over the past year was in the manufacturing, construction, professional services, scientific and technical industries.

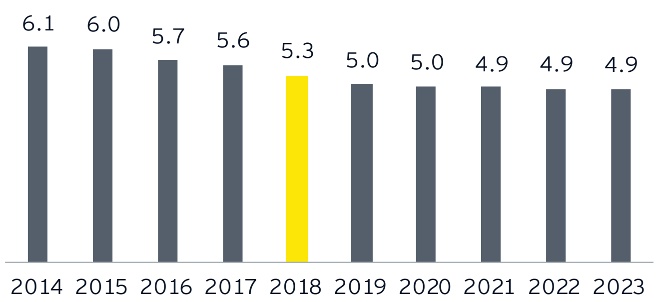
The increase in the manufacturing sector's employment is in line with the increase in manufacturing output over the past year, supported by strong growth in export demand for food products, strong demand related to building activity in the eastern states, investment in defence and a modest increase in demand from the mining sector.

Nominal GDP (AUDt) and percentage y-o-y change




Source: IMF

Unemployment rate (%)




Source: IMF

### Change in prices remains flat

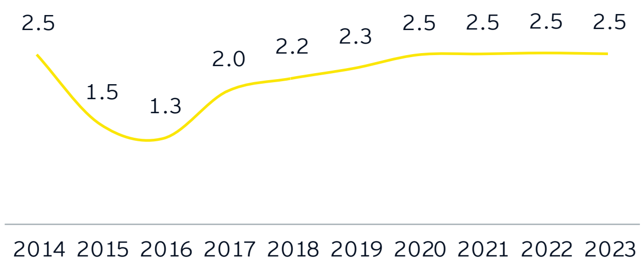
Australia witnessed a very marginal increase in CPI inflation from 111.2 in 2017 to 113.6 in 2018.

Although inflation is expected to rise as the economic recovery matures, prudent monetary policy guided by an explicit CPI inflation target for the RBA (of 2-3%) will limit the pace of price rises in the long run.

### Growth in retail investors

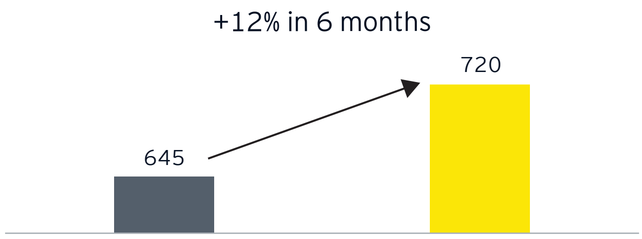
Low dormancy, strong client reactivation, and healthy inflows of new-to-market investors led the number of Australian retail online investors to surpass 700,000 for the first time by the end of May 2018.

