Sunrise or sunset?

Australia's take-private boom stokes fears about toppy markets

- The rise of ESG-linked credit facilities
- Core-plus infrastructure spreads its wings
- Fund-of-funds as start-up stimulators


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AVCJ Australia & New Zealand conference issue

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EDITORIAL

Managing Editor
Tim Burroughs
tim.burroughs@iongroup.com

Associate Editor
Justin Niessner
justin.niessner@iongroup.com

Reporter
Larissa Ku
larissa.ku@iongroup.com

Design
Edith Leung,
Rana Tang

RESEARCH

Senior Research Manager
Helen Lee
helen.lee@iongroup.com

COMMERCIAL

Event Director
Jonathan Cohen
jonathan.cohen@iongroup.com

Publishing Director
Allen Lee
allen.lee@iongroup.com

Hong Kong Headquarters
69th Floor, The Center,
99 Queen's Road Central,
Hong Kong
T. (852) 2158 9769
E. subs@avcj.com
URL. avcj.com

Beijing Representative Office
Unit 07, Level 6, China Central Place Tower 2,
79 Jianguo Road, Chaoyang District,
Beijing 100025, P.R. China
T. (86) 10 5869 6203
E. CAVCJ@avcj.com

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Australia in six trends

1 Bifurcation in fundraising

The buyout segment in Australia and New Zealand seems on course for one of its biggest fundraising years. With over half of 2022 still to run, nearly USD 2.6bn has been committed to buyout funds. The average for the previous five years is USD 1.9bn. Overall fundraising has already reached USD 3.3bn; the 12-month total for 2021 was USD 2.6bn. In a GP community that lacks depth, much depends on which managers are in the market. BGH Capital emphasized the gap between "haves" and "have nots" in fundraising, taking less than six months to close its second fund on AUD 3.6bn (USD 2.6bn) in early March. Mercury Capital has proved itself equally proficient at rapid fundraising in previous vintages and it recently launched Fund IV with a target of AUD 800m and a hard cap of AUD 1bn. BGH and Mercury both made sizeable contributions when fundraising for buyout strategies hit USD 3.5bn in 2018, the most since before the global financial crisis. Capital committed across all strategies that year amounted to USD 9.1 bn – an all-time high – helped by Macquarie Infrastructure & Real Assets weighing in with USD 3.3bn.

2 The rise and fall of Canva?

The recent sell-off of listed technology stocks has filtered through to private markets in Asia with T. Rowe Price and Franklin Templeton marking down their positions in Australia-based design and collaboration platform Canva by 19.9% and 58.5%. Franklin Templeton now values the company at USD 16.6bn; in September 2021, Canva was valued at USD 40bn. It coincides with a sharp drop in growth-stage investment in Australia and New Zealand tech companies – from a record high of USD 2.3bn in 2021 to USD 55m in 2022 to date. (Early-stage activity is holding steady.) Canva is significant as the key value driver in funds raised by local VCs like Blackbird Ventures, AirTree Ventures, and Square Peg Capital and as a bellwether for the start-up community. It is also the poster child for pandemic-driven uptake: annualised revenue was tracking at USD 1bn in September 2021, having doubled over the past year. In 2019, the company was valued at USD 3.2bn. Markdowns by muutal funds that dip a toe in private markets don't necessarily inflict lasting harm. Indian e-commerce player Flipkart suffered the same ignominy in 2016, completed a down round, and was then sold to Walmart at a premium to the previous high.

3 Utilities dominate deal flow

In the first three months of 2021, when private equity deal flow in Australia rose quarter-on-quarter while every other major market in Asia regressed, hospitality and healthcare were in the ascendency. After The Blackstone Group's AUD 8.9bn (USD 6.34bn) acquisition of casino operator Crown Resorts, three of the four announced transactions of USD 500m or more involved healthcare services or aged care. The fourth was a pet care deal. These are widely viewed as defensible plays in an uncertain market – and the theme has carried over into the recent spate of announced or attempted take-private transactions. Invariably, though, whenever headline PE investment hits a peak, it is driven by a handful of infrastructure and utilities deals. Nearly half the record USD 50.1bn deployed last year went into this sector, led by AusNet Services and Sydney Motorway. It was much the same in 2015, 2016, and 2018, the three other recent occasions when annual investment topped USD 20bn. The sheer size of these deals contrives to soften the impact of other trends. For example, technology investment has surpassed USD 4bn in three of the last four years. The cumulative total for the eight years prior is USD 6.2bn.

4 Devil in the definition (of infra)

The changing nature of Icon Group's ownership reflects how the Australian cancer care provider has evolved and scaled. Quadrant Private Equity grew it from a handful of centres to dozens across four countries. Goldman Sachs Asset Management, QIC, and Pagoda Investment took over in 2017 to continue this expansion drive. And then EQT, investing through an infrastructure fund, bought a majority stake for a valuation of AUD 2.3bn (USD 1.67bn) earlier this year. At the same time, EQT's arrival demonstrates how the line between PE and infrastructure is blurring. It's common for businesses with fixed assets to be reclassified as they are de-risked – moving from private equity to core-plus infrastructure to core infrastructure. But infrastructure managers are stretching the definition of core-plus, driven in part by low interest rates and ample liquidity. As returns on more conservative assets are bid down, they must move up the risk curve to meet targets, squeezing out PE rivals by virtue of a lower cost of capital. It remains to be seen how they address operational and governance issues presented by these assets.

5 IPO markets favour technology

Best & Less is a stirring private equity turnaround story that culminated in an IPO. Allegro Funds acquired the business from a distressed seller in 2019, restructured and revitalised it, and made a partial exit through the offering. The GP was sitting on an overall IRR of more than 500% when trading began in July 2021. Yet Best & Less, as a mainly brick-and-mortar baby and kids retailer, is atypical. Until recently, at least, public market investors in Australia and New Zealand prized one sector above all others: technology. Despite intermittent pandemic-related lockdowns, private equity-backed IPOs staged a resurgence in 2020 with USD 2.5bn raised through 16 offerings. It continued in 2021, which saw 15 companies raise USD 2.7bn. For context, during the golden period of 2014-2015, more than USD 10bn was raised across nearly 50 IPOs. Over the next four years, USD 1.9bn was shared by about 30 companies. More than a dozen of the IPOs in 2020-2021 involved technology companies. Healthcare, the next most prolific sector, only saw six. Analytics software provider Nuix led the way, followed by hotel booking platform SiteMinder, and direct-to-consumer meal service My Food Bag, and e-commerce enabler BigCommerce.

6 Alternatives managers for sale

EQT's acquisition of Baring Private Equity Asia (BPEA) and PAG filing for a Hong Kong IPO have grabbed the headlines in terms of GP-level M&A in Asia. Two situations towards the smaller end of the spectrum in Australia received less attention. First, Five V Capital sold a 25% GP stake to Pinnacle Investment Management Group, a listed platform investor that has interests in 14 Australian asset managers, including infrastructure investor Palisade Investment Partners and credit specialist Metrics. This was followed by the sale of New Forests, a sustainable real assets investment manager, to Japan's Mitsui & Co. and Nomura Holdings. While the global "fund of firms" have accumulated interests in GPs across North America and Europe, they have made little impression on Asia. The reality is few managers in the region meet all these investors' requirements in terms of track record, fee-generating scale, and business line diversity. There have only been three transactions of note, involving BPEA (Affiliated Managers Group), PAG (The Blackstone Group), and MBK Partners (Dyal Capital Partners). Deal flow is likely to remain intermittent, but there remain willing buyers and sellers beyond the realm of the large-cap managers.

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Principal-Primary Investments
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Jing Su Vivatrat
President & COO, Asia Alternatives
FRANKLIN TEMPLETON

ENQUIRY

REGISTRATION: Pauline Chen
T: +852 2158 9655 E: book@avcj.com

SPONSORSHIP: Anil Nathani
T: +852 2158 9636 E: sponsorship@avcj.com

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Australia take-privates: Going large

A combination of abundant dry powder and friendly financing conditions are encouraging global GPs to pursue ever-larger listed companies in Australia. For now, macro headwinds are no deterrent

The fervour that characterised the last three months of 2021 – when private equity investment in Asia hit a record high of USD 111.9bn – has long since passed. Deal flow in the first quarter of this year amounted to USD 70.9bn, a not insignificant total, yet uncertainties around the Russia-Ukraine conflict, rising interest rates, and volatile equities markets are all too visible.

