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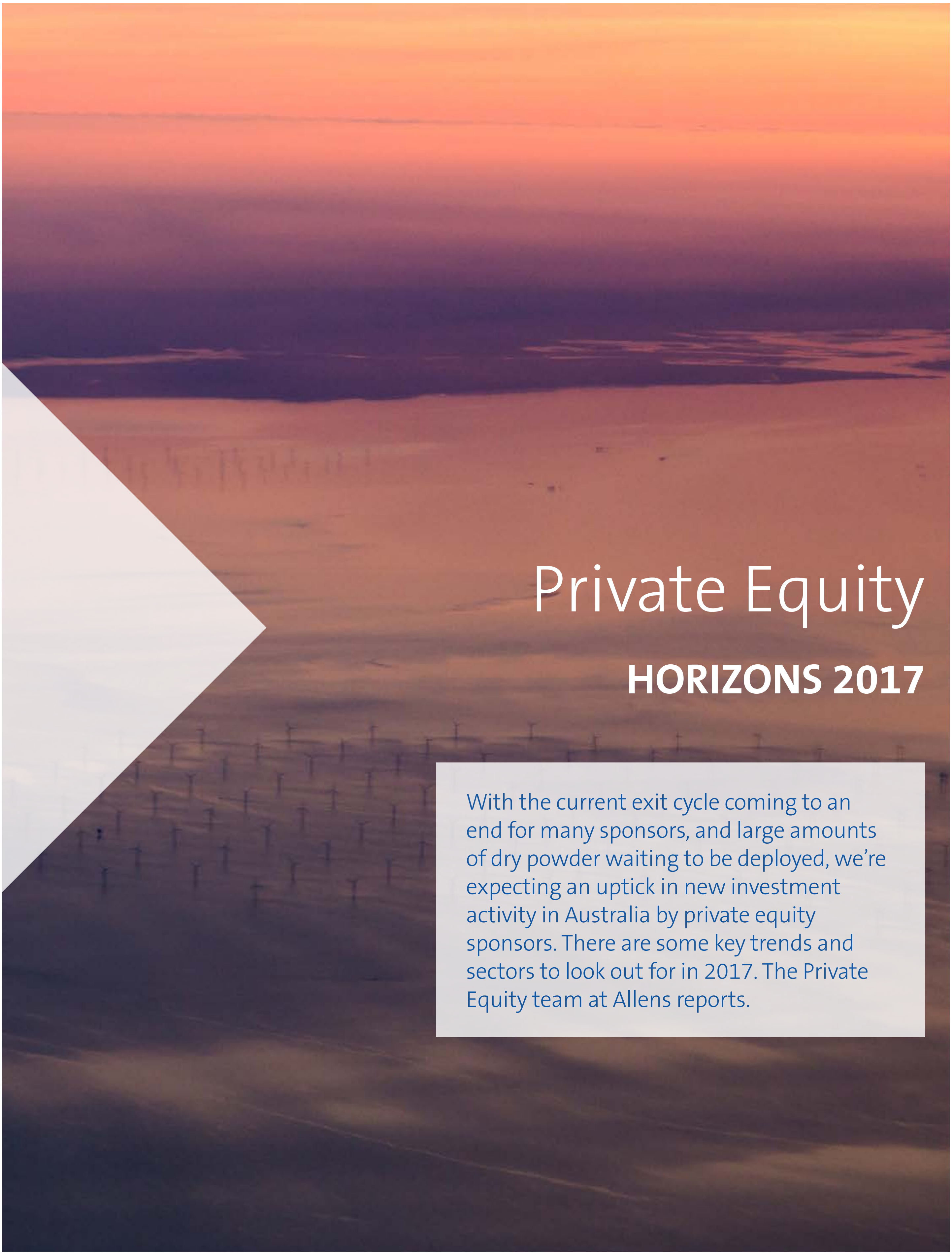
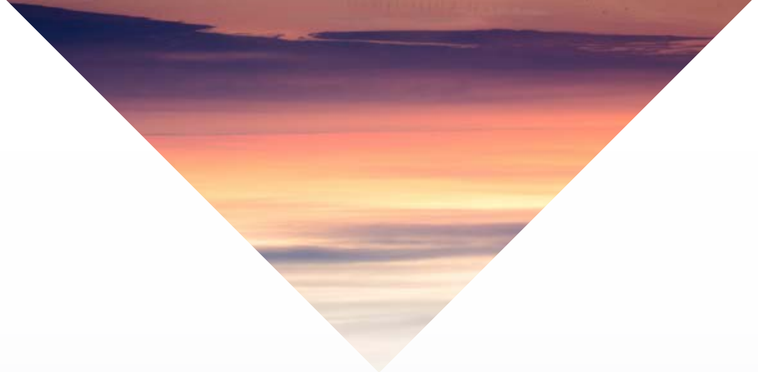


Private Equity

HORIZONS 2017

With the current exit cycle coming to an end for many sponsors, and large amounts of dry powder waiting to be deployed, we're expecting an uptick in new investment activity in Australia by private equity sponsors. There are some key trends and sectors to look out for in 2017. The Private Equity team at Allens reports.



