



AVCAL

The AUSTRALIAN
PRIVATE EQUITY &
VENTURE CAPITAL
ASSOCIATION Limited

December 2011

Deal Metrics Survey

A survey of Australian VC and
PE deal activity in FY2011

In association with

PACIFIC **STRATEGY** PARTNERS

Message from the Chief Executive

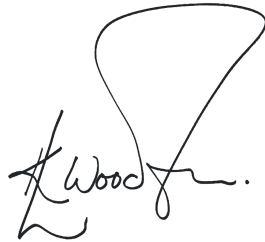
Welcome to the 2011 AVCAL and Pacific Strategy Partners Deal Metrics Survey: the third annual report of private equity (PE) and venture capital (VC) deal activity, covering deals executed up to the end of June 2011.

These deal metrics are important for the effective tracking of how PE and VC deals and valuations are trending over the short, medium and long term.

Since the last report, PE activity has shown some promising signs in spite of continuing economic uncertainty. This has been demonstrated through a significant increase in deal value compared to the prior two years, thanks to the gradual return of larger deals and continued resilience in the mid-market segment.

However, there have been continued challenges in the VC space. This is reflected in lower VC deal volumes and sizes, with older funds reaching the end of their lives and fewer and smaller new funds being established.

We would like to thank Pacific Strategy Partners for their valuable input into the production of this report.

A handwritten signature in black ink, appearing to read 'K Woodthorpe', with a large, stylized flourish above the name.

Katherine Woodthorpe
Chief Executive, AVCAL
December 2011

Executive Summary

With the launch of the third annual report of PE and VC deal activity, we have extended the coverage and depth of the deal database, which now covers transactions between FY06-FY11 across 116 PE funds and 58 VC funds. The database represents total PE investment of \$70.8b across 694 transactions, and total VC investment of \$980m over 731 investment rounds. We also interviewed 40 PE and VC funds, equity and debt providers and advisors to get their perspectives on deal activity and market outlook.

In the Australian PE market, there has been significant activity after two years of decline through the global financial crisis (GFC). The market has seen a return of transactions completed at attractive prices for quality businesses with robust underlying economics, solid earnings quality and strong growth prospects. Appetite for businesses falling outside this realm has attracted less attention, except for some opportunistic activity on turnaround and distressed businesses.

Valuation multiples have increased in line with the level of asset quality. This also reflects the continuing convergence of price expectations between buyers and sellers. However, many potential vendors are also reported to have remained on the sidelines, either waiting for better economic conditions or looking to firm up their businesses' performance before selling.

Access to debt remains difficult, however, debt funding markets have nevertheless improved compared to conditions observed during the GFC. Exit activity has surpassed expectations, with a number of exits generating attractive returns during the last financial year. While the IPO market remains virtually closed, secondary deals (sponsor-to-sponsor) have become an increasingly popular exit route. Furthermore, trade sales have also picked up in activity, largely driven by increasing interest from overseas.

The VC landscape has remained challenging, with fewer funds investing and consequently lower overall levels of investment. Government support in the form of the Innovation Investment Fund programme has been positive, although further policy support will be needed to stimulate greater private investment in the commercialisation of Australian innovation.

In summary, the market has demonstrated positive signs of renewed activity characterised by "good deals done at good prices" and once global economic uncertainty recedes, deal activity is anticipated to further improve.

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Private Equity

A focus on quality

FY11 marked a turning point for the Australian PE market compared to the preceding two years. The total enterprise value (EV) of transactions increased significantly from \$3.9b in FY10 to \$10.2b in FY11. There were fewer transactions – both new deals and bolt-ons – in FY11 compared to the previous year. However, new deals accounted for a slightly larger proportion of all transactions over the year (49% in FY11 compared to 46% in FY10).

Figure 1: Enterprise value of transactions, FY06-FY11 (A\$b)

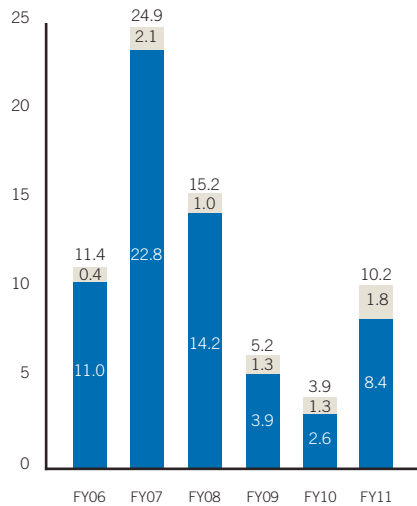
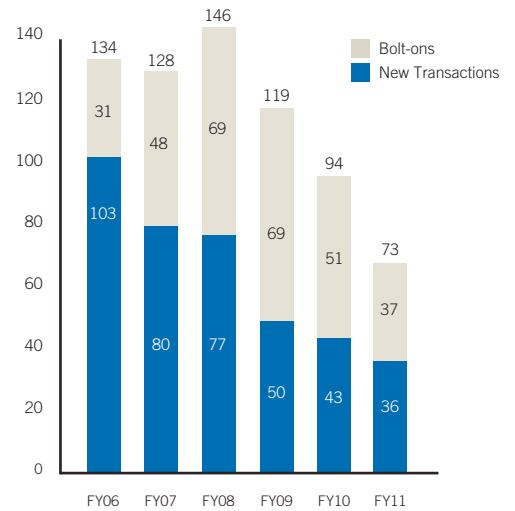