With GPs suddenly gun-shy, only one major market saw an uptick in activity. Investment in Australia reached USD 14.7bn, up 50% on the previous quarter, according to AVCJ Research. The Blackstone Group's agreement to acquire listed casino operator Crown Resorts at a valuation of AUD 8.9bn (USD 6.34bn) was the key driver.

Investment across Asia continues to slow, with approximately USD 15bn committed by the midpoint of the second quarter. Australia is no longer the exception to the rule, but the numbers are based on announced deal flow only. GPs are still aggressively chasing large assets in the public markets.

KKR has offered AUD 20.1bn for hospital operator Ramsay Healthcare while CVC Capital Partners pulled out of a bid for container supplier Brambles – reportedly worth AUD 20bn – at the 11th hour. Should the Crown deal close, it would be the largest private equity buyout in Australia outside of utilities and infrastructure. This glory would be short-lived should KKR reel in Ramsay.

"Many sponsors have a lot of money to deploy. One shouldn't underestimate the weight of that capital and the fact that opportunities to deploy it in sensible efforts is reduced at present. Finding big targets that offer a solid base for investment and put a lot of capital to work is attractive," said Mark McNamara, a partner at King & Wood Mallesons.

"Finding big targets that offer a solid base for investment and put a lot of capital to work is attractive"

– Mark McNamara

There are various subplots. Australia's large-cap buyout space is highly competitive with not only global private equity firms chasing opportunities, but also core-plus infrastructure managers with lower costs of capital. Lining up a mega-deal with complex financing and ample co-investment is a potential antidote: the few GPs capable of mounting a challenge are constantly playing catch-up.

Most Australian companies of suitable size are listed, so the public markets are a logical place to look. It played out the same way in the mid-2000s when annual buyout activity topped USD 10bn for the first time. While some are wary of drawing parallels with the boom-and-bust of the global financial crisis, noting differences in sector targeting and financing structures, others don't hold back.

"Australia's GDP is smaller than Korea's and you don't get USD 15bn leveraged buyouts in Korea. I'm reminded of 2008 and it's not only Australia. Buyouts are reaching USD 30bn in the US and USD 17bn in Europe; these are levels we haven't seen in 15 years," said one pan-regional fund manager.

"Over 50% of Brambles' business is in the US and US is heading for a recession. Walmart and Target have announced slowdowns – it's going to be brutal for retailers [who are Brambles customers]. These deals will only work out if you take a longer-term view and invest through long-dated funds. Even then, the IRR might only be 10%, which is fine for infrastructure, but not for private equity."

Safety in sectors?

Global GPs run multiple strategies and it is unclear how these mega deals will be divided up between different pools of capital. KKR has used its core investments – or longer hold, lower risk profile – ▶

Largest Australia and New Zealand buyouts

Date	US$m	Investee	Industry
2021	12,942	AusNet Services*	Utilities
2016	12,315	Ausgrid	Utilities
2016	9,047	Asciano Group	Infrastructure
2021	8,072	Sydney Motorway*	Infrastructure
2015	7,407	TransGrid	Utilities
2016	7,273	Port of Melbourne	Transportation/distribution
2018	6,738	WestConnex	Infrastructure
2022	6,508	Crown Resorts*	Leisure/entertainment
2015	6,277	GE Capital - Aus/NZ consumer lending business	Financial services
2017	5,622	Endeavour Energy	Utilities
2007	5,442	Investa Property Group	Financial services
2013	5,272	Port Botany & Kembla	Transportation/distribution
2009	5,272	Macquarie Communications Infrastructure	Financial services
2006-2008	4,824	PBL Media	Media
2021	3,609	Vocus Group	Telecom
2019	3,138	Healthscope	Medical
2011	3,038	Queensland Motorways	Infrastructure
2010	3,023	Intoll Group	Infrastructure

* Announced
Source: AVCJ Research

strategy in Australia before. Several Blackstone real estate funds are mentioned in Crown's filings.

However, infrastructure and infrastructure-like returns are a prominent theme among the 16 take-privates completed and 11 announced since the start of 2021. Financial sponsors feature in 10 of them, including waste management business Bingo Industries, Tilt Renewables, broadband providers Vocus and Uniti, Sydney Airport, Spark Infrastructure, and power grid operator AusNet Services. Real estate is also represented.

There is more industry variety in the deals pending than in those completed, but sponsors are focusing on what they see as defensible. Crown is an exception – a business mired in regulatory troubles that could be ripe for a turnaround. Healthcare (Ramsay) and logistics (Brambles) are seen as more representative of the general mood.

"There seems to be less irrational exuberance. We are not seeing take-privates in cyclical industries like mining services, in anything commodity-linked, in industries in structural decline or in consumer discretionary," said Peter Graf, a managing director at Ares SSG, which provides buyout financing. Business services, software, and non-discretionary consumer are highlighted as other active areas.

In some cases, there is a reassuring real assets angle buried in a PE deal. Ramsay owns 54 of the 72 hospitals and surgeries it runs, creating a sale and leaseback opportunity that Macquarie estimated could be worth as much as AUD 8.7bn.

While any public company could theoretically be picked off, these situations can be fraught with difficulty. Company boards are bound to push for the best outcome for shareholders, which often results in incremental price increases as deals progress from bidding through due diligence and shareholder vote. Blackstone is paying a 48% premium for Crown over what it originally offered.

Deals can become acrimonious. In the pending group is fertility care player Virtus Health, which has agreed to an AUD 706m acquisition by CapVest Partners. However, BGH Capital, which made the initial approach, is refusing to concede. Australia's takeover panel has received two complaints, one claiming Virtus' board was unable to entertain rival binds, and another saying the board wasn't willing to engage.

"Public to privates are harder to do in Australia. In other markets, they tend to be initiated by management, which convinces the board. In Australia, the primary form of communication is with the board," said Anthony Kerwick, a managing director at Adamantem Capital.

"Non-executive directors are well-represented, and they have a fiduciary duty to act in the interests of shareholders. They will explore whether another buyer can pay a fuller price."

Simon Moore, a senior partner at Colinton Capital Partners, who was previously Australia country head at The Carlyle Group, added that board members often hold few shares, so their personal economic interests are not necessarily aligned with maximising shareholder value even if that is the requirement. Moreover, some recognise they will lose their roles if they support a privatisation.

Boards are also subject to pressures from multiple constituencies – including institutional investors that might oppose a sale – so a seemingly attractive private equity offer doesn't elicit the expected response. There might be a difference of opinion as to whether and how soon the approach is disclosed, sometimes resulting in leaks by aggrieved parties.

"It's never a straightforward process," said Moore. "The response to the initial approach sets the course of the engagement. Some of it is down to the personality of the private equity firm, whether they want to play the long game or press the company into a process. The private equity firm must also assess the personalities on the board and how they are likely to respond to certain behaviour."

New habits

The recent crop of take-privates is notable not only in its overall number, but also in how many proposals have been made and then withdrawn. Brambles is one of seven that have stumbled since the beginning of 2021. Three of the six led by financial sponsors involved software providers: BGH and Hansen Technologies, EQT and Iress, and TPG Capital and Smartgroup.

Failure to agree pricing following a post-offer spike and businesses not appearing

so compelling on closer inspection may have contributed to these abandonments. Tim Sims, a managing director at Pacific Equity Partners (PEP), which has completed eight public-to-private deals, offers another theory: GPs are moving quickly on assets and reasoning that they can work out the details later.

"Historically, PE Firms in this market, have been very circumspect before announcing a bid for a public company," he said. "One possible conclusion is that some private equity firms, particularly with backgrounds in other markets have deviated from this historic playbook."

The playbook is also changing in terms of the willingness of GPs to build up positions in public companies before they make a formal approach. Again, understanding the personalities involved and how they might respond is key. Will target companies look for alternative solutions rather than do business with what they perceive as an overly aggressive party or appreciate the seriousness of the offer?

"That stake building tactic is more common than it used to be," said McNamara of King & Wood Mallesons. "People have decided it is important from a board interaction perspective because it gives you credibility. It also protects your downside from interloper risk. You don't have the protection of a normal private process. Someone could buy a stake and stuff any chance of a deal."

BGH built up a 19.99% stake in Virtus – reaching 20% triggers a mandatory tender offer – prior to submitting a take-private bid last December. CapVest was willing to pay more but BGH has enough shares to block a full acquisition through a scheme of arrangement. In response, CapVest made a parallel off-market takeover bid with a lower acceptance threshold.

