AVCAL

AUSTRALIAN PRIVATE EQUITY &
VENTURE CAPITAL ASSOCIATION
LIMITED

PRIVATE EQUITY IN AUSTRALIA

"Private equity offers a compelling business model with significant potential to enhance the efficiency of companies both in terms of their operations and financial structure. This has the potential to deliver substantial rewards both for the companies' owners and for the economy as a whole. This positive contribution to capital markets is expected to increase over time as the private equity market continues to grow and mature."

Private Equity: A Discussion of Risk and Regulatory Engagement, Financial Services Authority of the United Kingdom, November 2006.

Submission to the Senate Standing Committee on Economics
May 2007

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"Private equity can make an important contribution to the re-generation of the economy by nurturing new enterprises and re-energizing existing companies. In so doing, it can lay the seeds for sustained growth and job-creation and assist in the drive to be increasingly globally competitive. It has a proven track record in increasing productivity and profitability and at the same time creating jobs."

Report of the Alternative Investment Expert Group, European Commission, July 2006

Executive Summary

The Australian Private Equity & Venture Capital Association Limited ("AVCAL") welcomes the Inquiry into Private Equity by the Senate Standing Committee on Economics.

The inquiry provides a timely opportunity for fact-based discussion among all stakeholders.

ABOUT AVCAL

AVCAL was established in 1992 as a forum for participants in the private equity and venture capital industry. AVCAL is the central voice of the Australian industry and its membership includes almost all the domestic, regional and global private equity and venture capital firms active in Australia.

ATTRIBUTES OF PRIVATE EQUITY

Private equity is investment typically in unquoted companies that are considered to have high growth potential. Private equity investments have the following important characteristics that set them apart from other forms of business ownership:

- Alignment of interest between owners and management
  Each has a genuine stake in the business and is firmly focused on increasing its value.
- Long-term perspective
  Private equity investment has a three to five year horizon and places long-term growth ahead of short-term profit considerations.
- Detailed research
  Prior to investing in a business, a private equity manager conducts very thorough analysis and gains a detailed insight into the business's strengths and weaknesses, its potential for growth and the prerequisites for achieving this growth.
- Planning for growth
  As new owners, private equity develops with management a comprehensive and coherent long-term plan to grow the business and increase its value.
- Active stewardship
  Private equity owners monitor progress against plan closely. Plans and strategies are constantly re-assessed to address changing market conditions.

PRIVATE EQUITY INCREASES EMPLOYMENT AND PRODUCTIVITY

Private equity delivers significant benefits to the Australian economy.

Private equity businesses invest in new employees much faster than comparable businesses. They also invest more in measures that improve business performance including capital expenditure and employee training.

The resultant improvements in productivity help address economic issues arising from Australia's ageing demographic.

Major sections of this submission explore these most important contributions of private equity.

PRIVATE EQUITY INCREASES INVESTMENT RETURNS

Private equity has increased the savings of millions of Australian superannuation investors by out-performing other asset classes.

PRIVATE EQUITY IS NOT NEW OR LARGE

Private equity is not a new phenomenon but, over the last year, the level of private equity activity has increased significantly in Australia, as it has in the US and the UK.

Interest in a small number of well-known publicly listed Australian companies has led to the incorrect perception that private equity is a large part of the Australian economy.

In fact, in calendar year 2006, the value of all of businesses purchased by private equity was equivalent to less than 1.4% of the value of all businesses listed on the Australian Securities Exchange (“ASX”).

PRIVATE EQUITY ENHANCES CAPITAL MARKETS

Private equity enhances Australian capital markets by providing finance to small-to-medium businesses looking to expand and helps many of them develop to a stage where they consider listing on the ASX.

Private equity is also helping to address the issue of succession planning as many business owners approach retirement.

The Reserve Bank of Australia stated in its *Financial Stability Review*, March 2007 that, “The exposure of the Australian banking sector to private equity is well contained, and both the leverage and the debt-servicing ratios for the corporate sector as a whole remain relatively low.”

Private equity does typically use higher debt levels, however there are no signs of undue stress. Under three per cent by value of all loans by Australian banks are to private equity backed-businesses.

EFFECT ON TAX REVENUE

Private equity activity can lead to increases in receipts of capital gains tax and stamp duty.

Private equity can also increase tax revenue by increasing the profitability of companies and increasing the number of people employed.

Interest payments by private equity-backed businesses have no effect on tax revenue when paid to Australian lenders as these payments are taxable in the hands of the lenders.

In one respect however, private equity activity does cause a decrease in tax revenue when interest is paid to overseas lenders.

AVCAL estimates that, on balance, private equity should not have a material effect on taxation revenue collections in the long term.

REGULATION IS CONSISTENT

Private equity activity is subject to the same laws and regulatory frameworks that apply to transactions proposed by others.

Similarly, each business in Australia owned by private equity funds is subject to the same laws and regulatory frameworks as it would be if owned by a privately-held company.

In view of this, AVCAL considers that the current laws and regulatory framework are adequate.

THE FUTURE

Private equity has played a significant role in Australia’s economic development in recent years and is well placed to make an even greater contribution in the decades ahead.

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In calendar year 2006, the value of all businesses purchased by private equity was equivalent to less than 1.4% of the value of all businesses listed on the Australian Securities Exchange.
AVCAL analysis

Facts at a Glance

Private equity investment is a small but important part of the Australian economy. The value of businesses purchased by private equity in Australia in 2006 was less than 1.4% of the value of all businesses listed on the ASX.

Private equity-backed businesses generate jobs at a faster pace than comparable, traditionally financed businesses.

Private equity increases business revenue and exports.

Private equity investment boosts productivity and innovation.

Private equity increases the return on superannuation savings.

3% of total loans in the Australian banking system are to private equity-backed businesses.

2% of Australian superannuation is invested in private equity.

Private equity investment has a long-term approach involving ownership for typically 3 to 5 years. On average, shares listed on the ASX are held for 1.1 years.

2 of the 78 companies that de-listed from the ASX in 2006 did so as a result of a private equity transaction.

Private equity activity in Australia in 2006, at approximately 20% of total merger and acquisition activity, was half the corresponding level of activity in the US and the UK.

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The inquiry provides a timely opportunity for fact-based discussion among all stakeholders.

Introduction

The Australian Private Equity and Venture Capital Association ("AVCAL") welcomes the Senate Standing Committee on Economics ("the Committee") Inquiry into Private Equity and is pleased to have been invited to make this submission.

The inquiry provides a timely opportunity for fact-based discussion among all stakeholders.

Representatives of AVCAL would welcome the opportunity to appear and give evidence at Committee hearings.

The submission is not confidential. It has been prepared in consultation with AVCAL members and in discussion with similar organisations around the world, such as the British Venture Capital Association.

The Reserve Bank of Australia ("RBA"), in its March 2007 *Financial Stability Review* devoted a chapter to private equity and its implications for the Australian economy. AVCAL endorses the comments and findings in the review.

AVCAL is not in a position to comment on the details of current private equity transactions and has not done so in preparing this submission.

AVCAL may make further submissions in response to other submissions or evidence.

The submission covers all the terms of reference of the inquiry. The submission begins with a background and explanation of private equity, how it works and some of the significant facts and figures about the industry. The issues raised in the inquiry's five terms of reference are discussed and answered in detail.

David F. Jones
Chairman, AVCAL

Katherine Woodthorpe
Chief Executive, AVCAL

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AVCAL's investor membership comprises the vast majority of domestic, regional and global private equity and venture capital firms who are active in Australia.

About AVCAL

The mission of AVCAL is to create a world-best environment in Australia for private equity, venture capital and entrepreneurship.

AVCAL is the national association that represents domestic and international private equity and venture capital managers and investors who are active in this country. AVCAL was established in 1992 as a forum for industry participants to meet, to pursue topics of common interest, to promote the local industry and to encourage investment in growing business enterprises.

Since its formation, AVCAL has evolved to set industry standards, such as the *AVCAL Valuation Guidelines* and the *AVCAL Reporting Guidelines*, both of which were promulgated in 2004. These guidelines are consistent with global best practice and compliance with them is compulsory for all member firms. AVCAL also commissions independent research on investment returns and the economic impact of private equity and venture capital investments and provides training courses and networking events for industry participants.

Membership of AVCAL comprises venture capital firms, private equity firms, superannuation investors, banks, business incubators, 'business angels', corporate advisers, accountants, lawyers, government bodies, academic institutions, other service providers to the industry and individuals participating in the industry.

Investor membership is restricted to traditionally-structured venture capital and private equity firms which raise funds primarily from institutional investors, such as superannuation funds, and do so for investment in unlisted business enterprises with a view to patient equity investment and strategic input to the business. Investor membership is not open to listed 'cash boxes' or hedge funds or companies who may conduct private equity-style transactions using funds off their own balance sheet or from listed entities.

AVCAL's investor membership comprises the vast majority of domestic, regional and global private equity and venture capital firms who are active in Australia. These firms provide capital for seed and pre-seed ventures, early stage companies, later stage expansion and finance for management buyouts of established companies. AVCAL estimates that its members represent over 90% of the private equity capital invested in Australia.

AVCAL is actively involved in an informal network of similar assocations from around the world including the European Venture Capital Association and the British Venture Capital Association.

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3 DEFINITIONS OF PRIVATE EQUITY

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Private Equity – An Overview

5.1. DEFINITIONS

In its broadest sense, private equity is equity investment in a business not quoted on a public exchange. This would include, for instance, equity investment in a private family company.

Private equity is more often used in a second, narrower sense to describe investment in unlisted businesses with the aim of building and improving them over a period of years and then selling them at an increased price.

Private equity investment of this type is frequently categorised according to the stage of development of the company being invested in. The following categories are often used:

- seed investment;
- early stage investment;
- expansion stage investment; and
- buyout investment.

An even narrower definition of private equity arises from these categories. Expansion and buy-out stage investments are often termed 'private equity' investment whereas seed and early stage investments are termed 'venture capital' investment (see table above).

Private equity and venture capital have many common features despite the different development stages of the businesses invested in. Both involve equity investment typically over a 3 to 5 year investment period in unquoted companies that are considered to have significant growth potential. Both involve active involvement by the investor in the governance and management of the investee business and both contemplate, at the time of investment, the subsequent sale of the investment rather than the indefinite retention of it.

This submission uses the term 'private equity' in its narrowest sense as AVCAL understands that this is the focus of the committee's inquiry. However the views presented in the submission apply in large part also to venture capital.

5.2. PRIVATE EQUITY FUNDS

In Australia, and indeed other parts of the world such as the UK and US, almost all private equity and venture capital investment is conducted via investment funds formed specifically for this type of investment.

Private equity and venture capital funds in Australia and overseas typically have the following features:

- The funds are 'closed end' rather than ever-green. The legal documentation governing each fund contemplates that all investments of the fund will have been realised and the funds returned to the investors within a particular time-frame, usually 10 to 12 years.
- All investors are sophisticated (rather than retail or 'mum and dad') investors who, before deciding to invest in a fund, undertake detailed due diligence on the fund manager, often over a number of years, during which the manager's prior investment performance is monitored and assessed. The investors also rigorously review the fund documentation and have sufficient bargaining power to negotiate terms with the managers of the fund. These investors include superannuation/pension funds, insurance companies, banks and university endowments.
- These sophisticated investors utilise independent expert advisers whose level of scrutiny and due diligence is akin to that carried out by agencies such as Standard & Poor's and Moody's in other sectors of the economy.

PRIVATE EQUITY RETURNS – Periods to 30 June 2006
Source: Thomson Financial

STAGE	3 year (IRR pa)	5 year (IRR pa)	10 year (IRR pa)
AUSTRALIA Private Equity	33.5%	17.7%	14.9%
AUSTRALIA Private Equity & Venture Capital	29.4%	14.8%	12.6%
S&P/ASX3000 (Accumulation)	23.9%	12.3%	12.8%

- Each fund has a specific investment mandate which details important matters such as the stage of the investments that are targeted, industries (and countries) that can be invested in and the percentage of fund assets that can be allocated to any particular investment.
- The managers of the fund are typically described as ‘general partners’ in the fund because they manage the investment fund and are liable for its legal debts and obligations. The investors, on the other hand, are typically described as ‘limited partners’ in the fund as their liability for debts and obligations of the fund is limited to the amount of their investment in the fund.

5.3. INVESTORS INVEST IN PRIVATE EQUITY FOR HIGHER RETURNS

Sophisticated investors invest in private equity because they understand it and consider that the higher returns it offers, compared to less risky investments such as government bonds, more than justify the increased risk of the investment. As well, the long-term approach of such investors is consistent with the long-term approach of private equity managers.

According to AVCAL research, the target for private equity investment is to return 5% above the return on public equity markets. Australian private equity investment returns have been largely consistent with this target (see table above and quote on page 19).

5.4. HOW PRIVATE EQUITY FUNDS OPERATE

After a fund has closed (i.e. raised the funds that will be managed), the managers invest the fund’s capital across a set of investments that fit the fund’s investment mandate or focus. Once this process is complete, typically after 3 to 5 years, the fund is said to be ‘fully invested’.

Over the life of a fund, the managers will assess hundreds of potential investments, conduct detailed due diligence on perhaps 10% of these but only actually invest in a small number, usually around 10 to 15. Competition for investments is fierce and a fund manager’s bid will not always succeed, in which case the time and money expended on assessing an investment and preparing an offer is lost. Additionally, owners and managers of companies may reject approaches from private equity, as is their right.

Private equity investments, unlike venture capital investments, are financed partly with debt from third party lenders, rather than exclusively using investment capital from the fund. The use of debt has two important consequences:

- a fund can make more investments with a given amount of investment capital; and
- investors can receive a higher rate of return on the capital they have invested in the fund.

To ensure ready access to potential investments, a manager develops and maintains a strong network of relationships in appropriate commercial or technical areas.

Fund managers receive a management fee based on the size of the fund and also receive a share in the capital gains delivered to the fund's investors. The management fee is usually calculated as a percentage of the funds under management (i.e. the funds originally invested in the fund). The percentage is negotiated between the investors and the manager at the time the fund is raised.

An indicative figure is 2 to 2.5% per annum for smaller venture capital funds and 1 to 2% for larger private equity funds. This figure covers the overheads of the business including salaries and the costs of conducting due diligence on investments. The manager's share of capital gains is 20% in virtually all funds globally and is calculated after all fees and expenses paid by the fund have been returned to the investors.

Importantly, the private equity manager only receives a share in capital gains if the fund has delivered a minimum return known as the 'preferred return'. If the capital gains do not exceed the preferred return then the private equity manager receives no share in capital gains. The preferred return is usually similar to the long-term bond rate, currently about 8% per annum.

5.5. HOW PRIVATE EQUITY ADDS VALUE TO BUSINESSES

A private equity fund ensures that each investment it makes has the following characteristics.

<u>Alignment of interest</u>
The foundation of private equity's ability to add value is an alignment of interest between owners and management. Each has a genuine stake in the business and is firmly focused on increasing its value.

<u>Long-term focus</u>
Private equity invests with a 3 to 5 year horizon and is not focused on short-term growth at the expense of long-term success. Private equity-backed companies are therefore able to invest in new products, new businesses and new employees without concern for short-term earnings effects. This is in contrast to public companies that may be under pressure from analysts and shareholders for shorter-term returns.

<u>Detailed due diligence</u>
The research and assessment that private equity managers conduct during the investment process provides detailed insight into:

- a business's strengths and weaknesses, both financial and non-financial;
- the dynamics of the industry in which the business operates;
- the business's potential for growth; and
- the prerequisites for achieving this growth (e.g. change of strategy, operational improvements, capital expenditure).

<u>Planning for growth</u>
The insight from due diligence allows the private equity fund, as new owners of the business, to develop with management a comprehensive and coherent long-term plan to increase the value of the business. This plan will typically:

- stress the importance of sales growth as well as cost efficiency;
- emphasise cash as much as earnings;
- focus on a small number of essential performance metrics;
- include a training and development program for employees; and
- include a capital expenditure program to ensure that the business has the plant and equipment necessary to meet its growth targets.

Active stewardship
Performance metrics and progress against targets are monitored closely so that any remedial measures can be implemented promptly. Decisions are made swiftly and on a timely basis. Plans and strategies are constantly re-assessed to address changing market conditions.

These five factors are the hallmarks of private equity investment.

5.6. TYPES OF PRIVATE EQUITY TRANSACTION

Purchase of a private company
This type of private equity transaction is far more common than the purchase of a publicly listed company (or part of one) but examples are less frequently reported in the business press.

Owners of private businesses increasingly see private equity funds as an attractive source of expansion capital and management expertise that is needed to grow the business to a level where it will be suitable and ready for a trade sale or IPO. In such cases, the private equity manager invests capital for a stake in the business and also provides ongoing advice to management.

Many business owners who are looking to retire, after building up a business over many years, are selling to private equity managers.

In Australia today there are a higher than ever number of business owners approaching retirement, due in part to the post-war immigration boom. For many of these owners, private equity offers the only possible exit and realisation of the capital thay have built up in their business.

Purchase of a publicly listed company
Although a handful of recent acquisitions suggest otherwise, only about a dozen publicly listed companies in Australia have ever been taken private by private equity. Nevertheless, it is instructive to consider the benefits reported by publicly listed companies locally and offshore that have been taken private by private equity.

These include:
– a board less driven by process and better able to make decisions on a timely basis;
– a chief executive who is able to devote to the business valuable time (up to 20%) that was previously spent representing the company to the investor community;
– a board and management team that is no longer fixated on meeting short-term profit expectations of the public market, analysts and the media and is instead able to concentrate fully on what will be of most long-term benefit to the business (and its shareholders);
– a business now with an ownership and governance structure more conducive to resolving structural or strategic issues that may have troubled the business previously and which can only be solved by initiatives that may adversely affect profits and/or cash reserves in the short term; and
– fresh capital for investment.

Purchase of a division of a publicly listed company
Similar benefits have been reported in a far more common type of private equity investment, namely the purchase by a private equity fund of a division (rather than the whole) of a listed company. Often

the listed company concerned describes the division being sold as ‘non-core’ and has, for some years, concentrated its attentions (and capital investment) on other divisions. Commentators have, from time to time, described such business divisions as ‘unloved’ or as ‘orphans’.