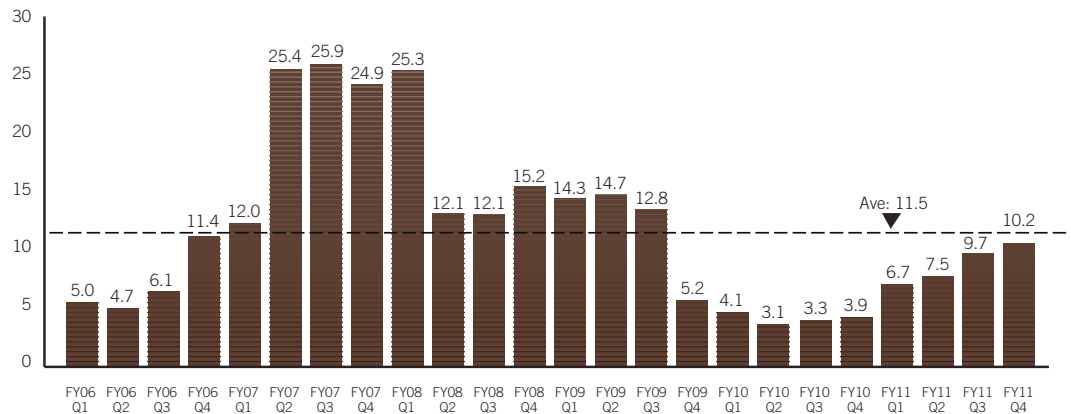
Figure 2: Number of transactions, FY06-FY11



The increase in the value of deal activity reflected both improved confidence among the investment community and debt providers, and the availability of high quality businesses. Many of the funds surveyed commented on the improved quality of deal flow in FY11 and improved conditions for completing deals. Consequently, buyers generally avoided assets which were perceived as riskier investments and which did not present the same quality – often those which were operating in markets with less attractive macro trends, or with higher volatility in their earnings.

Total deal value increased significantly in FY11, boosted by a couple of large transactions by international PE funds. Looking at deal value on a quarterly moving annual total (MAT) basis confirms the upward trend in activity over the last two years, and demonstrates that the industry has emerged from the lowest point of the cycle.

Figure 3: Moving Annual Total (MAT) of enterprise value of PE transactions, FY06 - FY11 (A\$b)



As a result of the shift in the mix of deal activity towards larger transactions, the average value for new deals increased from a low of \$60m in FY10 to \$234m in FY11, significantly higher than average value in the last three years. The average value of bolt-ons also experienced a notable lift, continuing the strong upward growth trajectory over the last four years.

Figure 4: Average enterprise value of new PE transactions, FY06-FY11 (A\$m)

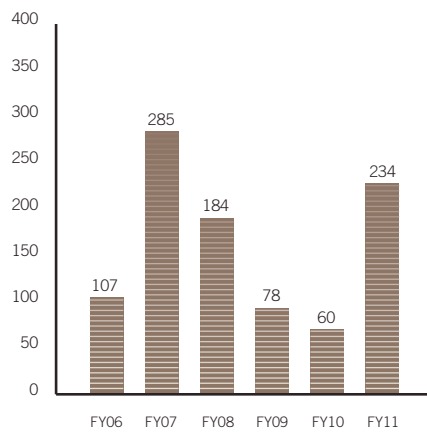
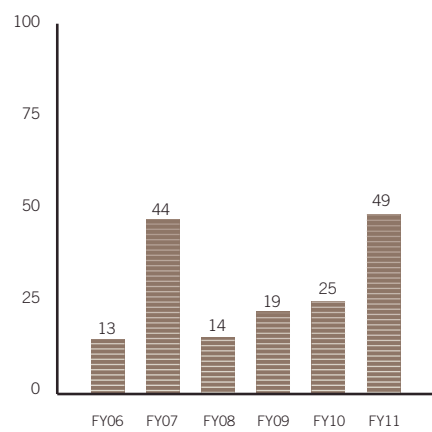
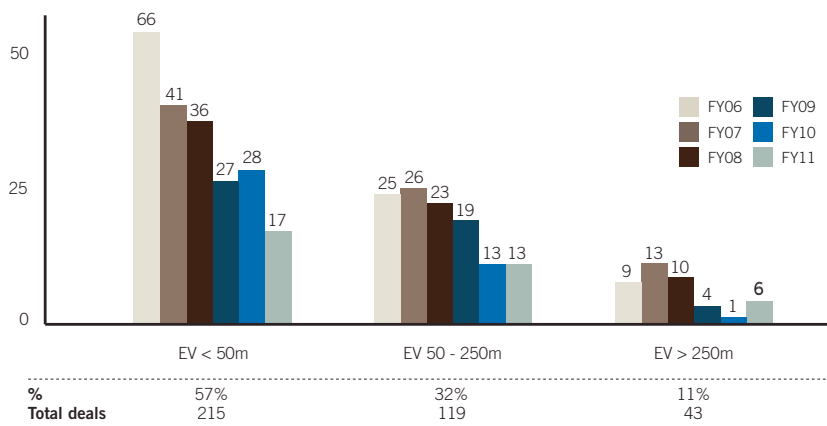