BGH may play the waiting game, reckoning that CapVest would rather withdraw and focus on other opportunities than run Virtus as a listed enterprise with a recalcitrant 20% shareholder on the register. Alternatively, the private equity firm could sell at a premium and allow CapVest to proceed, much like what happened when it lost out to Brookfield on Healthscope.

Virtus has received seven competing proposals from BGH and CapVest over about three months. Some pursuits have lasted even longer, such as PEP's acquisition of cleaning and catering contractor Spotless despite board resistance in 2012. In another instance, PEP held power distributor Energy Developments as a public company for five years after 25% of shareholders rejected a privatisation.

Overt hostility must be underpinned by a conviction that the target is truly mismanaged and undervalued. "If we cannot conduct due diligence and get access to enough information, we don't want to buy an asset, friendly or unfriendly," said the pan-regional buyout manager. "And if the situation is unfriendly, you don't really know what you are bidding on."

Middle moderation

The dynamics are often less fraught in the middle market. Adamantem's Kerwick notes that Australia hasn't seen a decline in the number of listed companies like the US and UK, but the same underlying drivers are present. A shift from active portfolio management to passive index tracking means fewer institutional investors want to hold smaller companies, while reduced research coverage at investment banks makes it harder for those same companies to raise capital.

"It is especially difficult if a company wants to change direction and needs investment, which involves taking on more debt or turning off the dividend tap. These would be viewed negatively in the public markets," he said. "At the same time, the relative balance of capital between public and private markets has changed enormously. Private markets can continue to fund companies."

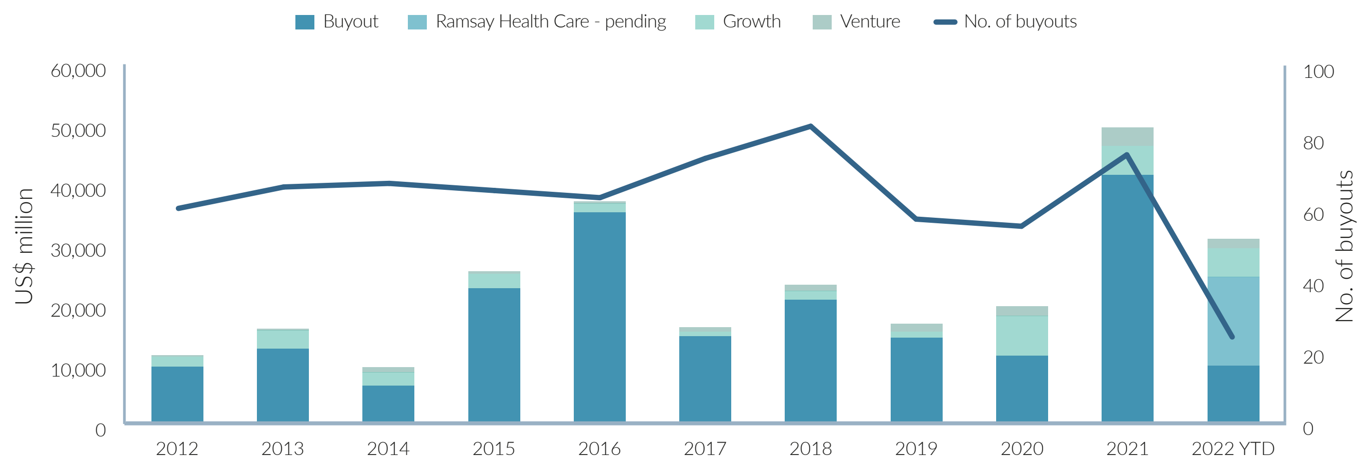
Two of the six investments in Adamantem's first fund were privatisations. One of them, Zenitas, was caught in the classic public markets bind. Near-term headwinds were expected in homecare and disability care but the long-term prognosis was strong. The company recognised it would struggle to raise capital to support growth and so Adamantem's take-private proposition was readily received.

Colinton has been involved in several situations where privatisation was unfavoured or unfeasible, so the firm proceeded with a PIPE deal, confident in its ability to bring about change. On one hand, there is less distraction, no need to pay a control premium, and the cost of execution is lower. On the other, getting aligned with shareholders that have different horizons and goals is difficult.

The mindset Moore described of how global sponsors think about take-privates is entirely different: "There will be half a dozen targets you've done work on, have management solutions ready to go, and you're waiting for them to come into strike zone. If the markets start moving, you either modify the proposal to reflect the conditions or you pay what you thought you might have to pay."

Assuming bids for the likes of Ramsay and Brambles were months in the making – likely, given the co-investment requirement –

Australia's superannuation industry



Source: AVCJ Research

> “The noise is there, but it’s not enough to deter people. If it intensifies and negative impacts are realised in the market, activity will drop” – *David Couper*

market conditions have moved substantially since deliberations began. Despite macro and geopolitical headwinds, the sponsors resolved to continue, helped by relatively little alteration in the quantum of financing and in the terms on which it is available.

“The Australian market is well-positioned in terms of sources of liquidity and the depth of those sources. There is too much competition for there to be a significant tightening of terms,” said David Couper, a partner at law firm Allens.

“In the last 18 months, we have seen a lot of new entrants with very deep pockets. Ares SSG is now established here, Goldman Sachs Asset Management is ramping up on private credit, and there are many mid-market credit funds that can pool together and offer tickets of AUD 300m to AUD 500m.”

When it comes to the larger transactions, no one financing market – commercial banks, financings underwritten and syndicated by investment banks, and the private debt providers – has done them all. Ramsay is a global company, generating more revenue internationally than within Australia, so KKR would likely tap the US term loan B (TLB) and euro high yield markets as well as local sources.

“Given the quantum of debt required, you have the flexibility to go into different markets globally,” said Graf of Ares SSG. “Do you want a different type of instrument that sits behind first lien senior secured? Does that stay at the operating company level, or do you do some holdco mezzanine? Could you break the business into parts and finance them independently?”

Cyclical and structural

Sponsors are thinking more carefully about their equity theses and the consistency of cash flows, but when it comes to financing terms, there is more talk than action. For the first time in years, Graf has seen all-in interest rate exposure return to the agenda. Some managers are asking about replacing floating rates with fixed rates – asking, not doing.

Russell Sinclair, head of Australia debt and capital advisory at PwC, believes the interest rate covenants dropped from many US TLB deals last year – leaving just the gearing ratio covenant – could be primed for a return. “But it’s for smaller borrowers only, not larger deals,” he stressed. “And it’s a discussion that’s only just beginning.”

There has been a shift in pricing, with Sinclair noting that high-yield rates are rising rapidly in the US. The consensus view is that it translates into a 100-200 basis point increase for deals out of Australia – not enough to stop a large transaction. After all, recent volatility means many companies are trading below pre-COVID-19 levels when approached by private equity and the investment thesis is in part predicated on recovery.

“The noise is there, but it’s not enough to deter people,” Couper of Allens added. “If it intensifies, and negative impacts are realised in the market, activity will drop. We just don’t see that happening in the next six months.”

Meanwhile, in the background, there lingers a long-term structural factor. The negative stigma in boardrooms about taking the privatisation route has largely dissipated, replaced by a recognition that public markets may not be the ideal venue for companies keen to pursue growth or transformation. Sims of PEP argues that private equity is now the optimal long-term backer.

“There is often an enormous amount of short-term performance pressure on public companies, which can compromise long-term strategic options. Share prices can be fragile and volatile, and public shareholders tend not to stay very long. That’s a difficult platform on which to build if your industry is under pressure,” he said.

“Those could be times when a different form of capital is required to maximise value.” ■

Leveraged finance: ESG sells

Private equity firms in Asia are increasingly willing to consider sustainability-linked credit facilities, and banks are generally happy to provide them. Speed is currently delaying standardisation

The USD 3.2bn loan issued to Baring Private Equity Asia (BPEA) last October, which includes interest rate breaks for the achievement of decarbonisation and diversity targets across the firm's PE portfolio, is only the second of its kind in the region and easily the largest. Yet it reflects a surge in sustainability-linked credit activity over the past 12 months most visible at the deal level.

The private equity firm first wound ESG [environment, social, and governance] targets into a buyout transaction in August 2021 with the USD 1.2bn carve-out of healthcare-focused IT services provider Hinduja Global Solutions. BPEA's capital markets team has explored repeating the trick on nearly every new investment since then, as well as on refinancings for existing portfolio companies.

"In most cases, banks are willing to do it – it makes sense for them, for us, and for the companies," said Zongzhong Tang, the firm's ESG and sustainability manager.

