

MAY 2009



AVCAL

*The AUSTRALIAN
PRIVATE EQUITY &
VENTURE CAPITAL
ASSOCIATION Limited*

Deal Metrics Survey

A survey of Australian VC and PE
deal activity from 2005 – 2008

In association with

 **CRESCENDO PARTNERS**

Message from the Chief Executive

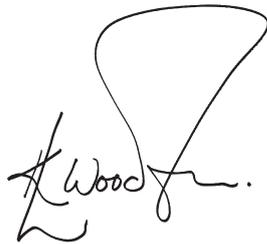
When AVCAL first commissioned Crescendo Partners to conduct a comprehensive survey of Australian VC and PE deal activity, few would have imagined that it would cover such a significant time in the industry's history.

The survey window of 2005 – 08 encompasses the 'coming of age' of the PE investment class in Australia. It covers the highs of deal activity in 2006 – 07. It also records the significant drop in the volume and size of transactions from the later part of 2007 to 2008.

The current economic crisis is emerging as one of the biggest challenges in the lifetime of the domestic VC and PE industry. And it is still evolving.

Even in these difficult times, however, VC and PE funds are continuing to invest in Australia's future where they can.

Looking forward, despite global and regional economic uncertainty and a difficult lending environment, we remain confident of one thing: the economy will eventually recover. When it does, the VC and PE industry will still be critical mainstays in helping Australian companies get back on their feet, and in fuelling continued expansion and innovation within the recovering economy.

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

KATHERINE WOODTHORPE
Chief Executive, AVCAL
May 2009

Executive Summary

¹ Crescendo Partners is a strategy consulting and advisory firm, serving its clients through the offering of strategy consulting services, M&A and capital raising support

² The survey received responses from 70% of AVCAL members. FY09 transaction data has been compiled by Crescendo Partners from publicly available information.

³ Removing deals in excess of \$1b, average EV across the period was \$90m with a debt/EBITDA ratio of 3.7.

⁴ *Economist Intelligence Unit White Paper, "Private equity moves in: the impact on business in Australia", 2008.*

In July 2008, AVCAL commissioned Crescendo Partners to survey its members and build a knowledge base of venture capital (VC) and private equity (PE) transactions during FY2005 – FY2008.¹ The survey, which covered 220 transactions with total enterprise value (EV) in excess of \$23.5b identified the strong growth in PE transactions in the Australian market, but also highlighted the start of the decline in deal activity which has continued over the last 9 months, driven by the global economic crisis.²

The survey period corresponds with the 'coming of age' of PE as a significant investment class in Australia – a record number of PE buy-outs and increasing deal sizes – highlighted by the high profile acquisitions and bids for Channel Nine, Channel Seven, Coles and Qantas.

Looking back on this period, what can be learned in terms of deal size and structure, and looking forward how will the Australian VC and PE landscape be altered in light of the changed economic conditions?

Despite the high profile and public attention given to the PE buy-out model, the average EV across the period was \$114m with a manageable debt to EBITDA ratio of 3.8.³ Furthermore, PE activity accounted for only 4% of all Australian M&A activity in 2007, significantly below the 31% and 21% experienced in the US and the UK respectively.⁴

The close of 2007 and early 2008 saw a dramatic shift in the Australian PE landscape with the US sub-prime crisis morphing into the global financial crisis which continues to play out. Financial institutions have been rocked by exposure to risky assets and declining market capitalisations, leading to a reduced availability of debt – a dynamic that is anticipated to continue well into 2010. VC firms, too, have been sharply affected by the reduced availability of funding.

While the macro-economic future remains uncertain, the fundamentals of the Australian industry remain sound with a strong deal pipeline and an established PE industry (both locally and internationally). As a result we anticipate a return to growth in deal volumes and expect increasing deal flow as the economy recovers.

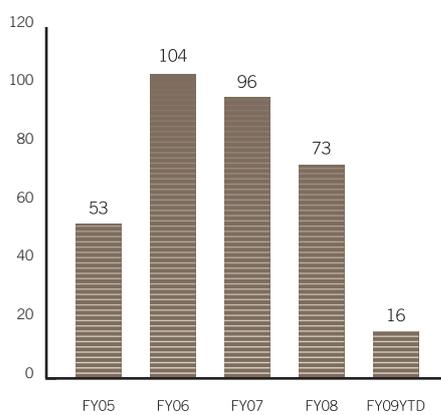
Private Equity Activity across the Survey Period

Number and Value of Transactions

336 PE deals were completed across the survey period, reaching ~100 transactions per annum in FY06 and FY07. Aggregate transaction size peaked in 2007, weighted by several multi-billion dollar deals.