Figure 5: Average enterprise value of bolt-on transactions, FY06-FY11 (A\$m)



Facilitated by converging price expectations and increased debt availability, there was a significant increase in the volume of large deals (above \$250m in EV) in FY11. The number of medium-sized deals (\$50-250m EV) remained consistent with the previous year, while deals under \$50m were slightly lower.

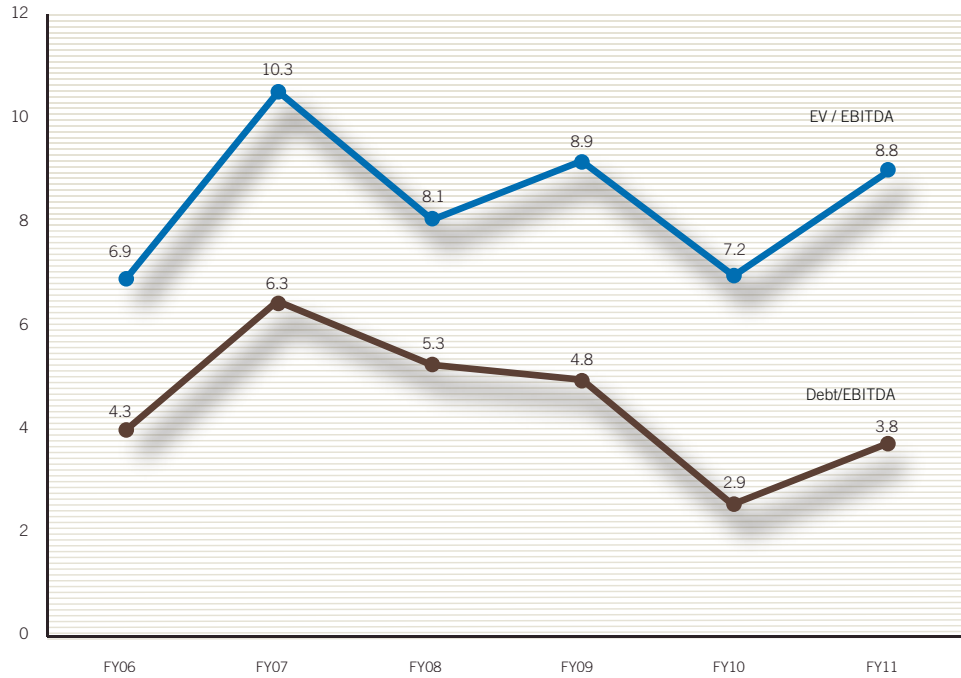
Figure 6: Number of PE transactions by EV band