"The mechanism is the same as at the portfolio level, but you can make the ESG targets very specific to the company's operations. For a manufacturing business, you might focus on electricity consumption as well as climate change and diversity. For a labour-intensive technology company, you might look at how to improve employee retention."

BPEA is not alone. Investors and advisors across the region report seeing an uptick in sustainability-linked loans (SLLs) in 2021. According to Tracy Wong Harris, head of sustainable finance in Asia at Standard Chartered Bank, last year the SLL market - for investment grade and non-investment grade instruments - grew 3x globally and 7x in Asia. Leveraged loans account for a relatively small

> "We need more standardisation and more engagement from lenders to ensure these facilities achieve a true impact"
>
> *– William Needham*

piece, but they are on the rise.

Russell Sinclair, head of Australia debt and capital advisory at PwC, claims that SLLs have been contemplated for every leveraged deal to cross his desk in the past six months. "All PE firms want to know what SLLs look like and how they can benefit," he added. "Lenders are equally excited. There is an alignment between what the funds want and what the lenders are willing to give."

What emerges is an image of a feeding frenzy that is broadly well-intentioned yet lacking in maturity. Transactions are often run at speed and feature an array of highly negotiated performance metrics, incentives, penalties, and assessment protocols. The timelines and the complexities of dealing with multiple lenders may result in ESG elements being dropped and a reversion to traditional financing.

Industry participants contrast this chaos with the order of sustainable finance in the public markets, acknowledging that private SLLs remain a work in progress. There is also concern that immaturity could be exploited.

"The risk is that this becomes a tick-the-box exercise with sustainability KPIs [key performance indicators] in every term sheet without too much thought about which ones are most meaningful to the ESG issues of the company. It may just become an easy way of getting a discount on a loan," said William Needham, a managing director in KKR's credit business. "We need more standardisation and more engagement from lenders to ensure these facilities achieve a true impact."

Progressive policies

SLLs have taken off in part because they represent a departure from the strictures of fixed income products in sustainable finance. Green bonds rose to prominence in the late 2000s as financing tools for projects that have positive environmental benefits, with their rigidity serving as a selling point. The proceeds can only be used for projects that meet qualification criteria at the time of investment.

This approach makes for an uncomfortable fit with ESG and impact strategies where the onus is on helping companies climb the sustainability curve, perhaps from a low starting point. In this context, the use of proceeds requirement for green bonds is limiting.

"As the field has matured, what we've realised we need is change over time across all industries," said Megan Starr, global head of impact at The Carlyle Group. "Every company is impacted by energy transition: we don't reward them based on whether they are green or brown on day one; we want to reward change over time provided it is material, ambitious, and tied to real performance."

SLLs, by contrast, are tangible and flexible, cut across sustainability topics, and can be tailored according to the ESG maturity of the target company. And rather than link baseline sustainability to use of proceeds, it is correlated to KPIs that filter through to interest rate discounts.

"One of the challenges faced by the sustainable finance market since its inception is that it has been viewed as somewhat fluffy and niche," said Xuan Jin, a counsel at White & Case in Hong Kong. "What we see now is hard edges forming and concepts and mechanisms that have achieved a critical mass of recognition among financial market participants, which are capable of being defined and which financial products can be built around."

The BPEA portfolio-level facility comprises four KPIs with associated sustainability performance targets (SPTs). Two of them relate to broadly applied best practices: the implementation of ESG assessment of investment opportunities; and the introduction of a science-based target for greenhouse gas emissions that covers internal operations and portfolio companies.

The remaining two are specific to emissions and diversity, with BPEA required to ensure compliance in at least three-quarters of portfolio companies, albeit with progressive mechanisms.

For example, companies that currently do not report emissions will be deemed compliant in year one if they start. Those already reporting must set an emissions reduction target in year one, while those already with targets must meet them. For gender diversity, the goal is to reach at least 40% at the senior management level, but there is a recognition that some companies will take time to achieve this.

"A lot of facilities have targets on diversity and climate change because these are more easily quantifiable and measurable, and they can apply to all companies. There are fewer governance-

> "Our European buyout portfolio is relatively mature on ESG, but in 2018, only 35% of companies knew what their carbon footprint was" – *Megan Starr*

related targets because those topics are more qualitative," said BPEA's Tang. "In general, data quality and availability are a challenge. Sometimes, we need to do capacity building at the portfolio companies and make sure they are tracking the correct metrics."

There is more variety at the transaction level, with electricity, water, and fuel usage, treatment of hazardous waste, health and safety, and employee satisfaction among the KPIs most frequently referenced. Much depends on the target company's business model, but the ability to capture data and do so for long enough to create meaningful benchmarks is a common issue.

Comfort and confidence

Carlyle has completed USD 18bn in ESG financing since 2019, starting at the transaction level and then moving into portfolio-level facilities. The way in which the latter have broadened in scope demonstrates increasing comfort with the data availability and quality.

In February 2021, the firm secured a USD 4.1bn facility tied to its Americas PE funds with a KPI of achieving 30% board diversity among majority-owned businesses in the portfolio. Later in the year, the same board diversity target was attached to a EUR 2.3bn (USD 2.5bn) facility for Carlyle's European private equity and real estate platform.

This time, however, it was accompanied by two additional KPIs: all portfolio companies must plot their carbon footprints; and a certain percentage of Carlyle employees who serve as board directors must undergo ESG-competent board training.

"Our European buyout portfolio is relatively mature on ESG, but in 2018, only 35% of companies knew what their carbon footprint was. You can't set energy transition targets on that basis. Now, we are up to 100% coverage of majority-owned companies in the latest vintages in our US, Europe, and Asia buyout strategies. And when we have those data, we can potentially translate them into doing ESG-linked financing," said Carlyle's Starr.

BPEA, Carlyle and most other PE firms active in SLLs are large enough to have internal resources across ESG and capital markets that work with companies on data collection and reporting and participate in financing negotiations with banks.

White & Case's Jin notes that the spectrum of sustainability ranges from "dark greens" that pursue ESG improvement primarily as a matter of principle and "light greens" that are motivated more by the bottom line. On a general level, smaller and less public-facing institutions, as well as those not set up to be ESG focused, fall on the lighter side of the spectrum.

As a smaller player, Singapore's Quadria Capital is an exception to the rule. The healthcare investor, which has USD 2.2bn in assets under management, became the first Asian GP to secure a portfolio-level SSL in 2019 when ING provided a USD 65m revolving capital call facility. It helped that there was an existing ESG program overseen by dedicated staff and validated by a third party.

"Sustainability and impact is one of the pillars of our thesis. We wanted that to permeate everything we do, and we have proprietary tools to measure that impact in terms of affordability, awareness, accessibility, and quality," said Sunil Thakur, a partner at Quadria. "When raising a subscription line for our fourth fund, we wanted to be rewarded for the impact we are trying to achieve."

The KPIs were drawn from eight ESG matrixes tracked by Quadria that are relevant to healthcare, from energy usage to ethics and anti-corruption to accessibility for underserved groups. Thakur added that the interest rate stepdown on achieving the KPIs is 15-20 basis points, while there is no step-up should Quadria fall short.

This carrot-but-no-stick approach is common ▶

in the region. Harris of Standard Chartered observes that 90% of SLLs in Asia are one-sided – at the transaction level and the portfolio level – although penalty structures feature more often than before. BPEA's facility is somewhat nuanced, with the GP required to use the increase in premium to buy carbon offsets rather than pay it to the lenders.

Several explanations are given for excluding penalty or punishment structures, such as lenders being happy enough with a company's ESG credentials that they choose not to force the issue or financial sponsors getting nervous about these clauses because it impacts their base-case underwriting. Perhaps most plausibly in an Asian context, it is about comfort at the company management level.

"While most management teams recognise the importance of integrating both interest incentives and penalties, some may wish to be more conservative when entering these structures for the first time. In these cases, they may propose starting with a stepdown only and look to introduce a step-up later," said Adam Heltzer, global head of ESG at Ares Management.

"It reflects one of the leverage points in a transaction – if management begins to find diminishing value in the structure they may wish to walk away, at which point lenders have the choice of whether to make such concessions."

These dynamics underline the lack of broad market consensus on SLLs. While the Loan Market Association (LMA) and Asia Pacific Loan Market Association (APLMA) have issued guidance documents, industry participants observe that these run to no more than a few pages. The drafting is still in its nascent stages and there's a shortage of helpful historical reference points.

Incentive and punishment structures and third-party verification are logical battlegrounds. On one side, the financial sponsors are concerned about cost, confidentiality, and timing. On the other, banks must meet internal protocols to qualify for better capital rating treatment, so they might hold their ground on issues like safeguards and testing.

