

September 2024



Deals down under

How private equity investors can access the plentiful and potentially more profitable Australian mid-market sector

In 2024 institutional investors are increasingly looking to private equity allocations to enhance returns. Q2 2024 saw the strongest global activity in private equity deals for two years, as investors increasingly deployed dry powder on the back of stronger growth outlook.¹

With strong competition and relatively high prices in home markets, many institutional private equity investors are scouring the globe for investment opportunities that can offer the potential for out-sized risk-adjusted returns.

But not all regions are created equal.

When it comes to investing in private equity, the first port of call for many investors is to seek out jurisdictions with effective government and well-regulated legal systems. Arguably, one of the chief market criteria is a strong, robust and efficient economy. As well, markets that are supportive of technology development, innovation and disruption are highly sought-after.

As a result, private capital investors are increasingly looking to Australia. In addition to ticking all these

¹ Private Equity Pulse: Key takeaways from Q2 2024, EY https://www.ey.com/en_gl/insights/private-equity/pulse

boxes, private capital investments in Australia have, on average, historically delivered robust returns at a lower average risk.

In a recent research report on the private equity market in Australia, the Reserve Bank of Australia found that, between 2010 and 2019, the share of capital committed to Australian private equity funds from foreign investors rose steadily to 45 per cent, compared with less than 10 per cent in 2010. Notably, this was primarily driven by investments from private equity funds based in the United States.²

Australia is an attractive place for private capital

The rationale driving the focus on Australia for private equity investment can be seen in Figure 1.

As is evidenced in Figure 1, investments in the Australian buy-out market between 2000 and 2023 outperformed other global private equity markets, including the US and Western Europe, on both a local currency and USD, time-weighted return basis. As well, Australian private equity outperformed the small cap listed market in the US over the same period, as tracked by the Russell 2000 Total Return Index.

Lower investment risk driven by lower entry valuations and lower leverage

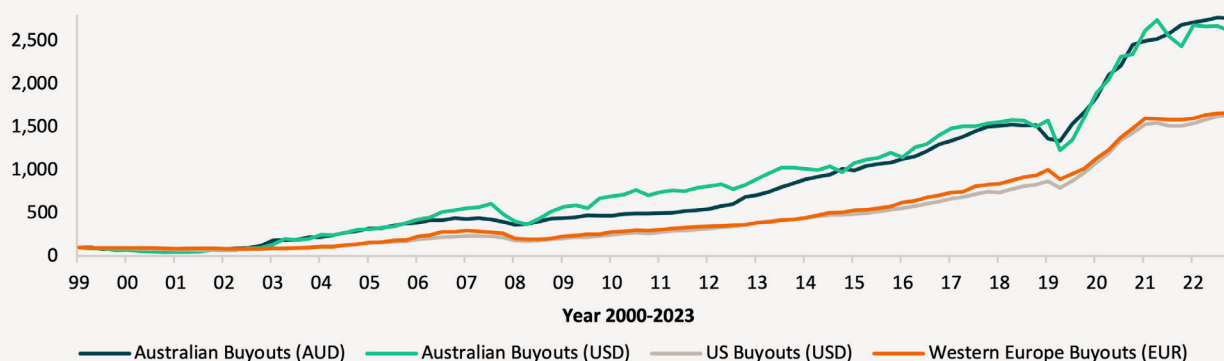
Analysis of Australian private equity investment valuations against USA and Europe valuations (Figure 2) and leverage (Figure 3) as a proxy for risk shows that, in addition to the sector delivering higher returns historically, it has also done so with relatively lower risk.

The median entry price for Australian private equity investments has been lower for the majority over time over the past fifteen years, with EBITDA multiples below those of both US and European markets, excepting for a period in 2018 that was caused by several outsized public-to-private transactions completed by offshore buyers (see Figure 2). This overall lower pricing for Australian private equity investments contributes to lower overall debt requirement, another factor helping to reduce investment risk.

Lower pricing and lower debt are factors that have supported Australian private equity performance (See Figure 1) and contributed to Australian private capital asset classes outperforming both the US and Europe regions.

FIGURE 1

AUSTRALIAN BUYOUTS HAVE OUTPERFORMED US AND EU BUYOUTS OVER THE LONG TERM³



Past performance does not guarantee future results. Data as at 30 June 2023.

² The Private Equity Market in Australia, Bulletin – April 2024, <https://www.rba.gov.au/publications/bulletin/2024/apr/the-private-equity-market-in-australia.html>

³ TWRR Index of net returns assuming investment in every fund; Source: Burgiss Private IQ database; Returns as at 30 Sep 2023; Data for 1,328 funds with US\$1.9trn in committed capital raised between 2000 and 2020; Australian Buy-out funds exclude Asian pan regional funds, which are included in Asia – Ex pacific.