Pricing & debt levels reflect focus on quality

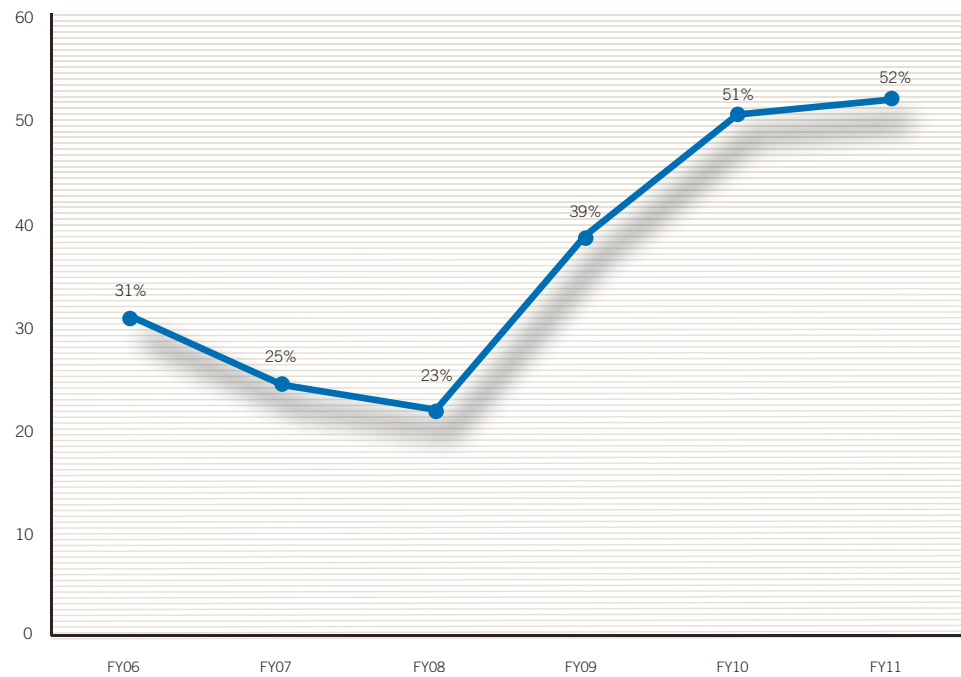
Price multiples (EV/EBITDA) increased in FY11, in spite of continued economic uncertainty. The increase was driven by a number of factors: the quality of assets acquired, continued convergence in vendor and purchaser pricing expectations, and a change in deal size mix (or more precisely, a skew towards larger deals and fewer bolt-ons which have traditionally been transacted at lower multiples).

Figure 7: Average EV/EBITDA and Debt/EBITDA multiples



Note: Weighted by transaction enterprise value

Figure 8: Average equity contribution (% of total EV)



Note: Weighted by transaction enterprise value

On the debt funding side, although most funds experienced improved access to debt, PE sponsors maintained relatively stable debt multiples at 3-4 times (3.8x in FY11) and equity contributions remained relatively high (52% in FY11).

Senior debt remained the primary source of debt funding, with PE firms preferring to deploy more equity rather than high-cost subordinated debt which was virtually non-existent in transactions in FY11.