"These are often large facilities with accelerated timelines, and each bank involved has different criteria, so bringing everyone together on the same page can be challenging. There have been situations where we started off intending to do an ESG-linked facility, but it proved too difficult," said Manas Chandrashekar, a debt finance partner at Kirkland & Ellis.

EcoVadis, best known for business sustainability rankings, is one of numerous groups pushing into the verification space. Beyond discussions on what data should be verified, to what level, and how much can be disclosed, there are sometimes

tensions as to what extent metrics should be top-down and applicable to all companies for benchmarking purposes rather than customised.

When conducting an assessment, EcoVadis relies on a reserve of more than 15,000 model questionnaires that vary based on size, country of origin, and industry. These are issued to target companies, the answers are verified, and scoring is normalised so lenders can draw comparisons. The methodology doesn't change, though lenders could focus on certain sub-scores.

"We see more recognition of the value of consolidated and aggregated ratings versus the tracking of KPIs, which can be too narrow," said Sophie Bertreau, a vice president at EcoVadis.

As to the structure of incentives, an interest rate stepdown of 10-15 basis points is considered typical. A 20 basis-point discount would be exceptional, although it is said to have reached around 25 basis points in the financing that supported KKR's NZD 455m (USD 320m) acquisition of a majority stake in Education Perfect. This was the first unitranche SLL in the Australian market.

The consequences of meeting some KPIs, but not all, are heavily negotiated. A stepdown of several basis points per metric is usually offered – in the 2-5 basis point range – with 10-15 basis points serving as the overall cap. It is suggested that some companies take advantage of the lack of standardisation to pad out deals.

"There seems to be a trend towards quantity over quality, for example, by having multiple KPIs – perhaps a pressure to have one for each of E, S, and G – but none of which may be particularly meaningful to the specific company," said Needham of KKR. "In these instances, I would prefer to have one KPI that is material and ambitious – that really matters to the company."

Seeking a balance

This goes to the heart of certain deeper concerns about SLLs. While a 10-basis-point stepdown might amount to a meaningful saving in a portfolio-level facility, it doesn't necessarily transform the economics on a transaction financing priced at 500 basis points above the bank bill swap rate.

And for PE players, it isn't just about the money. These financial incentives serve to encourage management teams to pursue ESG agendas that meet the wider needs of the company and the investor. In this way, they form part of a private equity firm's overall ESG policy and its positioning as a generator of returns that deliver in terms of financial performance and sustainability.

One pan-regional manager who was approached about a portfolio-level SLL claims to have been nonplussed by the offering. The manager recognised that it would burnish his firm's ESG credentials, but he concluded that the cost savings would be minimal. Meanwhile, the additional reporting would not be additive to what he claims is a comprehensive in-house ESG program.

"It's great in terms of fundraising. You can say you are at the forefront of ESG, to the extent that even your financing is green, and ESG is everything right now," the manager added. "It wasn't for me."

The key is balance. KPIs must meet the needs of all stakeholders – lender, sponsor, and company – by combining materiality and ambition with a dose of pragmatism. In selecting these metrics, a company is effectively mapping out its ESG journey, and this can only be achieved with detailed datasets and clarity as to what is being measured and what improvement looks like.

Heltzer of Ares notes that many businesses are still in the process of understanding how to put together ESG programs. The leap from there to true accountability based on an agreed set of metrics is substantial, but he has seen considerable progress in this area over the past few years.

Even as regulators and industry associations add flesh to the bones of policies and best-practice principles, helping to eliminate more reckless behaviour, a lot of experimentation is happening. This will add to the pool of knowledge and experience, and ultimately, help SLLs move towards greater standardisation and wider usage.

"Not all these things are going to work, and we need to be okay with that," added Carlyle's Starr. "We must experience failure, and then learn and progress from it. Sustainability-linked loans principles have been useful in outlining what makes a valid ESG-linked financing, and we see the sophistication and ambition ramping up with each financing." ■

Infrastructure: Out of the comfort zone

Infra managers in Australia are pushing into the PE space, competing with GPs for assets and buying businesses from them. It falls under the core-plus umbrella, but is the definition being stretched too far?

Pacific Equity Partners (PEP) is continuing its journey with Australia-based smart electricity meter business Intellihub. However, an asset that has been de-risked to the point of reclassification no longer belongs in the vehicle that originally housed it.

The GP acquired Intellihub in 2018 as the debut investment in its Secure Assets Fund, a vehicle designed for companies that generate infrastructure-like annuity income yet offer opportunities for PE-style operational improvement. At the end of last year, Brookfield Asset Management bought 50% at an enterprise valuation of AUD 3.2bn (USD 2.3bn). PEP plans to spin out the remaining 50% into a single-asset continuation fund.

"We are looking at giving investors a liquidity option, or an option for those that like the business and want to stay with it," said Andrew Charlier, a managing director at PEP. "Even though the expected returns will go down, the certainty around those returns has increased because it has been de-risked. A lot of value can be created by bringing businesses along that risk-return spectrum."

In the case of Intellihub, that de-risking was achieved through scale, longer contracts, and a more diverse revenue base. When PEP carved it out from Origin Energy and combined it with Landis+Gyr's smart meter business, there were 750,000 units and Origin was the primary customer. Now Intellihub has 2m meters and works with more than 30 counterparties in Australia and New Zealand.

This movement along the risk spectrum tracks an evolution from private equity to growth-oriented core-plus infrastructure to traditional core infrastructure. It is a well-trodden path in

"The envelope is being pushed more than it was in the past. With more dollars going into infrastructure, the competition for assets is intense"

– *Bruce Crane*

mature markets like Australia: PE investor takes asset with infrastructure-like characteristics, irons out operational, regulatory, and market complexities, and exits to an infrastructure investor at a healthy premium.

But the path is turning into a congested highway as infrastructure funds stretch the definition of core-plus to include businesses that arguably have more moving parts than fixed assets. While the phenomenon taps into super trends around demographics, energy transition, and technology, it is also a function of low interest rates and ample liquidity. As returns on more conservative assets are bid down, investors can only meet their return targets by moving up the risk curve.

"The envelope is being pushed more than it was in the past. With more dollars going into infrastructure, the competition for assets is intense," said Bruce Crane, a managing director for Asia Pacific infrastructure and natural resources at Ontario Teachers' Pension Plan (OTPP).

"If you are a seller with an asset on the cusp of infrastructure, all you need is one buyer to believe in the marketing and you get a great outcome. Time will tell whether these assets are core-plus infrastructure or private equity."

PEP is preparing to launch its second secure assets fund, targeting 50% more than the AUD 660m raised in the first vintage, according to a source close to the situation. The firm declined to comment on fundraising, but it was open regarding the origins of the strategy: frustration at losing out on infrastructure-like assets to rivals with a lower cost of capital.

One LP classified PEP's offering as private equity but knows of peers that placed it in the infrastructure bucket. "There were fewer infrastructure managers in that space when they raised the fund. In the last two years, we have seen more," the LP said. "They might have a 9% return target, but they can't get that on traditional infrastructure assets like utilities, so they go into digital."

Some of the infrastructure managers currently active in Australia, such as EQT and Stonepeak, run separate core and core-plus vehicles; others, like QIC and Brookfield, have funds that pursue a blend of core and core-plus assets. Ross Israel, global head of infrastructure at QIC, noted that the balance between the two has shifted as interests have fallen and returns have tightened in the core space. QIC has a 10-13% return target; pure core-plus funds usually aim for mid-teens.

The grey area between asset classes is being populated from the private equity side as well. Single-asset continuation funds are increasingly pitched as a means of retaining ownership of de-risked companies, while long-dated or perpetual capital pools are gaining traction. IFM Investors is said to be raising an Australia fund that will hold assets for 10-plus years.

Uncomfortable overlap?

Industry participants have different views on what sort of assets are appropriate for a core-plus portfolio, the key point of contention being whether managers are putting assets into funds that shouldn't be taking on that level of risk.

IFM outlined its parameters for core, core-plus, and long-term capital – which sits closest to traditional PE on the risk curve – in a recent white paper. Core infrastructure is characterised by monopolies or exclusive operating rights and concession agreements. With core-plus, regulation is limited but businesses still enjoy dominant market positions and long-term contracted cash flows.

Long-term capital represents an incremental dilution in predictability: favourable industry structures, strong market positions, ability to withstand disruption, positive cash flows, contracted or habitually occurring revenue streams, the ability to pay sustainable dividends, some cyclical exposure, limited regulation, long-term growth prospects tied to product and geographic expansion.