New private equity owners of such businesses are better equipped than the previous publicly listed company owners, to unleash their entrepreneurial spirit and provide them with the additional resources and capital investment that they require.

Sales of businesses by private equity
All businesses bought by private equity are sold, generally via either a private sale or an initial public offering on the ASX or, in a small but growing percentage of cases, to another private equity fund.

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> "Private equity-financed firms, on average, generate employment at a much faster pace than comparable, traditionally financed firms."
> *Creating New Jobs and Value with Private Equity*, A.T. Kearney, 2007

Benefits of Private Equity to the Australian Economy

Private equity delivers significant benefits to the Australian economy. In particular, private equity:
– increases employment;
– increases the funds management industry;
– increases productivity and innovation;
– increases superannuation savings; and
– increases business revenue and exports.

6.1. PRIVATE EQUITY INVESTMENT INCREASES EMPLOYMENT

Businesses owned by private equity managers boost the economy by investing in additional employees at a significantly faster rate than comparable companies. This is because private equity-backed businesses are actively managed and supported with new capital to grow strongly and so tend to increase their employee numbers more quickly than less dynamic businesses.

Employment growth though private equity ownership has been confirmed in numerous studies conducted in countries around the world, including Australia.

A recent international study concluded: "Private equity-financed firms, on average, generate employment at a much faster pace than comparable, traditionally financed firms."

The report of this study, *Creating New Jobs and Value with Private Equity*, A.T. Kearney, 2007 is included as Appendix 4 to this submission.

This study found that in the US, the UK, Germany and other European countries, annual employment growth of private equity-backed firms was significantly higher than that of traditionally financed firms. The results for these regions are presented on page 14 of this report.

An Australian study in 2006 concluded: "Private equity-backed companies are…an important job-creation driver, with 76% expecting to hire additional workers in 2007. According to Dun & Bradstreet, the corresponding economy-wide measure is 5%", *Economic Impact of Private Equity and Venture Capital in Australia*, PricewaterhouseCoopers, December 2006. The report of this study is included as Appendix 5 to this submission.

"During the five-year period to 2005/6, UK private equity-backed companies increased their worldwide staff levels by an average of 9% p.a. This is a significantly faster rate of growth than FTSE 100 and FTSE Mid-250 companies, at 1% and 2% respectively.", *The Economic Impact of Private Equity in UK*, IE Consulting, November 2006.

In addition to the regions mentioned on page 13, the results for which are presented below, above-average employment growth by private equity-backed businesses has also been reported in:

– France (4.1% p.a. compared to 0.6%):
– Spain (14.7% p.a. compared to 5.8%); and
– Italy (10.7% p.a. compared to 1.1%)

AVERAGE ANNUAL EMPLOYMENT GROWTH OF PRIVATE EQUITY BACKED FIRMS VERSUS TRADITIONAL FIRMS IN SELECTED REGIONS

FIGURE 1: Europe
Source: EVCA/CEFS

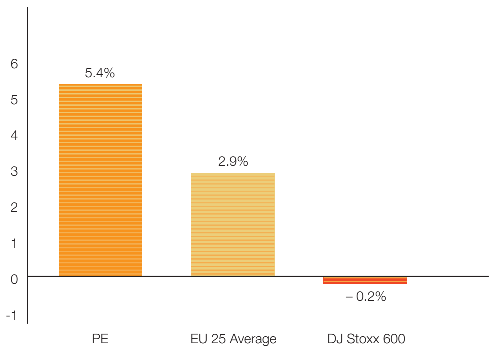


FIGURE 2: UK
Source: BVCA/IE Consulting

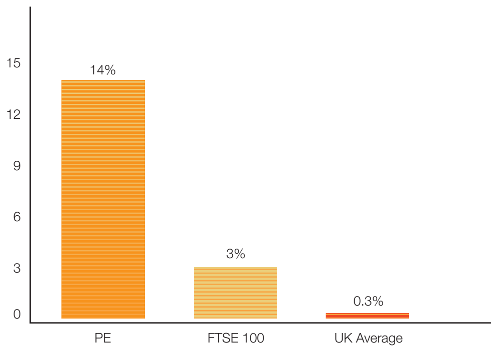


FIGURE 3: USA
Source: Global Insight/NVCA

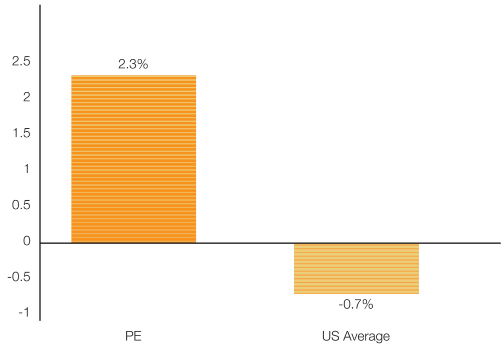
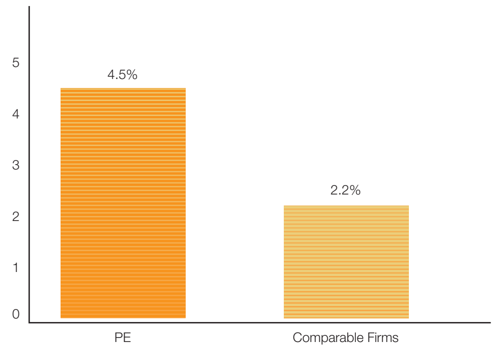


FIGURE 4: Germany
Source: Finance/DBAG



Creating New Jobs and Value With Private Equity,

6.2. PRIVATE EQUITY GROWS THE FUNDS MANAGEMENT INDUSTRY

Australia's funds management industry is the fourth-largest in the world and is very highly regarded internationally. Australian private equity managers have played an important role in the industry's development and are continuing to attract significant flows of investment capital into Australia.

6.3. PRIVATE EQUITY DRIVES PRODUCTIVITY GROWTH AND INNOVATION

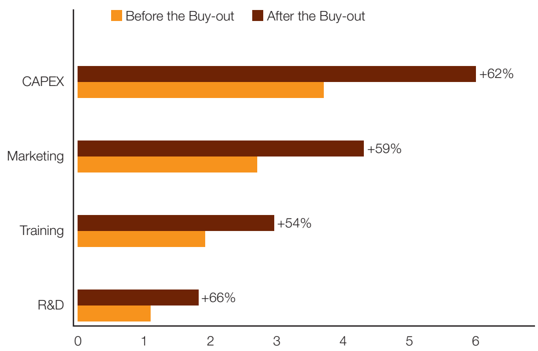
The ageing of the population is increasing the importance of productivity growth and innovation to Australia's future.

"As labour force growth slows with the ageing population, it will be important to lift productivity to sustain acceptable rates of economic growth.", *Intergenerational Report*, Treasury, 2007.

"At the enterprise level, productivity growth involves producing more or better quality output with the same inputs or producing the same output with less inputs, and thus at lower cost.", *Submission to the Agriculture and Food Policy Reference Group*, Treasury, 2003.

Private equity makes businesses more efficient. The methods by which private equity adds value to a business have been discussed in Section 5.5 of this submission. The increases in capital expenditure, marketing, training and research & development are often very significant, as shown in Figure 5.

FIGURE 5: Investment of buy-out financed firms in Europe as a percentage of sales before versus after the buy-out
Source: EVCA/CMBOR



An independent study commissioned in 2004 by AVCAL indicated that the labour productivity of private-equity backed firms increased over a period of two years by a total of 6.3% which was almost double the comparable national figure of 3.4%. This study is annexed to this report as Appendix 6.

"Australian technological innovation and R&D commercialisation are some of the main benefits of private equity investment.", *Economic Impact of Private Equity and Venture Capital in Australia*, PricewaterhouseCoopers, December 2006.

6.4. PRIVATE EQUITY ACTIVITY INCREASES RETURNS TO INVESTORS

Private equity increases returns to Australian investment portfolios, including superannuation accounts and leads to more rapid growth in retirement savings.

This important benefit is discussed in sections 5.3 and 8.2 of this submission.

6.5. PRIVATE EQUITY ACCELERATES REVENUE GROWTH AND EXPORTS

Businesses owned by private equity managers increase sales at a much higher rate than comparable businesses not owned by private equity managers. Growing businesses grow sales.

The superior sales growth of private equity-backed businesses has been confirmed by studies in various countries.

"Exports by private equity-backed companies grew by 6% p.a., compared with a national growth rate of just 2%.", *The Economic Impact of Private Equity in UK*, IE Consulting, November 2006.

FIGURE 6: Comparative annual Italian revenue growth
Source: AFI and PricewaterhouseCoopers

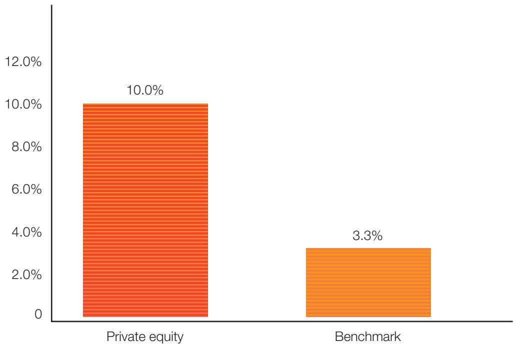


FIGURE 7: Comparative annual UK revenue growth
Source: Deutsche Beteiligungs AG, FINANCE and BVCA 2004)

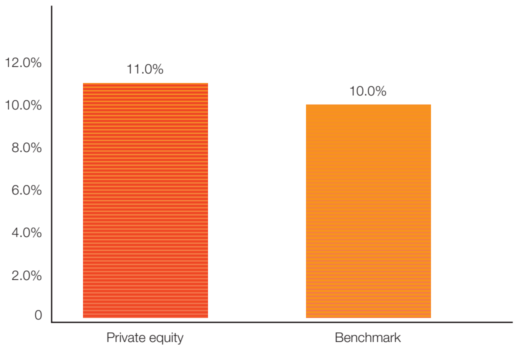


FIGURE 8: Comparative annual French revenue growth
Source: INSEE & DIANE

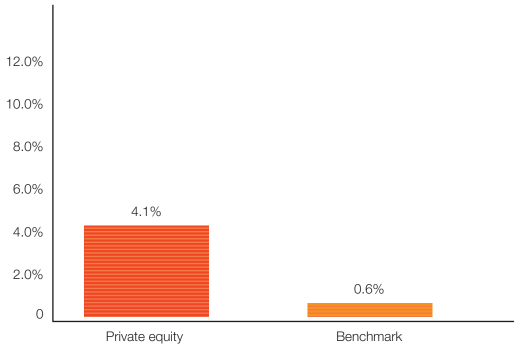
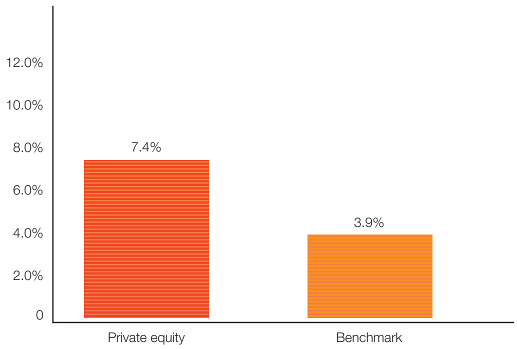


FIGURE 9: Comparative annual German revenue growth
Source: Deutsche Beteiligungs AG, FINANCE and BVCA 2004)



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Over the last two years private equity activity on any measure has increased significantly in Australia.

Trends in Private Equity

Over the last two years private equity activity on any measure has increased significantly in Australia. AVCAL suggests that this increase has been caused by three factors:

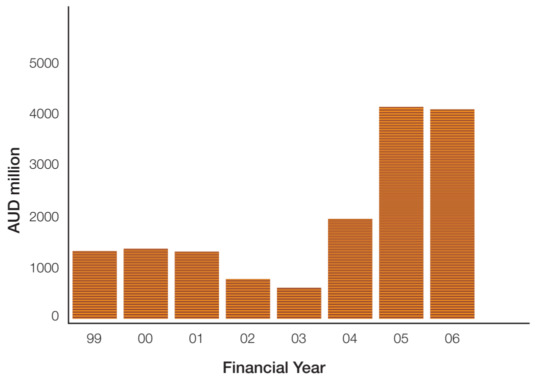
- the high returns delivered by private equity managers which have prompted institutional investors, such as superannuation funds, to increase their allocation to the sector;
- the global market for debt has grown which has resulted in private equity managers (and other borrowers) being able to borrow more; and
- strong growth in the level of superannuation savings in Australia which has made more money available for all categories of investment.

The effects of these factors have, in AVCAL's view, been boosted by strong economic growth in Australia.

AVCAL notes that despite recent growth, the private equity industry in Australia appears to be around half the relative size of the industry in the US and the UK. This suggests that there may be further opportunity for growth in the Australian market.

7.1. FUNDS RAISED BY AUSTRALIAN PRIVATE EQUITY MANAGERS

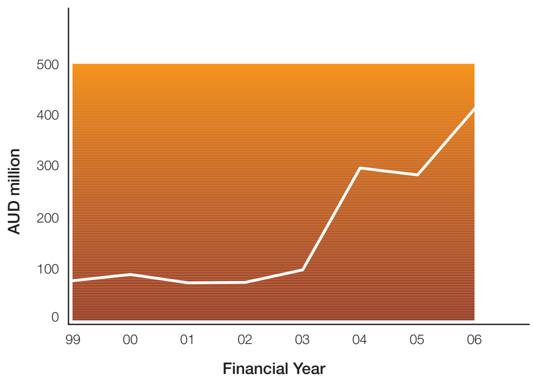
FIGURE 10: Funds raised by fiscal year
Source: Thomson Financial



Australian private equity and venture capital managers have reported a significant increase in funds raised in the last three years.

7.2. SIZE OF FUNDS

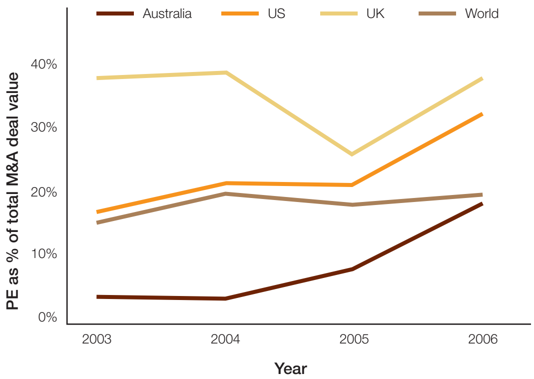
FIGURE 11: Average size of fund by year of formation
Source: Thomson Financial and AVCAL Survey, fiscal year ended 30 June 2006



As investor interest in private equity has increased Australian private equity managers have raised larger funds.

7.3. PRIVATE EQUITY ACTIVITY AS % OF TOTAL MERGERS & ACQUISITIONS

FIGURE 12: The value of private equity transcations as a proportion of total M&A transactions
Source: Dealogic 2006



Despite recent increases the level of Australian private equity activity continues to be lower than in the United States and the United Kingdom.

8 |

“Private equity forms part of our overall portfolio of off-market investments. We currently allocate about 5% of our funds to Private Equity. We benchmark returns to listed equities plus 5% and see it as both a diversifier and an enhancer of risk:return.”

Trish Donohue, Investment & Governance Manager,
Cbus – Construction and Building Industry Super, April 2007

Effect on Capital Markets

8.1. POSITIVE EFFECT ON SMALL-TO-MEDIUM ENTERPRISES

Private equity provides important assistance to small-to-medium enterprises (‘SMEs”) by:

- increasing the availability of capital to SMEs; and
- providing SME proprietors wishing to retire from their businesses with a staged and attractive method of doing so.

Availability of funding

For most SMEs raising funds from the stockmarket will be inappropriate or too expensive. Bank funding may be restricted due to perceived risk. Friends and family are typically limited in the amount of funding that they can provide. Non-financial assistance from these sources is also limited.

Private equity provides a viable alternative for those SMEs needing capital to grow as it not only provides funding but also, and more significantly, valuable non-financial assistance.

Succession

In view of Australia’s ageing demographic, succession planning in family businesses is an issue of growing importance for the economy.

Again, private equity is playing a valuable role assisting owners to exit their businesses whilst improving rather than jeopardising the ongoing prospects of the businesses.

8.2. POSITIVE EFFECT ON SUPERANNUATION PERFORMANCE

Private equity contributes positively to the Australian superannuation system by boosting returns.

As discussed in sections 5.3 and 6.3, private equity investment has historically increased the return of investment portfolios.

Adding private equity to a portfolio of stocks and bonds will increase the returns of the portfolio and also lower the volatitility of the portfolio’s returns. This is because the correlation between the returns of stocks and the returns of bonds is higher than both the correlation between private equity returns and stock returns and that between private equity returns and bond returns.

Allocations to private equity by any Australian superannuation fund are spread across a large number of private equity-backed businesses (AVCAL estimates at least 50 on average) because investments in private equity by superannuation funds are split across a number of private equity funds rather than a single fund. Each of these funds then further spreads the investment across a portfolio of businesses (approximately 10 to 15 per fund in most cases).

Additionally, no more than 2%, on average, of Australian superannuation is invested in private equity. This percentage represents a very low exposure to any risks inherent in private equity. It can also be considered a very low exposure to the increased returns delivered by private equity.

> “Private equity can play a legitimate role alongside the public market, as long as regulatory balance across both forms of equity is maintained.”
>
> Robert Elstone, Chief Executive, Australian Securities Exchange Ltd, April 2007

8.3. POSITIVE EFFECT ON ASX

Private equity, despite its small relative size, complements and enhances the operation of the ASX by building many businesses to a stage where they can be listed.

The level of private equity activity in Australia is small compared to the ASX – currently around 1% of enterprise value.

The total enterprise value of companies listed on the ASX is $1.6 trillion dollars – being the sum of the total market capitalisation ($1.4 trillion) and the debt of these companies (approximately $200 billion).

AVCAL's research indicates that in the calendar year 2006, Australian private equity managers invested $21.7 billion purchasing 32 companies. This amount equates to approximately 1.4% of total ASX enterprise value.

AVCAL estimates its members currently have $12 billion available for investment in Australian businesses over the next 2 to 3 years. Hypothetically, this amount could be used to acquire businesses worth $40 billion, assuming an additional debt component of $28 billion (being 70% of the total amount). This amount equates to approximately 2.5% of total ASX enterprise value.