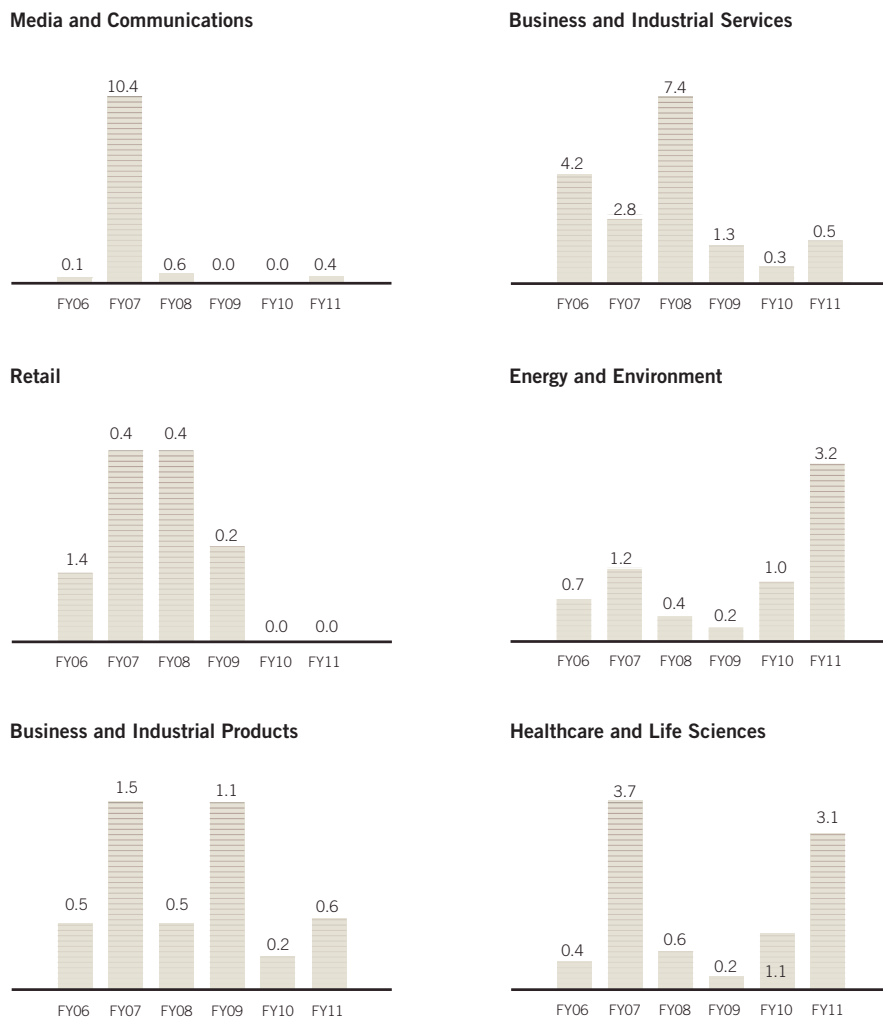
Exit activity resilient

There were many successful exits over the last financial year with attractive returns that were above expectations, particularly given the uncertain economic environment. Secondary transactions (sponsor-to-sponsor) gained popularity as a means of exit in FY11, fuelled in part by the lacklustre IPO market for non-resources stocks. Trade sales also continued to feature as a key route to exit, including increased activity from international trade buyers.

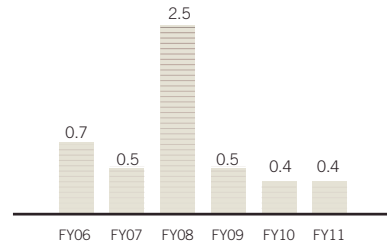
Focus on sectors with strong fundamentals

The Healthcare, Energy and Consumer Goods sectors saw an increase in investment relative to prior years, as investors backed transactions exposed to the strong underlying macro trends in these sectors.

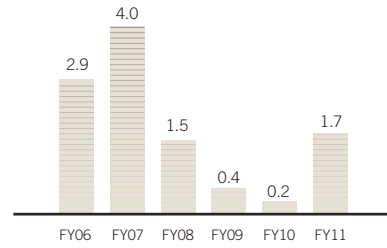
Figure 9: PE transaction value by industry sector, FY06 - FY11 (A\$b)



Hospitality and Consumer Services

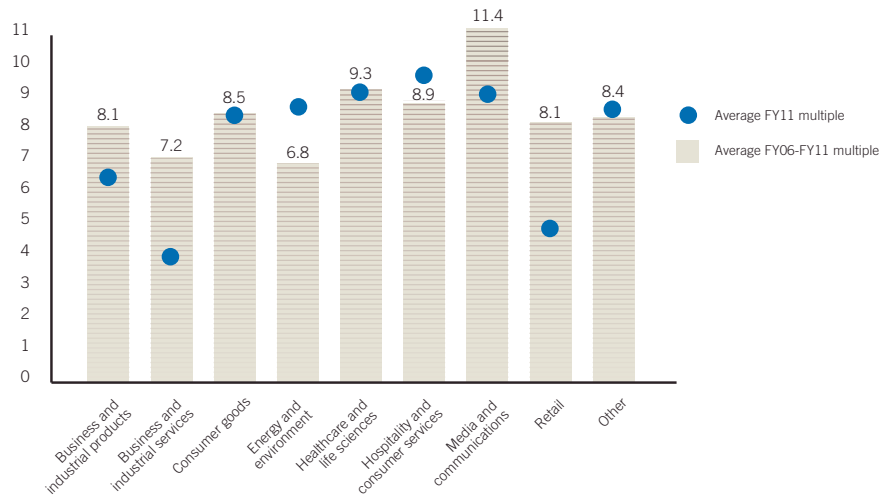


Consumer Goods



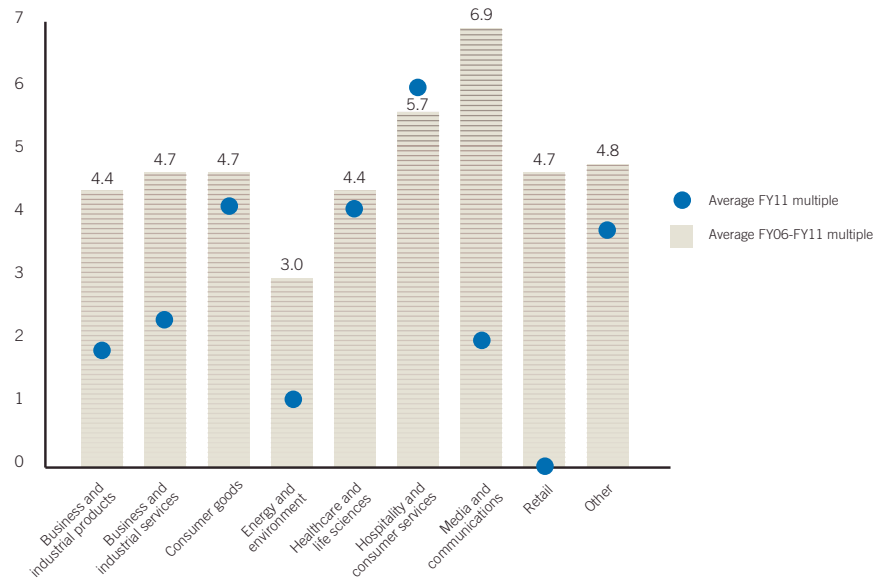
In FY11, EV/EBITDA and Debt/EBITDA multiples for Healthcare & Life Sciences, Consumer Goods, and Hospitality & Consumer Services remained relatively consistent with previous years. Across most other sectors, EV/EBITDA multiples, and to a greater extent Debt/EBITDA multiples, have generally declined.