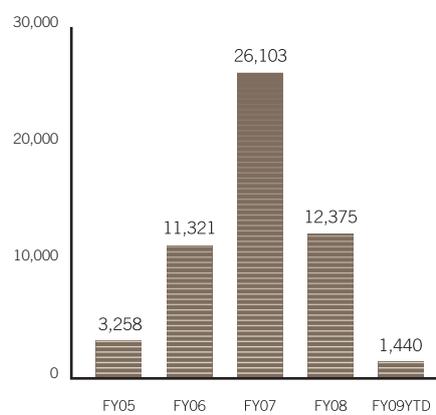
Number of transactions, FY05 – FY08

Source: AVCAL, Thomson Reuters, company websites, press releases



Value of transactions, FY05 – FY08 (A\$m)

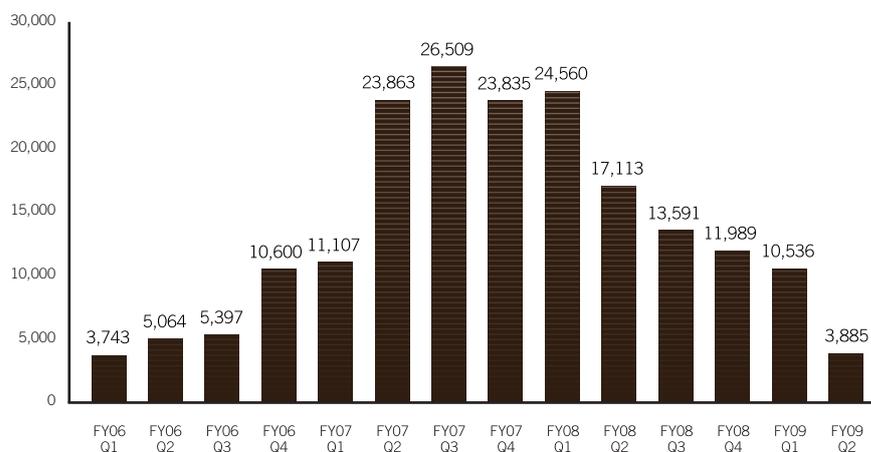
Source: AVCAL, Thomson Reuters, company websites, press releases



Despite the survey results indicating significant deal activity in FY08, 60% of the FY08 deals were actually completed in calendar year 2007, which is consistent with the timing of the tightening of debt availability. The peak and subsequent drop off in PE activity is illustrated by the quarterly moving average total (MAT) of the EV of buyout transactions from July 2005 to March 2009.

Moving average total (MAT) of new PE transactions' enterprise value, FY05 – FY09 (A\$m)

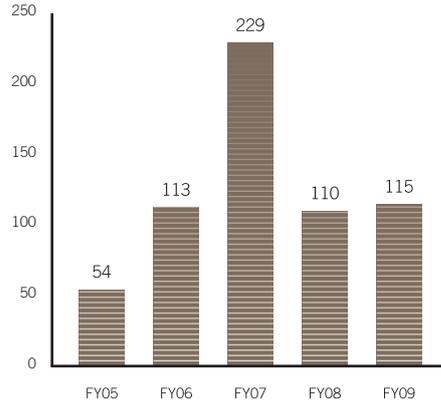
Source: AVCAL, Thomson Reuters, company websites, press releases



Over the survey period a number of transactions caught the attention of the public due to their size and the iconic nature of the Australian companies targeted. Despite a number of large deals, the average size of transaction peaked in 2007 with an EV of \$229m. This dispels the broadly held view that PE deals have only been occurring at the top-end of the M&A market, while confirming the PE industry view of the world – that despite high multiples being paid over this period, average EV reflects the focus of the majority of Australian PE funds on small and medium sized businesses.