In 2006, 195 companies were listed on the ASX, and 78 companies were de-listed, 2 of them due to a private equity transaction.

Private equity investments are always sold after a period. AVCAL estimates that approximately 25% of all sales of private equity investments are via public offering on the ASX thereby returning the business to the listed market, usually with a more solid and profitable outlook. The larger the business the more likely it will be sold via public offering on the ASX.

8.4. POSITIVE EFFECT ON DEBT MARKETS

Private equity has helped to develop the debt capital markets in Australia by attracting more international banks to participate in them.

The entry of new lenders into the market has increased the availability of funding for all Australian businesses.

In addition, private equity activity has helped to build in Australia a liquid market in subordinated debt. This market is accessible to all Australian businesses and investors.

Both these effects have benefited Australian business and increased the efficiency of Australia's capital markets.

9 |

"The exposure of the Australian banking sector to private equity is well contained, and both the leverage and the debt-servicing ratios for the corporate sector as a whole remain relatively low."
Financial Stability Review, Reserve Bank of Australia, March 2007

Impacts on the Australian Economy

Private equity owns stakes of varying sizes in a small number of businesses in Australia. AVCAL estimates fewer than 500.

9.1. OWNERSHIP

AVCAL believes that any concern about the issue of public versus private business ownership (discussed in section 8.2) is unfounded and will remain so.

AVCAL notes that laws in relation to foreign investment in Australia apply equally to transactions proposed by private equity funds as to transactions proposed by others.

9.2. DEBT

"Overall, private equity exposures amount to less than 3% of total loans in the Australian banking system. The exposure of the Australian banking sector to private equity is well contained, and both the leverage and the debt-servicing ratios for the corporate sector as a whole remain relatively low.", *Financial Stability Review*, RBA, March 2007.

Australia is a market economy in which businesses, and individuals, are free to make their own financial decisions, within a long-established legal and prudential framework.

Private equity owners of a business will allow it to borrow no more than they consider prudent and necessary, in the particular circumstances of the business. Further, lenders will not allow the business to borrow any more than they are satisfied that the business will be able to comfortably repay. It is in no one's interest for a business to over-borrow.

In addition, lenders tend to take security over the businesses and assets, fully securing the debt.

AVCAL suggests that the owners of, and lenders to, a business are best placed to determine what is an appropriate level of borrowing and is unaware of a particular level of borrowing against which actual levels of borrowing can or should be compared.

AVCAL's research indicates that recent private equity acquisitions in Australia have had, on average, an equity component of 30% and a debt component of 70% of the total purchase price. This percentage of debt has stayed constant throughout this decade even though transactions have grown in size. This is a key difference from the US in the 1980s when some private equity transactions had a debt component as high as 90 to 95%.

AVCAL recognises that as a general principle increased debt leads to an increase in risk. In the case of private equity however the increase in risk is mitigated by a number of factors including:

- the extensive experience of private equity managers in operating businesses with increased debt;
- the extensive level of pre-acquisition due diligence that is conducted by private equity managers;
- the high percentage (typically 80 to 100%) of the interest on debt in private equity transactions is typically fixed; and
- the budgets on which loan principal and the pay-down are calculated prudently allow for varied operational scenarios.

If a business does experience difficulties meeting its obligations then its private equity owners would have a clear incentive, as well as the business skills and financial means, to help guide the business back to financial health.

The track record of the private equity industry shows that it is well-equipped to manage businesses throughout the economic cycle.

10

"The implications for Government revenue are hard to ascertain as there are currently insufficient data to fully model the effects of private equity on tax revenue."
Financial Stability Review, Reserve Bank of Australia, March 2007

Tax Implications

Private equity is subject to the same taxation framework as all other areas of economic activity in Australia.

AVCAL believes that the effects of private equity on tax revenue were recently considered by the Council of Financial Regulators ("the Council") which is the co-ordinating body for Australia's main financial regulatory agencies. The Council's membership is comprised of:
- the RBA, which chairs the Council;
- the Australian Prudential Regulation Authority (APRA);
- the Australian Securities and Investments Commission (ASIC); and
- the Treasury.

AVCAL understands that the Council concurred with the RBA that: "The implications for Government revenue are hard to ascertain as there are currently insufficient data to fully model the effects of private equity on tax revenue.", *Financial Stability Review*, RBA, March 2007.

AVCAL agrees it is difficult to "fully model" the effects of private equity on tax revenue given the lack of available data. However, AVCAL suggests that the following areas should be considered when estimating the effects of private equity on tax revenue :
- interest on debt;
- capital gains;
- company profits;
- stamp duty;
- carry forward of tax losses; and
- fees paid.

AVCAL comments below on the potential effect of each of these areas.

Based on preliminary analysis summarised in Appendix 7 to this submission, AVCAL suggests that, on balance, private equity should not have a material effect on taxation revenue collections in the long term.

10.1. INTEREST ON DEBT

AVCAL acknowledges that there is a public perception that the gearing involved in private equity investments leads to reduced taxation revenue collections. However for the following reasons, AVCAL contends that the long-term effect on tax revenue collections is in fact negligible.

<u>Interest deductions</u>
Private equity borrowers are subject to all the same rules in relation to deduction of interest as other Australian businesses.

Interest expenditure by an Australian business is generally an allowable deduction but there are exceptions to this general principle. These exceptions include rules relating to thin capitalisation, benchmarking and transfer pricing, all of which can operate to limit interest deductions.

For instance, the thin capitalisation rules limit the amount of deductible interest-bearing debt a foreign-owned Australian entity can maintain by denying deductions for interest expenses when certain debt/equity ratios are breached.

<u>Interest income</u>
Interest paid on funds borrowed from Australian resident lenders is included in the assessable income of the lender. Therefore, the net effect on taxation revenues is nil.

Interest paid on funds borrowed from non-resident lenders results in less taxation revenue than equivalent amounts of interest paid to Australian resident lenders. This difference is reduced to the extent that interest withholding tax is deducted from payments to non-resident lenders.

Not all interest paid to non-resident lenders is subject to withholding tax due to the operation of certain exemption rules.

Australian resident lending vs. non-resident lending
AVCAL research indicates that:

– most private equity-backed businesses borrow only from Australian resident lenders;
– there is no incentive for private equity-backed businesses to borrow from non-resident lenders unless their requirements exceed the capacity of Australian resident lenders;
– where less than $1B is borrowed by a business, Australian resident lenders generally provide all of it, non-resident lenders none; and
– where more than $1B is borrowed by a business, Australian resident lenders provide at least two-thirds with non-resident lenders providing the balance.

AVCAL suggests therefore that the effect on taxation revenues of private equity borrowing is minimal.

10.2. COMPANY PROFITS

Private equity increases the operating profit of businesses through business improvement measures. (See section 5.5 above)

Increases in operating profit generally lead to an increase in the taxable income of a business.

The taxable income of a business will be reduced by any deductible interest expense. This issue of deductible interest expense in relation to private equity has been considered above.

In AVCAL's opinion, a proper analysis of the effects of private equity on tax revenue must take account of the following significant factor.

An increase in the operating income of a private equity-backed business should increase tax revenue to the extent that it leads to one or more of the following, in any particular case:

– a distribution to, and therefore increased tax payments by, investors;
– increased borrowing leading to more taxable income in the hands of lenders;
– investment of the increased income (or increased borrowing) in further profit-improvement initiatives leading to further increases in operating income;
– repayment of loan principal which will reduce future interest payments leading to further increases in operating income; and
– an increase in the value of the business that will be reflected in increased capital gains tax ("CGT") when the business is sold by the private equity fund.

10.3. CAPITAL GAINS

Private equity has the potential to increase capital gains tax collections by:

– bringing forward and increasing the number of taxing points; and
– increasing the value of businesses and therefore the size of taxable gains on sale.

Taxing points

Private equity investment results in a transfer of business ownership. The outcome of business transfers is that unrealised capital gains (and potentially losses in some circumstances) are brought forward, thereby triggering a taxing point earlier than would otherwise have occurred.

Generally, a private equity fund will have a limited term of approximately 10 years. Accordingly, an investment period by private equity of less than 10 years in the life of a business will inevitably lead to a greater number of taxing points for the various investors into that business. With each taxing point triggered, the potential for the realisation of unrealised capital gains arises.

AVCAL notes that in some cases a private equity investment will cause a business to be brought into the CGT system for the first time and to that extent private equity, again, will increase tax revenue.

Gains on sale of a business

Private equity investment generally increases the value of a business over time and so can be expected to deliver a gain on sale for investors.

The tax consequences of a divestment by a private equity fund will depend on the location of the fund investor and its tax attributes.

An Australian investor in the fund will pay tax.

In respect of a non-resident investor, factors including the investor's specific residency will play a part in determining the Australian tax paid.

However, in most cases, "business profits" (as defined under a relevant tax treaty) of a non-resident vendor arising on the sale of Australian investments have for many years been not subject to tax in Australia. Recent changes relaxing the CGT rules for non-residents have not affected the tax treatment of many non-resident investors (including private equity investors).

The carried interest entitlement of Australian private equity managers is taxed in Australia when paid.

Australian management equity in a company owned by a private equity fund will, in most cases, also be realised when the business is sold. Any gain that has been made will be taxed at this point.

10.4. STAMP DUTY

Private equity increases stamp duty payments to the states and territories by causing changes in ownership of businesses to occur earlier and more often than would otherwise be the case.

When a private equity fund buys or sells a business stamp duty will generally be paid in relation to the transfer of assets of (or shares in) the business.

In particular circumstances, land-rich duty may be payable as may duty on loans to the private equity business.

10.5. CARRY FORWARD OF TAX LOSSES

Private equity increases tax revenue by preventing businesses they purchase from claiming any carry forward tax losses which were available immediately prior to the purchase.

In almost all cases, a private equity purchase causes a break in 'continuity of ownership' of the business. As a result carry forward tax losses can no longer be recouped against future taxable income and are in effect lost.

10.6. FEE INCOME

Private equity increases taxation receipts by increasing the fee income of Australian resident taxpayers.

Management fees received by Australian resident private equity funds from non-resident investors are taxed in Australia and increase tax revenue.

Further, private equity increases the level of transaction activity which increases the fee income of advisers involved. These fees in a transaction are approximately 4 to 5% of transaction value.

The fees are assessable income in full in the year they are earned. However, only a small percentage of these fees are fully tax-deductible on an up-front basis. The remainder must be capitalised and claimed over a period of years. This leads to an increase in tax revenue.

Similarly, the fees will often be subject to Australian goods and services tax ("GST") but in most cases part of the GST paid cannot be claimed as a credit and is said to be 'irrecoverable'. Private equity acitivity increases taxation revenue to the extent it results in irrecoverable payments of GST.

11

"In Australia, transactions by private equity funds are subject to the same regulation through the Corporations Act as other transactions… Reflecting this, private equity transactions do not of themselves raise wholly new regulatory issues..."
Financial Stability Review, Reserve Bank of Australia, March 2007

Regulatory Framework

Private equity in Australia is thoroughly regulated and monitored today.

11.1. REGULATION OF PRIVATE EQUITY FUNDS

Fund raising activities carried out by private equity funds in Australia are subject to the same regulatory regime that applies to other funds or companies when they raise funds in Australia.

AVCAL suggests that the regulatory regime is re-inforced by due diligence and the negotiation of terms by the sophisticated investors who invest in private equity funds (see section 5.2). These investors also require and receive regular monitoring reports typically using the *AVCAL Reporting Guidelines* which are consistent with global standards.

11.2. REGULATION WHEN A BUSINESS IS PURCHASED BY A PRIVATE EQUITY FUND

Competition law
The Trade Practices Act applies equally to transactions proposed by private equity funds as to transactions proposed by others.

Public company takeovers
The long-established regulatory regime in this area applies equally to transactions proposed by private equity as to transactions proposed by others.

Foreign investment
Laws in relation to foreign investment in Australia apply equally to transactions proposed by private equity funds as to transactions proposed by others.

Sector-specific legislation
Specific restrictions for companies operating in sectors such as media, finance and insurance, aviation, health and gaming also apply to transactions proposed by private equity funds.

11.3. CONFLICTS OF INTEREST

Conflicts of interest are regulated by existing rules at common law and under statute which apply equally to transactions proposed by private equity funds as to transactions proposed by others.

In March 2007, the Takeover Panel ("the Panel") released an Issues Paper entitled "*Insider Participation in Control Transactions*" proposing that the Panel issue a Guidance Note containing recommendations as to how market participants should address perceived conflicts of interest.

The private equity industry was represented on the Panel during the preparation of the draft Guidance Note and issues paper. AVCAL has written to the Panel to express its support for the draft Guidance Note.

11.4. INSIDER TRADING

The law in relation to insider trading applies equally to transactions proposed by private equity funds as to transactions proposed by others. Instances of insider trading are actively monitored and, where applicable, prosecuted by ASIC.

In its March 2007 *Financial Stability Review*, the RBA noted that private equity transactions may be susceptible to conflict of interest and insider trading issues to a greater degree than "traditional" merger and acquisition activity. Notably however, it reinforced the view that these issues are currently regulated by the Corporations Act for both private equity and other transactions, and concluded that "many of the potential problem areas… [regarding conflicts of interest and insider trading]… can be dealt with by ensuring that advisers and participants in private equity transactions have robust and effective information barriers", while noting that it is the responsibility of the private equity fund, directors, advisers and others involved in private equity transactions to ensure that their conduct is appropriate and complies with all legal requirements.

11.5. REGULATION WHEN A BUSINESS IS SOLD

When it divests one of its investments, a private equity fund will typically do so via a private sale or via an initial public offering. In both cases, the private equity fund is subject to the same laws as any other seller.

An initial public offering is regulated through the Listing Rules of the ASX together with the disclosure laws set out in the Corporations Act.

A private sale will be commercially negotiated and subject to the operation of the Trade Practices Act and other statutory and common law rules.

11.6. REGULATION OF BUSINESSES OWNED BY PRIVATE EQUITY FUNDS

Businesses owned by private equity funds are subject to the same laws and regulatory frameworks as they would be if owned by a privately-held company.

12 | Conclusion

Private equity has played a significant role in Australia's economic development in recent years. It is well placed to make an even greater contribution in the years ahead.

Private equity is a dynamic sector of the economy that is increasing employment and lifting superannuation returns. Private equity is not new but has had increased coverage in the last 12 months due to the size and profile of some of the transactions completed or proposed.

Private equity, in spite of its small size, contributes strongly to Australia's economic growth by transforming companies. The private equity approach to business ownership adds value in a number of ways and, in particular, by creating a true alignment of interest between owners and management.

The private equity industry in Australia is leading the region and the high level of overseas investment that it attracts confirms that it is world-class.

AVCAL's submission has:
- described what private equity is and how it works to boost economic well-being;
- detailed the significant economic benefits delivered to Australia by private equity investment;
- provided a perspective on how private equity enhances, and fits within, the capital markets;
- discussed potential impacts on the economy;
- suggested that tax implications of private equity are likely to be not material;
- shown that private equity is already regulated appropriately and in a manner consistent with other sectors of the economy; and
- demonstrated a commitment to ongoing engagement with the community in general and policy-makers in particular.

SIGNIFICANT ECONOMIC BENEFITS

Private equity investment delivers significant benefits to economies in which it is allowed to compete on an equal basis.

In Australia, private equity is:
- increasing employment in Australia;
- increasing productivity growth and innovation and helping to address issues presented by the ageing demographic;
- increasing returns to the millions of who have invested in Australia's superannuation system;
- increasing tax revenues;
- increasing business growth;
- increasing the funds management industry which is already the fourth-largest in the world; and
- increasing exports and improving the balance of payments.

BENEFITS TO THE CAPITAL MARKETS

Private equity also benefits Australia's capital markets by:
- providing finance to small-and-medium enterprises and assisting business owners with succession planning;
- increasing Australia's retirement savings;
- complementing the operation of the ASX by building businesses to a stage where they can be listed and providing an alternative form of ownership for businesses already listed; and
- increasing the liquidity of debt markets, thereby making debt finance cheaper and more readily available to all Australian businesses.

POTENTIAL IMPACTS ON THE ECONOMY

Private equity owns stakes of varying sizes in no more than 500 Australian businesses.

Concerns about levels of debt are unwarranted. The RBA has indicated that, “the exposure of the Australian banking sector to private equity is well contained”.

The risk of increased debt borne by private equity-backed businesses is fully mitigated by:

– the extensive experience of private equity in operating businesses with increased levels of debt;
– the high level of due diligence, planning and research conducted;
– fixed interest rates on 80 to 100% of the debt; and
– repayment budgets that allow for a range of operational scenarios.

TAXATION IMPLICATIONS ARE GENERALLY POSITIVE

Private equity is subject to the same taxation framework as all other areas of economic activity. AVCAL agrees it is difficult to “fully model” the effects of private equity on tax revenue given the lack of available data.

Nevertheless, AVCAL has analysed the potential effect of: interest on debt, capital gains, company profits, stamp duty, carry forward of tax losses and fees paid. AVCAL suggests that, on balance, private equity should not have a material effect on taxation revenue collections in the long term.

REGULATION IS CONSISTENT AND APPROPRIATE

Analysis shows that both private equity funds and private equity-backed businesses are thoroughly and appropriately regulated by existing laws and frameworks.

Additional regulation is unnecessary and would be counter-productive to the extent that it increases business costs and/or reduces economic growth.

THE FUTURE

AVCAL, as the central voice of the Australian private equity industry, looks forward to ongoing dialogue with all stakeholders.

Private equity has played a significant role in Australia’s economic development in recent years and is well placed to make an even greater contribution in the decades ahead.