FIGURE 2

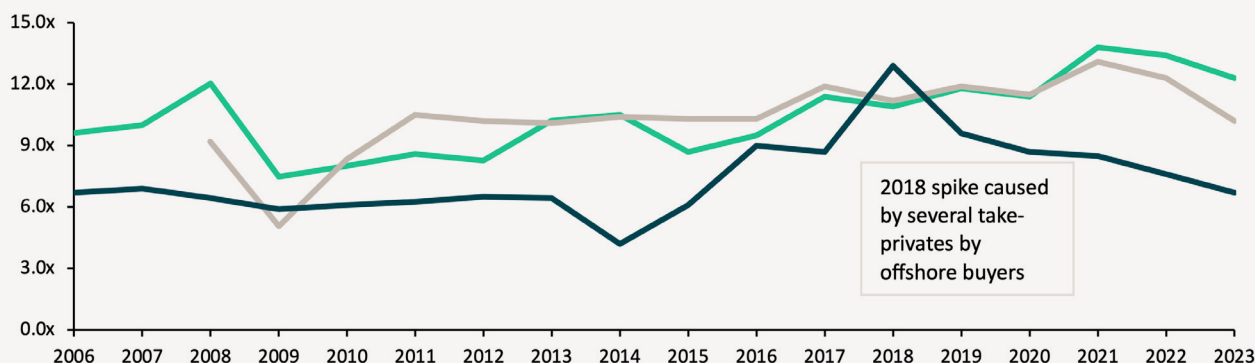
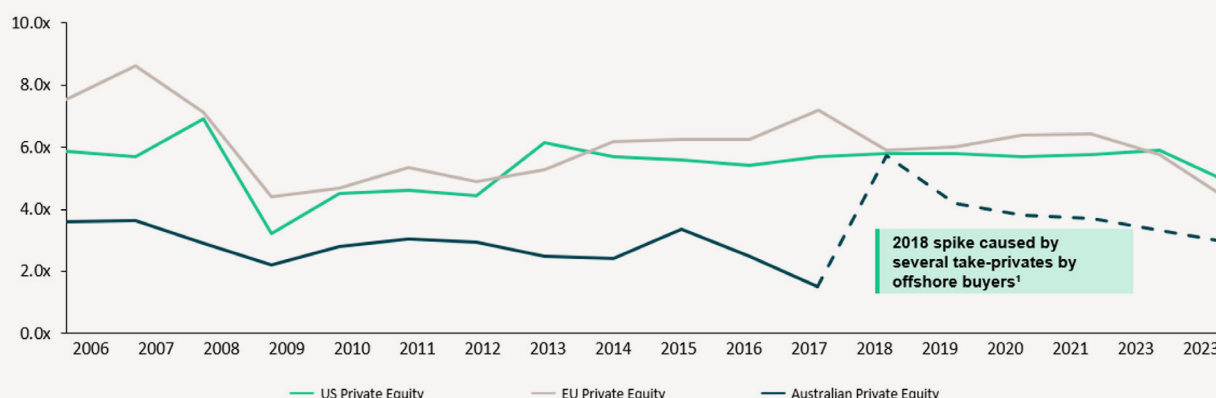
AUSTRALIAN PRIVATE EQUITY HAS GENERALLY PROVIDED LOWER ENTRY VALUATIONS⁵

FIGURE 3

AUSTRALIAN PRIVATE EQUITY MEDIAN ENTRY NET DEBT VERSUS EBITDA VALUATION⁶

The depth of the Australian private equity market

The Australian private equity market is sizeable, with an average of 100+ deals completed annually for the 10 years to 2022 (see Figure 4).

Data points to technology as a deal driver. Artificial intelligence is not only a value creation lever for portfolio companies but also an active investment