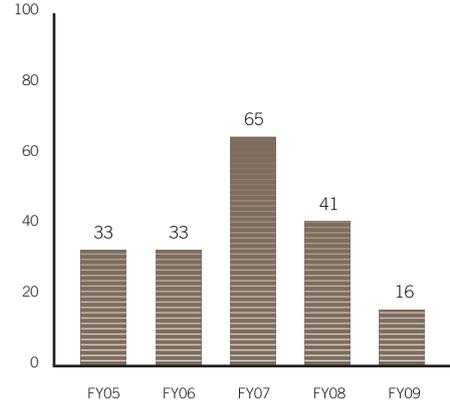
Average enterprise value of new PE transactions, FY05 – FY08 (A\$m)

Source: AVCAL, Thomson Reuters, company websites, press releases



Average enterprise value of bolt-on transactions, FY05 – FY08 (A\$m)

Source: AVCAL, Thomson Reuters, company websites, press releases

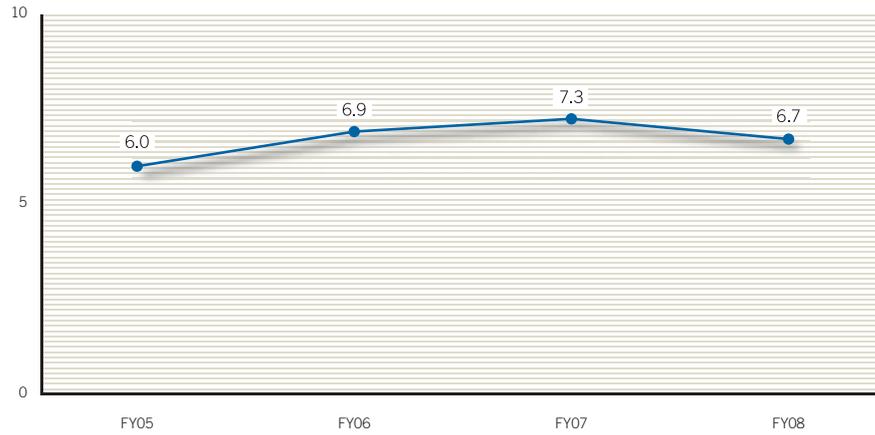


Average Transaction Multiples

Despite the strength of the Australian M&A market and intense competition for assets over the survey period, the average EBITDA multiple paid on entry remained within the traditional target range for PE funds, between 6x – 7x.

Average PE transaction EBITDA multiples, (EV/EBITDA, FY05 – FY08)

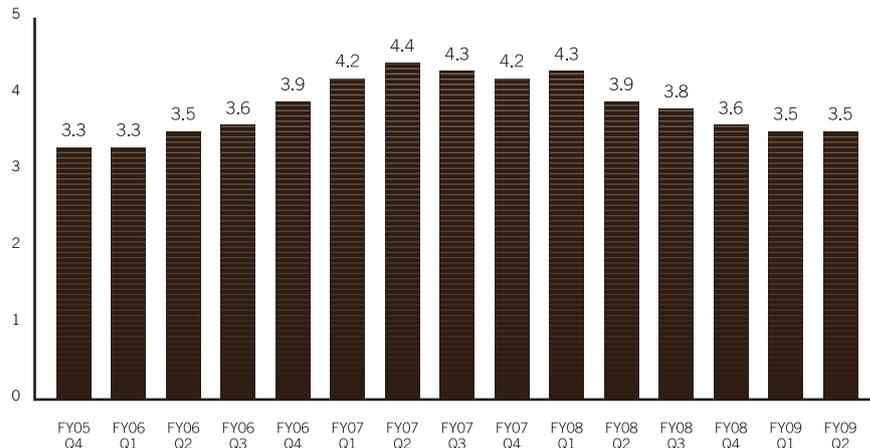
Source: AVCAL



The average transaction debt multiple (debt to EBITDA ratio) peaked in late 2006 at 4.4x. Moving forward, it appears that funding is likely to be mainly available at lower debt multiples of 2.0 – 2.5 x EBITDA.

Moving average total (MAT) of debt/EDITDA, FY05 – FY08 (xEDITDA)