Sectors to watch

Informed by discussions with financial sponsors in Australia, across the region and in the US, the sectors to watch in 2017 are:

2017: Health, Education, Technology, Agri

2016: ICT, Health, Consumer & retail, Financial services, Energy

HEALTH

Sponsors continue to demonstrate significant appetite for Australian healthcare assets, tempered only by the challenges in finding available acquisition targets amid intense competition. Areas of specialised medicine such as radiology and oncology, where some businesses remain under doctor ownership, are a focus for some sponsors. Others are looking to take advantage of ever increasing government and private sector healthcare spending by targeting pharmaceutical and other products supplied to the industry.

Tom Story
Partner – Sydney

Allens deals

Advised the lenders to Quadrant on its acquisition of Fitness First, Goodlife and Jetts gym businesses.

Advised Archer Capital on the sale of HealtheCare to Luye Medical Group.

EDUCATION

We have seen enormous demand for education services businesses. Opportunities continue to present in tertiary student accommodation, early childhood learning centres and after-school care.

Sponsors are attracted to the opportunity to create platforms from bolt-ons and the operational expertise that they can bring to bear on these assets; and demand for quality accommodation continues to rise, underlined by increases in international student numbers. This looks set to continue, thanks to Brexit and US immigration policies.

Emin Altiparmak
Partner – Melbourne

Allens deals

Acquisition of Camp Australia, an Australia-based outside of school hours care business by Bain Capital.

Advised Goldman Sachs Special Situations Group on its joint venture with Blue Sky Private Real Estate to establish a new student accommodation platform.

TECHNOLOGY

Technology to keep users safe online, digital verification technology and anything cyber-security related present real opportunities in 'digital trust', a growth area for our times. Businesses that have broad data sets will present opportunities to sponsors looking to exploit 'big data' and other analytics opportunities. In particular, the exploitation of information held by financial services and consumer businesses will be something to watch.

Mark Malinas
Partner – Melbourne

Allens deals

Advised HRL Morrison and its clients CSC and Infratil on their acquisition of Canberra Data Centres from Quadrant Private Equity.

Advised NSI Ventures on a Series B investment on Whispir Limited.

AGRI & FOOD

Australian sponsors have had a long track record of investing in branded consumer food businesses. Pacific Equity Partners has led recent activity in this space, with investments in Patties Foods and Pinnacle Bakery and Ingredients, as well as associated bolt-ons such as Allied Mills. We continue to see opportunities for private equity in this sector, as multinational players look to rationalise their businesses and divest non-core assets.

Mark Kidston
Partner – Sydney

Allens deals

Advised Pacific Equity Partners on its acquisition of Patties Foods by way of public to private scheme of arrangement.

Advised Pacific Equity Partners on its acquisition of Allied Mills.

Major trends in 2017

1 MORE NEW INVESTMENT ACTIVITY FOR PRIVATE EQUITY

Following several years of strong exit activity, 2017 should be the start of a new buying cycle for many private equity sponsors in Australia, utilising around $7 billion of funds in reserve. With a relatively stable Australian economic environment, characterised by lower interest rates, healthy debt markets and an Australian/US dollar exchange rate in the 70 cents, we are expecting to see local and foreign financial sponsors become more active on the buy-side.

We are seeing a number of new opportunities arising for private equity sponsors as both domestic and multi-national corporates look to rationalise their portfolios and dispose of non-core assets. However, auction processes will remain competitive throughout 2017, with continuing strong competition from listed corporates and other strategic buyers seeking growth, as well as superannuation funds and sovereign wealth funds increasingly investing capital directly. There is a sense that private equity sponsors are being squeezed by this competition for assets. However, private equity sponsors tend to thrive and outpace this competition when the asset or opportunity presents complexity (such as a carve-out transaction or asset with complicated separation issues, or more complex public-to-private transactions) or a platform to scale or expand into new markets (such as roll-up opportunities, or brand buys for expansion into China and other parts of Asia).

