

## News

# Force for Growth – Private Equity Model Evolves to Meet Challenges

The 2011 Grant Thornton Global Private Equity Report, released today, highlights the important shifts that have occurred in the industry to date and our expectations for the sector as the world struggles with an evolving financial operating environment.

Private equity professionals revealed that, globally, nearly half (44%) of firms now view performance improvement with portfolio companies as the main value driver with 22% expecting to be more involved in the future. Similarly, around 33% of South East Asian private equity professionals are seeking to increase their level of hands on management.

Private equity firms are driving value by becoming involved in key management functions such as strategy (46%), financial planning (35%) and human resources (30%). With debt markets still constrained, financial engineering's role is now negligible, with just over 2% of those interviewed citing it as a value driver.

The last three years have seen the private equity model evolve to meet a new set of challenges. Investors have become more analytical, demanding transparency from private equity partners – a sentiment echoed by regulators and the public both in Australia and overseas.

“Investors want growth, but they also want to know how it’s being delivered and to have the assurance that it’s being achieved in a responsible way. Given the economic backdrop in the developed economies, private equity can’t look to market growth to drive value. This means that there’s a pressure on practitioners to really perform and build demonstrable track records in order to prosper,” said Scott Griffin National Head of Corporate Finance Australia.

Competition for deals has also intensified. Firms are contending with domestic and foreign private equity players, as well as trade buyers adding to the tension by pushing prices upwards.

“Not all private equity firms will survive these challenges. While private equity firms rarely fail and disappear overnight, a period of Darwinism is likely to continue for some years to come. Successful firms are likely to have addressed the need to add value and drive growth in their portfolio companies.

“What we’re seeing is private equity beginning to live up to its promise. But the sector as a whole still needs to work harder to improve its reputation, countering suspicion and ignorance, by demonstrating that it is socially responsible and by explaining the value it can deliver. If this research highlights one thing, it’s that the sector can be part of the solution to our current economic difficulties rather than part of the problem. For that reason the private equity industry needs support,” said Mr Griffin.

Whilst the underlying economic trading conditions are vastly better in the Asia Pacific than in the Northern Hemisphere markets, the feedback from local participants on the common operating issues currently facing private equity are considerably aligned with their overseas peers.



Two thirds of the Asia Pacific respondents are expecting deal activity levels to increase over the next year. These deals are expected to originate from a wider range of sources than in other markets. This conveys the importance of strong local networks and good track records in the region.

Australian opportunities are expected to occur in sectors such as mining services and healthcare, whilst the expanding South East Asian middle class is expected to drive consumer-focussed opportunities.

“The Australian private equity findings by respondents are remarkably similar to their international peers notwithstanding greater exposure to sectors influenced by strong Asian growth. I suspect issues such as crowding, transparency and fund raising reflect Australia’s continuing juggle with our multi-speed economy.

“The private equity market place is acutely attuned to the sensitivity of sector allocation and those businesses and management who can best respond to our volatile and changing market conditions,” said Mr Griffin.

All Australian respondents expect deal multiples to either stay the same or decrease over the next year in contrast to South East Asian participants with 50% expecting multiples to increase.

“Whilst the booming South East Asian markets and the consequential increase in capital flooding to the region will naturally lead to increased deal multiples, the Australian situation is more complex as a delayed bout of negative consumer sentiment outweighs the macro fundamentals driving the wider Asian growth story,” said Mr Griffin.

Exit activity is expected to increase over the next 12 months in the region with 33% of respondents stating they plan to exit more than half of their portfolio in that time. The recent rise of secondary transactions and the continued pressure to exit pre-GFC vintage assets should drive strong exit numbers over the next 12 months.

In relation to fund raising, respondents were more negative about the environment than their counterparties in other regions. In particular, Australian participants pointed to reduced exposure from local superannuation funds, tax issues and concerns over track records as the main drivers of this negative sentiment. This is requiring funds to source greater levels of their capital overseas.

Overall, respondents identified the key positive factors supporting the local market as the strength of consumer demand, access to natural resources and proximity to China and India. In contrast, key challenges of the region included poor perception of the value of private equity and the continued lack of deep debt capital funding pools.

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