The white paper links sectors to strategies based on those attributes. Land registries, pipelines, ports, toll roads, and utilities are core infrastructure; car parks, data centres, and market exchanges are core-plus. Long term capital encompasses business and technology services, consumer staples, distribution networks, healthcare and aged care, logistics, packaging, and waste.

Recent Australia and New Zealand deal flow ▶

suggests that core-plus infrastructure investors are less rigid in their definitions. In late 2021, an EQT infrastructure fund agreed to buy Icon Group, a cancer care specialist owned by PE in the previous two cycles. QIC was one of the sellers. Meanwhile, QIC's infrastructure team bought New Zealand hospital operator Evolution Healthcare – from a PEP private equity fund – adding it to a portfolio that includes Australia's Nexus Day Hospitals.

Industry advisors expect core-plus infrastructure or long-term capital funds to be in the running for pallet leasing businesses Brambles and Loscam Australia and for Beijing Capital's New Zealand waste management unit. With core-plus said to be willing to pay 20x EBITDA for certain assets, several turns beyond most private equity bids, the hunt is on for more supply to sate this appetite.

"Bankers are looking for infra-like assets that sit within corporates," said Emin Altiparmak, a partner at law firm Allens. "Telstra restructured, separating its infra and retail assets, and that led to the towers deal. Other sectors such as oil and gas players are contemplating the same. Some of this activity might be through more synthetic structures, where separation of the actual infra-like assets is challenging including because of joint venture partner or other counterparty consents."

Altiparmak has found that some investors are comfortable bidding on businesses as core-plus despite a lack of significant hard assets if there is little prospect of competition or pricing is regulated. Others are happy with long-term stable or contracted returns and limited retail or merchant risk.

Disruptive forces

For those aiming to generate a premium return by pushing assets along the risk curve, there is plenty of case history. Data centres were originally more of a real estate play, but they progressed rapidly from private equity to core infrastructure as outsourcing models became increasingly complex, digitalisation took hold, and information shifted to the cloud.

Quadrant Private Equity invested in Canberra Data Centres (CDC) in 2014, when the business had only a couple of facilities and a concentrated customer base. Over the next two years, CDC became larger and more diversified, which led to an acquisition by HRL Morrison and Commonwealth Superannuation Corporation. Future Fund bought a stake last year, making its data centre debut.

"Data stored in the cloud and therefore data centres are now seen as a part of core digital infrastructure used by everyone all over the world," said Anthony Muh, Asia chairman at HRL Morrison. "The same is happening with social infrastructure as investors that already provide the hardware around schools and hospitals have evolved to own the next part of the value chain, services providers."

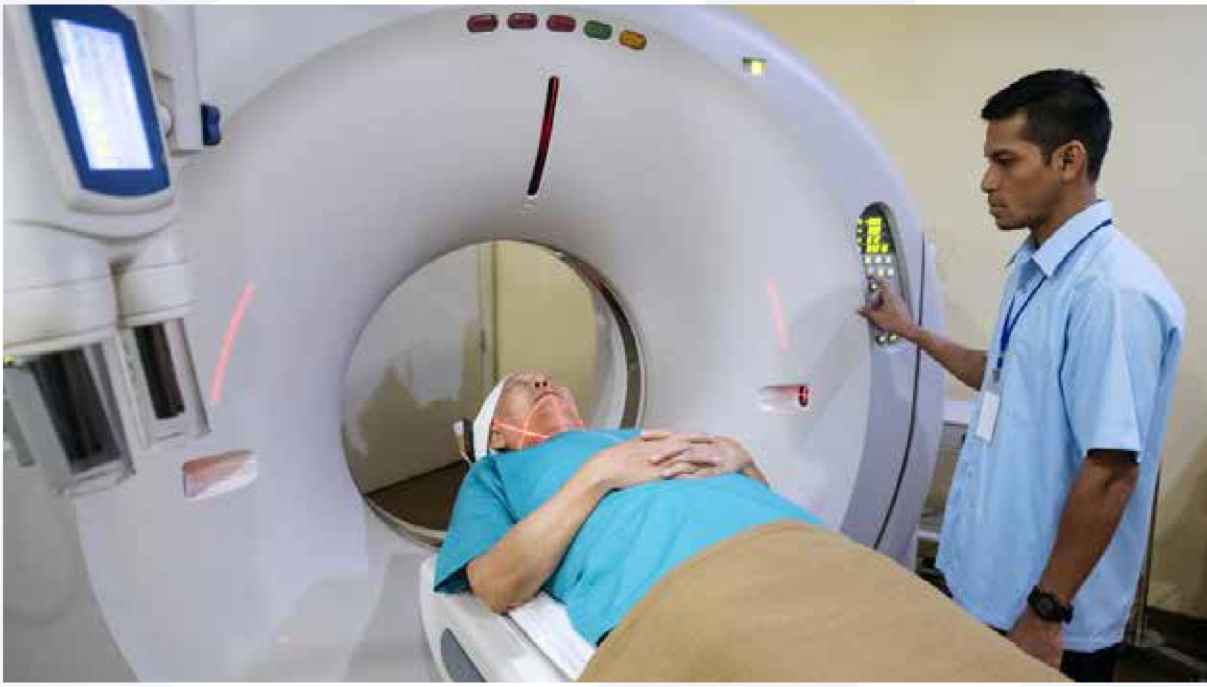
Last year, HRL Morrison facilitated another exit for Quadrant when it acquired Qscan, a radiology clinic chain. Muh described it as a relatively capital-intensive investment, given the need to support nationwide expansion, yet one that offers volume and economies of scale once operations can be standardised and replicated at scale.

The prospects for consolidation – and by extension, diversification of customer base – is part of the rationale behind QIC's foray into hospitals. It also detected a thematic trend around ageing and increased demand for healthcare services.

"Some businesses are core-plus today, but in time they will be regarded as core because sectors are being disrupted. It's happened with digital assets, like data centres and fibre, and the underspend on public health presents a

"Some businesses are core-plus today, but in time they will be regarded as core because sectors are being disrupted"

– Ross Israel



similar opportunity. These hospital businesses can become a valid core component of an infra portfolio," said Israel.

He applies this reasoning to energy and the electrification of transport assets as well. Increased utilisation of remote power and energy storage solutions has served to decentralise asset bases, leading to different operating models. These require capital and scale to be de-risked. QIC expects much the same of electric vehicle (EV) charging infrastructure.

Devil in the detail

However, individual nuances around licensing and regulation – and even the types of services offered within a specific area and how they are paid for – are just as important to underwriting as broad sectoral themes. This is perhaps especially true of healthcare.

Nexus and Evolution sit together in QIC's infrastructure portfolio, but the LP cited earlier, on considering co-investments in both assets, categorised the former as private equity and the latter as core-plus infrastructure. The decision was based on an assessment of Nexus' competitive position: it was too easy for customers to find an alternative provider in a neighbouring suburb.

"Evolution has a dominant share in its main coverage areas, and it has less competition. It also has stronger relationships with public hospitals, whereas in Australia it's more ad hoc," the LP said.

When assessing businesses focused on elective surgery, investors stress the importance of catchment analysis in establishing the nature of local competition and the strength of supposed monopoly positions. With Nexus and Evolution, the underlying demand drivers were not at issue, rather it was a question of how the identity of the payer might impact income stability.

In New Zealand, there is more emphasis on public health insurance and hospitals enter contracts directly with district health boards, whereas private insurance dominates Australia. Meanwhile, a growing number of patients are willing to pay out of pocket for procedures by specific doctors instead of being outsourced to other providers through the public or private systems.

It is suggested similar dynamics influenced the divestment of Healthscope's pathology assets. New Zealand Superannuation Fund

Long-term private capital strategies relative to other equity investment classes

Lower — Indicative Gross IRR — Higher

Category	Core infrastructure	Core-plus infrastructure	Long term capital	Traditional private equity	Venture capital
Capital intensity	High	High	Variable	Typically less	Typically low
Typical characteristics	• Monopoly or exclusive right to operate • Formal regulatory framework or concession	• Dominant market positions or exclusive rights to operate • Long-term contracted cash flows • Limited or no regulation • Significant hard asset backing	• Favourable industry structures • Strong market position • Ability to withstand disruption • Cash flow positive • Contracted or habitually recurring cash flows • Ability to pay sustainable dividends • Potential for some cyclicality • Limited or no regulation • Platform for long-term growth	• Good market position • Growth options • Cost out opportunities • Unregulated • Require multiple exit options	• Early stage • Not cash flow positive • High loss rates
Example industry/sector	• Land registries • Pipelines • Air and sea ports • Toll roads • Utilities	• Car parks, parking meters • Data centres • Embedded infra (gas gathering lines, processing plants) • Market exchanges	• Business services • Consumer staples • Distribution networks • Embedded technology service providers • Healthcare and aged care • Logistics • Packaging • Waste/ environmental	• Sector agnostic (excluding infrastructure, real estate, mining)	• Sector agnostic, but a general focus on technology and medtech

Higher — Typical leverage — Lower

Source: IFM Investors

and OTPP acquired the New Zealand business in 2020. Crescent Capital Partners and TPG Capital respectively carved out the Australia and Southeast Asia operations in 2015 and 2018. The Australia unit listed last year; Southeast Asia is expected to follow suit.