**Inflation, average consumer prices (%)**

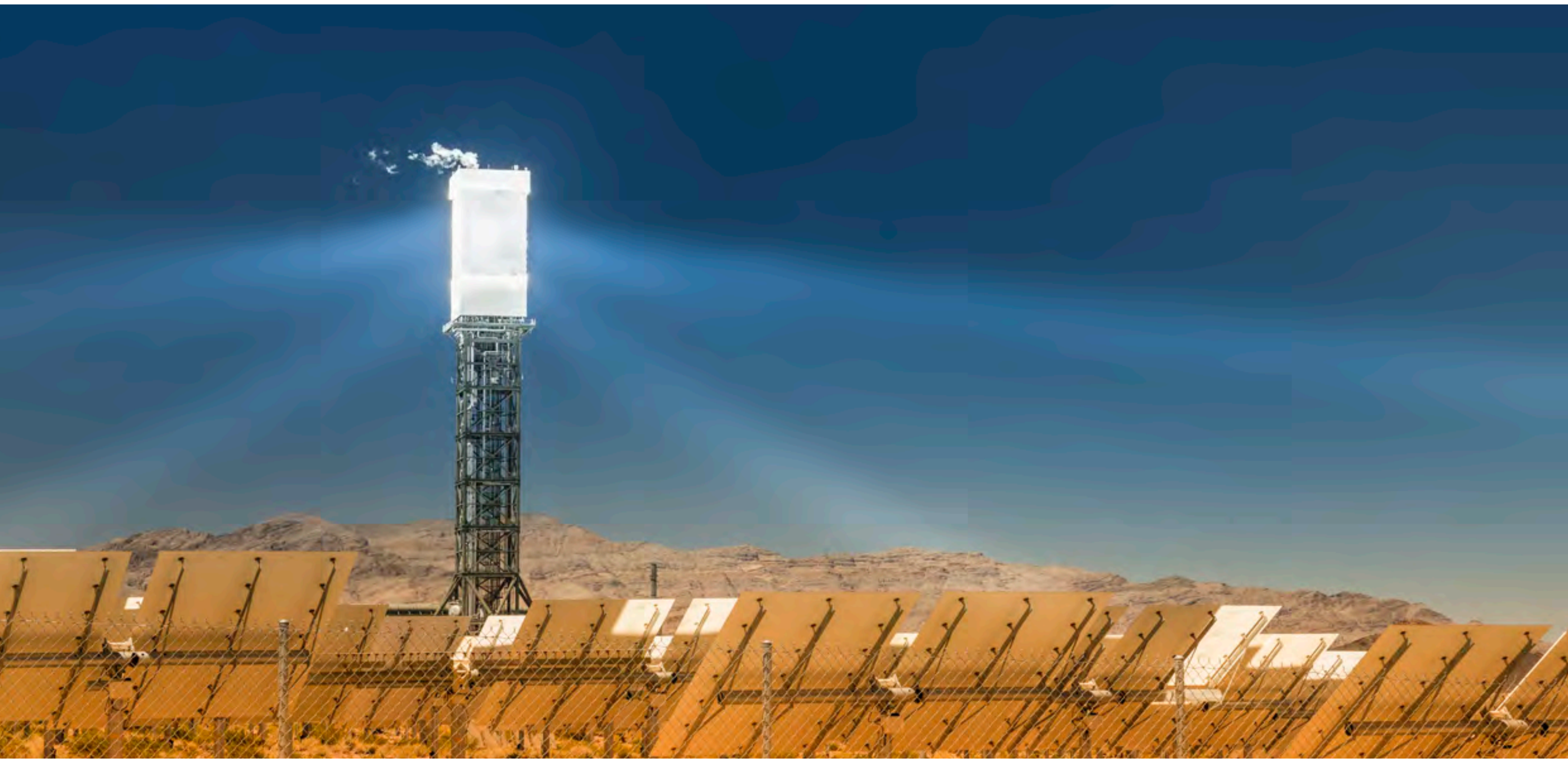



Source: IMF Economic Database, Reserve Bank of Australia, EY analysis

**Number of retail online investors ('000)**

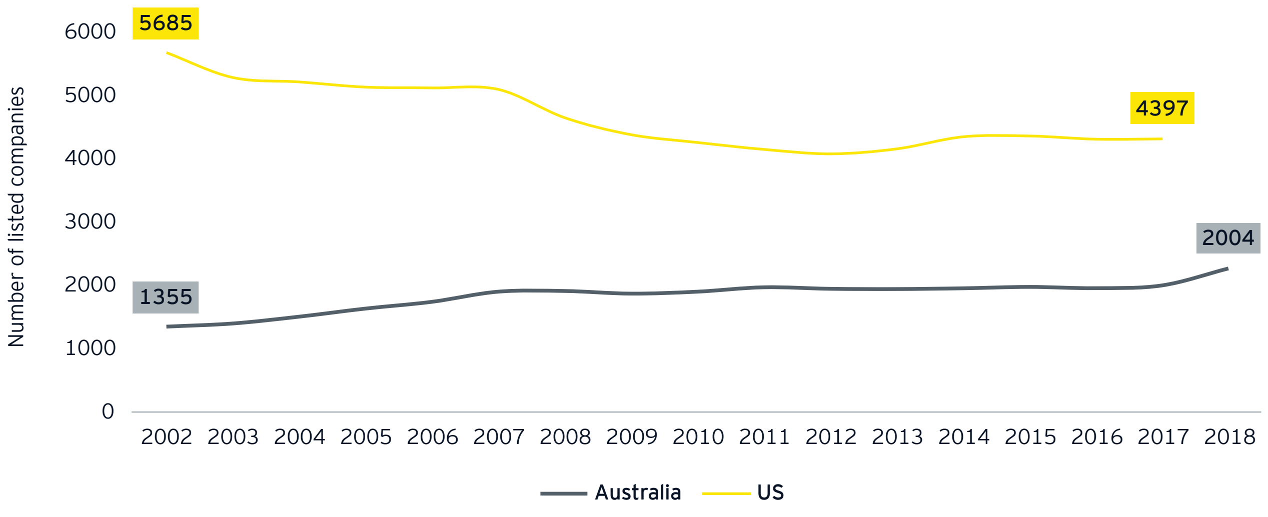



Source: Money Management



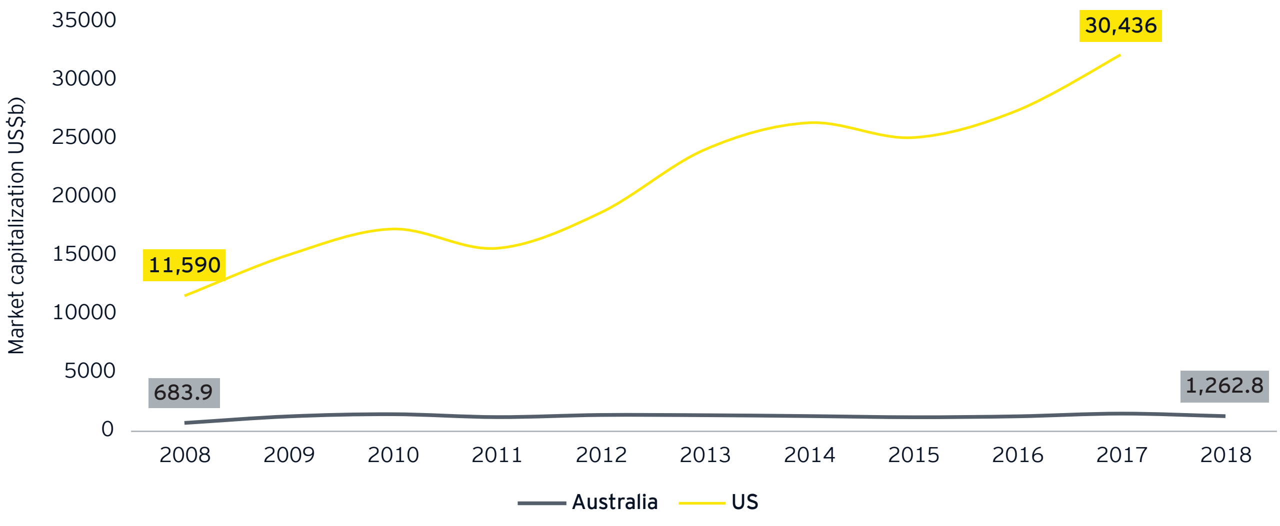
## While shrinking public markets are limiting the playing field in the US, Australia's growth was relatively flat in market capitalisation of listed entities

**Number of publicly listed companies in Australia and US**




Source: World Development Index Database, World Bank

**Domestic Equity Market Capitalisation (US$b)**




Source: World Development Index Database, World Bank
Note: US data not available for 2018

### Trends in other economies

| Country | Number of listed entities (2002) | Number of listed entities (2017) | Increase/Decrease in listing (Percentage change) |
|---|---|---|---|
| US | 5,685 | 4,397 | -22.7% |
| Australia | 1,355 | 2,004 | 47.8% |
| New Zealand | 149 | 131 | -12% |
| Indonesia | 330 | 619 | 87.8% |
| Malaysia | 857 | 902 | 5.3% |
| Singapore | 321 | 482 | 50.2% |
| Philippines | 233 | 264 | 13.3% |
| Thailand | 398 | 704 | 76.9% |
| Vietnam | 162* | 373 | 130% |
| India | 5,650 | 5,065 | -10.4% |
| Japan | 2,119 | 3,652 | 72.3% |

Source: World Development Index Database, World Bank
Note: *For Vietnam, number of listed entities stands as of 2008.

The US witnessed a 23% decline in the number of listed entities from 2002 to 2018. This was driven by the reluctance of highly valued companies to go public and an increasing number of public to private deals. Private companies in the US preferred to raise late-stage venture and other private capital on equal or better terms and with lesser regulatory burden than in the public markets.

In contrast, the number of listed entities in Australia increased significantly since 2002 driven by a strong interest of companies for listing on the ASX which has lower valuation requirements and plenty of appetite for tech stocks. The success of domestic listed tech companies such as WiseTech, Afterpay, Altium, Appen and Xero has also driven the increase in public listing of firms in Australia.

Noticeably, Southeast Asian countries witnessed an increase in public listings such as Vietnam which recorded the highest increase of 130%, mostly driven by stable economic growth, favourable government policies and cheaper valuations. Meanwhile, Singapore saw an increase of 50% in public listings since 2002. The introduction of dual-class share structures enabled the Singapore Stock Exchange to support high-growth companies and attract blockbuster listings from around the world, while broadening options for investors.

An increase of 72% in public listings in Japan was primarily driven by a strong and steady performance of the country's large corporations and a stable Nikkei 225 Index. Strong Abenomic reform policies, Japan's hosting of the Rugby World Cup in 2019 and the Olympics in 2020 are contributing to country's strong economy.

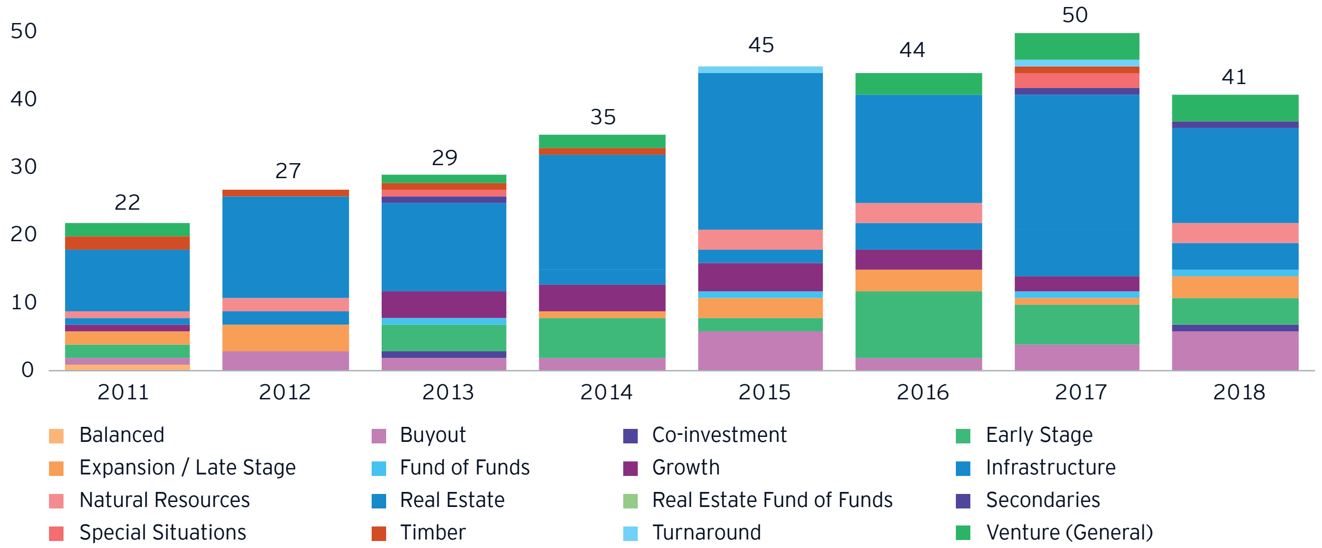
# State of play in private capital

**The strong historical performance of private capital markets in Australia sets the background for future capital flows and deployment through private investments.**

# Investor enthusiasm towards the private capital market in Australia has increased significantly in recent years

**Domestic fund managers had access to varying and deeper pools of funds over the last few years. It is reflected strongly in the fundraising environment which has picked up pace significantly in the past decade. The trend is evident from doubling of the number of funds closed (including interim closes) and aggregated capital raised tripling between 2011 to 2018.**

**Number of Australian-based funds closed (including interim closes)**

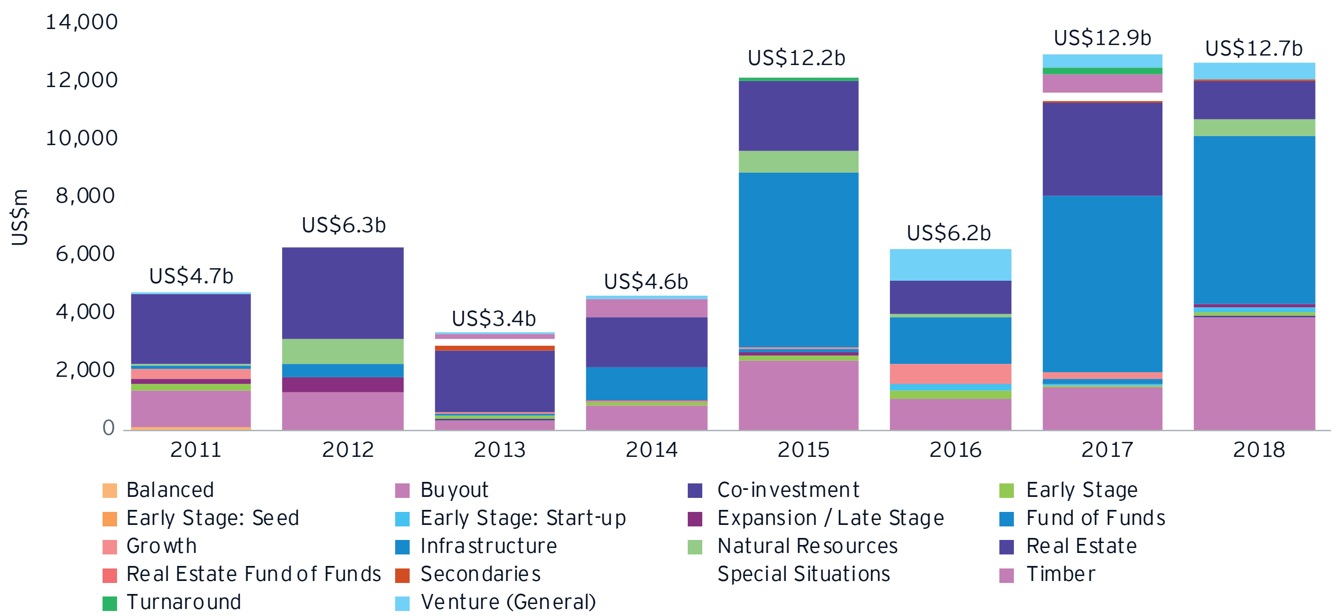



Source: Preqin

Since 2008, **Infrastructure** has remained a key theme for fundraising as 28% of the capital raised until end of 2018 was committed to the sector. **Buyout** (27%) and **Real Estate** (27%) were the other fund types contributing significantly to capital raised by Australian based firms in the past decade.