Quadrant Private Equity has been particularly active in making investments in this form, rolling up complementary businesses to enter a market; for example, the recent play for the health club industry through the acquisitions of Fitness First, Jetts Fitness, and Goodlife Health Clubs. Similarly, Quadrant has targeted tourism with the acquisitions of The Ghan, Indian Pacific owner Great Southern Rail, Cruise Whitsundays and Rottnest Express. 2017 is also likely to see deal activity from a new generation of Australian private equity managers who have established new funds, including names such as Potentia Capital, Adamantem Capital and Odyssey Private Equity. It is a positive and welcome development for the Australian private equity mid-market that seasoned dealmakers have returned to investing and are injecting new growth into the roster of Australian mid-market GPs. We wish them well.

2 CHINA RESTRICTIONS ON OUTBOUND M&A – AN OPPORTUNITY FOR PE

The State Council of China is enforcing new restrictions on outbound foreign investment that seek to impose greater restrictions on Chinese buyers seeking to invest overseas in certain sectors. In the past two years, private equity sponsors have been outbid by Chinese capital on a number of assets in Australia, including in the auctions for Pacific Hydro, Healthe Care and GenesisCare.

These changes, which are largely driven by foreign exchange considerations rather than any fundamental policy shift from the State Council, are nevertheless likely to result in reduced competition from Chinese capital. This is a development that will be welcomed by private equity sponsors, particularly global funds that are chasing opportunities at the bigger end of the market. As a result of the proposed measures, we think that financial sponsors could see more opportunities in sectors that have been identified by the State Council as attracting higher scrutiny and capital restrictions, including real estate, hospitality, entertainment, movie theatre chains and sports clubs. Chinese buyers have also been less competitive in transactions involving assets that typically connect well with private equity sponsors. These restrictions out of China are now also likely to slow Chinese bidding in competitive sale processes.

3 DISRUPTION TO CREATE OPPORTUNITIES

Disruption in the Australian market looks to present some real opportunities for private equity in 2017. We believe that significant changes in the market landscape in 2017 will continue to bring new sources of demand for private capital and present novel opportunities for capital investment within traditional industry sectors. The new vanguard of cross-category e-commerce retailers like Amazon and Alibaba pose a threat for traditional retailers and, with Australia now clearly on the radar of global players, 2017 could see movement along the retail distribution chain as private equity sponsors look to take advantage of new opportunities in the market.

For example, with Amazon actively pursuing opportunities to vertically integrate ocean freight and inland parcel delivery to reduce reliance on third party logistics providers, private equity sponsors could look to invest in similar businesses ahead of Amazon's physical launch in Australia.

Similarly, 2017 might also be the year that brings disruption to important, if often overlooked, fund administration and back-office functions. Recent media reports of the potential use of blockchain technology designed to consolidate and automate the largely manual processes currently used by GPs, administrators and other service providers offer a potential taste of the efficiencies that might be offered by more coordinated use of data across multiple back-office roles within the industry.

4 DEBT MARKETS TO HELP FUEL GROWTH

With the return of non-Australian lenders (both bank and non-bank) to the Australian market and a resulting increase in competition among financiers, the past 12 months has seen private equity sponsors benefit from the reduction or removal of amortisation requirements, greater flexibility for borrowers and a focus among bank lenders on securing ancillary business from borrowers.

Underwriting appetite from banks will continue to be strong and private equity sponsors will take advantage of generous permitted acquisition baskets and accordion facilities under existing financing arrangements to finance bolt-on acquisitions. The growing presence of global sponsors in the Australian market will mean that there will be an increased level of discussion on unitranche and term loan B facilities for the leveraged finance market.

5 CO-INVESTMENT BETWEEN PE AND SUPER FUNDS

While capital raising for funds from superannuation and other Australian institutional investors generally remains challenging for a variety of reasons (not least of which being the continuing focus in the superannuation industry on costs of investments), we do think that 2017 may signal a rise in co-investment between private equity sponsors and super funds.

In particular, as the large Australian superannuation funds continue on their path towards increasing levels of internalisation of investment management, private equity co-investment opportunities, both in Australia and offshore, are beginning to become more attractive and realistic investment opportunities for them. Working well with super funds and other similar institutional investors on co-investment opportunities may become an increasingly important way for private equity funds to keep that investor group engaged in the private equity market in Australia.