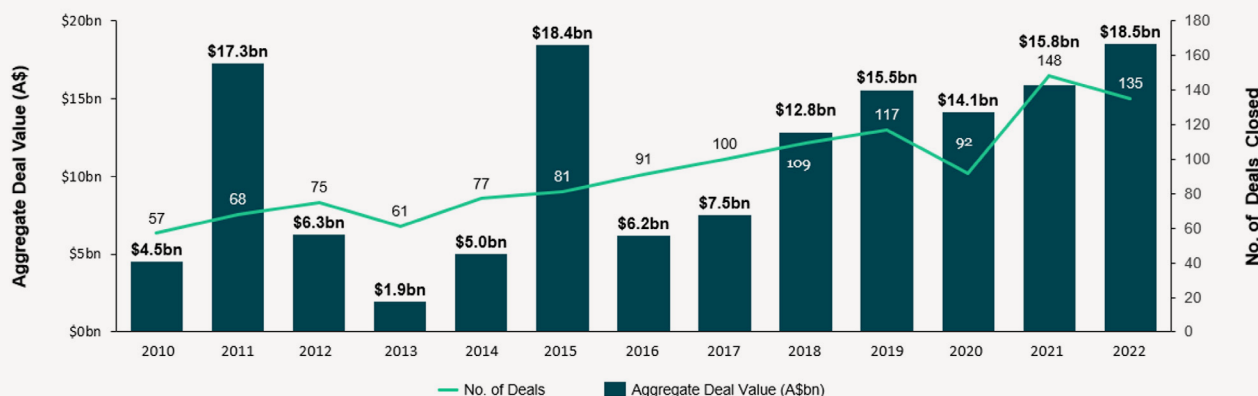
thesis. Significant investments continue to be made in software and technology enabled business-to-business companies that are servicing financial services, energy transition, infrastructure sectors. Transaction numbers across the information technology and business services sectors have grown steadily over the last few years, while deals for consumer sector businesses have reduced. Healthcare, too, has been a consistent sector that has attracted private equity investment.

⁵ Source: Pitchbook (2023) Annual PE Breakdown for US and EU data; Aust PE represents AVCAL data for 2006-2013 (no longer reporting); Preqin data 2014-2020 (Aus buyout deals – no data beyond 2020); CapIQ 2021-2023 (Aus closed M&A deals). Note, Australian Private Equity spiked in 2018 due to several public-to-privates completed by offshore buyers. (Prominent among these were Sirtex – China Grand Pharmaceuticals 23.7x, Scottish Pacific – Affinity 29.3x, MYOB – KKR 17.9x.)

⁶ Source: Pitchbook (2023) Annual PE Breakdown for US and EU data; AVCAL for ANZ data. AVCAL, now AIC, stopped collecting deal metric data in 2018 (dotted blue line represents an estimation by IFM based on historical average net debt / EBITDA relative to actual EV / EBITDA multiples from previous slide). Note, Australian Private Equity spiked in 2018 due to several public-to-privates completed by offshore buyers. (Prominent among these were Sirtex – China Grand Pharmaceuticals 23.7x, Scottish Pacific – Affinity 29.3x, MYOB – KKR 17.9x.)

FIGURE 4

AUSTRALIAN PRIVATE EQUITY MARKET HAS AVERAGED 100+ TRANSACTIONS P.A. (10 YEARS TO 2022)⁷



The lower-middle market opportunity set

What stands out across the private equity landscape in Australia is where the deals can be found. The Australian lower and mid-market economy, that is, companies with A\$10m to A\$100m annual revenue, offers a large opportunity set (Figure 5). There are more than 22,000 companies in Australia with this revenue profile.

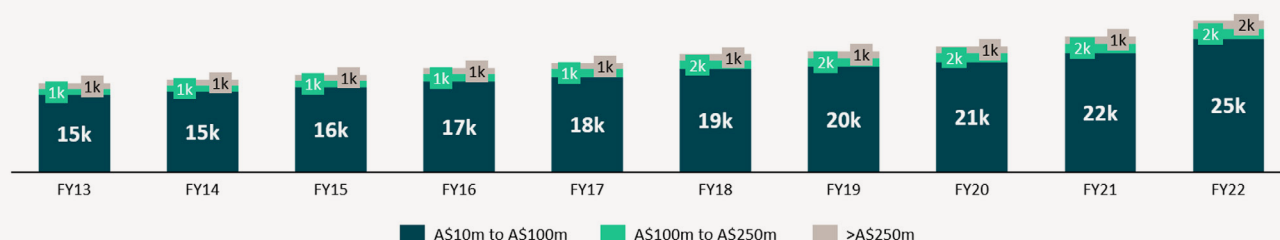
By comparison, only ~1,000 businesses in Australia have revenue over AU\$250m, of which many are publicly listed and others are local subsidiaries of multi-national corporations.

Figure 5 highlights that the Australian lower-middle market presents as the weightiest market segment, with opportunities spanning family-owned business, corporate carve outs, secondary sales and public to private. Further to the relatively plentiful opportunities, there are other observable advantages:

- relative valuations are lower than the upper mid-market
- founders and management are increasingly looking for capital and actively seeking strategic growth partners
- there is growing opportunity for growth and value creation.