Notably, capital committed towards **Early Stage** investment in 2018 more than doubled from the year before. Reflecting investor confidence and in line with regional trends, **Venture** fundraising increased by 1.4 times by Australian based firms last year.

**Capital raised by Australia-based funds (incl. final and interim closes)**




Source: Preqin

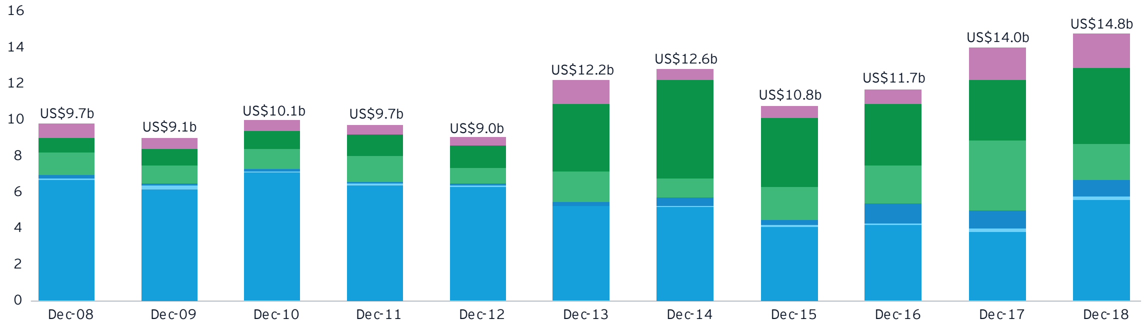
# Fund managers have a more than sufficient war-chest at their disposal indicating an upsurge in deal activity in the future

Dry powder committed for investment in Australasia reached a record level at the end of 2018. The growth in dry powder reflected a consistent theme of greater allocated capital towards private markets across developed economies and resulted in a large amount of cash stock piling awaiting deployment. Fund managers were under pressure to identify innovative deal structures in order to accelerate investment processes whilst holding back from overpaying for an acquired asset.

The following will play pivotal roles going forward: leveraging digital analytics for deal sourcing; adhering to stringent due diligence processes; building value creation strategies pre-acquisition; and assessing the stability of the cash flow model.

Fund managers, now more than ever, are required to make analytics-driven investment decisions to ensure their future success and keep investor confidence intact.

**Dry powder committed for investments in Australia**

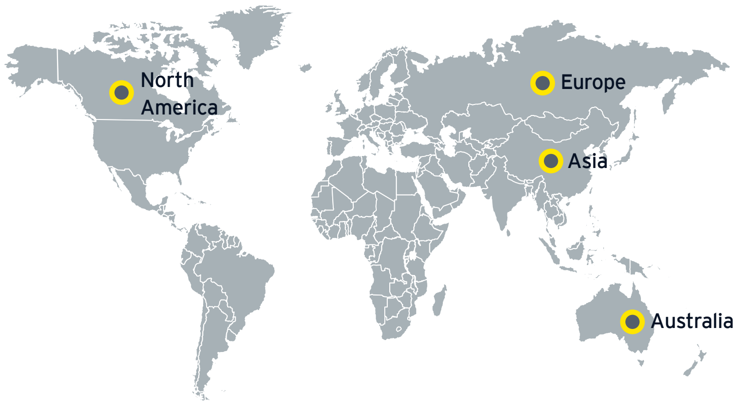



Source: Preqin

Global dry powder allocation — Australia versus global regions

**North America**
2017: US$936.8b
2018: US$1050.9b
Change: **12.2%**

**Rest of World**
2017: US$77.3b
2018: US$74.5b
Change: -3.6%




**Europe**
2017: US$371.0b
2018: US$414.7b
Change: **11.8%**

**Asia**
2017: US$310.60b
2018: US$352.9b
Change: **13.6%**

**Australia**
2017: US$14.0b
2018: US$14.8b
Change: **6%**

Source: Preqin

In 2018, Australia witnessed a 2% decline in private capital fundraising and a 70% increase in PE and VC deployment activity (by value). Consequently, it led to a small increase of 6% in dry powder available for investment from US$14.0b in 2017 to US$14.8b in 2018.

In Asia, PE houses have ventured into Southeast Asia, where recent changes in market regulations and the proliferation of new technologies led to the emergence of new opportunities. Warburg Pincus, KKR and TPG have all made sizable investments in Indonesia and Vietnam, while Morgan Stanley Private Equity Asia raised over US$440m in Nov 2018 for a Thailand-focused fund (North Haven Thai Private Equity LP), thereby, leading to an increase in dry powder.

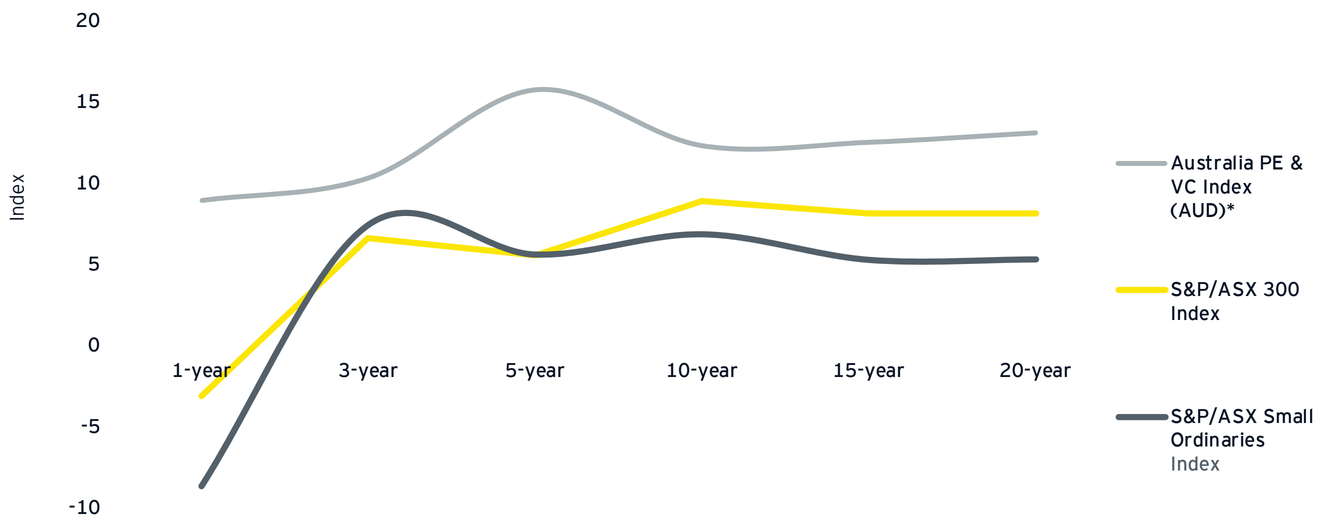
North America experienced an increase of 12.2% in dry powder due to the closing of some of the largest mega funds during 2018. These included Carlyle Partners VII (US$18.5b), Hellman & Friedman Capital Partners Ix (US$16b), and Sequoia Capital Global Growth Fund III (US$8b).

In Europe, the increase in dry powder is attributed to the success of PE firms in fundraising, in part driven by a relatively unchanged macroeconomic environment, with continuing low interest rates and PE's prospects of higher returns than in public equities.