Source: AVCAL, Thomson Reuters, company websites, press releases

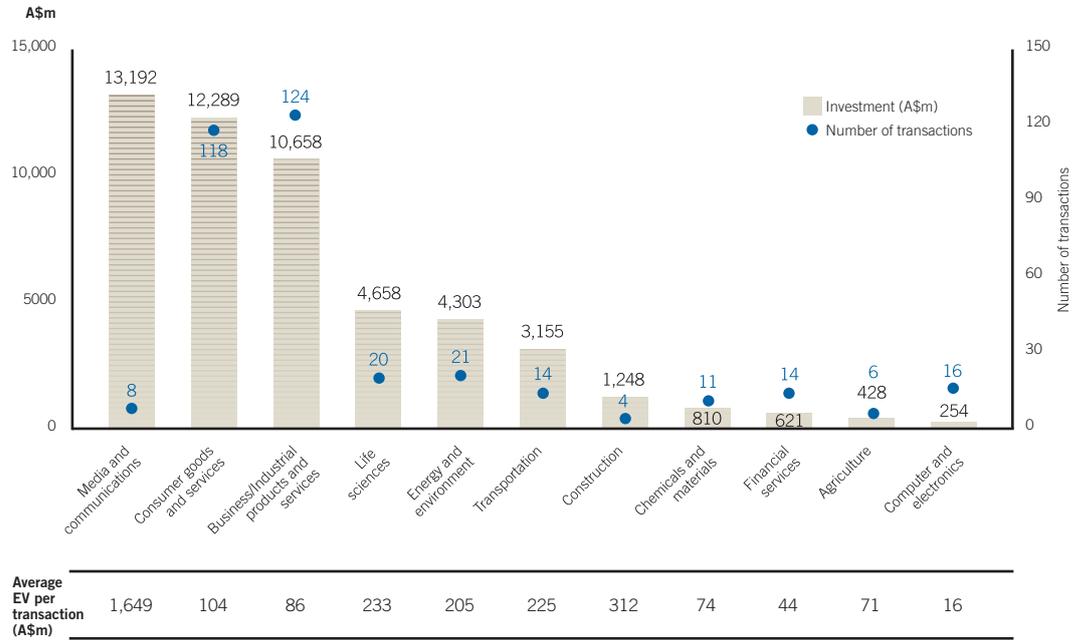


Industry Transaction Multiples

Taking a sector perspective, consumer goods and industrial/business sectors have been the focus for most PE transactions, driven by industry structure and the appeal of assets in these industries to the PE model. Not surprisingly, the media/communications industry has experienced the largest average EV transactions due to the PE joint ventures with the Seven Network, PBL and others in 2006 following the change in media ownership laws.

PE investment by industry sector, FY05 – FY08 (A\$m)

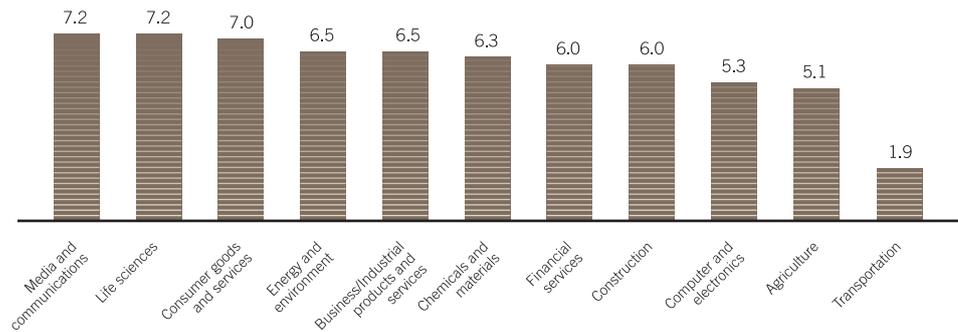
Source: AVCAL



EV/EBITDA and Debt/EBITDA multiples vary by industry, but for the most part have been relatively consistent and stable across the survey period.

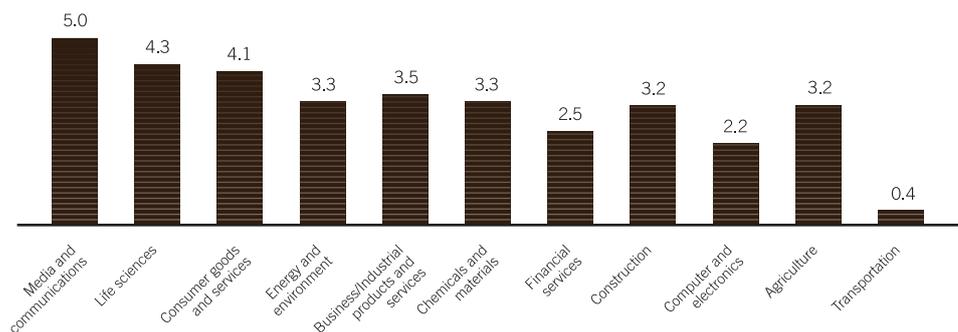
EV/EBITDA per industry sector, FY05 – FY08 (xEDITDA)