13

Appendices and References

13.1. AVCAL Investor Members

13.2. Selected Other AVCAL Members

13.3. Reports and Studies

13.4. A.T.Kearney Report on Employment

13.5. PricewaterhouseCoopers Report on Economic Impact of Private Equity in Australia

13.6. Meyrick & Associates Study on Productivity Growth

13.7. AVCAL Preliminary Analysis of Taxation Revenue

13.1. AVCAL INVESTOR MEMBERS

ABN AMRO Capital Management
Accede Capital
Accretion Investment Management
Advent Private Capital
Affinity Equity Partners Australia
Allen & Buckeridge
Allen Capital Private Equity
AMP Capital Investors
ANU Connect
ANZ Capital
Archer Capital
Babcock & Brown Direct Investment
Baring Private Equity Asia
Business Management
Catalyst Investment Managers
CCMP Capital Asia
CHAMP Private Equity
CHAMP Ventures
Citigroup Venture Capital International
CM Capital Investments
Colonial First State Private Equity
Crescent Capital Partners
CVC Asia Pacific Limited
CVC Managers
Deutsche Bank – DB Capital Partners
Direct Capital Private Equity
Equity Partners
Fulcrum Capital Partners
GBS Venture Partners
Goldman Sachs JBWere Private Equity
Gresham Partners
Hastings Private Equity
Hawkesbridge Private Equity
Helmsman Capital
Innovation Capital Associates
Intermediate Capital Asia Pacific Limited
Investec Wentworth Private Equity
Ironbridge Capital
Jolimont Capital
Kestrel Capital
KKR
Knox Investment Partners
Merrill Lynch Global Private Equity
NBC Capital
Neo Technology Ventures
Netus
Next Capital
Nikko Principal Investments
Pacific Equity Partners
Paragon Advisory
Pencarrow Private Equity
Quadrant Private Equity
Queensland BioCapital
RMB Capital Partners
SciVentures Investments
Souls Private Equity Limited
Southern Cross Venture Partners
Starfish Ventures
Technology Venture Partners
The Carlyle Group
TPG
Uinseed Management
Venture Capital Partners
Wolseley Private Equity

13.2. SELECTED OTHER AVCAL MEMBERS

Allens Arthur Robinson
ANZ Leveraged Finance
Aon Risk Services Australia
AusBiotech
Australian Trade Commission (Austrade)
Axiss Australia
Baker & McKenzie
Blake Dawson Waldron
BOS International (Australia)
Citigroup Global Markets Australia
Clayton Utz
Commonwealth Bank of Australia
Corrs Chambers Westgarth
Credit Suisse (Australia)
Deacons
Deloitte Corporate Finance
Department of Communications, IT and the Arts
Department of Industry Tourism and Resources
Deutsche Bank AG
Ernst & Young
Freehills
Gilbert + Tobin
Goldman Sachs JB Were
Government of South Australia –
Office of Venture Capital Board
HarbourVest Partners (Asia)
Industry Funds Management
ING Investment Management
Invetech
KPMG
L.E.K. Consulting
Macquarie Bank
Macquarie Funds Management
Maddocks
Mallesons Stephen Jaques
Minter Ellison
MMC International
National Australia Bank
National ICT Australia
Pacific Strategy Partners
Pantheon Ventures
Partners Group
PKF Australia Limited
PricewaterhouseCoopers
Quay Partners
Queensland Government –
Department of State Development, VC Unit
Quentin Ayers
St George Bank
Sustainable Energy Authority Victoria
Terra Rossa Capital
UBS Investment Bank
Uniquest
Vantage Asset Management
Victorian Department of Innovation, Industry
and Regional Development
Westpac Institutional Bank
William Buck
Willis Australia
Wilshire Australia

13.3. REPORTS AND STUDIES

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13.4. A.T.KEARNEY REPORT ON EMPLOYMENT

13.5. PRICEWATERHOUSECOOPERS REPORT ON ECONOMIC IMPACT OF PRIVATE EQUITY IN AUSTRALIA

Economic Impact of Private Equity and Venture Capital in Australia

2006

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Contents

Highlights

1

This report presents PricewaterhouseCoopers's findings on the economic impact on Australia of private equity and venture capital investment – collectively referred to as 'private equity' (PE) in most instances.

The information contained in this report was derived from an in-depth survey of Australian companies that have received PE or venture capital investment over the past five years and other research.

The key findings are summarised below.

Employment generation

PE backed companies are a major employer group, providing jobs for up to 650,000 Australians, being 8% of total private sector employment. They are also an important job-creation driver, with 76% expecting to hire additional workers in 2007. According to Dun & Bradstreet, the corresponding economy-wide measure is 5%.[1]

Innovation facilitator

Australian technological innovation and R&D commercialisation are some of the main benefits of PE investment: three-quarters of investee companies launched new products in the past year, while only 27% did so prior to the PE investment. Furthermore, for the recipients of venture capital in particular, the investment is usually necessary for the first product launch to occur.

Management advice

PE managers are having overwhelmingly positive impacts on companies' cost management, efficiency, cash flow and strategy formulation and implementation. This improves Australia's overall productivity and competitiveness.

Investment in people

PE investee companies are committed to the training and development of their staff. For instance, 21% of the surveyed businesses offer apprenticeships and 82% provide ongoing technical training

Good governance

The closer interaction between PE shareholders and management provides robust strategic and risk management oversight. Hence, PE investee companies generally have strong corporate governance. Furthermore, the independence of PE investee companies' boards is comparable to that of the ASX200.

Sharing the profit

PE investee companies share profits with employees, as 79% of respondents distributed some of the wealth created by the business through employee share options programs and bonus plans.

Future opportunities

The Australian PE industry has significant scope for further growth when compared to other countries with mature developed economies and sophisticated financial systems.

This is the first of what will be an annual report. From next year, the information gathered for this report will be used to make comparisons between years and identify trends in the industry.

The report also shows that the Australian PE industry is expanding at an increasing rate. The cumulative amount invested since 1999 is $14 billion[2]; the average fund has grown in size by 27% per year between 1999 and 2006, reaching AUD 415 million[3]; and the total number of investee companies is approaching 900 (including New Zealand).

Finally, featured case studies reveal that private equity funding was crucial in the development of such diverse businesses as Austal, JB Hi-Fi and Seek.

1 Dun & Bradstreet in their National Business Expectations Survey – November 2006 Results indicate that 5% of executives expect to hire more staff in the March 2007 quarter than a year ago.

2 Thomson Financial and AVCAL Survey, fiscal year ended 30 June 2006

3 Thomson Financial and AVCAL Survey, fiscal year ended 30 June 2006

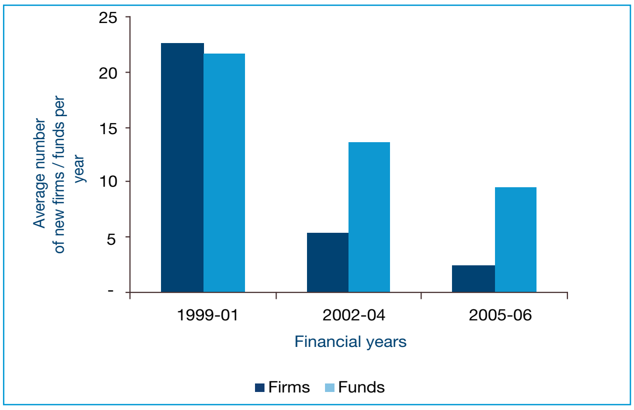
Introduction

2

Private equity (PE) firms establish funds to invest in companies whose shares are not publicly traded, or to privatise public companies. The funds made available to companies are often comparable in size to those available to businesses whose equity is quoted on a stock exchange; however PE arguably offers significant advantages. Venture capital is a subset of private equity that is primarily targeted at businesses at an early stage of development.

The PE industry in Australia is experiencing strong growth. Concurrently, the number of new PE firms being formed is slowing, as shown in Figure 1, indicating a maturing of the market.

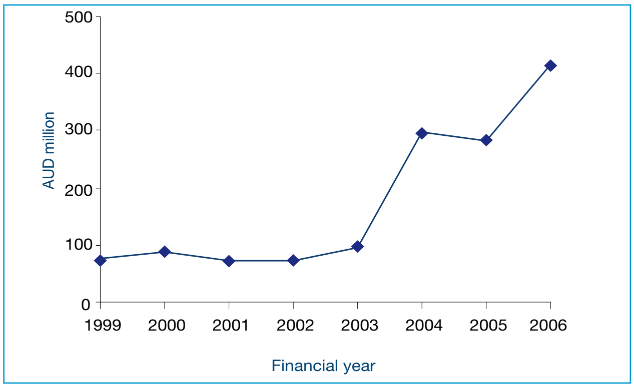
Figure 1: Number of new Australian PE firms and funds



Source: Thomson Financial and AVCAL Survey, fiscal year ended 30 June 2006

Consistent with the increasing fund concentration [4], the size of the average Australian PE fund in terms of amount committed peaked in 2006, at AUD 415 million, as represented in Figure 2.

Figure 2: Average size of fund by year of formation

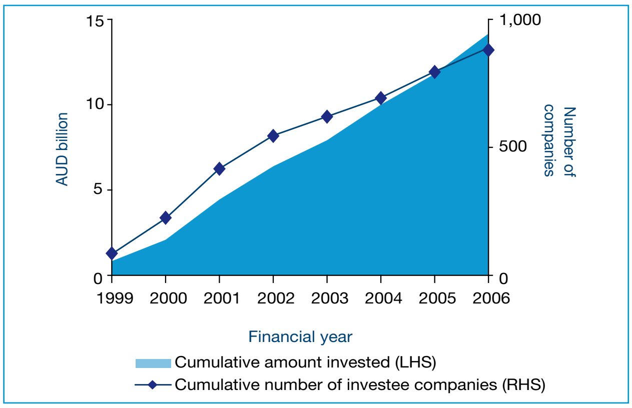


Source: Thomson Financial and AVCAL Survey, fiscal year ended 30 June 2006

The CAGR of the size of the average fund was 27% from 1999 to 2006; however, the 2003–2006 period had an even higher CAGR, at 63%.

In line with the growth of the PE funds' capital, the amount invested in the Australian economy is increasing apace, with the number of companies to have received PE funding approaching 900.

Figure 3: Cumulative number of investee companies [5] and the cumulative amount invested [6] since 1999



Source: Thomson Financial and AVCAL Survey, fiscal year ended 30 June 2006

4 Fund concentration refers to the average number of funds per firm

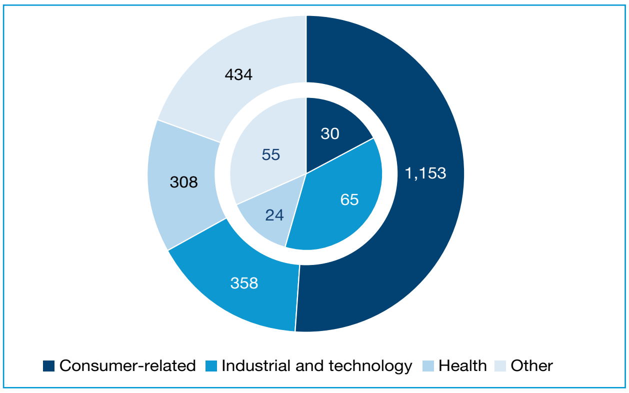
5 The cumulative number of investee companies includes those companies based in New Zealand.

6 The cumulative amount invested includes follow-on investments to existing investee companies. It also includes the amount invested in New Zealand companies.

Analysing the information shown in Figure 3, the CAGR of the amount invested was 52%, while that of the number of investee companies was approximately 41%.

Slightly over half of the money invested to date has gone to consumer-related business, with the innovative health and technology sectors receiving slightly more than a quarter of the funds. This is represented in Figure 4.

Figure 4: Private equity investment in Australia by sector
Outer circle: PE amount invested in Australia in 2006 by sector (AUD million)
Inner circle: Number of PE investee companies in Australia in 2006 by sector

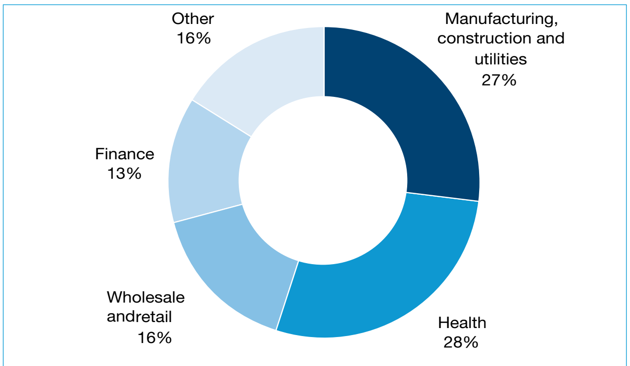


Source: Thomson Financial and AVCAL Survey, fiscal year ended 30 June 2006

However, the industrial and technology segment attracted the highest number of investment deals.

This investment diversity reflects the fact that respondents to the survey were spread across a number of industries, as demonstrated in Figure 5.

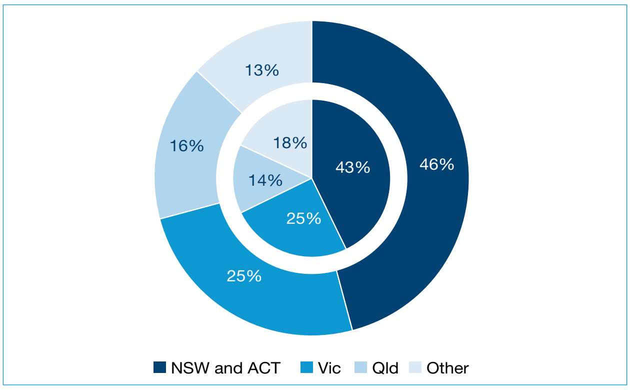
Figure 5: Industries in which responding businesses operate



Source: PricewaterhouseCoopers and AVCAL survey 2006

In addition, the respondents to the survey were generally representative of the geographic distribution of PE investment in 2006, as shown in Figure 6.

Figure 6: Location of headquarters and deals by state
Outer circle: Location of business headquarters
Inner circle: The number of investment deals in Australia in 2006

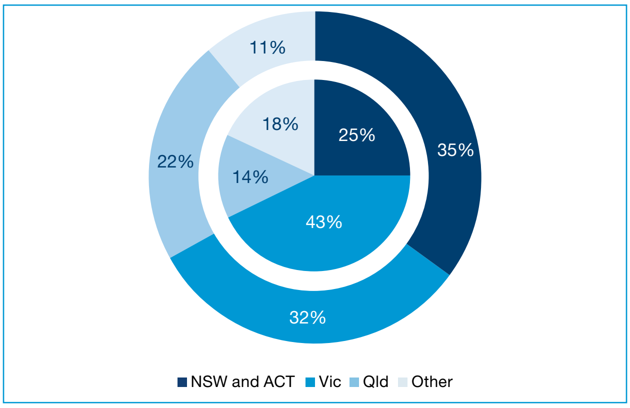


Source: PricewaterhouseCoopers and AVCAL survey 2006

Furthermore, 6% of the respondents' businesses are based outside of the capital cities.

Almost 90% of invested funds were deployed to companies headquartered in the three eastern mainland states and the ACT, where, in turn, almost 80% of Australia's population is resident. Nonetheless, the other states still accounted for 10% of PE investment, as shown in Figure 7.

Figure 7: Private equity investment in Australia by state
Outer circle: Percentage of PE invested in Australia in 2006 by state
Inner circle: Percentage of PE investment deals in Australia in 2006 by state



Source: Thomson Financial and AVCAL Survey, fiscal year ended 30 June 2006

The over-representation of Victoria and Queensland can be explained thus:

- Victoria has historically had prominent industrial and IT sectors; and

- Queensland's share is partly a reflection of its 'Smart State' initiatives.

Furthermore, when looking at the number of deals, Victoria and Queensland's overrepresentation is corrected in favour of the other states.

Although the Australian PE industry is recording strong growth, it is still in its early stages when benchmarked against global leaders, as highlighted in Figure 8. Relative to GDP, the level of Australian PE investment is around three-quarters of that in the UK. Compared to the US and Israel, the Australian industry is approximately one-third the size.

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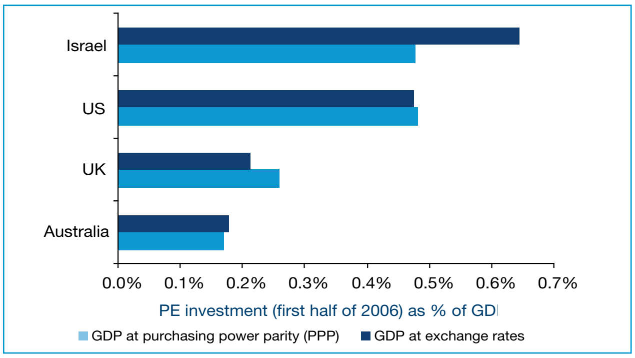
Compared to the US and Israel, the Australian industry is approximately one-third the size.

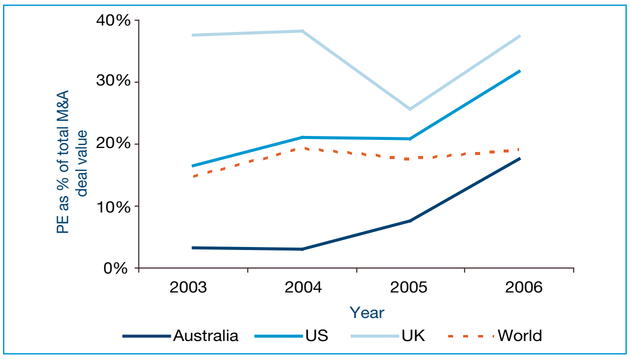
Figure 8: New PE investment as a proportion of GDP[7]



Source: The Economist and CIA World Factbook

Similarly, Australian PE deals as a proportion of overall M&A activity is still below the global average. This is shown in Figure 9.

Figure 9: The value of PE deals as a proportion of total M&A deals



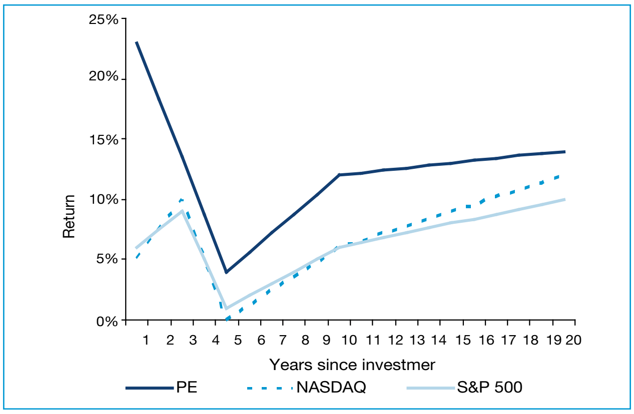
Source: Dealogic 2006

Therefore, the Australian PE industry has significant scope for further growth when compared to other countries with mature developed economies and sophisticated financial systems. Its fund-raising and capital-deploying performance to date confirms its ability to join the ranks of the global leaders.