# Australian PE and VC investments outperforming public equities indicate an attractive private capital market

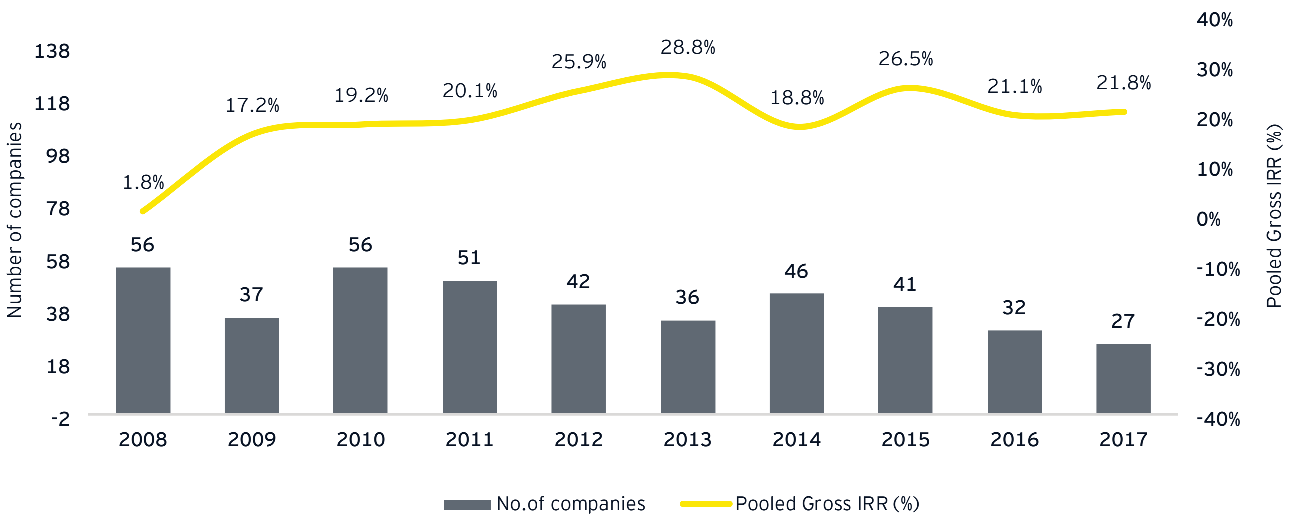
**The Australian PE & VC index performance was ahead of public markets by 200 to 400 basis points according to the Q3 2018 PE and VC Benchmark Index report published by the Australian Investment Council (formerly AVCAL) in partnership with Cambridge Associates. This strong performance has set the backdrop for future capital flow deployment through private investments.**

**Horizon Pooled Return (as of 31st December 2018)**




Source: Cambridge Associates' Private Investments Database, September 2018
*Note: The index is a horizon calculation based on data compiled from 102 Australia private equity & venture capital funds, including fully liquidated partnerships, formed between 1997 and 2018

**Pooled Gross IRR* (%) of companies receiving initial investment in 2008 to 2017**



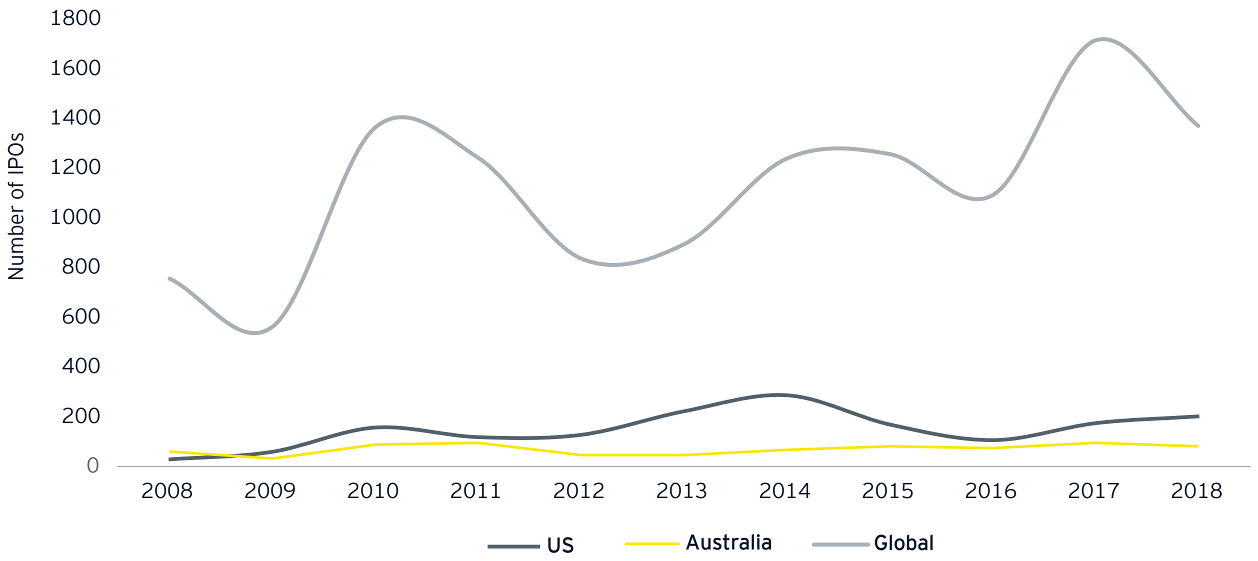

Source: Cambridge Associates' Private Investments Database, December 2018

*Note: Internal Rate of Return

# The growing private capital market means IPOs are no longer the primary source to fund growth or access liquidity

**Growth in Australia's IPO market remained almost flat as many IPO candidates ended up rethinking their listings. EY's Global IPO trends report published in December 2018 highlighted that investors in Australia will continue to be selective in which larger IPOs (by deal size) they support, restricting IPO volumes at the top end of the market in 2019. IPO activity instead will focus on smaller cap issuers, mining and metals and technology companies.**

**Number of IPOs (2008 – 2018)**



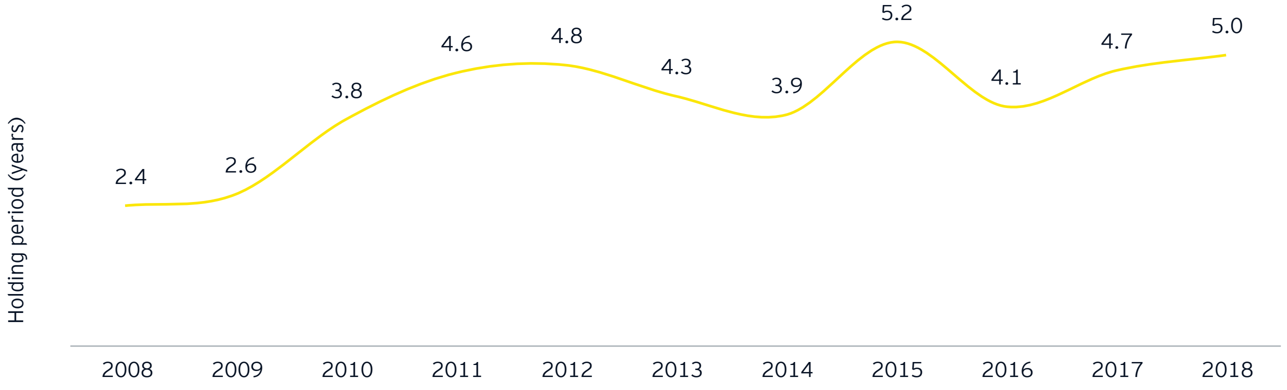

Source: EY Global IPO Trends, 4Q18

Businesses exploring opportunities to access funds for liquidity or investing in future growth are increasingly evaluating private capital options.

In addition to gaining flexibility in capital structure, firms are seeking private capital benefits from the industry expertise that private capital providers, such as PE firms, have built and aim to leverage these specialised skills for pursuing future growth of their organisations.

With the ease of obtaining private capital, businesses are preferring to stay private for much longer as evident in the increase of the median age of firms at the time of exit which shot up by 108% between 2008 and 2018.

**Holding period for Australia-based exits (years)**




Source: Preqin, EY Analysis

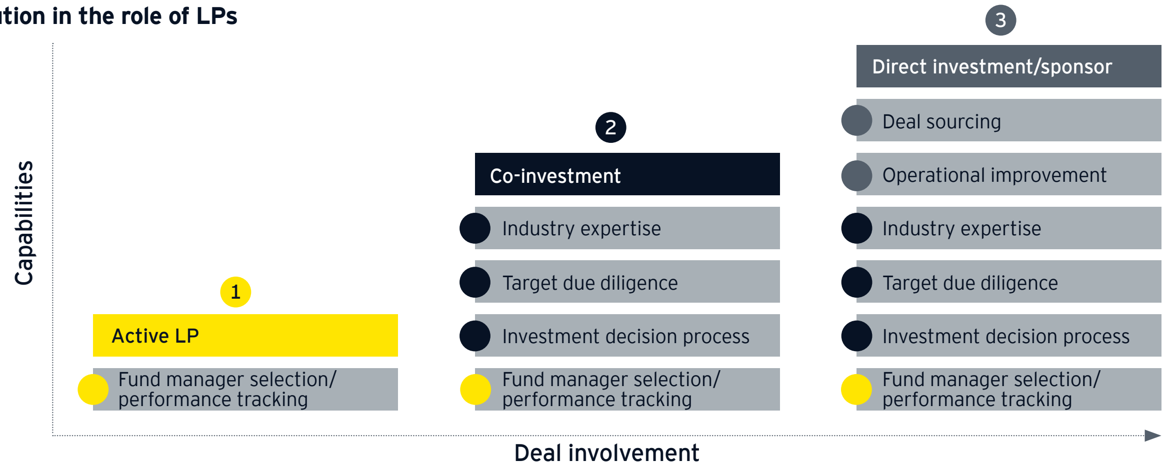
# Evolving role of Limited Partners

**The role of Limited Partners is evolving to directly invest or co-invest alongside experienced GPs to boost returns and retain greater control of their capital. As a result, institutional investors are becoming more capable, aware and analytically enabled than they ever were.**