Figure 10: Average EV/EBITDA by industry – new deals



Note: Weighted by transaction enterprise value

Figure 11: Average Debt/EBITDA by industry – new deals



Note: Weighted by transaction enterprise value

Venture Capital

Lower level of venture investment

The VC environment remained challenging in Australia, as reflected in a decline in both investment value and volume. The value of VC investment in FY11 at \$119m was the lowest recorded over the last five years. Similarly, the number of new investments fell to 35, also the lowest recorded.

Figure 12: Value of VC investments, FY06-FY11 (A\$m)

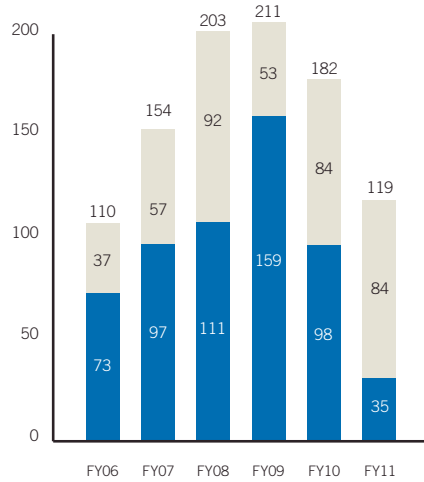
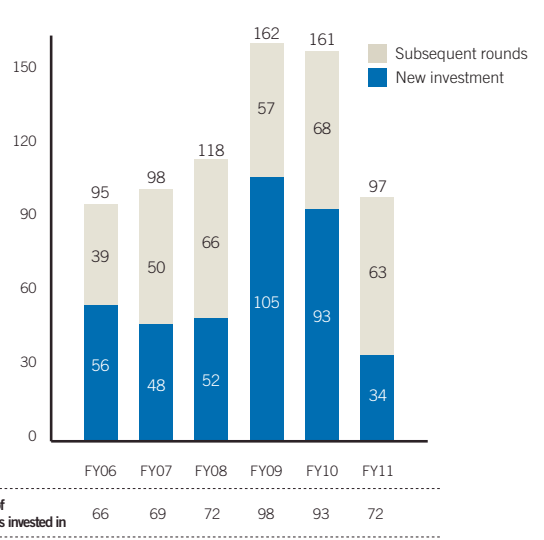
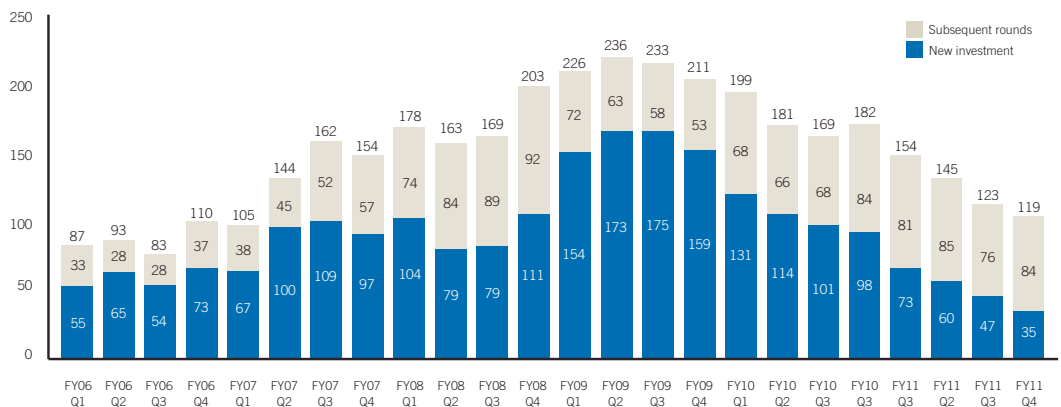


Figure 13: Number of VC Investments, FY06-FY11



Looking at VC investment value on a quarterly MAT basis clearly shows the continued decrease in new investments over the last nine quarters.