PricewaterhouseCoopers estimates that the PE industry-backed companies employ up to 650,000[8] Australians, which represents approximately 8% of total private-sector employment.

The current trends and the opportunities for further growth are occurring at a time when PE investment is being seen to be outperforming that of publicly listed companies, as indicated by the information in Figure 10.

Figure 10: Thomson Financial US Private Equity Performance Index 30 June 2006[9]



Source: The Australian Financial Review, 20 November 2006

Having established the general contours of the industry, it would be useful to analyse and understand the impacts of PE investment at the investee company level. To this end, PwC surveyed the representatives of a sample of investee companies.

7 Gross Domestic Product (GDP) figures are for 2005 and were reduced by 50% to yield an estimate for the first half of the year.

8 According to the Thomson Financial and AVCAL Survey Fiscal Year Ended 30 June 2006, total private equity under management was approximately AUD 22.445 billion. Data available for the fiscal year 2006 indicated an average PE investment amount representing 24% of total Enterprise Value (EV). Subsequent calculations demonstrate that for approximately AUD 4 billion in EV, or AUD 970 million in investments made by PE funds (representing around 4% of total capital under management), PE firms employed 28,000 people. This figure was obtained from available employee statistics at investee companies. When multiplied proportionately, the PE-related employment estimate is around 650,000 jobs.

9 Not all the tracked PE investee companies remain private-equity backed over the entire analysis period. However, the analysis implies there are lasting effects of the PE investment even if the investee company is listed after a few years, for instance.

3

Methodology

A confidential survey of companies which have received PE funding was determined to be the most representative and robust method of studying the economic impacts of PE investment in Australia.

The starting point in developing the survey sample comprised of two steps:

- a questionnaire was sent to 55 Australian PE fund managers, with the aim being to identify the companies that have received PE funding and to obtain their contact details; and
- listings of PE transactions compiled by the Asian Venture Capital Journal were consulted in order to supplement the responses to the fund managers' questionnaire.

The targeted PE investments were those that were either made after 2001 or were still active in 2006. Therefore, some of the respondents no longer receive PE funding and are even listed on a stock exchange.

A population of almost 700 companies which have received Australian PE funding was identified. Removing the companies based outside of Australia and those which were not willing to participate in the survey, a sample of 296 was selected.

The online survey was accessible only with the unique user names and passwords that were provided to a nominated representative of each company in the sample. The duration of the survey was from 13 October to 1 November 2006.

4

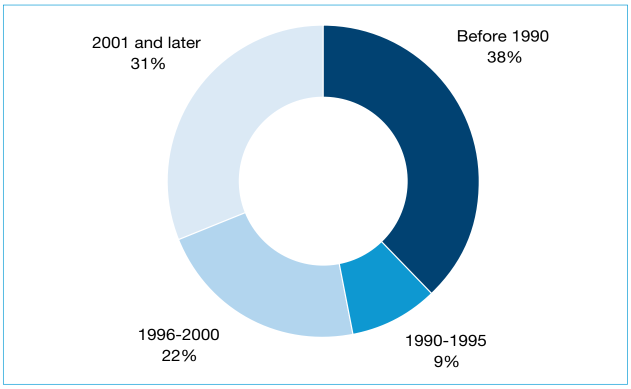
Findings

By 1 November 2006, 50 submissions were received, being a 17% response rate. The findings that follow are based on those responses.

Respondents' characteristics

Figure 11 shows that respondents represented a broad range of businesses, from start-ups to corporate spin-offs and companies involved in public-to-private transactions.

Figure 11: Year of business formation



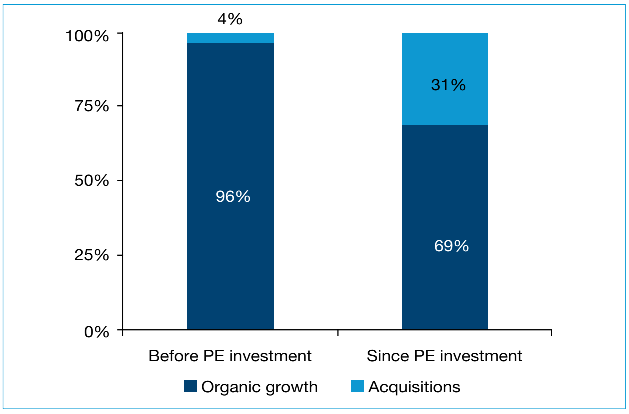
Source: PricewaterhouseCoopers and AVCAL survey 2006

These results demonstrate the diversity of PE investee companies. In particular, they illustrate that PE investment is not limited to new businesses, as the more established companies also benefit.

Economic impacts of PE investments

The first benefit of PE investment, illustrated by the information in Figure 12, examines the respondents' opportunities for growth and expansion.

Figure 12: Methods of expansion

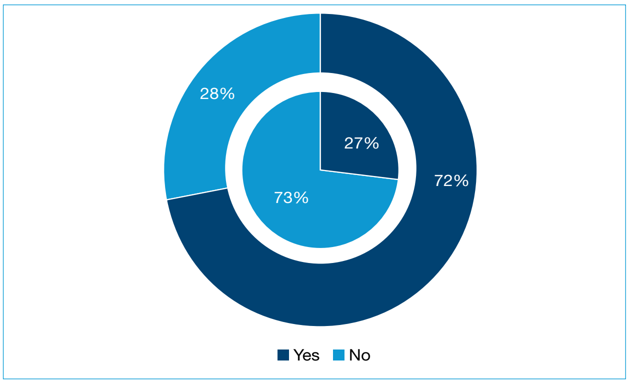


Source: PricewaterhouseCoopers and AVCAL survey 2006

The increase in post-PE investment acquisitiveness indicates that additional funds allow for diversification of growth methods. Furthermore, contrary to popular perceptions, only 4% of the responding companies have made divestments of divisions or subsidiaries following the original PE investment.

PE investment was found to also have a strong positive effect on the ability of investee companies to innovate. This is shown in Figure 13.

Figure 13: Introduction of new products by investee companies
Outer circle: Investee companies that have introduced new products in the past 12 months
Inner circle: Investee companies that introduced new products in the 12 months prior to the original PE investment

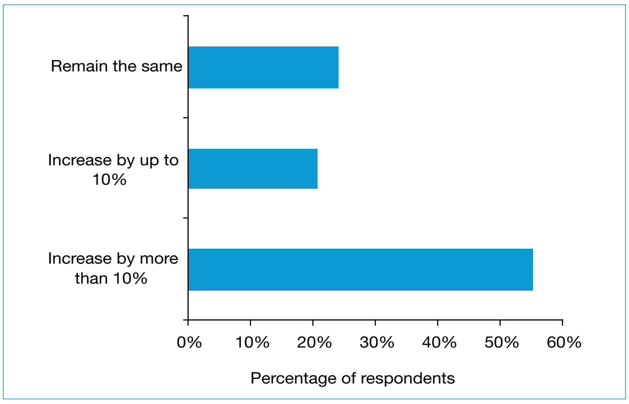


Source: PricewaterhouseCoopers and AVCAL survey 2006

There is a significant growth in the focus on innovation by the investee companies after the original PE investment. This suggests that PE managers encourage innovation, which is consistent with the anecdotal evidence gathered during the study. Furthermore, the benefits extend to the academic sector, as 45% of respondents report collaborating with universities in R&D.

PE-backed companies also appear to be very optimistic regarding increases in their employee numbers, as presented in Figure 14.

Figure 14: Investee companies' expectations of the change in the number of their employees over the next 12 months

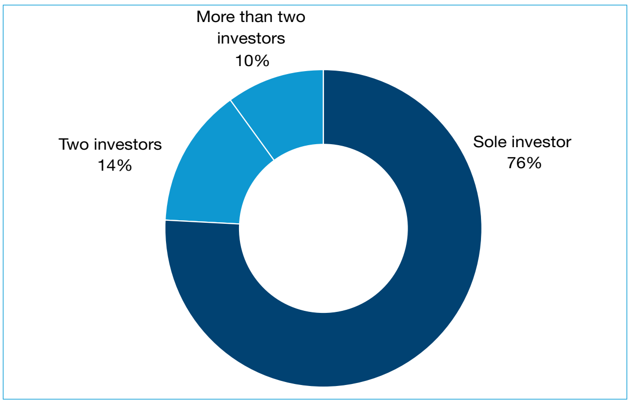


Source: PricewaterhouseCoopers and AVCAL survey 2006

These responses indicate a confident outlook which fosters employment generation. Importantly, no respondent expected a decrease in the level of employment at their company. By contrast, the economy-wide Dun & Bradstreet Business Expectations Survey from November 2006 reveals that only 5% of the respondents expect an increase in staff numbers, with 12% foreseeing a reduction. Furthermore, the corresponding November 2006 Sensis Business Index shows that 65% of small and medium-sized business respondents are confident about their commercial prospects over the subsequent 12 months. Finally, while ANZ identified a 5.8% rise in job advertisements in October 2006[10], the St George-Australian Chamber of Commerce and Industry Business Expectations Survey from November 2006 noted that '*confidence in Australian economic growth declined over the quarter and entered negative territory indicating that business expects growth to be less in one year's time than it is at present*'.

Figure 15 indicates that the majority of Australian PE investments are by sole investors.

Figure 15: Type of investment



Source: PricewaterhouseCoopers and AVCAL survey 2006

Finally, the majority of the respondents plan an eventual stock market listing and expect to do so within three years. The information regarding listings is shown in Table 1.

Table 1: Respondents' status regarding listings

Of all the respondents	
Already listed	7%
Plan to list	46%
No plan to list	47%
Total	100%
Of those planning to list	
Will do so within 12 months	23%
Will do so within three years	46%
Will do so later than within three years	31%
Total	100%
Of those planning to list	
Will do so on the ASX	92%
Will do so on an overseas exchange	8%
Total	100%

Source: PricewaterhouseCoopers and AVCAL survey 2006

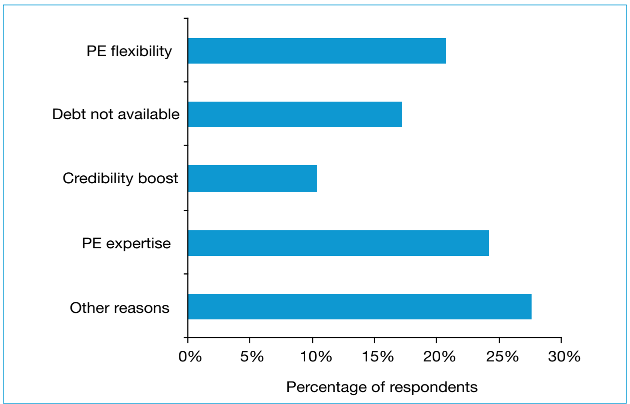
Importantly for Australia, 92% of those intending to list plan do so locally.

10 'Job Advertisements rise strongly in October', ANZ press release, 6 November 2006

Benefits of PE investments to investee companies

As shown in Figure 16, the main reasons for seeking PE investment were the expert advice and guidance that accompanies it and the flexibility this form of funding affords the recipient. PE flexibility relates to the various funding structures available and the relative simplicity of the process, especially when compared to raising public equity.

Figure 16: The main reason for seeking the original PE investment



Source: PricewaterhouseCoopers and AVCAL survey 2006

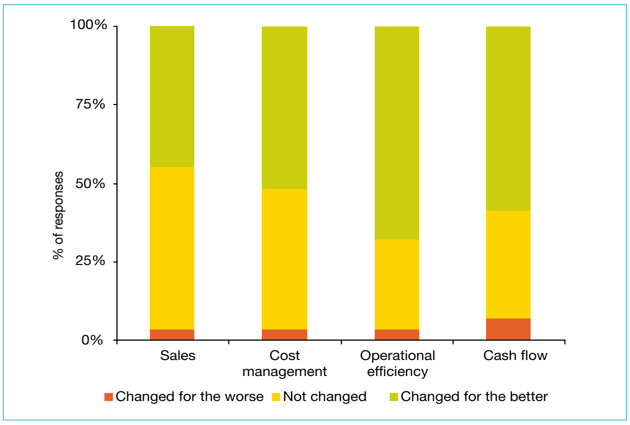
Some of the other reasons offered by respondents for seeking PE investment are *'to share financial responsibility for growth'* or the fact that *'PE funding was the only type available for the technology at the early stage of development'*.

Of equal importance are the responses about what would have occurred without the original PE investment. The answers included looking to sell the business or applying for government grants while *'moving very slowly'*. Some respondents answered bluntly that they would have *'gone under'* or been forced to sell their intellectual property (IP) and liquidate. Finally, the role of PE investment in supporting the development of as-yet-uncommercial technologies is encapsulated in the following response:

'At [the] *stage of introducing PE, the company had no cash flow … still developing essential IP. The company had already enjoyed a seed round of "family and friends",* [but had] *no cash flow to support debt and* [it was] *too early … for* [an] *IPO.'*

Figure 17 showcases the overwhelmingly positive impact of PE investment on the financial circumstances of the investee companies.

Figure 17: Changes in the investee company's financial performance as a result of the PE investment

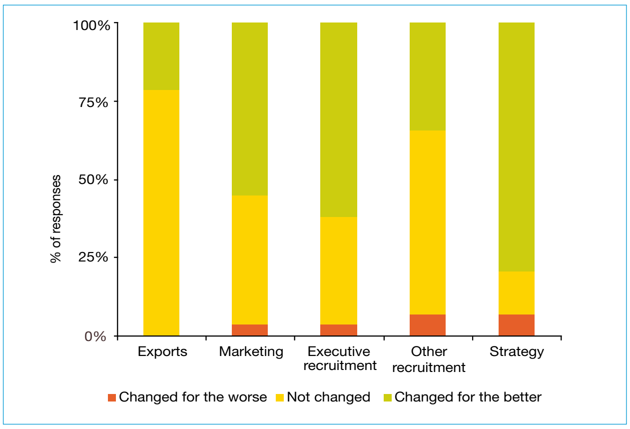


Source: PricewaterhouseCoopers and AVCAL survey 2006

The financial effects are generally strongly positive, with most showing that the change has, on average, been for the better. A particularly positive impact of PE investment was registered for the key consideration of operational efficiency. Finally, 59% of respondents indicated that cash flow improved as a result of the PE investment, which is an important outcome, given the central role of cash flow sustainability in successful businesses.

Similarly, PE investments were found to have positively impacted the non-financial aspects of investee companies' operations, as shown in Figure 18.

Figure 18: Changes in the investee company's non-financial performance as a result of the PE investment

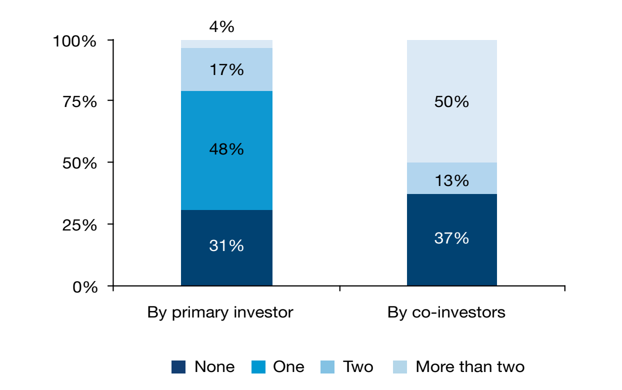


Source: PricewaterhouseCoopers and AVCAL survey 2006

Improvements in marketing and executive recruitment were some of the key changes for the better, while almost 80% of respondents indicated that the PE investors' expertise in strategy resulted in a positive impact on the investee company.

Such strongly positive effects are also reflected in the readiness of both investors and investees to follow up the original PE investment with subsequent rounds, which is demonstrated by the information in Figure 19.

Figure 19: The number of subsequent rounds of PE investment received



Source: PricewaterhouseCoopers and AVCAL survey 2006

The willingness of the majority of primary investors and their co-investors to provide funds in addition to those in the original investment illustrates the PE firms' ongoing commitment to the investee companies. It also implies positive results of the initial investment, both for the investor and the investee.

Those positive results and the optimism regarding future employment generation are corroborated by the historical growth in headcount of 30%, as shown in Table 2.

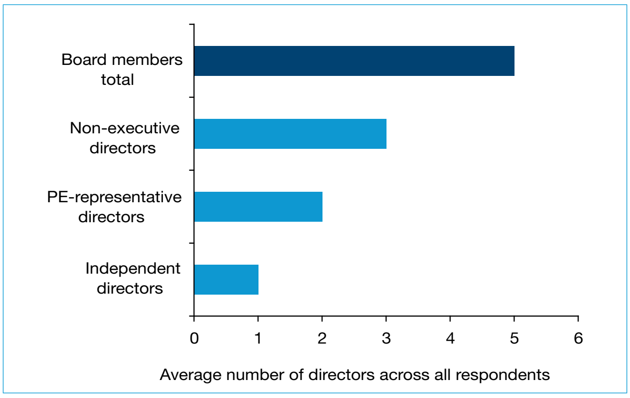
Table 2: Other data regarding PE-backed companies

Average equity share held by PE investors	58%
Average headcount in 2006	69
Average headcount CAGR	30%

Source: PricewaterhouseCoopers and AVCAL survey 2006

On average, PE investors held a majority equity stake in the investee companies in 2006. However, they tended to maintain only a minority board representation, indicating that they do not control or dominate the board. The corporate governance findings are summarised in Figure 20.

Figure 20: Respondents' corporate governance profile[11]



Source: PricewaterhouseCoopers and AVCAL survey 2006

The responses indicate that investee companies have effective corporate governance and compact boards. In particular, non-executive and independent directors together constitute the majority on the average PE investee company board, which, at 67%, is the same as for the average ASX 150 board[12].

11 Independent directors are defined as those directors who are not current or ex-employees of the company, have no commercial dealings with the company and are not related by family to members of the management team.

12 Suchard et al (2006).

Social benefits

The PE-backed companies also appear to have a strong commitment to broadening and deepening Australia's stock of human capital, as shown in Table 3.