"They were able to distinguish between the various parts of the business and get different valuations," one industry advisor explains.

Contract tenor is another key factor when underwriting assets. A 20-year take-or-pay agreement under which the buyer pays a set amount regardless of how much volume is utilised might ensure core status. Extending contracts from 3-5 years to 10 years-plus helped push Intellihub in that direction. At the same time, stretching the definition of core-plus brings in shipping, where contracts can be 1-3 years and volume specific but not price specific or the other way around.

"The type of contract can change the definition from core-plus to core or private equity to core-plus," said OTPP's Crane. "It's the difference between knowing you will get paid a certain amount for the next 20 years no matter what happens and having to manage customers because the market fundamentals will shift and underlying contracts will reprice every three years."

Two shipping assets have made the transition from private equity to infrastructure in recent years. QIC acquired Sea Swift, which serves fishing communities and natural resources outposts off Australia's northern coast, from CHAMP Ventures in 2019. Last year, CPE sold StraitNZ, an operator of freight and passenger services between New Zealand's two main islands, to Morgan Stanley Infrastructure Partners.

Israel noted that creating a sustainable business that can expand into different service areas, thereby offsetting issues around competition, volumes, and pricing, is among the biggest portfolio challenges QIC currently faces. "Institutionalising the model is a bigger and deeper exercise than Nexus," he added. "There is real risk in core-plus, no question."

Operational angst

Getting to grips with complexity is a feature of the broader core-plus universe – and where investors are moving from facility provision to service provision, people management is a common pain point.

"A toll road has very few moving pieces in operational terms," said Mark McNamara, a partner at law firm King & Wood Mallesons. "Conversely, a cancer care business is operationally much more complicated and

> "Core-plus is often about managing complexity and growth, so you need industry operators who can roll up their sleeves and engage"
>
> *– Anthony Muh*

requires a significant amount of stakeholder management given so much of the value is tied to the medical specialists."

Private equity investors have backed a string of doctor-shareholder businesses in Australia, with mixed results. I-Med Radiology Network was the highest-profile failure in the post-global financial crisis years. A large group of doctors, disillusioned with the company's management and precarious finances, splintered off in 2009 to form a competing business. More were agitating to do the same when creditors brought in turnaround experts to mount a successful three-year recovery effort.

The solution is corporatisation and alignment: create a single ownership layer and a growth-oriented business plan; award economic interests to doctors in a way that facilitates succession planning and binds younger members to the business long term; and demonstrate the benefits of a scaled operation in terms of training, branding, and capital investment, as well as cost savings.

The continued lever-pulling of this active management approach is removed from core infrastructure, where the emphasis tends to be on transaction structuring and pricing. As investors step outside their comfort zone into a flexibly defined core-plus arena that asks difficult operational and governance questions, it is unclear whether they are bringing the necessary skillsets.

"If investors don't have experienced operational experts to manage businesses, it's hard to add value," said Muh of HRL Morrison. "Core assets are often bought by consortiums, so no single investor has absolute control and management is done by professionals. Experienced board members are necessary to challenge management. Core-plus is often about managing complexity and growth, so you need industry operators who can roll up their sleeves and engage."

Still in abundance

Mangled execution means the journey from core-plus to core is at best protracted and at worst uncompleted, potentially resulting in exit multiples that don't justify entry premiums. Misreading macro trends – investing in roadhouses only as in-home EV charging takes off or backing cleantech solutions that fail to catch on – would create stranded assets and deliver similar outcomes.

It is generally accepted that some investors who neglect to price risk appropriately will get their fingers burned. But neither this nor an upward adjustment in interest rates is tipped to dampen enthusiasm for infrastructure and the search for returns further along the curve.

"I don't think people will necessarily get less aggressive," said OTPP's Crane with respect to the impact of an interest rate hike. "Returns might adjust but you'll still have a lot of competition for a limited number of assets, where the price floor depends on those individual assets and the extent to which they have inflationary pass-throughs."

If anything, the surge of capital into private markets is likely to sustain the current dynamic and encourage fundraising, led by the global multi-strategy firms but filtering down to country level. Charlier of PEP contends this will see the grey area between private equity and infrastructure become more defined as managers from both sides adopt increasingly idiosyncratic mandates.

"There will always be people stretching outside of their manor, but I think there will be more specialisation around those risk profiles," he observed. ■

Australia VC:
An ideal match?

Having backed Australian VCs for Hostplus, Neil Stanford is now raising a fund-of-funds with a view to catalysing a state-wide start-up ecosystem. A preferred return structure is being used to lure LPs

In more than seven years at Hostplus, Neil Stanford oversaw a tenfold increase in the private equity program to AUD 8bn (USD 5.8bn). The Australian superannuation fund carved out a niche in domestic VC as one of the first in its peer group to back a new generation of managers – but there were plenty it couldn't invest in for size reasons, which prompted Stanford's next career move.

He has established V-Ignite, which was recently named as manager of the Victorian Startup Capital Fund (VSCF), an AUD 120m fund-of-funds that will support early-stage GPs. The state government will contribute AUD 60m, rising to AUD 75m if the hard cap is reached, provided V-Ignite secures an equal amount from independent LPs.

"The cheque sizes at superfunds are too big for some of these managers. There was a lot of that at Hostplus, especially as the fund became larger. It is now AUD 82bn, so maintaining exposure to the early-stage space will be challenging," said Stanford. "We can act as an intermediary, bridging the gap between start-ups at one end of the spectrum and risk-averse superfunds at the other."

A first close of at least AUD 40m is scheduled for late May so that V-Ignite can draw down on government money before the end of the current financial year. In addition to superfunds, the firm is targeting family offices, wealth management platforms, and high net worth individuals (HNWIs).

The broad private wealth segment is increasingly seeking alternatives exposure and being sought out by private equity managers, as evidenced by the rise of wealth management

"We can act as an intermediary, bridging the gap between start-ups at one end of the spectrum and risk-averse superfunds at the other"

– Neil Stanford

platforms and the deployment of feeders to aggregate commitments. Stanford has spoken to several of these groups already, typically those with no previous VC exposure that want an easy way to get started.

"Small investors have limited capital, so it's hard for them to get the level of diversification they need when investing in start-ups," said Stanford. "Every start-up is risky. One failure doesn't mean all will fail, but small investors want to spread their bets and a fund-of-funds offers diversification."

The multiplier effect

Australia has experimented with public-private matching schemes before, notably the federal-level Innovation Investment Fund (IIF) system whereby government money went to start-ups that secured backing from licensed fund managers. It was discontinued in 2015.

V-Ignite is pursuing a similar kind of multiplier effect: the government matches whatever VSCF raises from independent LPs; and then VSCF backs funds on the same basis.

The fund-of-funds will make 8-10 fund investments, with an up to 20% allocation for direct investments and follow-on rounds, but the goal is to catalyse the entire ecosystem by establishing clusters of skills and knowledge.