# The role of LPs is steadily evolving from an investor in funds, to becoming a partner with GPs in deals

**In line with global trends, the relationship between institutional investors and fund managers in Australia has evolved over the past decade with GPs now expected to deliver higher returns and LPs are expected to offer a higher capital. A drive to lower investment management fees is often considered the main factor behind rising LP co-investments and direct deals.**

**Evolution in the role of LPs**

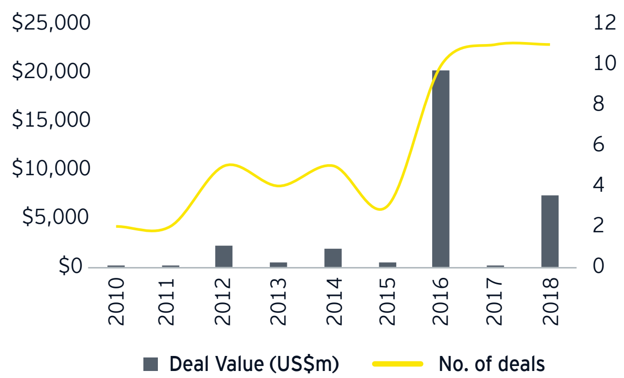



PE firms are increasingly competing on deals with institutions who traditionally would have been their core clients. LPs see the advantage of a direct investment approach which includes the potential for better returns and the absence of the traditional two and 20 fee structure.

Direct investing carries risks and LPs will need to ensure they hire experienced and qualified private equity professionals to mitigate any challenges.

**Direct investment by LPs**

Direct investments by LPs based in Australia




Source: Pitchbook

According to Pitchbook, direct PE and VC investments by LPs based in Australia spiked significantly in 2016, with deal value increasing to US$20b from US$0.4b in 2015.

Further, according to another source, Preqin, out of total LPs based in Australia and having Australasia as an investment focus, 37.5% are already co-investing with GPs and 22.5% of them are considering co-investing in the near future.

Similarly, regarding the LPs based outside Australia but focused on Australasian investment, 41% are already co-investing with GPs while 11% are considering the same.

There are multiple factors contributing to these rises. By directly investing or co-investing alongside experienced GPs, LPs can boost returns as well as retain greater control of their capital.

The option to co-invest has been increasing as GPs entice LPs to contribute with the attraction of fee discounts. Since the need for greater transparency into fee structures is growing around the globe, LPs are pushing for increased involvement in investing as a way to better track performance.

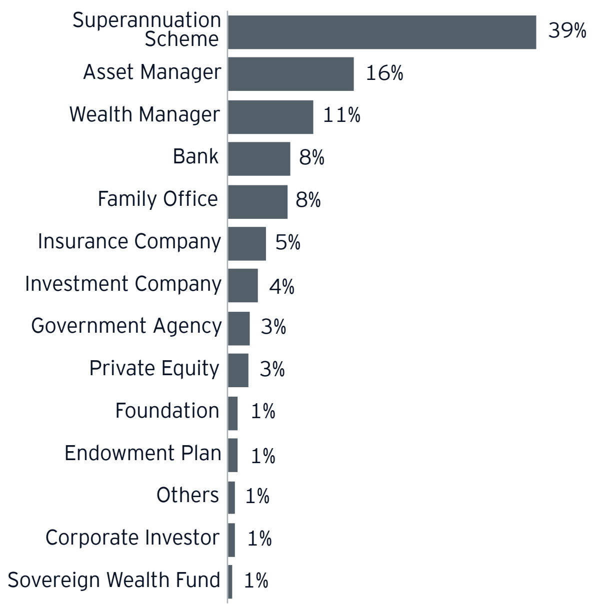
Sources: Preqin, Factiva, Pitchbook and EY analysis

# Different investor groups heading towards the private capital market are increasingly seeking co-investments alongside GPs in pursuit of higher returns and control

**Fund managers have access to a diverse and deep capital pool. This allows flexibility of investments to capitalise on, including innovative deal structures to pursue complex acquisitions.**

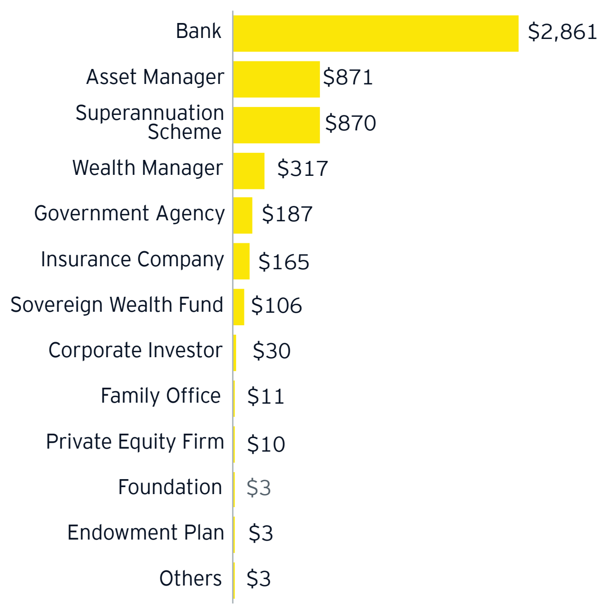
**Investor profile:** Investor mix in the Australian private capital market and aggregate funds under management held by respective investor type.

**Investor type as a % of total investors in the market**




Source: Preqin

**Aggregate funds under management of each investor type (US$b)**

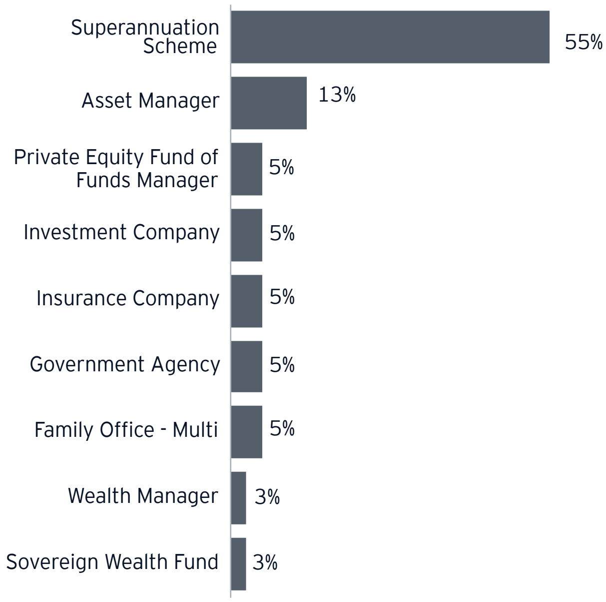



Source: Preqin

Increasingly, investors are seeking co-investment, and consequently, are allocating more capital to the deal type. Fund managers need to exhibit superior capability and sector expertise to make investors realise the value in partnering with them on deals.

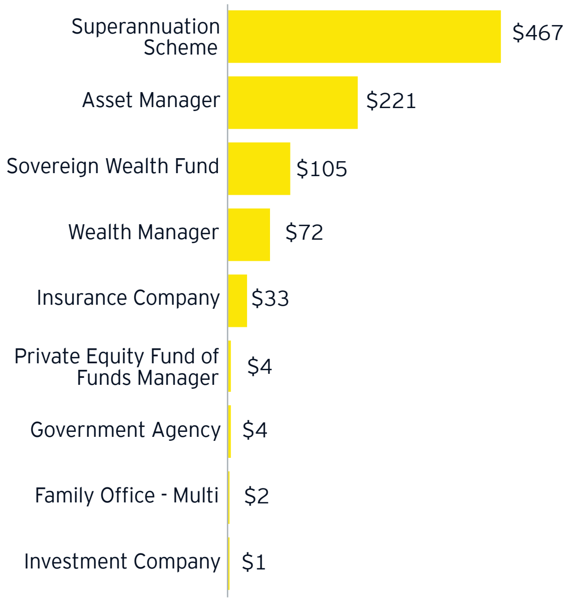
**Co-investor profile:** Investor mix in the Australian private capital market and aggregate funds under management held by investors which are seeking co-investment.