6 ARE OVERSEAS TAX CUTS A THREAT?

If the US administration's plans to dramatically reduce the US company tax rates go ahead, it will be a potential game changer for the Australian tax landscape. While the UK has already scheduled reductions in the company tax rate to 19% from April 2017 and 18% from April 2020, the prospect of the US Administration reducing the rate to somewhere in the 20% range and imposing a US-favoured border adjustment tax has the potential to super charge the push for corporate tax reform in Australia. There are doubts as to whether Australia could respond in the near to medium term with meaningful reductions to the 30% company tax, which creates challenges and opportunities for private equity investment. Unless Australia can respond to the international competition on tax rates, the after-tax return from deploying capital into Australian opportunities compares unfavourably with offshore opportunities. If the US border adjustment tax is enacted, we can see capital being directed away from Australian firms with significant exposure to the US market, as the trading conditions of firms importing goods into the US are expected to deteriorate. On the other hand, the Australian MIT regime continues to provide favourable after-tax outcomes, and so the opportunities for private equity to partner with foreign-based funds remain strong.

*An estimated **$7B OF DRY POWDER** is available for investment by Australian private equity and venture capital fund managers, a 13% increase on last year.*

Our deals in 2016/17

SPONSORS

Bain Capital – advised on its acquisition of Camp Australia, an Australia-based outside of school hours care business.

Pacific Equity Partners (PEP) – advised on its acquisition of Allied Mills, one of the country's largest manufacturers and distributors of flour and bakery pre-mixes.

Pacific Equity Partners (PEP) – advised on its acquisition of Patties Foods by way of public to private scheme of arrangement.

The Future Fund Board of Guardians – advised Australia's sovereign wealth fund on numerous private equity co-investments across a range of sectors.

HRL Morrison – advised HRL Morrison and its clients CSC and Infratil on the acquisition of Canberra Data Centres from Quadrant Private Equity.

Goldman Sachs Special Situations Group – advised on its joint venture with Blue Sky Private Real Estate to establish a new student accommodation platform.

Goldman Sachs Special Situations Group – advised on its equity investment in Evolution Healthcare.

Goldman Sachs Special Situations Group – advised on its exit from Swisse Vitamins and sale to Biostime.

Onex Corporation – advised Canadian based private equity house Onex Corporation on the acquisition of the Intellectual Property & Science business of Thomson Reuters.

VENDORS

Archer Capital – advised on its $938 million divestment of private hospital business Healthe Care to China's Luye Medical Group.

Zimmermann – advised leading luxury fashion brand ZIMMERMANN on its next phase of growth with a minority investment in the brand from General Atlantic, a global growth equity firm.

FINANCIERS

Anglo American Qld Coal Assets – advised the financiers on Apollo Global Management's ultimately unsuccessful bid for the assets.

Gyms (Fitness First, Goodlife and Jetts) – advised the lenders to Quadrant on its acquisition of Fitness First, Goodlife and Jetts gym businesses.

Pacific Hydro – advised the lenders to Pacific Equity Partners on its unsuccessful bid for Pacific Hydro.

Australian agribusiness – advised the lender to Belgian-based private equity fund Nomura on its acquisition of an Australian agribusiness.

Lynch Group – advised the financiers to Next Capital on the financing aspects of its acquisition of the Lynch Group.

Pinnacle Foods – advised the lenders to Pacific Equity Partners on its acquisition of Pinnacle Foods.

Private equity funds – advised various financiers in putting together a number of capital call facilities to certain private equity funds.

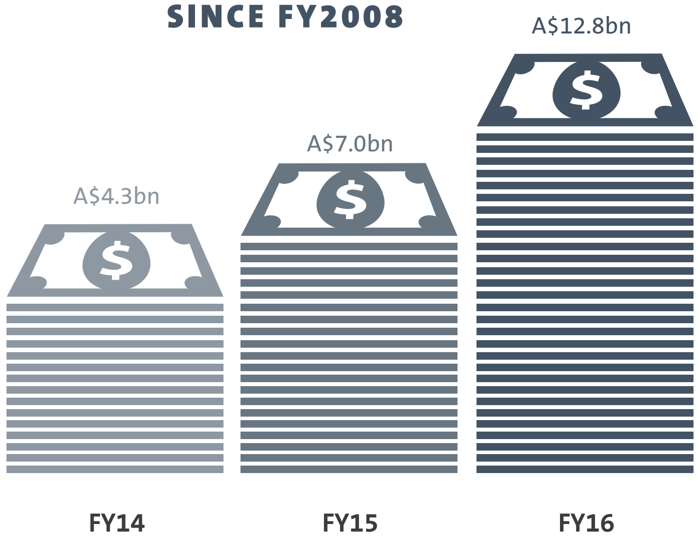
Underground Cable Systems – advised lenders to Hawkesbridge Capital on its acquisition of Underground Cable Systems.