FIGURE 5

AUSTRALIAN COMPANIES BY REVENUE⁸



⁷ Source: Australian Private Capital Market Overview: A Preqin and Australian Investment Council Yearbook 2023. Includes bolt-ons

⁸ Source: Australian Tax Office; Fiscal Year-end June. Updated 24 July 2024.

Despite this significant opportunity set, the lower mid-market tends to attract less competition than other segments. The number of deals completed over the last three years by firms active in Australia (see Figure 6) were, on average, more than 3 deals per active investor in the lower midmarket, compared to 2.4 deals per investor in the upper mid-market and 1.3 deals per investor in the large caps market.

Opportunities for growth through value creation

When it comes to providing capital for growth in the Australian lower-middle market we aim to partner with like-minded founders and management teams, seeking to accelerate and build capabilities for long-term success. We seek companies with resilient business models and a clear growth agenda, where our capital and expertise can make a positive impact on the company and provide attractive risk-adjusted returns to our investors.

Across the Australian lower-middle private equity market we continue to observe:

- opportunities for capital-light, technology based businesses taking share from more asset-

intensive traditional businesses

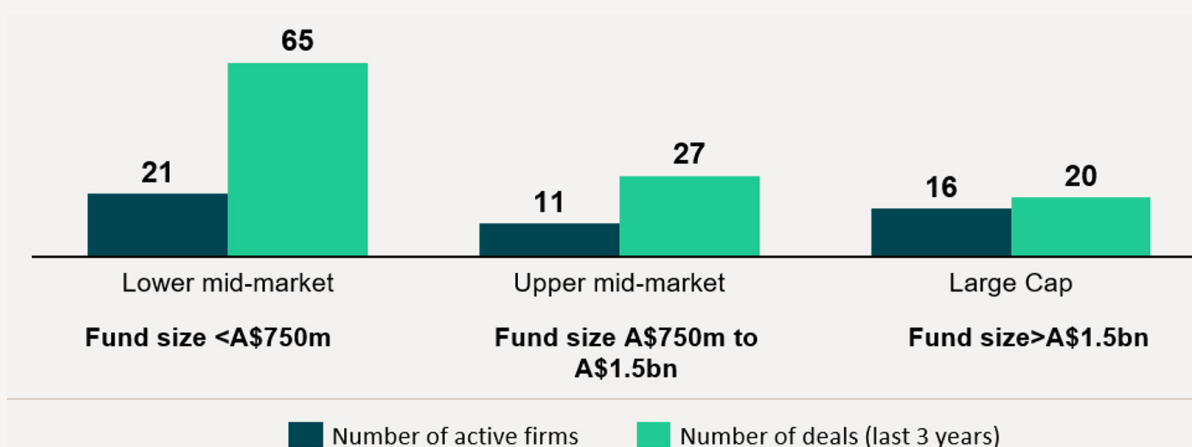
- opportunities amongst healthcare and business services companies to accelerate growth amidst favourable economic and social conditions, and
- increasing openings for established, sustainable companies with the growth potential to impact decarbonisation across their ecosystem.

As the business landscape continues to evolve, we have observed company founders and management increasingly motivated to find equity partners that can help them leverage growth opportunities and provide risk management expertise. Other opportunities could also emerge as larger corporates seek to divest non-core assets and pursue rationalised strategies aimed at repairing their balance sheets.

Regardless of the motivation, Australian businesses that are now coming to market are typically on the cusp or their growth trajectory, seeking new capital and value creation ideas to bolster and build their business. These emerging market opportunities serve to further bolster the appeal of Australia's mid-market, which we believe represents an area that may have flown under the radar for global private equity investors.

FIGURE 6

ACTIVE FIRMS VS. DEALS COMPLETED BY SEGMENT FOR AUSTRALIAN PRIVATE EQUITY⁹



⁹ Source: Preqin, Mergermarket, CapitalIQ, Firms websites; As at 31 January 2024. Active firms are PE firms either with an Australian investment office or fly-in offshore firm who has invested in Australia in the past 3 years; Data based on publicly available information and may not be complete; Lower mid-market defined as funds under \$750m, mid-market funds \$750m to \$1.5bn and Upper market \$1.5bn+ & pan regional managers.

Important Disclosures

The following disclosure applies to this material and any information provided regarding the information contained in this material. By accepting this material, you agree to be bound by the following terms and conditions. The material does not constitute an offer, invitation, solicitation, or recommendation in relation to the subscription, purchase, or sale of securities in any jurisdiction and neither this material nor anything in it will form the basis of any contract or commitment. IFM Investors (defined as IFM Investors Pty Ltd and its affiliates) will have no liability, contingent or otherwise, to any user of this material or to third parties, or any responsibility whatsoever, for the correctness, quality, accuracy, timeliness, pricing, reliability, performance or completeness of the information in this material. In no event will IFM Investors be liable for any special, indirect, incidental, or consequential damages which may be incurred or experienced on account of a reader using or relying on the information in this material even if it has been advised of the possibility of such damages.