Figure 14: Moving Annual Total (MAT) of VC investments, FY06-FY11 (A\$m)



The average size of new and subsequent round VC investments remained relatively unchanged from the previous year at \$1m and \$1.3m respectively.

Figure 15: Average VC new investment size, FY06-FY11 (A\$m)

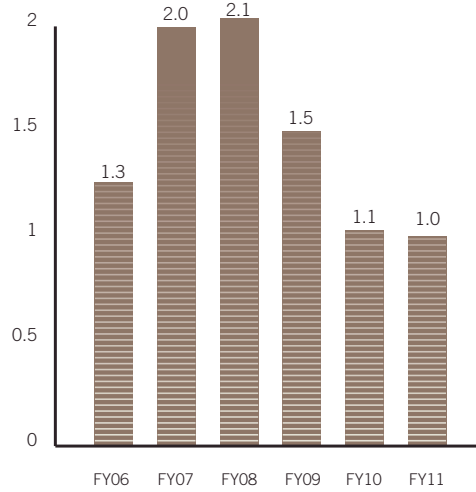
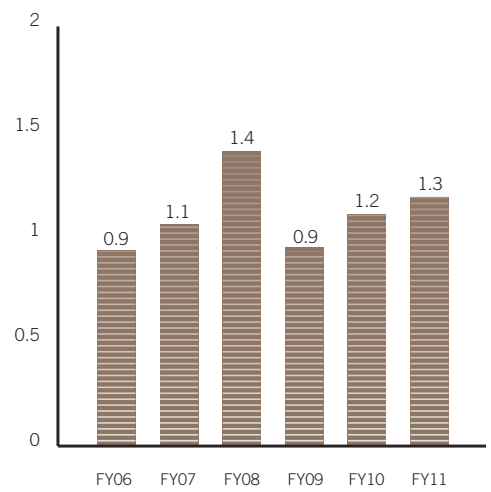


Figure 16: Average VC subsequent round investment size, FY06-FY11 (A\$m)



While activity was lower across all industries, Healthcare & Life Sciences, and Computer & Consumer Electronics continued to lead the top VC investment sectors in FY11. From a longer term perspective, these two sectors accounted for 49% and 23% respectively of the total value of VC investments from FY06 to FY11.

Figure 17: VC investment by industry, FY06-FY11 (A\$m)

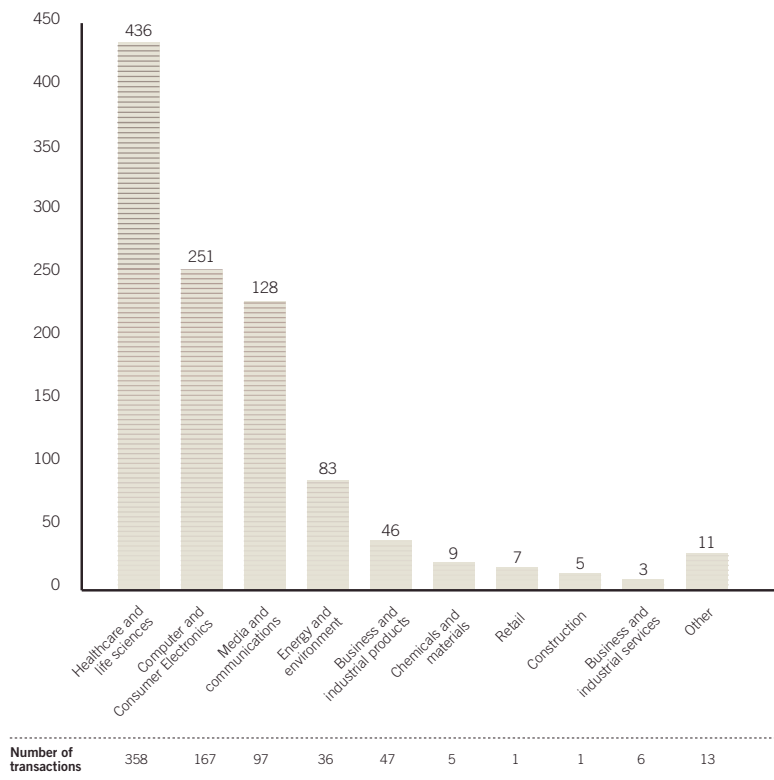
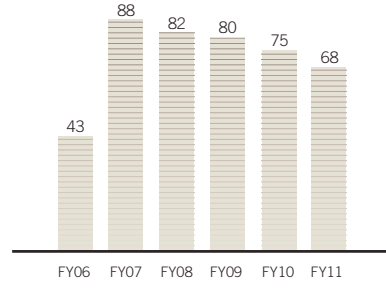
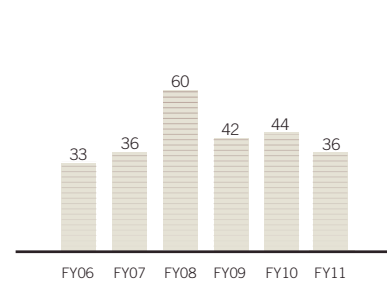