Source: AVCAL



Debt/EBITDA per industry sector, FY05 – FY08 (xEDITDA)

Source: AVCAL

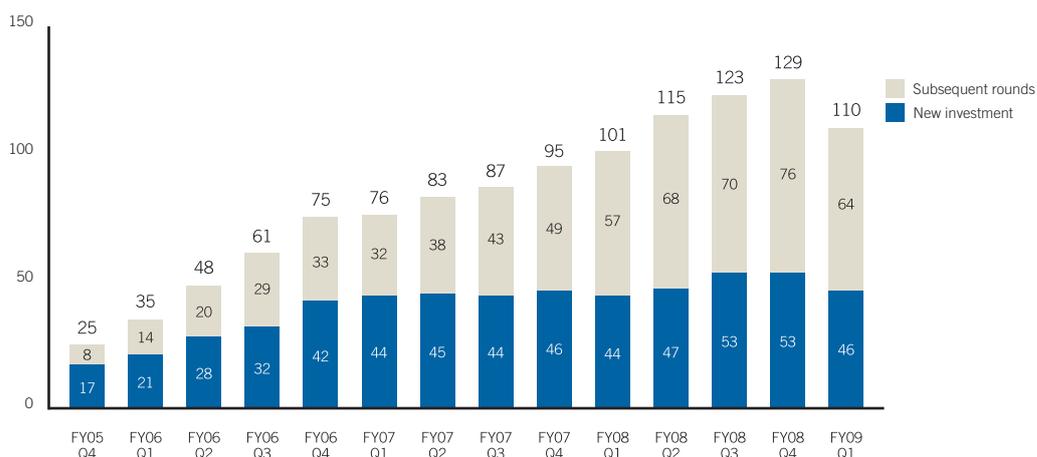


Venture Capital Activity across the Survey Period

VC activity peaked in late FY08 with a MAT of 129 transactions. It can be seen, however, the number of new investments has declined steadily as a proportion of overall VC investment since mid-2007.

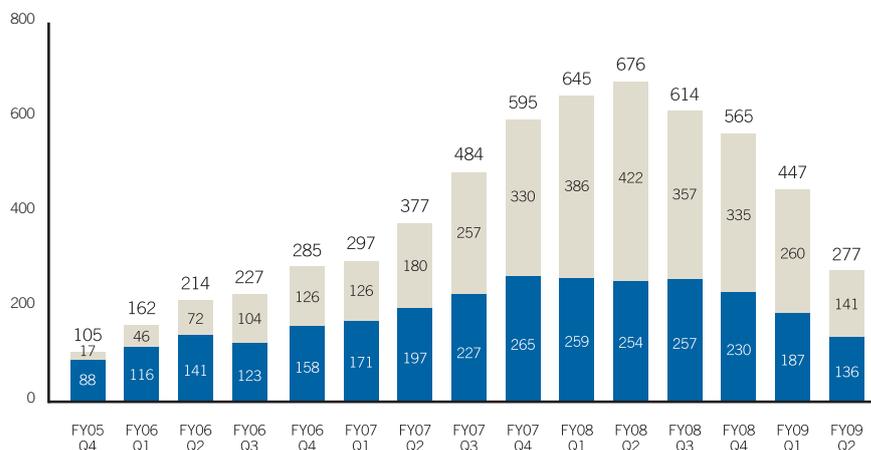
Moving average total (MAT) of number of VC transactions, FY05 – FY08

Source: AVCAL, Thomson Reuters, company websites, press releases



Moving average total (MAT) of total value of VC transactions, FY05 – FY08 (A\$m)