Table 3: Respondents' training profile

Respondents offering apprenticeships	21%
Respondents offering technical training	82%
Respondents offering soft skills* training	43%
Respondents offering external training for:	
Management only	14%
Non-management only	4%
All staff	39%
Total	57%

Source: PricewaterhouseCoopers and AVCAL survey 2006

* Soft skills relates to a range of personal and inter-personal skills, such as self-management, integrity, teamwork and negotiation.

With the majority offering both internal and external training, PE investee companies are contributing to productivity improvements and ongoing Australian R&D. With 21% of respondents offering apprenticeships, the PE investee companies are generally in line with the wider economy, where 28% of employees had an apprentice or trainee in 2005[13]. Also, 53% of Australian employers offered unaccredited, on-the-job training in 2005[14], which is less than the 82% of the respondent PE investee company that do so.

Furthermore, the majority of the respondents share the wealth created with their employees, with 79% of respondents having share option programs and bonus plans.

Finally, many of the investee companies appear to be consistently and deliberately environmentally aware and responsible. From using rainwater and liquefied petroleum gas (LPG) in the company car fleet to emphasising *'electronic data-capturing systems to reduce paper copies'* and sourcing *'all directly controllable power requirements* [from a] *green supplier'*, the economic growth appears well balanced by corporate social responsibility initiatives. In fact, the business of one of the respondents is *'developing fuel cell technology which is a highly efficient way to produce electricity … the increase in efficiency of generation results in 60% less CO2 emissions compared to a coal-fired power station'*.

13 'Australian vocational education and training statistics – Employers' use and views of the VET system', NCVER, 2005 Summary

14 Ibid.

8

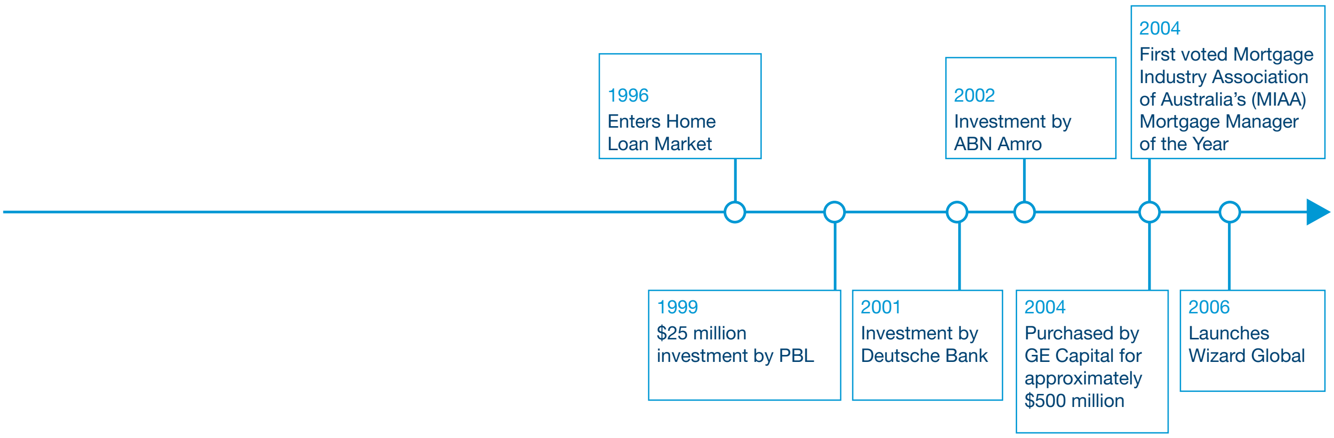
Case studies

Case study 1: Wizard

Wizard Home Loans is one of Australia's leading non-bank lenders. Since entering the home loan market in 1996, it has expanded its product portfolio to include personal loans, car finance and credit cards. Wizard currently operates more than 250 branches across the country.

Having been voted best non-bank lender by Australian Banking and Finance Magazine three times, Wizard is also involved in the community through a variety of initiatives, including:

- key sponsor of Queensland's Quest Community Business Awards, New South Wales' Cumberland Business Awards and Victoria's Leader Business Awards;
- a sponsor of Sydney's Powerhouse Museum, including launching the 'Powerhouse Wizard' award to honour innovative endeavour; and
- supporting Habitat for Humanity and raising funds for the children in the Vincentian Village family crisis centre in East Sydney.



Contact details

12 Castlereagh St
Sydney NSW 2000
1300 657 355

www.wizard.com.au

Case study 2: Seek

Seek was formed in 1997 to match job seekers and employers over the internet and is Australia's leading company in the online training and employment market, serving SMEs, large corporations, and government and recruitment agencies. At any one point in time there are approximately 80,000 jobs advertised on its sites. Its monthly audience of 1.4 million individual site visitors equates to 14% of the Australian workforce. Also, Seek Volunteer uses Seek's technology to provide a free service to match volunteers and non-profit organisations.

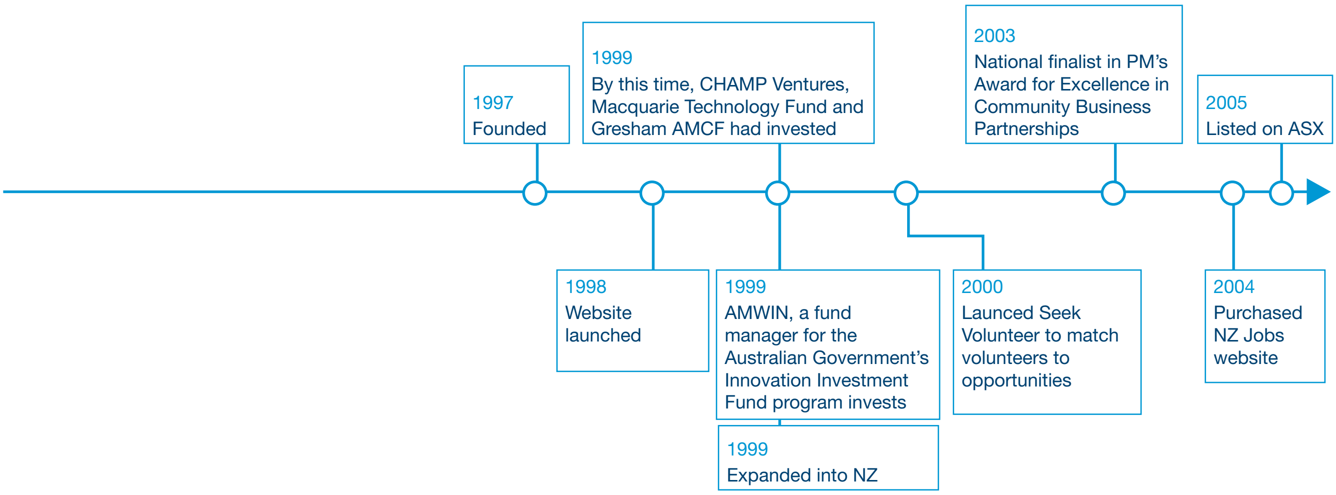
Seek has since expanded into the New Zealand and UK markets and is listed on the ASX. Looking forward, Seek hopes to improve its advertising volumes in industries such as health and education and in regional areas. Seek is also developing new tools to help enterprises shortlist, test and communicate with candidates.

Seek has around 230 employees and is based in Victoria, with branches in all the mainland state capitals, Auckland and London. It has been awarded the Hitwise 2004 Best Business & Finance Employment Website for 2004 and the Boss 2005 Special Commendation Award in Best Employers to Work for in Australia.

"Seek raised several rounds of early stage [PE] *capital ... in order to fund our growth and, therefore, the availability of this capital was a key factor in enabling us to achieve our objectives. Several of these* [investors] *... provided important strategic input as well as access to their networks.*

The growth of the [PE] *industry is an important ingredient for the ongoing health of early stage businesses in Australia."*

Paul Bassat
CEO, Seek



Contact details

Level 2
3 Wellington St
St Kilda VIC 3182
(03) 9510 7200

www.seek.com.au

Case study 3: Austal

Austal is the world's leading manufacturer of 40-metre passenger catamarans and the largest manufacturer of fast ferries, having delivered vessels to 31 nations around the world. Its shipyards are located in Western Australia and Alabama

The key clients of this ASX-listed company include:

- Australian Customs Service;
- the US military;
- Royal Australian Navy;
- the police and military in the Caribbean; and
- the tourism industry in the Middle East.

1987
Founded to provide lobster fishing craft to WA

1994
CHAMP Investors led syndicate worth $15 million in venture capital.

1998
Supplied vessels to Australian Customs Service and Royal Australian Navy

1998
Listed on ASX

1999
Built US shipyard

2001
First company to provide high speed vessels to US military

Contact details
100 Clarence Beach Road
Henderson WA 6166
(08) 9410 1111

www.austal.com

Case study 4: Pharmaxis

Pharmaxis is a specialist pharmaceutical company that researches, develops and brings to market human therapeutic products to treat chronic respiratory and autoimmune diseases. It is listed on both the ASX and the NASDAQ. Pharmaxis currently has 65 employees located in its manufacturing and clinical facilities in NSW. Research activities employ eight people at the Australian National University in Canberra.

The trials of its drugs have been conducted in Australia, Europe and North America, with plans for global market coverage. Looking forward, Pharmaxis is developing drugs for the management of the following conditions:

- asthma;
- cystic fibrosis;
- multiple sclerosis; and
- rheumatoid arthritis.

1998
Launched

1999
Seed funding from Rothschild Bioscience Management

2000
Awarded $3 million AusIndustry start grant

2002
Private funding of $9.6 million

2003
Listed on ASX, additional AusIndustry start grant

2005
Listed on NASDAQ

2006
Asthma medication launched

Contact details
Unit 2
10 Rodborough Rd
Frenchs Forest NSW 2086
(02) 9454 7200

www.pharmaxis.com.au

Case study 5: bCODE

bCODE Mobile Ticketing has developed a paperless method for providing tickets for transport, sporting, movies and other events. Tickets are sent in the form of an SMS text message which is read by an optical scanning device at the event entrance. bCODE also offers technologies to support other services such as ticket booking, information enquiry, customer service, account notifications and direct marketing.

The company currently has over 70 customers across industries including:

- aviation;
- banking;
- entertainment;
- retail; and
- government.

"We must utilise our available capital to develop and test the product in Australia, and then create an export path to US and Europe ASAP… it is unlikely we would have a chance at making this unique opportunity a success without PE and PE managers."

Michael Mak
CEO, bCODE

1990s
Launched as START Corporation

2005
Investment of $5 million by CM Capital and Innovation Capital

2005
ADI invests seed funding in START Corporation

2006
Changes name to bCODE

2006
Wins The Australian IT and Ericsson's Frontier Award

Contact details
Level 2
2A Glen St
Milsons Point NSW 2061
(02) 9954 4411

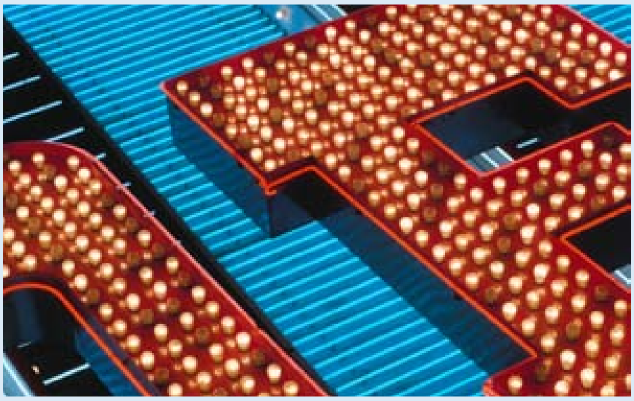
www.bcode.com.au

Case study 6: Austar

Austar is one of Australia's leading subscription television and broadband internet access providers, offering primarily digital satellite services to customers in regional and rural areas. This ASX-listed company currently has half-a-million pay TV subscribers and slightly less than 50,000 internet and mobile telephony customers. It employs over 800 people across the Gold Coast, Sydney and Darwin. Looking forward, AUSTAR has formed an alliance with Soul and Unwired to seek funding under the Australian Government's $1 billion Connect Australia program to build an affordable alternative wireless broadband network.

Some of the key positive outcomes for Australia are:

- to date, Austar has invested over $1 billion to establish its technology platforms, a state-of-the-art customer service centre and to provide innovative services to regional Australia;
- the company has also invested over $5 million in Australian content TV programs;
- Austar for Schools provides 1,400 schools in regional Australia with free access to educational programs; and
- The company sponsors the Bell Shakespeare drama company.



- 1995 Established
- 1999 Listed on ASX
- 2002 CHAMP and its strategic partner Liberty Global Inc acquired 82% of Austar for $82 million
- 2004 Austar Digital launched
- 2006 Joined ASX 200

Contact details
Locked Bag A3940Sydney
South NSW 1235
(02) 9251 6999

www.austarunited.com.au

Case study 7: JB Hi-fi

JB Hi-Fi is one of Australia's leading music, DVD and video game retailers. It started from a single store in Victoria and has expanded to over 60 outlets located across the mainland. It is now an ASX-listed company and recently bought a regional electrical goods retailer.

JB Hi-Fi has created a significant online presence, including through the following initiatives:

- online sales of CDs and DVDs;
- sales of legal music downloads; and
- sales of mobile phone ringtones and wallpapers.

"I was able, as CEO, many times to bounce off what we were thinking of doing with [the PE representative on the board], *knowing that we would get a great input to the strategies."*

Richard Uechtritz
CEO, JB Hi-Fi

- 1975 Starts trading from single store
- 1983 Founder sells business
- 1999 Operates 10 stores
- 2000 Purchased by private equity backers and senior management
- 2003 Floated on ASX
- 2004 Purchased 70% of Clive Anthony electrical retailer
- 2006 Operates over 60 stores nationwide

Contact details
14 Spink St
Brighton VIC 3186
(03) 8530 7333

www.jbhifi.com.au

www.visiongroupaustralia.com

Case study 8: Vision Group

Vision Group is one of the largest providers of ophthalmic care in the Australia. It has expanded from its base in Victoria through acquisitions in the other eastern states. Vision Group focuses on cataract procedures and refractive surgery, and is comprised of 16 dedicated ophthalmic consulting facilities, seven day surgeries and six refractive surgery and laser centres.

The group is listed on the ASX. It employs approximately 320 staff in nursing, orthoptics, marketing, administration and finance, including 28 doctor partners and 50 associate and day surgery partners.

Vision Group is a major sponsor of The Fred Hollows Foundation and its surgeons also attend to Aboriginal patients in Far North Queensland.

2001
Group formed from existing Camberwell Eye Centre

2001
Receives private equity investment of $14 million from funds managed by AMP

2004
Floated on ASX

2005
Purchased the Eye Institute in NSW

2005
Added to ASX 300

2006
Acquires Southline Eye Centre & Central Queensland Eye Clinic

Contact details
Level 5
409 St Kilda Rd
Melbourne VIC 3004
(03) 8844 4000

www.visiongroupaustralia.com

Case study 9: CEA Technologies

CEA Technologies is a developer of advanced radar and communications technology, excelling in the application and commercialisation of Australian technological innovation. Its workforce of over 200 is spread across the ACT, Victoria, South Australia and California.

CEA has successfully exported a range of high technology radar surveillance systems and communications systems to several countries throughout the world. The radar technology in particular is in use by the Australian, US and Middle Eastern governments in defence, counter terrorist and border protection applications.

Approximately 60-70% of CEA's resources are committed to research and development

1983
Company launched

1991
Australian Small Business of the Year

2001
Deutsche Asset Management invests $11 million

2005
CEAMOUNT system sold to Navy had been developed with aid of AusIndustry grant matched by BAE Systems Australia

2006
Received investment and signed strategic agreement with Northrop Grumman

2006
Goodwin & Kenyon Group and Deutsche Asset Management sell stake

Contact details
59-65 Gladstone St
Fyshwick ACT 2609
(02) 6213 0000

www.cea.com.au

Case study 10: CogState

CogState specialises in the development and commercialisation of technologies related to the testing of cogitative response in clinical trials. The technologies are used to quantify the effect of disease and of drugs, devices or other interventions on human subjects participating in clinical trials conducted by companies in industries including:

- pharmaceuticals;
- biotechnology;
- nutraceuticals; and
- functional food.

The ASX-listed company is present in the UK, USA and Japan, and is quickly increasing its global market share in the industry. Cognitive testing in clinical trials currently accounts for almost 80% of CogState's revenue. Some of its key clients include Pfizer, Johnson & Johnson and the US Government's Centers for Disease Control and Prevention.

"[PE] brought a professional approach…[they] understood that you needed to make margins on business and not spend too much."

Peter Bick
CEO, CogState

1999
Founded to commercialise cognative tests developed while working with Aboriginal communities

2001
Recieves AusIndustry start grant of $1.4 million

2004
Began selling cognitive tests into the clinical trial market.

2004
Floated on the ASX

2005
Signs funding agreement with Pfizer worth up to $1.3 million

2005
Places additional shares to increase sales resources

2006
Divests therapeutic drug development portfolio

2006
Began providing tests to Merck & GlaxoSmithKline

2006
Began providing tests to Merck & GlaxoSmithKline

Contact details
Level 7
21 Victoria St
Melbourne VIC 3000
(03) 9664 1300

www.cogstate.com

Case study 11: Mincom

Mincom is a leading global specialist in enterprise asset management solutions and services for asset-intensive organizations industries including:

- mining;
- utilities;
- transport;
- defence; and
- government.

Mincom is an export-focussed company, supporting customer sites in more than 40 countries and has over 1,200 employees in 18 offices in 13 countries.

It is the winner of the 2003 Queensland Premier's Smart Award for Science & Technology.

1980s
Commences exports to US, Latin America and Africa

1995
Colonial First State managed fund first invested; total funds invested now approximately $20 million

1997
Formed strategic relationship with Caterpillar, now principal shareholder

1998
One of the first private companies to offer stock options to attract talented employees

2003
Winner of the inaugural Queensland Premier's Smart Award for Science & Technology

2006
Grows to encompass exports to 40 countries

Contact details
193 Turbot St
Brisbane QLD 4000
(07) 3303 3333

www.mincom.com.au

Case study 12: Dynamic Hearing

Dynamic Hearing researches and develops technologies to provide better hearing. It licenses digital signal processing technology for hearing aids, entertainment and audio communication devices, and its technology is used to enhance the quality and volume of sound for the hearing impaired.