**Co-investor type as a % of total investors in the market**




Source: Preqin

**Aggregate funds under management of each co-investor type (US$b)**




Source: Preqin

# List of top 20 investors based in Australia that co-invest alongside GPs

| Investor | Type | Funds under management (US$b) | Current allocation to PE (%) |
|---|---|---|---|
| AMP Capital Investors | Asset manager | 135.1 | NA |
| Future Fund | Sovereign wealth fund | 104.9 | 15.80% |
| AustralianSuper | Superannuation scheme | 102.6 | 3.20% |
| MLC | Wealth manager | 72.1 | 5% |
| QIC | Asset manager | 61.5 | 6.80% |
| QSuper | Superannuation scheme | 61 | 5% |
| First State Super | Superannuation scheme | 53.7 | 2% |
| SunSuper | Superannuation scheme | 39.3 | 5.90% |
| Construction and Building Industries Superannuation Fund | Superannuation scheme | 34.3 | 4.30% |
| Commonwealth Superannuation Corporation | Superannuation scheme | 32.1 | 5.80% |
| HESTA | Superannuation scheme | 29.6 | 3% |
| HOSTPLUS | Superannuation scheme | 26.2 | 7% |
| Perpetual Investments | Asset manager | 22.4 | NA |
| Government Employees Superannuation Board | Superannuation scheme | 19.7 | 2.80% |
| Transport Accident Commission | Insurance company | 10.3 | 0.40% |
| CareSuper | Superannuation scheme | 9.3 | 4% |
| Local Government Superannuation Scheme | Superannuation scheme | 8.6 | 5% |
| MTAA Superannuation Fund | Superannuation scheme | 8.4 | 1.70% |
| Mine Super | Superannuation scheme | 7.6 | NA |
| Tasplan | Superannuation scheme | 6.3 | 0.5% |

Source: Preqin

Note: The above table gives top (on basis of Funds under Management) 20 LPs (investors) based in Australia and having Australasia as a major geographic focus.

# Superannuation funds

**Increasingly, super funds, and other institutions, are taking a more assertive role in ensuring all their investments deliver appropriate returns - a material change for listed equity executives, who are used to receiving benevolent institutional support.**

# Superannuation funds, constituting 39% of the investors in the private capital market, remain the key growth driver

**As per the statistics released by the Association of Superannuation Funds of Australia (ASFA), superannuation schemes allocate 47% of total assets to Australian and international equities, 21% to fixed interest, 10% to cash and 3% to listed property.**

**The remaining 19% is allocated to various alternative asset classes, such as private equity, hedge funds, unlisted real assets and private debt.**

**Australia's $2.8 trillion superannuation industry has demonstrated a strong commitment to investment in alternative assets. This is expected to increase alongside the growth of the industry and the desire for diversification as market forces change.**

### Investment considerations

**Alternative structures:** Co-investments, joint ventures and separate accounts are gaining more prominence in serving as differentiated and cost-efficient vehicles through which superannuation funds can penetrate into real estate investments.

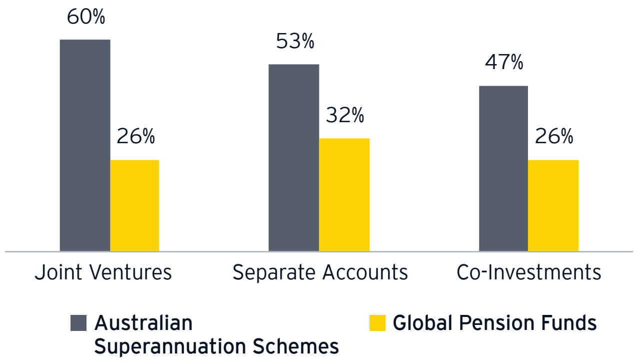
**Strong affinity towards real estate:** Despite prevalent views that real estate prices are artificially inflated, superannuation funds have increased allocation to the asset class. Over 95% of Australian superannuation schemes have a regional preference to invest in the domestic real estate sector attributed to factors such as tax breaks, capital gains shelter and tax benefits.

**Infrastructure play:** Australian superannuation schemes look to infrastructure as a source of stable return, as asset classes are often defensive and income generating in nature for most superannuation funds' investment portfolios. Core infrastructure assets are predominantly favoured among the industry according to Preqin data.

**Caution towards PE:** The expensive nature of PE returns, due to costs associated with fees, has led superannuation funds to consider the asset class weighted towards PE fund managers over investors. Timely exits are also a concern. Amidst these concerns, superannuation funds have been cautious when investing in PE funds.

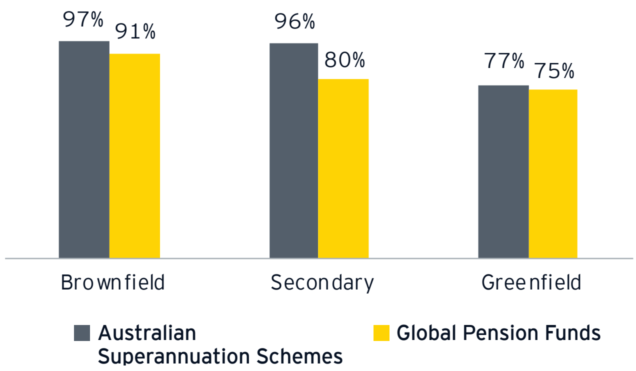
**Diversification plan:** Superannuation funds appreciate the optimistic side of PE investments. In a survey conducted by Preqin, some superannuation funds expressed the view that PE provides good returns and diversification. They highlighted the importance of understanding the effects of previous years on a superannuation fund's portfolio and finding a manager with a solid track record.

**Appetite for Alternative Structures:**
Australian Superannuation Schemes vs. Global Pension Funds




Source: Preqin

**Project Stage Preferences of Investors in Infrastructure:**
Australian Superannuation Schemes vs. Global Pension Funds




Source: Preqin

# Infrastructure investing

**Australia's robust economy and transparent business environment creates an ideal climate for many firms to finance, construct and manage major infrastructure assets.**

# The majority of global investors consider Australian infrastructure assets to be stable, significantly lower in risk, and offering attractive returns compared to other asset classes

Infrastructure development has been a core focus area for the Australian Government. The sector has played a critical role in shaping public policy.

Superannuation funds, which constitute a staggering 39% of the investors in the private capital market, are strongly inclined to invest in the domestic infrastructure market space.

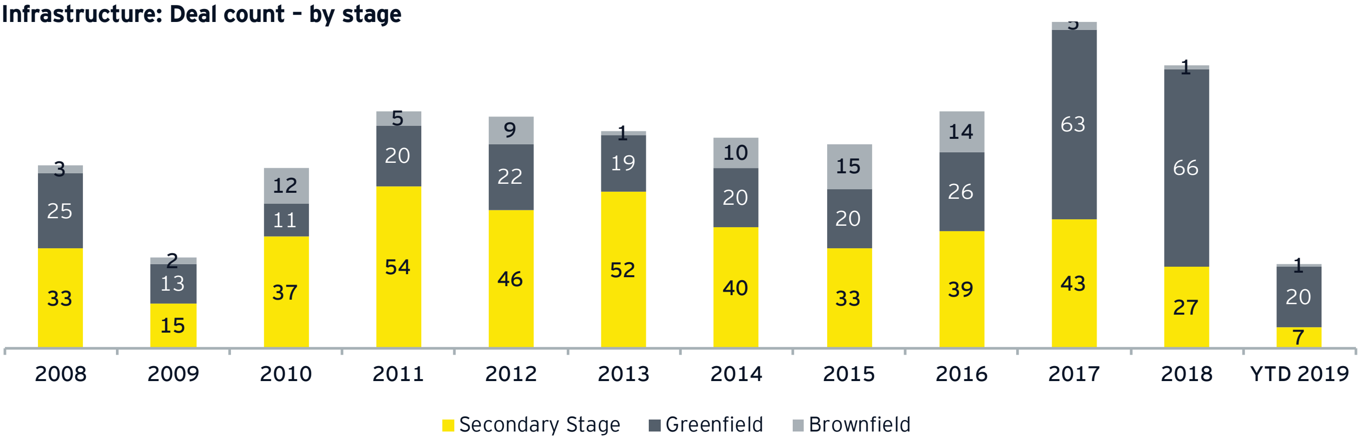
Superannuation funds value the benefits associated with the ease of accessing and managing infrastructure assets.

Core infrastructure assets in Australia are favoured in the industry. Preqin data suggests that Australian superannuation schemes have a greater preference for brownfield (97%) and secondary (96%) investments than their global pension fund counterparts.

Fund size determination is one of the key considerations for Australian superannuation funds regarding infrastructure. As per recent survey results published by Preqin, a good proportion of superannuation schemes cited that a substantial amount of 'buy-in' capital is required to invest in infrastructure to see any material returns on their overall portfolio.

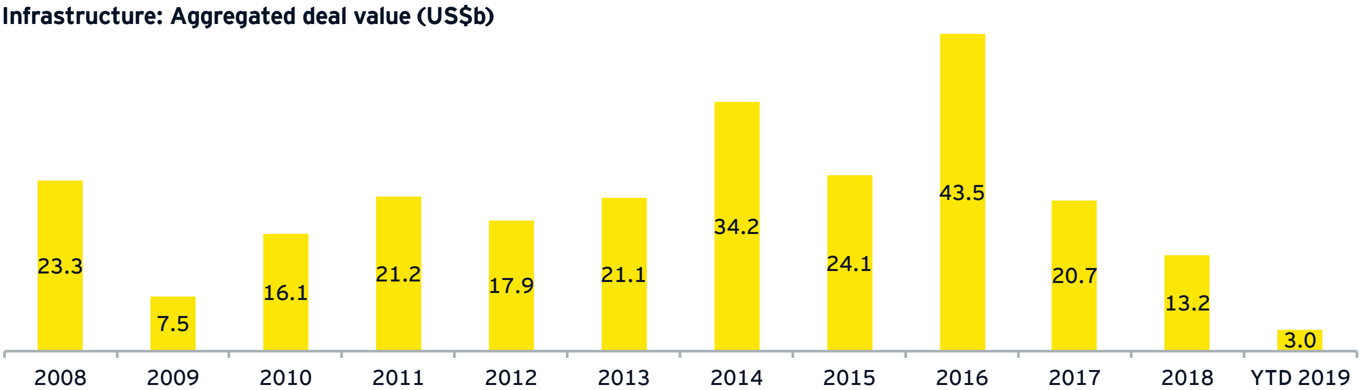
However, political risk, competition for assets and uncertainty in some of the key sectors, like energy, are key challenges and present a potential downside for investment in infrastructure.

