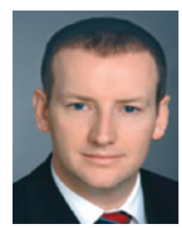
BDO KNOWS INTERNATIONAL PRIVATE EQUITY:
SPOTLIGHT ON ASIA-PACIFIC

With private equity (PE) investment activity in the Asia-Pacific region gaining momentum, **Lee Duran**, BDO USA's Private Equity Practice Leader sat down with **Sebastian Stevens**, Partner in Charge of the Corporate Finance practice at BDO Australia, to discuss his firsthand observations and predictions for PE activity in the region.

Lee Duran



Sebastian Stevens

Can you describe the state of the PE market in the Asia-Pacific region over the past few years?

The past three to five years have been challenging for the PE industry in the Asia-Pacific region. Specifically, volatility in the Australian stock market has made it very difficult for many PE firms to sell their assets, which were acquired with cheap debt at the height of the boom. This has resulted in a growing number of secondary transactions, which is when one PE firm sells its assets to another PE firm. For example, Archer Capital sold its accounting software business to Bain Capital for a reported $1.2 billion.

However, market volatility has not been all bad news for the industry. Concerns surrounding European government debt, combined with short-sighted investor sentiment, have resulted in a weaker domestic stock market. Thus, some PE firms have been able to acquire potentially solid businesses below their previous valuations.

Another trend that has emerged in the past five years is the growing presence of distressed debt funding. In a distressed debt transaction, a PE firm raises funds from investors as a means of purchasing the debt of companies that are struggling to repay said debt. Should a distressed company default on its debt, the PE firm swaps the debt for equity in the company. Essentially, this is another way for a PE firm to acquire a business. In Australia, most debt is purchased from the banks that originally lent the money to the companies before they became distressed. Within the past five years, the largest of such transactions was the debt-for-equity swap of Channel 9 network.

Staying on the topic of PE activity in Australia, the last six to nine months have seen a complete turnaround on both the buy and sell sides of the PE market. How have consolidation, mergers and acquisitions (M&A) and initial public offerings (IPOs) contributed to this improvement in the market?

One source of the increased buy and sell activity in the Australian PE market is the recovery in the equity markets, which, over the past two years, has prompted PE firms to look into exiting their investments through

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IPOs. For example, Quadrant Private Equity successfully exited now-public VirtusHealth for more than $338 million.

Furthermore, M&A deals have also contributed to the PE resurgence. From January 2011 to March 2014, PE buyers—who are roaring back to life after soft deal flow since 2012—comprised 14 percent of all M&A deals. While this would appear to be a small portion, PE firms are much more prevalent in larger deals and have been involved in two of Australia's 10 biggest deals in the past three years.

The Wall Street Journal reported that in the first five months of 2014, announced PE takeover deals in Australia reached $5.5 billion, a higher amount than that of any full year since 2006. More specifically, Australia has seen an increase in cross-border deals by U.S.-based PE funds. What do you think are the driving forces behind this trend?

First, it is important to note that although Australia is a relatively small, isolated market, its economic stability is highly inviting to investors. Equally as inviting is Australia's geographic location in regards to trade with Asia. Many PE firms that do business in Australia are looking for companies with strong brands they could use to improve their own portfolios, but also sell into Asia. Recent trade agreements with Japan and Korea have enhanced this attraction to Australia for PE investors.

What is your prediction for PE in the Asia-Pacific region, particularly Australia, over the next six to 12 months?

As the economic uncertainty caused by the financial crisis slowly recedes, I expect the renewed interest in PE investments to continue to grow. Consumer and business behavior will likely return to "normal," causing PE industry participants to feel more confident when it comes to making significant investment decisions. Throughout the global financial crisis, the distinction between permanent structural changes and temporary cyclical changes was not clear, thereby increasing the risk profile of prospective investment opportunities. Consequently, many PE firms have pooled funds from investors over the past five years without actually undertaking many investments. Now that conditions are stabilizing, investment activity is expected to resume.

Specifically in Australia, a greater inflow of funds into superannuation—or pension contributions—will benefit the industry, especially with compulsory employer superannuation contributions increasing from 9.25 percent to 12.0 percent by 2019. With more than half of PE investments coming from superannuation funds, growth in superannuation savings will translate to asset growth within the industry.

Will U.S. PE firms continue to ramp up their activity in Australia? In the Asia-Pacific region, what other countries are primed for increased investment activity?

Given Australia's economic stability and prime geographic location, I expect U.S. PE investment to continue to increase. Looking at the region as a whole, I believe that continuing economic growth in Asia will attract greater foreign PE fund interest and investment. In particular, the rapid development in Indonesia, which is now the fourth most populous country globally, is likely to offer numerous investment opportunities for shrewd investors.

For more information on Private Equity in Asia-Pacific, please contact one of the following practice leaders:

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