In 2002, two major clinical trials demonstrated the benefits of its technology. Since then, Dynamic Hearing has developed several key commercial partners and grew from five to 20 employees, including eight engineers and four audiologists. The company is a recipient of R&D tax concessions and export grants by the Australian government.

"Without PE we would not have been able to access the IP from the research institution, build a product suite and market presence, all of which have been critical in gaining market confidence and a revenue stream from satisfied customers."

Elaine Saunders
CEO, Dynamic Hearing

2002
Investment of $2 million by GBS Venture Partners & Nanyang Ventures

2002
Investment by AusIndustry

2002
Spun off from CRC

2003
ADRO technology receives the CRC Association's innovation award

2004
Further investment of $3 million over 2003/04 by GBS Venture Partners & Nanyang Ventures

2005
Signed licensing agreement with Canadian-based Gennum Corporation

2005
AusIndustry provides $1.2 million

Contact details
2 Chapel St
Richmond VIC 3121
(03) 8420 8500

www.dynamichearing.com.au

Case study 13: G2 Microsystems

G2 Microsystems designs and manufactures ultra-low-power Wi-Fi integrated circuits for the asset tracking, wireless sensor and mobile device markets. It is a major investor in Australian innovation.

It employs 26 local researchers and has received Australian Government funding. One of its most topical areas of R&D focus is Wi-Fi RFID technology.

G2 Microsystems received the 2006 Entrepreneurial Company of the Year Award from Frost & Sullivan.

"Australian [PE investors] *have had a major impact on the company's success by providing strategic direction and general advice to G2's executive team. They have also made important introductions that have led to customer opportunities and investments. Accede Capital, Starfish and Siemens are an integral part of G2's team, rather then being strictly investors."*

John Gloekler
CEO, G2 Microsystems

2004
DB Capital Partners invests (now Accede Capital)

2005
Series A funding of $6 million from DB Capital Partners and Starfish Ventures

2005
UPS invests in extension to Series A funding

2005
Receives $1.9 million government grant

2006
Series B funding of $14 million with investment from Siemens AG and previous investors

Contact details
G2 Microsystems
Level 15, 24 Campbell Street
Haymarket, NSW, 2000
(02) 9209 4211

www.g2microsystems.com

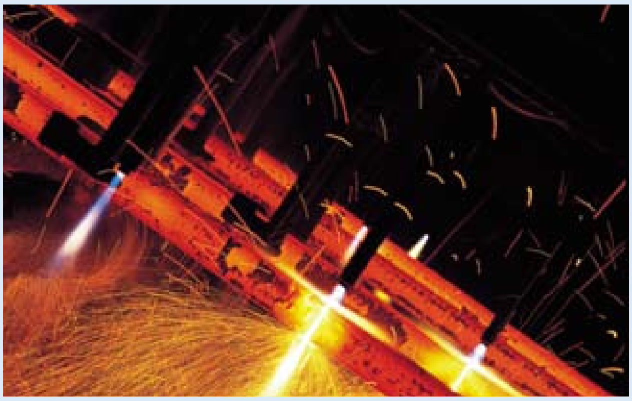
Case study 14: Intercast & Forge

Intercast & Forge is Australia's largest independent iron foundry group. It is the result of consolidation of three foundries from South Australia and NSW. The company currently produces over 60,000 tonnes of castings per year for the automotive, rail and general industrial markets.

While the company can trace its roots back to 1854, it today employs around 450 people. Intercast & Forge won the contract to supply the track fastening components for the Alice Springs to Darwin rail link. It directly exports over 39% of its total sales, with a further 15% exported indirectly as components within customer's products.

"We felt a lot of freedom to develop the non-automotive business…I've been quite pleased and very comfortable with the [PE] *relationship."*

Geoff Blomfield
CEO, Intercast & Forge



1963
Seven Hills Plant built

1998
Wingfield Plant built

2000
Company formed from Australian assets of BTR, investment led by CHAMP Ventures

2002
Participates in Federal Automotive Competitiveness and Investment Scheme, assistance helped make investment in additional equipment viable

2003
Disamatic casting line installed in Seven Hills Plant

2005
Received $2.5 million Federal grant as part of $19 million investment in new moulding line at Wingfield Plant

Contact details
1 Schumacher Rd
Wingfield SA 5013
(08) 8344 0100

www.intercast.com.au

Case study 15: CAP-XX

CAP-XX designs, manufactures and sells supercapacitors for portable electronic devices. These devices provide bursts of high power and can also provide a short term back up energy source. The company's production is split between its NSW facility, employing 48 staff, and a contract manufacturer in Malaysia.

R&D is conducted in concert with the CSIRO. CAP-XX is listed on the London Stock Exchange alternative Investments Market.

In 2005 CAP-XX was named a Technology Pioneer by the World Economic Forum.

"Private equity capital was crucial in getting CAP-XX to where it is today"

Anthony Kongats
CEO, CAP-XX

1994
Company associated with Anthony Kongats enters agreement with CSIRO to commercialise supercapacitor technology

1997
Launches and recieves an Ausindustry R&D Start Grant (will receive $5.4 million)

1999
Raised US$1 million in seed capital and builds factory in Lane Cove, Sydney

2000
Receives second round financing from Innovation Capital, Intel Capital and Technology Venture Partners

2001
Receives additional financing worth US$17 million, new investors included ABN AMRO, Walden International, and Acer Technology Ventures

2003
Commenced shipping products.

2005
Expands production capacity through agreement with PTA of Malaysia

2005
Named a Technology Pioneer by the World Economic Forum

2005
Receives passive financial assistance of $3.215 million

2006
Listed on London Stock Exchange AIM market raising £17 million

Contact details
Units 9&10
12 Mars Rd
Lane Cove NSW 2066
(02) 9420 0690

www.cap-xx.com

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vartguess.markarian@au.pwc.com

www.pwc.com/au/economics

PricewaterhouseCoopers

13.6. MEYRICK & ASSOCIATES STUDY ON PRODUCTIVITY GROWTH

MEYRICK AND ASSOCIATES

Labour Productivity Study

Prepared for

Australian Venture Capital Association Limited

June 2004

ABN 85 061 120 652
Incorporated in New South Wales
www.meyrick.com.au

Disclaimer

This study was undertaken for Australian Venture Capital Association Limited (AVCAL). The intention of the study was to provide an assessment of the labour productivity improvements obtained by a cross-section of companies that had undergone management buyouts, and to compare this to movements in national labour productivity. Use of this report by any other party, or for any other purpose, is not authorised by Meyrick and Associates, and Meyrick and Associates accepts no responsibility for any loss or damage that may result from such use.

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1. INTRODUCTION

The Australian Venture Capital Association is keen to understand the impact management buyouts have had on labour productivity. To provide some insight into this, Meyrick and Associates was engaged to undertake an analysis of labour productivity movements for a sample of firms that have recently been bought out by management, and to compare the outcome with national movements in labour productivity over the same period. The results of this analysis are presented below.

2. STUDY METHODOLOGY

2.1 Overview

Because of the very short time period for which data was available – in most cases three years or less since the buyout took place – and the limited data that was available even for that period, the use of sophisticated econometric techniques such as total factor productivity analysis was ruled out from the outset of the study. Instead, a partial productivity approach was adopted.

In order to make the outcomes of the analysis as compatible with National Accounts data as possible, the partial productivity measure adopted for each firm was Value Added per unit of labour input.

2.2 Data inputs

The selection of companies to participate in the survey and the collection of data from these companies was undertaken by Australian Venture Capital Association. A simple survey form was designed, and used to obtain data for the study, which was collected from ten companies covering the manufacturing, communications, retail and personal services industries. (The form is presented as an attachment to this report).

The participating companies were requested to provide a range of data inputs, which can be broken into two groups; essential data and desirable data.

2.2.1 Essential data

Essential data includes total revenue including sales revenue, total expenses and employment costs. This was used to estimate the value added for each company in each year. Companies were also asked to provide details of employee numbers, average hours, standard working week and overtime hours.

2.2.2 Desirable data

Our preferred approach to indexing the value added for each firm was to develop a firm-specific price index using actual sales data for the firm. We therefore requested a breakdown of sales by major product group. Data requested was the number of units sold and the share of total sales revenue.

Three companies were able to provide this data.

2.2.3 Size of sample

Because one of the buyouts was very recent (2004), it was not possible to use the associated return in the analysis. Information provided by three other companies was incomplete to the extent that we were unable to undertake the required analysis. Useable data was obtained for a total of eight companies spread across four industry sectors: because one of these was bought out only in 2003, only seven of these eight could be included in the main aggregated analysis.

2.3 Calculations

2.3.1 Deriving constant dollar value added series

A price index was developed to allow the value added figures for each year to be converted to a common basis.

Where the detailed information described in Section 2.2.2 was provided, the share of revenue was multiplied by total revenue and divided by product quantity to produce an estimate of movements in the prices of individual products. The individual prices were then combined (using the Fisher Index) to produce a representative price index for the company concerned.

Where the detailed sales information was not provided, the Gross Value Added (GVA) price deflator for the appropriate industrial sector compiled by the Australian Bureau of Statistics was used as a proxy.

As the national accounts deflator was generally normalised to 2002, the price index calculated using company data was also normalised to the same year.

The gross value added (GVA) for each company was estimated using accounting information provided in one of two ways, depending on the precise information provided by the company:

- By adding labour-related cost to the EBITDA
- By deducting non-labour operating costs from revenues.

2.3.2 Estimating labour input

Where complete data was provided, the labour input was estimated as the product of the number of full-time equivalent employees and the standard working hours, plus overtime worked. However, only four of the ten sample companies where able to provide information on overtime worked. In such cases, equivalent full-time employee numbers was used as a proxy. This may have lead to a slight over estimation of labour productivities for some companies. However, as overtime data was omitted for every year in the series it is unlikely that this deficiency will have materially affected estimates in changes in labour productivity from year to year.

In one instance, while salary and wages expenditure data was available for all years, physical labour input was only available for a single year. Because of the very small sample of companies available, it was decided that, rather than exclude the company from the analysis, it would be better to use indirect estimates of physical labour inputs, than to discard the data altogether to this end a proxy series for physical labour input was constructed by a two-stage process:

- Total labour-related expenditure was converted to a labour quantity index series using the GVA, labour share of GVA, and labour input information for the appropriate sector from the national accounts data
- Using this index and recorded physical labour inputs for the year in which this data was available, estimates were made labour inputs for each year.

2.3.3 Computing labour productivity movements

The GVA was divided by the quantity of labour and then normalised to 2002, resulting in an index for labour productivity for each company.

3. RESULTS

3.1 Aggregated Analysis

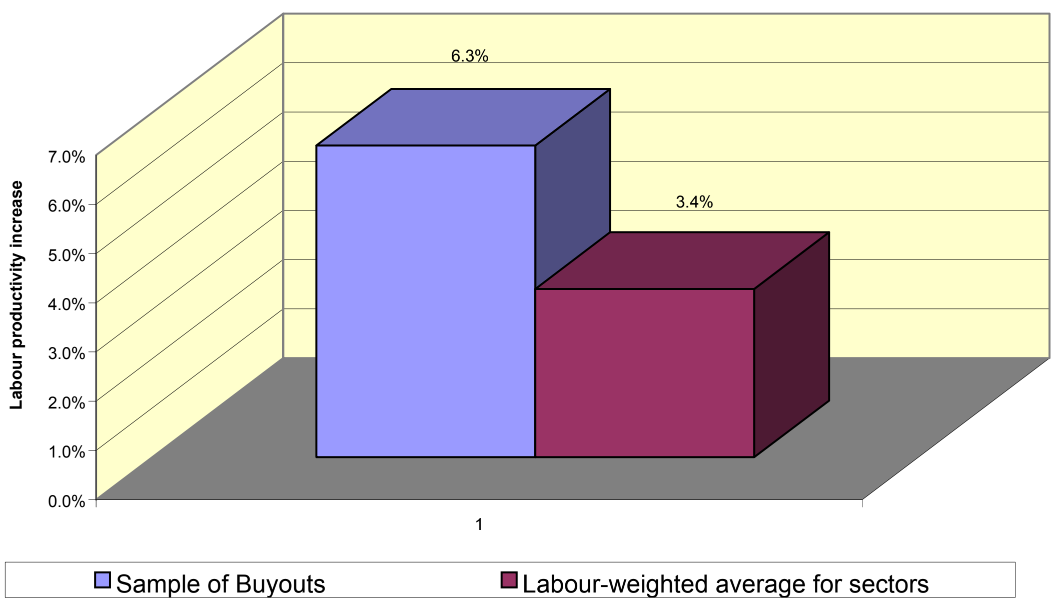
In the aggregated analysis, the total value added for all of the companies combined was summed, as were the total labour inputs. The change in labour productivity for the group was then computed.

To provide a comparable national figure, a weighted average productivity increase for the relevant industrial sectors was computed using the number of labour-hours for each firm as the weights. This weighted average sector labour productivity increase provides a suitable benchmark against which the labour productivity of the sample firms can be assessed. (For the sake of brevity we will refer to weighted average sector labour productivity index as the 'national comparator' from now on).

The seven firms that were bought out in 2001 or earlier, and for which data was available for 2001, 2002 and 2003, were included in this calculation.

The results are shown in Figure 1 below.

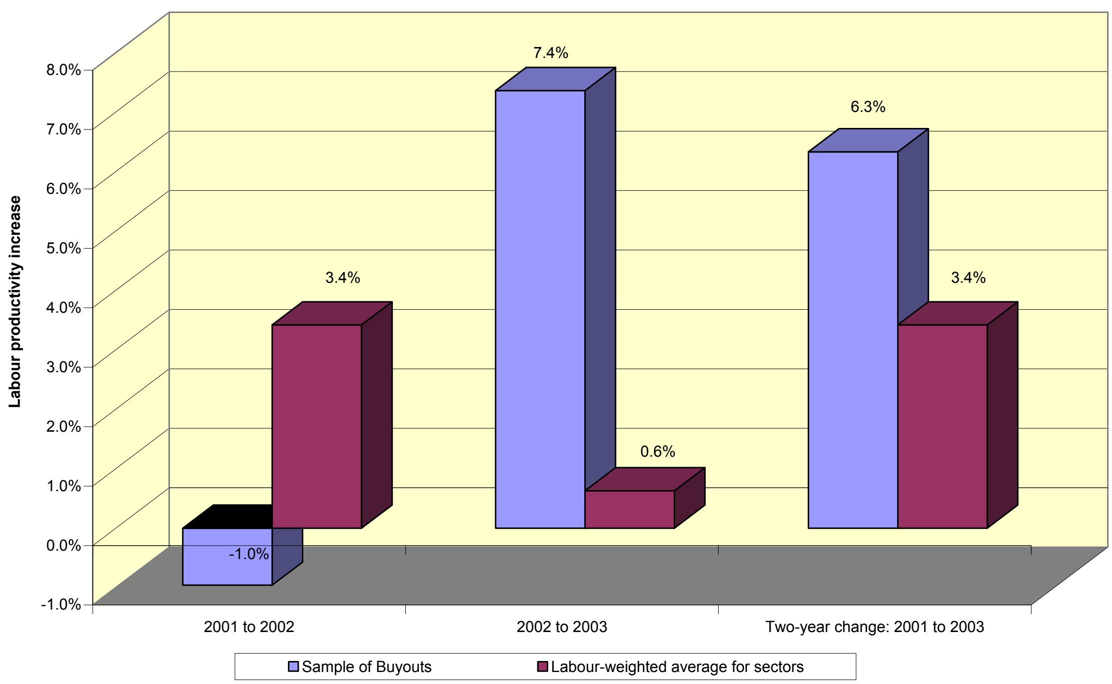
FIGURE 1: INCREASE IN LABOUR PRODUCTIVITY OVER PERIOD 2001 TO 2003



The figure shows that, over the two-year period 2001-2003, the labour productivity of the seven firms increased by a total of 6.3%. The national comparator increased by 3.4% over the corresponding period.

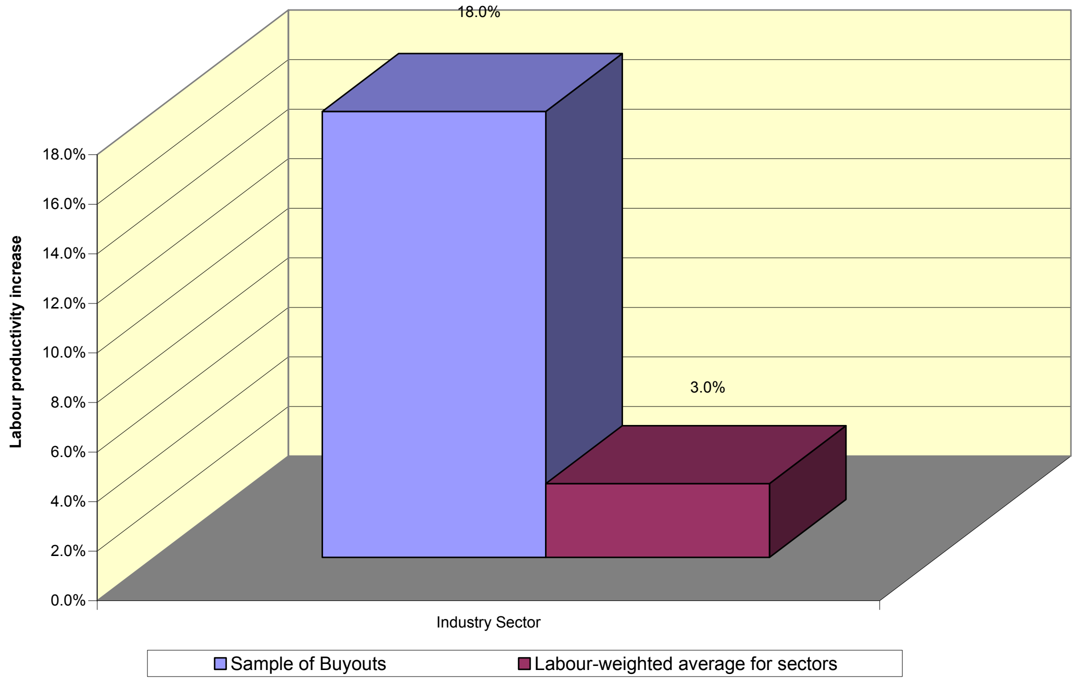
It seems reasonable to expect that the uncertainties and restructuring of the immediate pre- and post-buyout periods would have an effect on labour productivity outcomes. A breakdown of the two-year aggregate figures shown in Figure 1 would appear to support this. In the first year, there was an aggregate decline in labour productivity, followed by very strong growth in the second year, during which labour productivity grew by 7.4%, compared with an increase in the national comparator of 0.6% (see Figure 2).