**Infrastructure: Deal count - by stage**




Source: Preqin

**Infrastructure: Aggregated deal value (US$b)**




Source: Preqin

Note: *YTD refers to 25th Jun 2019

# Deal landscape

**In the mature US market, the trend is for companies to stay private for longer. This will in turn see the rise of a scaled and strong market for capital outside Australia's traditional listed markets, challenging the current timing/basis for companies to seek an initial public offering, and reducing the volume of companies on the ASX.**

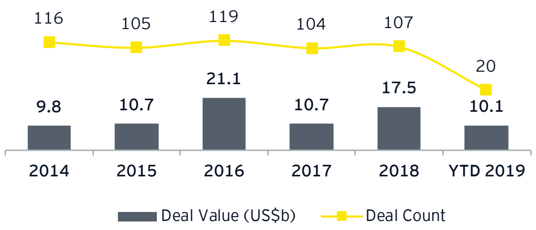
# Fund mangers have access to a record level of capital and are required to prioritise the deployment process

The private investment market environment in Australia has seen mixed activity over the last several years. Due to a greater focus on fundraising, a competitive market environment, and macroeconomic uncertainty, number of GPs have waited to put their capital to work.

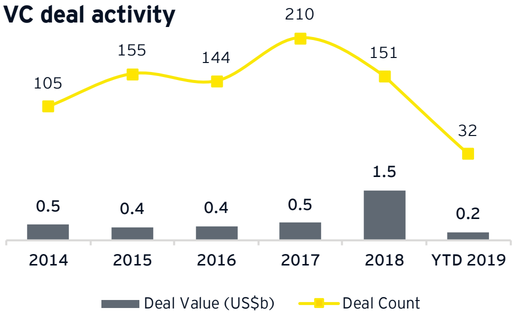
In 2018, the mountain of dry powder competing for limited opportunities, combined with elevated EV/ EBITDA multiples across many sectors, resulted in PE sponsors to become innovative and flexible in their capital deployment strategies. In response to the higher level of entry valuations, buyside activity saw increased levels of public-to-private transactions, as cashed up GPs turned their sights to ASX listed targets trading at reasonable or attractive valuations. In 2019, the Australian PE market looks to become ever more complex as it continues to surge.

2018 witnessed strong PE investment activity, both in terms of aggregate deal value and the volume of deals. VC deal value improved in 2018, despite a fall of 28% in deal volume. In the largest deal of 2018, WestConnex was acquired by a consortium formed by AustralianSuper, Abu Dhabi Investment Authority, and Transurban for US$6.7b. In the past year, PE bidders were increasingly prepared to form consortia with other PE players, superannuation funds and/or cashed-up corporates, making it easier to acquire larger listed targets. The consortium structure adopted in the acquisition of Healthscope by BGH Capital alongside AustralianSuper, Australia's largest superannuation fund and Healthscope's largest individual shareholder, is perceived as the beginning of a new phase in PE in Australia, with large superannuation funds participating as a bidder directly, as opposed to a subsequent syndication or passive co-investment.

**PE deal activity**




**VC deal activity**

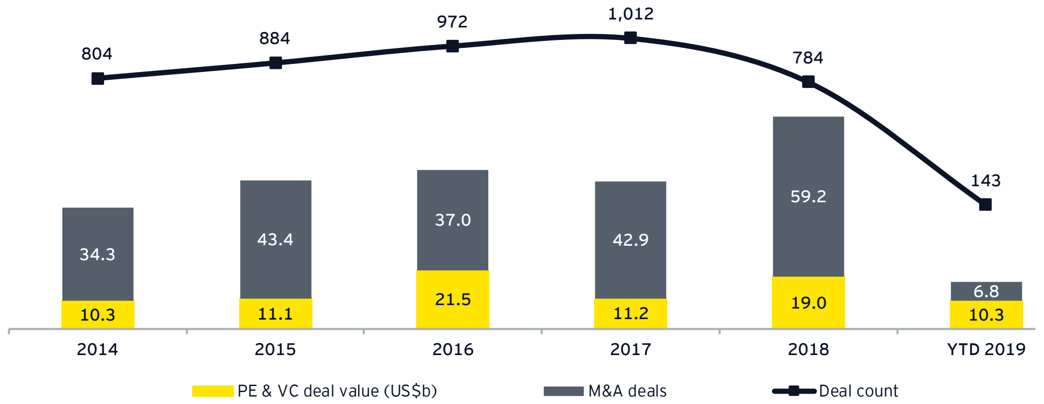



Source: Pitchbook

## Aggregate deal landscape

The overall deal making environment in Australia remained encouraging in 2018 as the average ticket size witnessed an incline in comparison to the preceding year.

**Aggregate deal activity (volume and value analysis)**

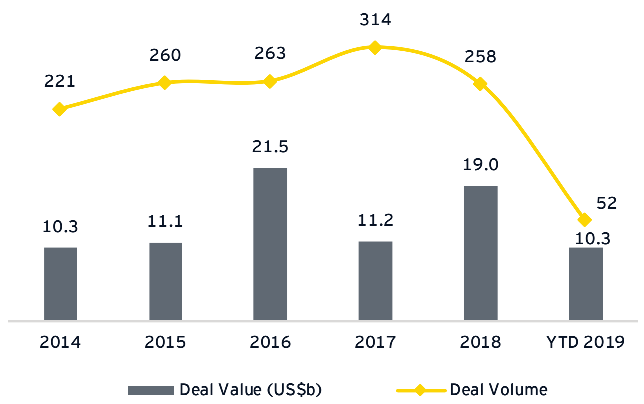



Source: Pitchbook

Note: PE deals include includes buyout, management buy-out, secondary buyout, public to private, PIPE, and growth/expansion deals | VC deals include (includes accelerator, angel, seed, Early stage VC, late stage VC deals | Aggregate deals includes PE, VC, and M&A deals | YTD 2019 refers to 25th Jun 2019

# Technology, Diversified Industrials and Consumer are the key sectors that gained maximum traction from PE firms

**PE and VC deal activity: 2014-YTD 2019**




Source: Pitchbook

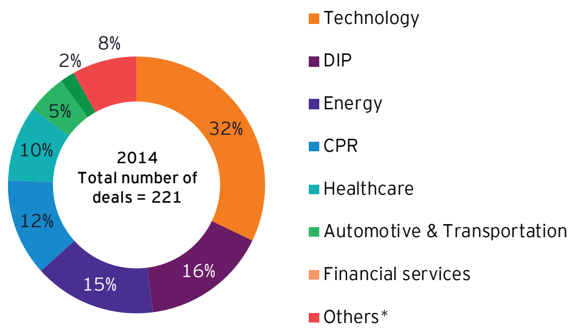
**Current state**

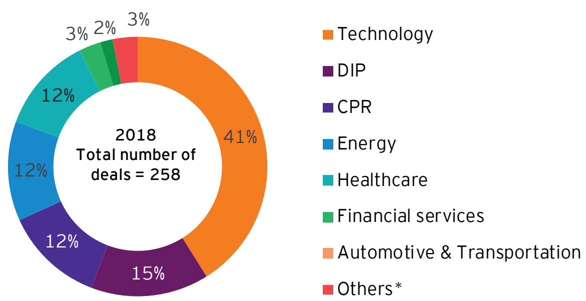
PE firms announced deals worth US$19b during 2018, an increase of 70% from the previous year.
The deal volume, however, declined by 18% over 2017 to reach 258 deals during the year. The average deal size declined by 106% to reach US$73.7m in 2018 versus US$35.7m in 2017.

The technology and DIP together dominated the deal environment in 2018, constituting more than half of the deal volume. From value perspective, automotive & transportation and health constituted the majority (64%) of deals in 2018. The technology sector is continuing to receive significant attention from PE particularly those businesses that have exposure to high-growth areas such as healthcare, online education and logistics management. PE bidders can therefore expect to pay high multiples for data-rich businesses where such data can be exploited to take advantage of broader macroeconomic trends. Recently, MYOB Technology, Australia-based accounting software firm, was acquired by KKR for US$1.2b in May 2019.The consumer sector also had a strong year, with US$2.8b of PE/VC deals announced in Australia during 2018. PE interest has focused on food and beverage businesses with strong market positions and opportunities for growth offshore, such as the ROC Capital / Wattle Hill acquisition of Capilano Honey for US$144m and Carlyle Group's acquisition of Accolade Wines from CHAMP Private Equity for US$750m.