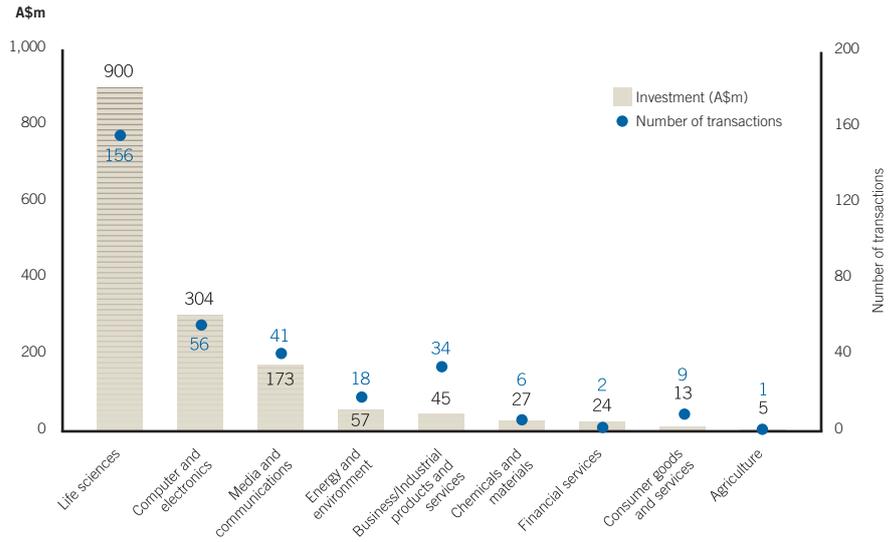
Source: AVCAL, Thomson Reuters, company websites, press releases



Across the survey period capital contributions to Australian VC funds invested increased from 28% in FY05 to 37% in FY08.

Historically, VC activity has been supported by government funding which has also attracted funding from the private sector. However the loss of the government approved funding through the Commercial Ready Grants is resulting in an investment shortfall in this asset class. The life sciences sector, unsurprisingly, attracts 60% of VC investment, and accounts for approximately half of all VC-related transactions. However, recent anecdotal evidence suggest that the quantum of VC investment in life sciences is currently on the decline. Short-term economic pressures in this sector are resulting in reduced R&D spend, which is consequently impacting new product development and the availability of clinical trials.

Total VC investment by industry sector, FY05 – FY08 (A\$m)
 Source: AVCAL



The Australian VC industry is faced with a challenging environment with limited opportunities for fundraising in the short to medium term. VC funds are now less willing to do new deals in favour of conserving funds to support current investments. Tough fund raising conditions are putting a strain on many VC firms, particularly those with funds that are approaching the end of their lifecycle.

How has the Australian investment landscape changed, and what does this mean for VC and PE activity?

⁵ David Rubenstein, Carlyle Group, as quoted in *Economist Intelligence Unit White Paper, "Private equity moves in: the impact on business in Australia"*, 2008.

The new economic environment has created a number of challenges for VC and PE funds, as well as for the broader commercial sector (reduced growth, higher cost of debt).

The changed investment dynamic will impact the PE industry in a variety of ways. These include:

- An increasing focus by PE funds on portfolio management, notably servicing debt arrangements. Some industries will be more exposed to the downturn than others, e.g. those closely linked to construction and discretionary spending
- Reduced options to exit investments, due to lower EBITDA multiples being paid and equity market volatility limiting the appetite for IPO listings
- Fewer acquisition targets, with an expected increase in the number of bolt-ons as well as targeted public-to-private transactions
- Likelihood of failures of PE-owned businesses – consistent with business failures in the broader market – which will impact the IRR for some funds

Over the short term, PE is expected to continue to be active, focusing mainly on distressed assets and smaller transactions. It is anticipated that PE transaction volumes will return to the Australian market as the Australian economy and specific industries recover over the course of the next couple of years. The return of the Australian PE industry to the levels experienced during the survey period will be closely linked to the availability of debt, regional and global economic growth, and an improvement in consumer confidence.

Opportunities still remain

Despite the lull in deals over the last 12 months, many Australian PE funds remain well capitalised. As with previous downturns impacting the global PE industry, “changes were made and private equity came back stronger”.⁵ PE funds that can spot the right opportunities will continue to deliver absolute returns in excess of alternative investment opportunities.

- Anecdotal evidence indicates banks are still willing to finance smaller transactions that involve appealing assets and PE funds with a successful track record
- There will be an increase in assets available on the secondary PE market with an opportunity for debt arbitrage due to the high gearing of some distressed assets
- PE is emerging as an alternate source of capital for corporates to fund growth strategies and re-finance debt due to the capital market constraints impacting all types of borrowers

Specifically this means that deals in the Australian market will most likely continue – particularly smaller situations and mid-market deals – and buy-outs/LBOs will remain an attractive investment opportunity due to PE being underweight as a percentage of Australian M&A. PE will also deliver a wider benefit to the Australian corporate landscape as an alternative funding opportunity in rescue finance, the provision of bridge loans and in corporate restructures.

The funds that can successfully manage this downturn will emerge stronger and deliver investment returns in the course of helping Australian companies navigate this challenging period.