Blackstone's acquisition of IXOM – adved JP Morgan on its Term Loan B to fund Blackstone's acquisition of IXOM, formerly the Orica Chemicals Business.

2016 ACTIVITY IN AUSTRALIA

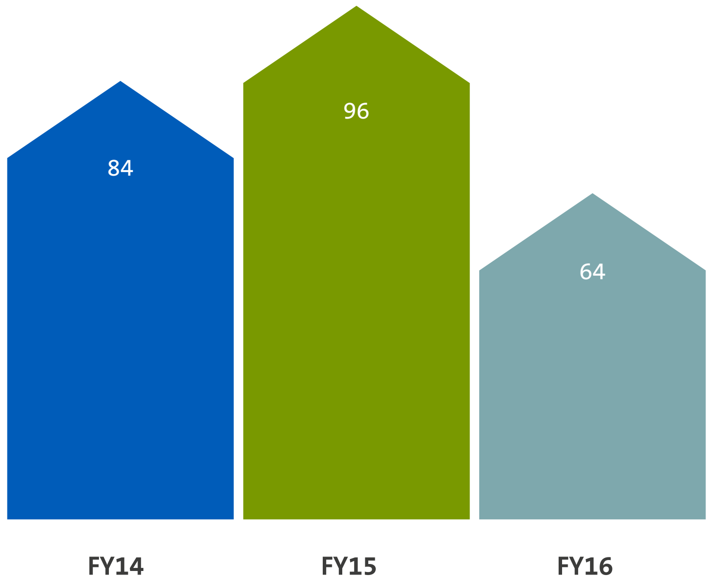
VALUE OF DEALS (A$bn)

Largest deal value
SINCE FY2008



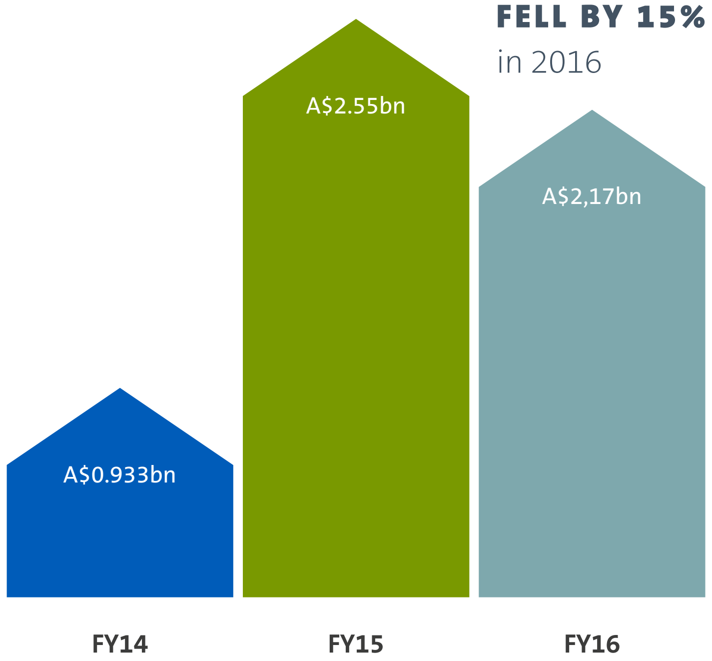
NUMBER OF DEALS

32% DECREASE
in number of deals



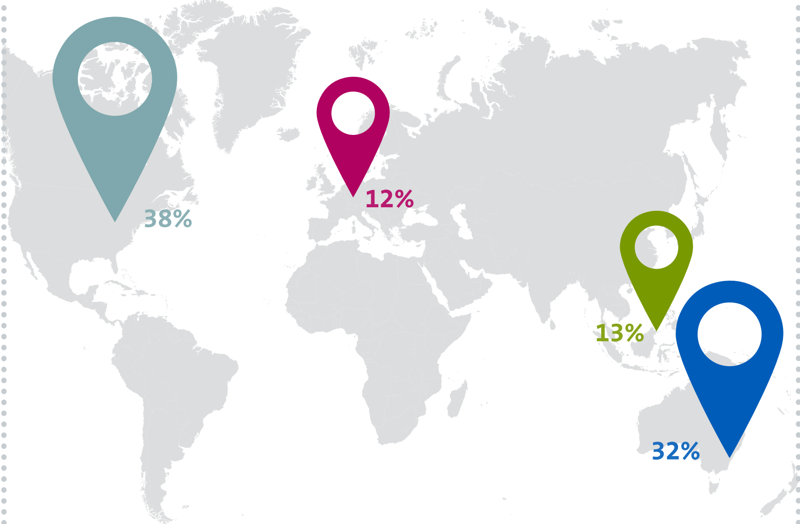
1. FUNDRAISING (A$bn)