Figure 18: VC investment by industry and year, FY06-FY11 (A\$m)

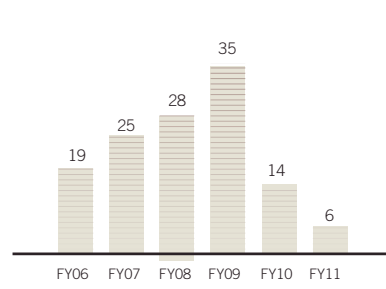
Healthcare & Life Sciences



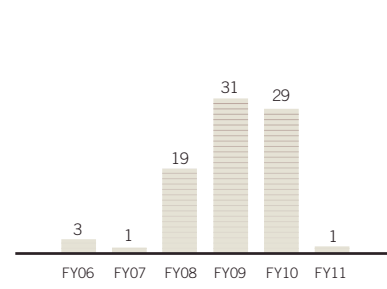
Computer & Consumer Electronics



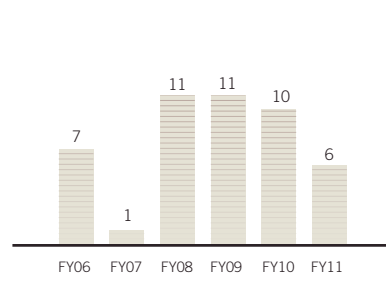
Media & Communications



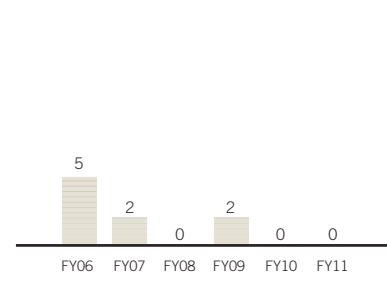
Business & Industrial Products



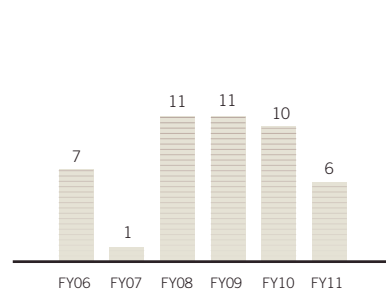
Energy & Environment



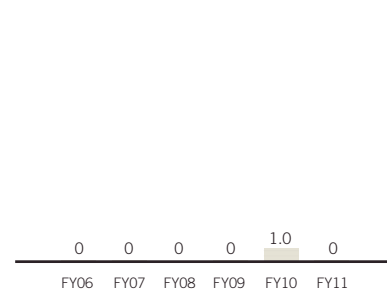
Retail



Construction



Business and Industrial Services



Outlook

Promising signs but risks remain

Australian PE activity has seen a return to growth, and barring any significant financial shocks, many market participants expect there will be continued growth in PE activity. The next couple of years may present some excellent opportunities for investing in Australia, and could prove to be a great ‘investment vintage.’

Investment activity is expected to pick up as the economic outlook improves and uncertainty reduces. Consequently, deals for quality assets should continue to be done at attractive prices. While there has been some rationalisation of PE funds, and there may be more to come, there is a strong base of local and international PE funds operating in Australia with access to substantial dry powder that are delivering strong returns.

A number of risks remain, including the potential for further credit tightening as European sovereign debt issues unfold and the potential for a second wave of the GFC. These risks, combined with continued uncertainty over Government policy initiatives across a range of industry sectors, have made investors cautious and may constrain fundraising activity.

Partly as a result of these risks, the focus of deal making has reverted to industries and companies with strong fundamentals and traditional approaches to value creation, with PE funds working closely with management teams to drive profitability and growth within the business. In line with this, the focus on due diligence prior to investment has continued to increase.

From a sectoral perspective, businesses linked to resources and healthcare are likely to be strong target areas for growth. Sectors which have underperformed over the last few years (e.g. retail) may also present new opportunities for investment as these sectors bottom out and revert to growth.

In the VC sector, the environment remains challenging. While Government initiatives such as the Innovation Investment Fund have been welcomed, further industry rationalisation is expected unless new or existing VCs can raise substantial new funds within the next few years to replace many of the current funds which are reaching end-of-life, and invest in the many attractive opportunities available in Australian early-stage enterprises.

Nevertheless, it is expected that the PE market’s renewed activity, with deals currently at attractive valuations, should continue to set the tone for the months ahead.

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