FIGURE 2: BREAKDOWN OF LABOUR PRODUCTIVITY MOVEMENT BY YEAR



Five of the sample firms were able to provide information for the year 2004 as well as for 2003. It is not possible to compare these with national level indicators, as these are not yet available. In Figure 3 below, we have instead compared the outcome (an increase of labour productivity of 18%) with the average annual growth in the national comparator of the period 1998-2003 (3%). We would however caution that it is not possible to say at this time how closely actual national labour productivity growth in 2003/4 will match this average.

FIGURE 3: LABOUR PRODUCTIVITY INCREASES: 2003 TO 2004

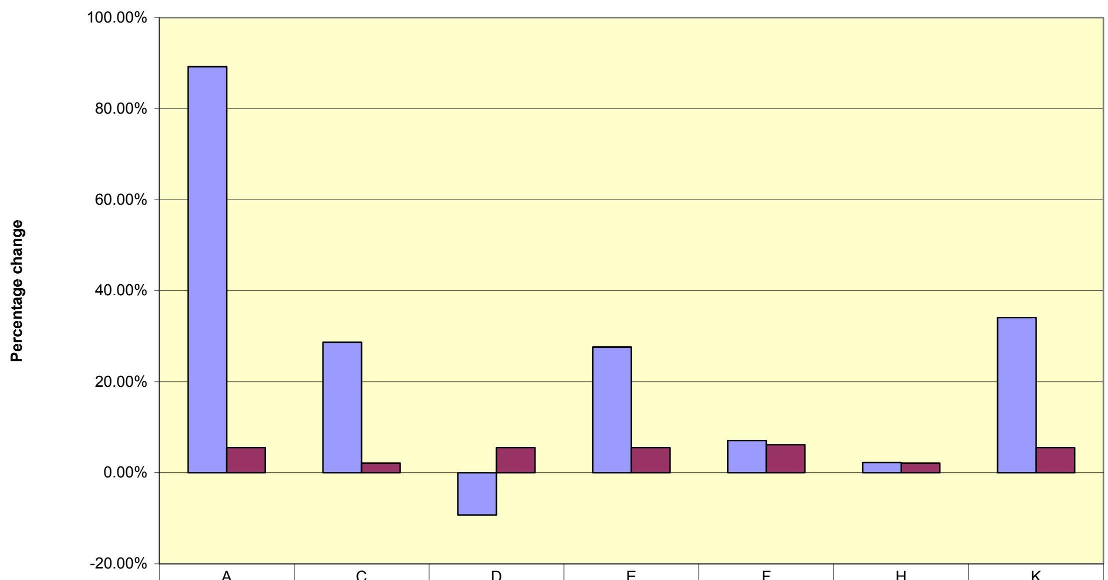


3.2 Labour productivity changes - company by company

The following charts show changes from year to year for those companies who provided the required data. For reasons of confidentiality, companies are not identified by name.

3.2.1 2001 – 2003

FIGURE 3: INDIVIDUAL COMPANY LABOUR PRODUCTIVITY CHANGE – 2001 TO 2003



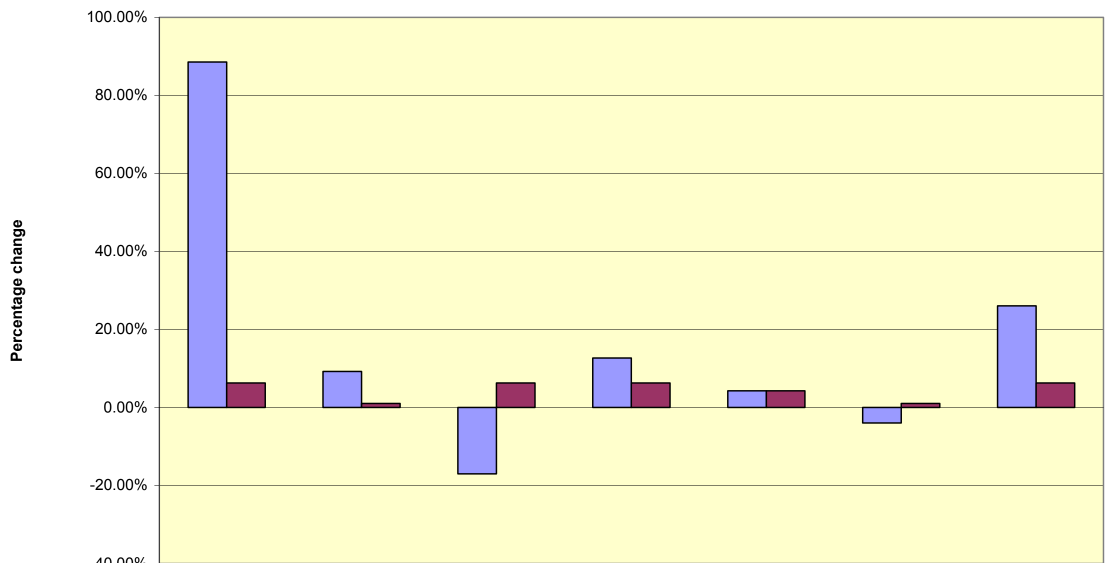
	A	C	D	E	F	H	K
Company	89.22%	28.70%	-9.29%	27.63%	7.09%	2.27%	34.11%
Industry Sector	5.53%	2.12%	5.53%	5.53%	6.15%	2.12%	5.53%

Company

Figure 3 shows that labour productivity change for 2001 to 2003 moved in a positive direction in six out of seven of the companies for which data was available. For four of the companies the change was well above the industry sector change.

3.2.2 2001 –2002

FIGURE 4: INDIVIDUAL COMPANY LABOUR PRODUCTIVITY INCREASES: 2001 TO 2002



	A	C	D	E	F	H	K
Company	88.54%	9.23%	-17.05%	12.64%	4.26%	-3.99%	26.02%
Industry Sector	6.27%	1.01%	6.27%	6.27%	4.28%	1.01%	6.27%

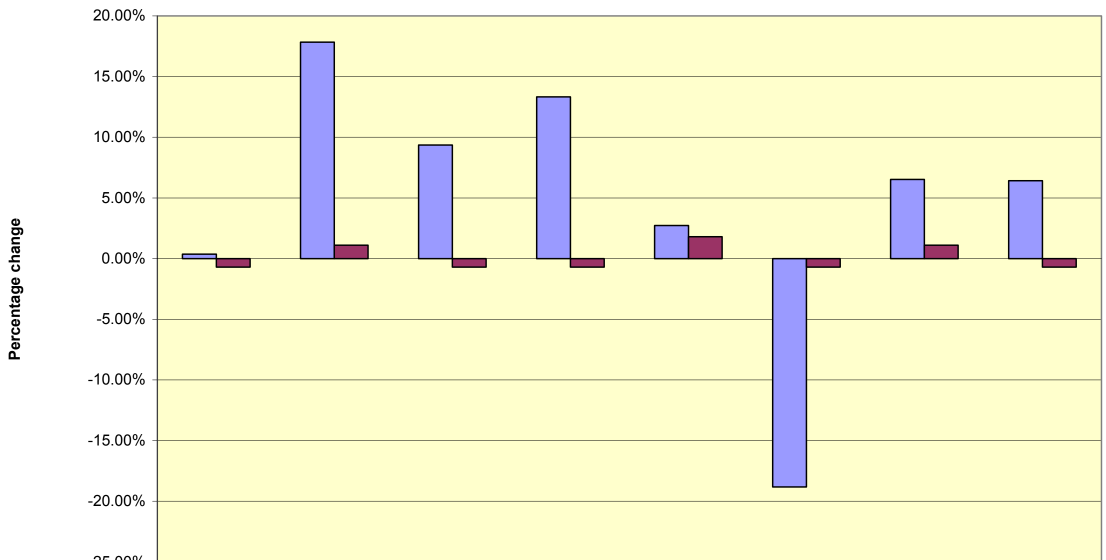
Company

Figure 4 shows rather variable outcomes in the year immediately following the buyout. Four companies clearly outstripped comparable sector performance, with labour productivity nearly doubling in one instance.

However, labour productivity actually declined for two of the seven companies, and was indistinguishable from the sector average in the case of the third.

3.2.3 2002 –2003

FIGURE 5: INDIVIDUAL COMPANY LABOUR PRODUCTIVITY INCREASES: 2002 TO 2003



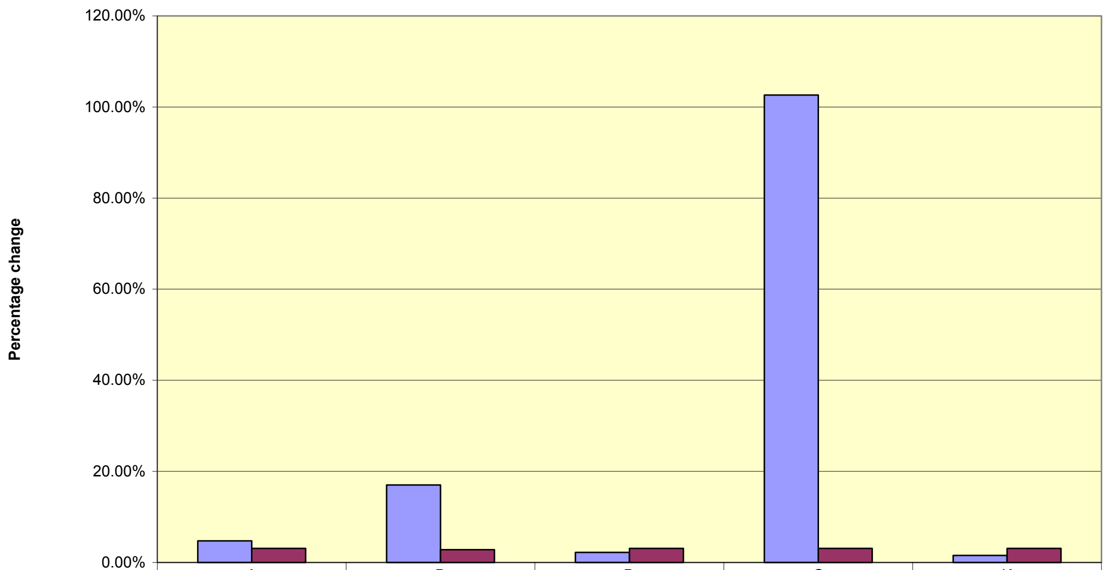
	A	C	D	E	F	G	H	K
Company	0.36%	17.83%	9.36%	13.32%	2.72%	-18.83%	6.51%	6.42%
Industry Sector	-0.70%	1.10%	-0.70%	-0.70%	1.80%	-0.70%	1.10%	-0.70%

Company

Figure 5 shows that in second year after the management buyout labour productivity changes were more consistent, with only one company of the eight for which data was available suffering negative result. All of the other showed labour productivity gains well ahead of the relevant national comparator.

3.2.4 2003 –2004

FIGURE 6: INDIVIDUAL COMPANY LABOUR PRODUCTIVITY INCREASES: 2003 TO 2004



	A	B	D	G	K
Company	4.72%	17.00%	2.20%	102.64%	1.53%
Industry Sector	3.09%	2.81%	3.09%	3.09%	3.09%

Company

From 2003 to 2004 change in labour productivity shows a similar pattern. All companies recorded labour productivity gains, with gains in three of the five cases outstripping the national comparator. Two of the four companies experienced very large productivity gains.

13.7. AVCAL PRELIMINARY ANALYSIS OF TAXATION REVENUE

PRELIMINARY MODELLING OF TAX EFFECT OF A PRIVATE EQUITY TRANSACTION
Summary of Findings

AVCAL has prepared a set of four financial models to illustrate the potential effects of a 'typical' private equity investment on tax revenue collections.

The results of the modelling suggest that, on balance, private equity should not have a material effect on taxation revenue collections in the long term.

This is because private equity investment will tend to increase receipts of capital gains tax more than it may reduce income tax receipts.

Each financial model estimates the tax revenue collections over four years under a particular scenario. The models are conceptually identical but incorporate different assumptions, or inputs, to reflect different scenarios.

The four scenarios represented include two base cases, where no private equity investment occurs, and two other cases where a private investment is made and then sold after 4 years.

The assumptions for each scenario are described below.

SCENARIO 1 – BASE CASE A:

- Australian investment ("Ausco") is a company listed on the ASX;
- Ausco has a current enterprise value of $500m (comprising $200m of debt and $300m of equity value), with equity market value growth forecast to be 10% pa;
- Ausco has debt of $200m, 80% of which is provided by Australian lenders and 20% by non-resident lenders;
- Ausco's annual earnings before interest and tax are $70m. Turnover is $700m and is growing at 4%pa for the following 4 years;
- Fully-franked dividends are paid to shareholders, based on a pay-out ratio of 66% of net profits;
- Ausco's shareholders are all Australian residents, 50% represented by individuals and 50% by superannuation funds; and
- The total shareholder cost base for tax purposes is $150m. Shareholder "churn" is 10%pa for the following 4 years. That is 10% of shares are assumed to be sold each year.

This scenario does not involve private equity activity of any kind and estimates the tax revenue arising from Ausco's operations and also the selling activity of its shareholders.

SCENARIO 2 – BASE CASE B:
This scenario is identical to Base Case A with the exception of the last assumption which relates to the tax base of shareholders and the frequency with which shares are sold.

Unlike Base Case A, this scenario does not assume that the shareholder tax base and the rate of churn is homogenous across all shares. Instead, Base Case B assumes that the shareholders in Ausco each fall into one of three groups, each of which has a different investment profile.

Specifically, Base Case B assumes that:

- 40% of the shares in Ausco have been held by shareholders for an average of 10 years and will not be sold during the period covered by the model;
- 40% of the shares in Ausco have been held by shareholders for an average of 4 years and one-twentieth of these (or 2% of the total shareholding) will be sold biannually. The cost base of the shares sold is assumed to be the price of an Ausco share 2 years prior to when they are sold;
- 20% of the shares in Ausco have been held by shareholders for less than 12 months and one-fifth of these (or 4% of the total shareholding) will be sold every 3 months. The cost base of these shares is assumed to be the price of an Ausco share 3 months prior to when they are sold. The remaining four-fifths of these (or 16% of the total shareholding) will be sold every 12 months. The cost base of these shares is assumed to be the price of an Ausco share 12 months prior to when they are sold, and it is assumed that these shares are held on revenue account.

Like Base Case A, this scenario does not involve private equity activity of any kind and estimates the tax revenue arising from Ausco's operations and also the selling activity of its shareholders.

This scenario leads to lower receipts of capital gains tax than Base Case A. Income tax revenue is unchanged with the result that Base Case B delivers slightly less tax revenue than Base Case A.

SCENARIO 3 – PRIVATE EQUITY CASE A:
The private equity case involves Ausco, as depicted in the Base Case scenario, being acquired by private equity and re-listed on the ASX after 4 years of ownership.

Private Equity Case A makes the following assumptions:

- Ausco is acquired by private equity funds for $600m (i.e., a premium of 20% of enterprise value assumed under Base Case A); (as to 90%), together with Australian management (as to 10%). The funds are sourced 80% by foreign superannuation funds and 20% by Australian superannuation funds;
- The acquisition is funded 70% with debt ($420m) and 30% with equity ($180m);
- 60% of the debt will be provided by Australian lenders and 40% by non-resident lenders. $20m of debt will be repaid each year during the period of private equity ownership;
- The equity investment of $180m will be funded 90% by the private equity funds and 10% by management. The investors in the private equity funds are assumed to be 80% foreign superannuation funds and 20% Australian superannuation funds;
- Ausco's EBIT is $70m. Turnover is $700m and will grow at 7% p.a. under private equity ownership (rather than 4% p.a. under the Base Case 1 and Base Case 2);
- Transaction costs of $25m arise at the time of the Private Equity acquisition. Further, transaction costs of $10m arise upon re-listing after 4 years. In both cases the fees will be split 80% to banks and 20% to advisors (e.g. legal and accounting). It is assumed that the advisors' taxable profit margin on fees is 33%; and
- Private Equity will list Ausco on the ASX again after 4 years of ownership at an enterprise value of $800m, with $320m of debt and equity value of $480m.

Private Equity Case A leads to a significant increase in capital gains tax receipts compared to Base Cases A and B. Overall, revenue collections are higher under Private Equity Case A compared with Base Cases A and B, but receipts of income revenue are somewhat lower.

SCENARIO 4 – PRIVATE EQUITY CASE B:
This scenario involves a private equity purchase of a business that is not publicly listed in its own right. It could be a privately held company or a division of a publicly listed company. The business is assumed to be identical in all other respects to Ausco as described in Private Equity Case A.

Private Equity Case B leads to a further significant increase in capital gains tax receipts compared to Private Equity Case A (and both Base Case scenarios). The income tax receipts under Private Equity Cases A and B are the same.

Summary of results over a 4 year period

Summary of Tax revenue collections over 4 years	Scenario 1 Base Case A $m	Scenario 2 Base Case B $m	Scenario 3 Private Equity A $m	Scenario 4 Private Equity B $m
CGT revenue	13.17	7.46	54.76	88.20
Income tax revenue	98.04	98.04	78.86	78.86
TOTAL	111.21	105.50	133.62	167.06

Conclusion from preliminary analysis
Private equity should not have a material effect on taxation revenue collections in the long term.

A particular reason for this is that private equity has the potential to significantly increase receipts of capital gains tax which may outweigh any decrease in income tax revenue.

Other tax comments

- The Private Equity cases also have the potential to increase GST collections (particularly in respect of higher revenues and transaction fees) and the potential to increase employment tax collections (i.e. salary withholding, FBT, payroll taxes etc) based on the performance of portfolio companies. These positive effects have not been modelled.
- Interest withholding tax has not been analysed on the assumption that a withholding tax exemption applies to non-resident lenders (i.e. as a consequence of s128F or a double tax agreement).

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