Private equity
fundraising
FELL BY 15%
in 2016



> Sources of new private equity & venture capital commitments

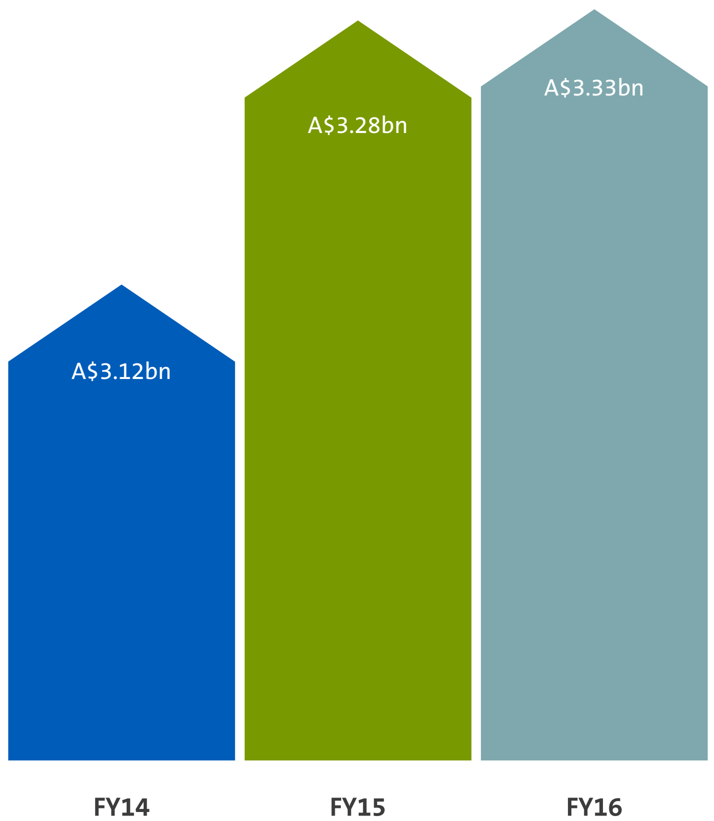
63% of new commitments came from **OUTSIDE AUSTRALIA** in 2016



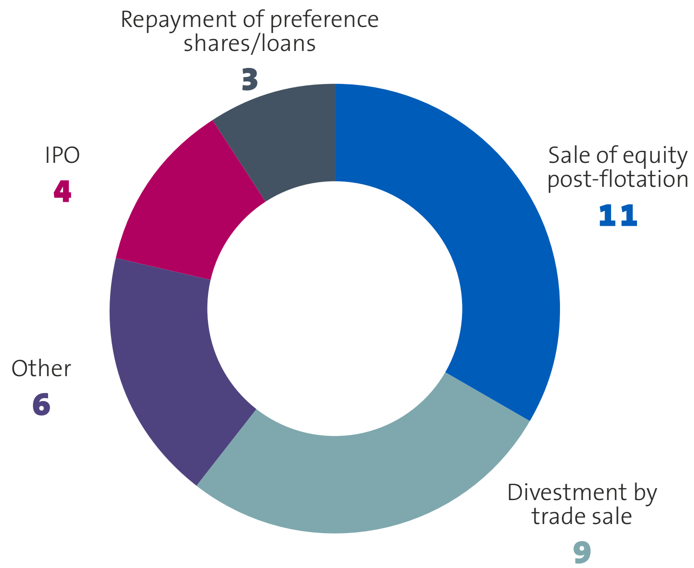
2. INVESTMENT (A$bn)

Total private equity investment grew to **$3.33bn** in FY2016, a 2% rise on 2015.

However, the number of companies invested in by private equity fell to 60, a **30% REDUCTION.**



3. DIVESTMENT



Number of companies exited by private equity and venture capital fell to 42 (FY2016), 11 fewer than the FY2015

Total private equity divestments
33

All figures from AVCAL 2016 yearbook https://www.avcal.com.au/documents/item/1315

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