Certain statements in this material may constitute "forward looking statements" or "forecasts". Words such as "expects," "anticipates," "plans," "believes," "scheduled," "estimates" and variations of these words and similar expressions are intended to identify forward-looking statements, which include but are not limited to projections of earnings, performance, and cash flows. These statements involve subjective judgement and analysis and reflect IFM Investors' expectations and are subject to significant uncertainties, risks, and contingencies outside the control of IFM Investors which may cause actual results to vary materially from those expressed or implied by these forward-looking statements. All forward-looking statements speak only as of the date of this material or, in the case of any document incorporated by reference, the date of that document. All subsequent written and oral forward-looking statements attributable to IFM Investors or any person acting on its behalf are qualified by the cautionary statements in this section. Readers are cautioned not to rely on such forward-looking statements. The achievement of any or all goals of any investment that may be described in this material is not guaranteed.

Past performance does not guarantee future results. The value of investments and the income derived from investments will fluctuate and can go down as well as up. A loss of principal may occur. This material may contain information provided by third parties for general reference or interest. While such third-party sources are believed to be reliable, IFM Investors does not assume any responsibility for the accuracy or completeness of such information. This material does not constitute investment, legal, accounting, regulatory, taxation or other advice and it does not consider your investment objectives or legal, accounting, regulatory, taxation or financial situation or particular needs. You are solely responsible for forming your own opinions and conclusions on such matters and for making your own independent assessment of the information in this material. Tax treatment depends on your individual circumstances and may be subject to change in the future. This material is confidential and should not be distributed or provided to any other person without the written consent of IFM Investors.

This material is provided for informational purposes only. This material does not constitute an offer, invitation, solicitation or recommendation in relation to the subscription, purchase or sale of securities in any jurisdiction and neither this material nor anything in it will form the basis of any contract or commitment. Past performance does not guarantee future results. The value of investments and the income derived from investments will fluctuate and can go down as well as up. A loss of principal may occur. This material is confidential and should not be distributed or provided to any other person without the written consent of IFM Investors.

Australia Disclosure

This material is provided to you on the basis that you warrant that you are a "wholesale client" or a "sophisticated investor" or a "professional investor" (each as defined in the Corporations Act 2001 (Cth)) to whom a product disclosure statement is not required to be given under Chapter 6D or Part 7.9 of the Corporations Act 2001 (Cth). IFM Investors Pty Ltd, ABN 67 107 247 727, AFS Licence No. 284404, CRD No. 162754, SEC File No. 801-78649.

Netherlands Disclosure

This material is provided to you on the basis that you warrant that you are a Professional Investor (professionele belegger) within the meaning of Section 1:1 of the Dutch Financial Supervision Act (Wet op het financieel toezicht). This material is not intended for and should not be relied on by any other person. IFM Investors (Netherlands) B.V. shall have no liability, contingent or otherwise, to any user of this material or to third parties, or any responsibility whatsoever, for the correctness, quality, accuracy, timeliness, pricing, reliability, performance, or completeness of this material.

United Kingdom Disclosure

This material is provided to you on the basis that you warrant that you fall within one or more of the exemptions in the Financial Services and Markets Act 2000 ("FSMA") [(Financial Promotion) Order 2005] [(Promotion of Collective Investment Schemes)(Exemptions) Order 2001, or are a Professional Client for the purposes of FCA rules] and as a consequence the restrictions on communication of "financial promotions" under FSMA and FCA rules do not apply to a communication made to you. IFM Investors (UK) Ltd shall have no liability, contingent or otherwise, to any user of this material or to third parties, or any responsibility whatsoever, for the correctness, quality, accuracy, timeliness, pricing, reliability, performance, or completeness of the information in this material.

Switzerland Disclosure

This Information is provided to you on the basis that you warrant you are (i) a professional client or an institutional client pursuant to the Swiss Federal Financial Services Act of 15 June 2018 ("FinSA") and (ii) a qualified investor pursuant the Swiss Federal Act on Collective Investment Schemes of 23 June 2006 ("CISA"), for each of (i) and (ii) excluding high-net-worth individuals or private investment structures established for such highnet worth individuals (without professional treasury operations) that have opted out of customer protection under the FinSA and that have elected to be treated as professional clients and qualified investors under the FinSA and the CISA, respectively.

IFM-16SEP2024 - 3843307