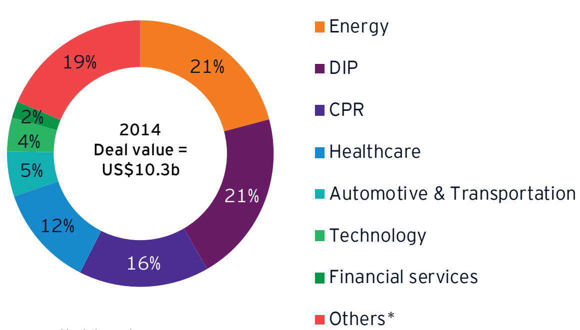
**PE and VC deals: Sector wise analysis**

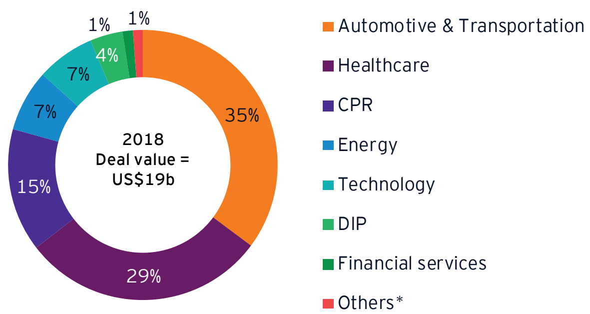
**Break-up of deal volume by sectors (2014 vs 2018)**




**Break-up of deal value by sectors (2014 vs 2018)**




Source: Pitchbook

Note: *Others include commercial products, commercial services, containers and packaging, non-financial services, and other business products/services.

# Top 20 PE deals by value in Australia (2014-19*)

| Deal Value (US$b) | Target | Investor | Sector | Deal Date |
|---|---|---|---|---|
| **5.9** | Latitude Financial Services | KKR, Deutsche Bank | Financial services | Nov-15 |
| **2.1** | Navitas | BGH Capital | Government & Public Services | Apr-19 |
| **1.6** | Moly-Cop Chile | American Industrial Partners | Diversified Industrial Products | Jan-17 |
| **1.3** | Goodman Group | The Blackstone Group | Real estate | Oct-16 |
| **1.2** | MYOB Technology | KKR | Technology | May-19 |
| **1.0** | I-MED Radiology Network | Permira | Healthcare | Feb-18 |
| **0.9** | iNova Pharmacticals | The Carlyle Group, Pacific Equity Partners | Healthcare | Sep-17 |
| **0.8** | Billabong | Oaktree Capital Management | Consumer Products & Retail | Aug-14 |
| **0.8** | Icon Group (Cancer Care Provider) | Pagoda Investment, Queensland Investment Corporation | Healthcare | May-17 |
| **0.8** | Greencross | The Carlyle Group | Healthcare | Jan-16 |
| **0.8** | Accolade Wines | The Carlyle Group | Consumer Products & Retail | Jun-18 |
| **0.7** | Ventia (Australia) | Apollo Global Management | Infrastructure | Dec-14 |
| **0.7** | Greencross | TPG Capital | Healthcare | May-15 |
| **0.6** | Ixom (formerly known as Orica Chemical Business) | The Blackstone Group | Diversified Industrial Products | Dec-17 |
| **0.5** | Pepper Group | KKR | Financial services | Aug-17 |
| **0.5** | Laser Clinics Australia | KKR | Healthcare | Jan-19 |
| **0.5** | Device Technologies | Navis Capital Partners | Healthcare | Apr-15 |
| **0.5** | TEG Live | Affinity Equity Partners | Media & Entertainment | Dec-17 |
| **0.5** | Swire Cold Storage (ten cold storage ass | The Blackstone Group | Real estate | Feb-19 |
| **0.5** | Scottish Pacific Business Finance | Affinity Equity Partners | Financial servicwes | Feb-18 |

Sources: Pitchbook, EY Analysis
Note: *refers to 21 Jan 2019

# Responsible investing

**The responsible investment industry is continuing its upward trajectory and now makes up the majority of the overall investment market in Australia.**

# In line with global trends, fund managers are increasingly committing to responsible and sustainable investments

**Assets Under Management (AUM) using a responsible investment approach continue to rise and are increasingly delivering strong (above benchmark) results. As of 31st December 2017, responsible investment constituted AU$866b AUM, up 39% from AU$622b in 2016.**

**Responsible investing is classified into Core and Broad responsible investment. Core responsible investment further consists of negative, positive or norms-based screening; sustainability themed investing; impact investing and community finance; or corporate engagement.**

## Key aspects of responsible and ethical Investing

**ESG integration**
Consideration & analysis of environmental, social and governance (ESG) factors as part of investment decision making

**Negative screening**
Industry sectors or companies excluded/ divested from to avoid risk or better alig with values

**Positive or best-in-class screening**
Investments that target companies or industries with better ESG performance

**Thematic/ Sustainability-themed investments**
Investments that specifically target sustainability themes such as clean energy, green property

**Impact investing – market rate**
Investments that target social and environmental impact and deliver market rate financial returns

**Impact investing – concessionary rate**
Investments that target social and environmental impact and deliver below market rate returns

Source: Responsible Investment Benchmark Report 2018, Australia

**Responsible investing in Australia**

According to a report by the Responsible Investment Association Australasia, this industry consists of AU$866b of assets, or 55.5% of all assets professionally managed in this country as of 2017.

In 2017, AU$679.3b in AUM was invested by 22 asset managers who demonstrated a leading approach to ESG integration, a growth of 22% from 2016.

In 2017, Core responsible investment funds increased by 188% to AU$186.7b AUM. Screening, both positive and negative, continues to be the most popular strategy applied to Core responsible investment assets in Australia.

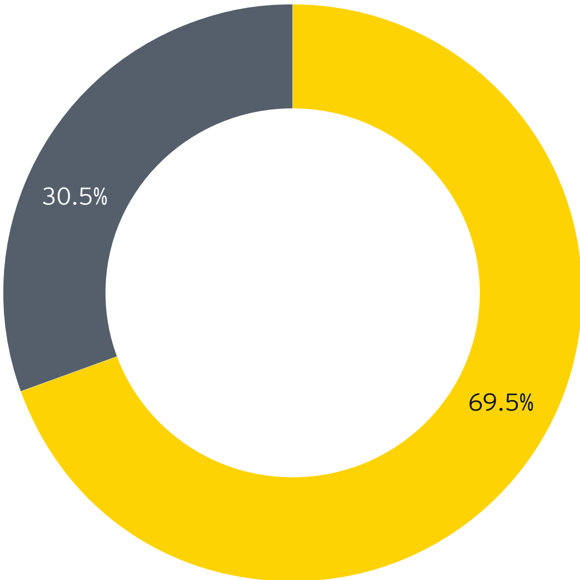
As per the report, top drivers for growth in responsible investing include ESG factors impacting on performance, demand from institutional investors, demand from retail investors, and purpose alignment.

Some examples of PE and VC firms based in Australia which launched funds focused on responsible investing:

| PE/VC firm | Fund |
|---|---|
| **Artesian Venture Partners** | Artesian Clean Energy Seed Fund |
| **Australian Impact Investments** | Community Impact Foundation |
| **Impact Investment Group** | IIG Solar Income Fund I, Giant Leap Fund |
| **AMP Capital Investors** | AMP Capital Infrastructure Debt Fund III, II, I |
| **New Forests** | Australia New Zealand Forest Fund 3, 2 |

Sources: Responsible Investment Association Australasia, Preqin, Factiva, EY analysis
*Note: Assets Under Management

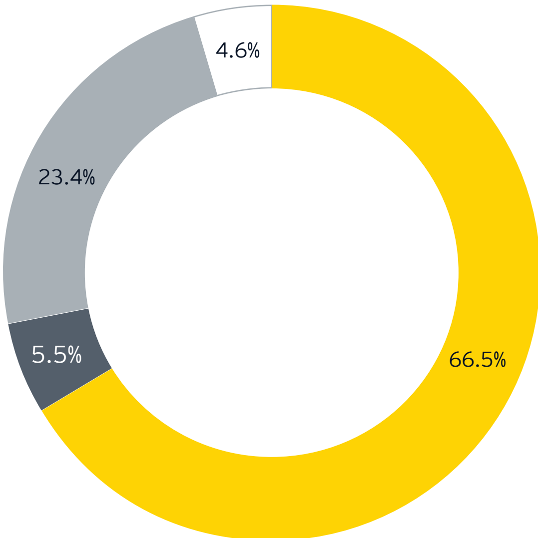
**Responsible investment by approach (as a % of total AUM) (Total AUM = AUD980b)**




Broad Responsible Investment: ESG Integration
Core Responsible Investing

Source: Responsible Investment Benchmark Report 2018, Australia

**Core Responsible Investing breakup (as a % of total AUM) (Total AUM = AUD299b)**




Negative screening
Positive screening
Sustainability-themed investing
Impact & community investing

Source: Responsible Investment Benchmark Report 2018, Australia

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