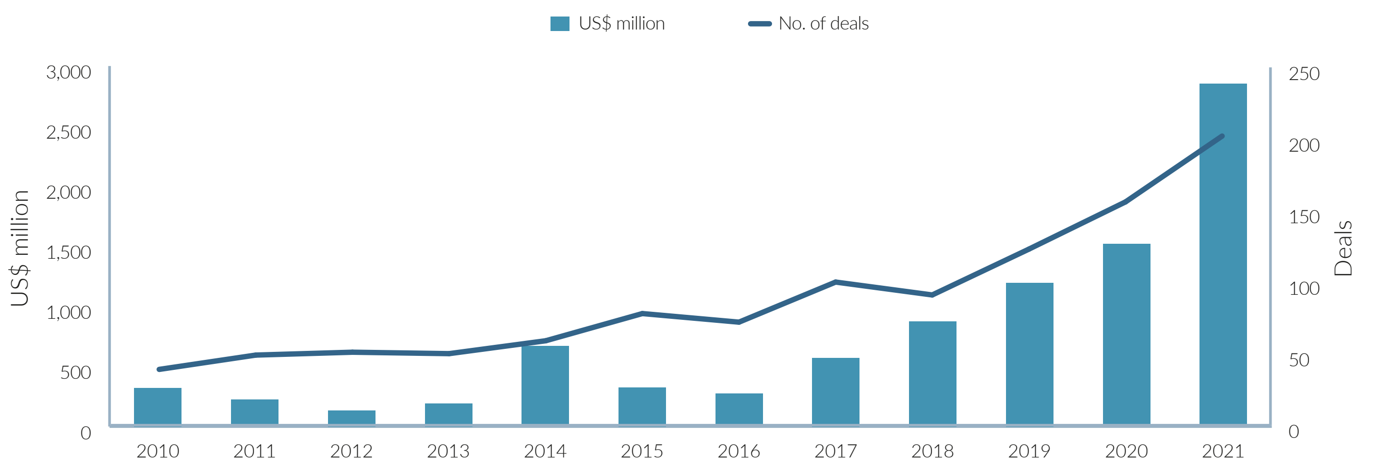
The kicker from an independent investor perspective is the preferred return. The government's return is capped at 5%, so assuming there is additional upside, it all goes to the independent LPs.

"It's a real win-win-win. Start-ups get the capital they need; the government achieves its objectives in terms of creating new high-tech companies, industries, and jobs; and the private investors get the higher returns they want," said Stanford. "We saw a lot of funds at Hostplus but never came across one with two preferred returns. It's highly differentiated. Whether it's unique, I don't know."

Localisation is one of the defining criteria in manager selection. At least half the corpus must go to GPs that are newly established and based in Victoria. Alternatively, they could be based elsewhere and expand into Victoria. For example, Sydney-based AirTree Ventures, which recently closed its fourth fund, could qualify in the next vintage by opening a satellite office in Melbourne.

VSCF is the brainchild of LaunchVic, an independent agency formed in 2016 to develop a start-up ecosystem in the state. As of June 2020, this ecosystem comprised 2,100 start-

Australia venture capital investment



Source: AVCJ Research

ups with an estimated cumulative value of AUD 7bn, a threefold increase on 2018.

This appears to track a nationwide trend. Approximately USD 2bn was channelled into early-stage rounds for Australian start-ups last year and an additional USD 2.3bn went into growth-stage investments, according to AVCJ Research. This compares to USD 595m and USD 982m in 2018.

Filling the gap

Victoria was responsible for two of Australia's earliest start-up success stories, jobs platform Seek and automotive marketplace Carsales, each of which ended up going public. More recently, the likes of cross-border payments player Airwallex and enterprise technology provider Culture Amp have achieved unicorn status. But LaunchVic believes the state is missing out.

"They identified a recurring lack of capital available for early-stage start-ups. Even though funding into venture overall was going up, it had plateaued at the early stage," said Stanford. "Historically, Sydney has been the financing capital of Australia and that has flowed into the venture ecosystem. Victoria isn't keeping up."

The state suffers an AUD 96m shortfall in annual early-stage funding, LaunchVic noted in a November 2020 presentation, citing third-party research. Moreover, Melbourne is home to just 20% of Australia's early-stage VCs. "Too few Victorian early-stage start-ups receive funding to scale. This results in less high-growth firms and fewer exits, which disincentivises investors," it noted.

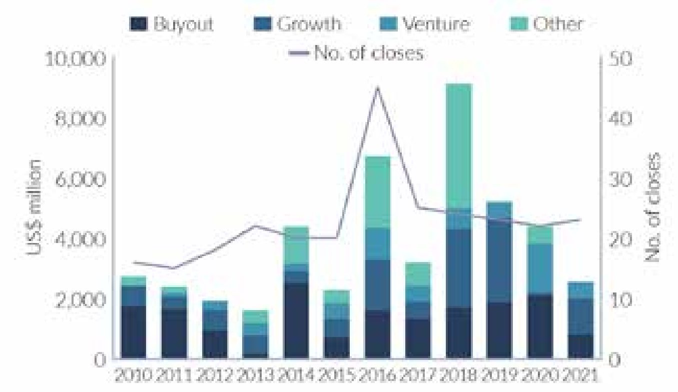
Having resolved to create a fund-of-funds, LaunchVic CEO Kate Cormick approached Stanford for advice on structuring the vehicle so that it appealed to a wide range of investors. He expressed an interest in serving as the manager, but V-Ignite still had to prevail in a more than six-month request for proposal (RFP) and assessment process.

Stanford is joined by Brighid Pappin, who worked alongside him at Hostplus for three years as a private equity investment specialist. Brandon Capital, an Australia-based healthcare investor and Hostplus portfolio GP, is providing back-office support. It cannot receive capital from VSCF.

"My background is engineering, so a lot of people ask how I ended up working at a superfund. Prior to Hostplus, I worked at Jana, an investment advisor to Hostplus, so [V-Ignite] is the final piece in terms of going through the ecosystem myself," Stanford added. "It's also useful experience in terms of bringing an investor mindset to a fund manager." ■

Data file: Australia, New Zealand by numbers

Fundraising by strategy



Source: AVCJ Research

Exits by type

Source: AVCJ Research

Largest private markets funds, 2016-2021

Fund	Strategy	Manager	Vintage	Size (US$m)
Macquarie Asia Infrastructure Fund 2	Infrastructure	MIRA	2017	3,300
Macquarie Asia Infrastructure Fund	Infrastructure	MIRA	2014	2,300
Provincial Growth Fund (PGF)	Growth	Grow Regions	2019	1,960
BGH Capital Fund I	Buyout	BGH Capital	2017	1,862
Pacific Equity Partners VI	Buyout	Pacific Equity Partners	2019	1,790
Quadrant Private Equity No.7	Buyout	Quadrant Private Equity	2020	888
Quadrant Private Equity No.6	Buyout	Quadrant Private Equity	2017	823
Powering Australian Renewables Fund	Infrastructure	QIC Global Infrastructure	2016	716
Quadrant Private Equity No.5	Buyout	Quadrant Private Equity	2016	702
Pemba Capital Partners Fund I	Growth	Pemba Capital Partners	2016	650
Crescent Capital Partners VI	Buyout	Crescent Capital Partners	2018	573
Adamantem Capital Fund II (ACF II)	Buyout	Adamantem Capital	2019	570
CHAMP Buyout IV Fund	Buyout	CPE Capital	2015	526

Note: Final closes only
Source: AVCJ Research

Largest private markets exits, 2016-2021

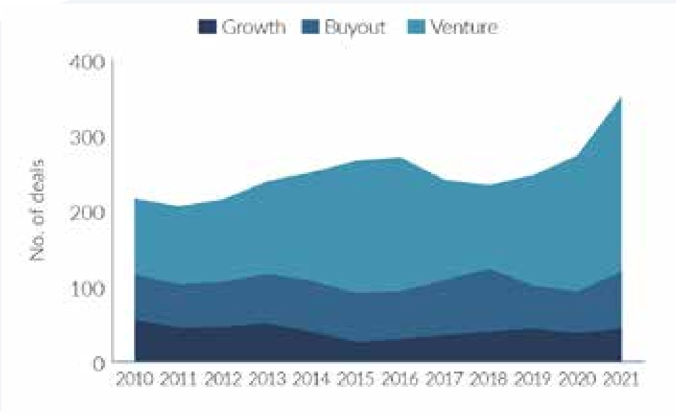
Year	Investee	US$m	Industry
2017	Alinta Energy Group	3,012	Infrastructure & utilities
2018	Quadrant Energy	2,150	Mining & metals
2020	AirTrunk	2,086	Technology
2021	Icon Group	1,760	Healthcare
2021	One Rail	1,743	Transportation & distribution
2021	Ausgrid	1,400	Infrastructure & utilities
2020	TransGrid	1,399	Infrastructure & utilities
2021	MessageMedia	1,300	Telecom
2018	MYOB Group	1,128	Technology
2016	HeartWare International	1,100	Healthcare
2021	Seequent Holding	1,050	Technology
2018	I-Med Holdings	1,010	Healthcare
2021	Two Degrees Mobile	896	Telecom
2021	Lifehealthcare Group	892	Healthcare
2017	Metronode	794	Technology

Source: AVCJ Research

Investment value by strategy

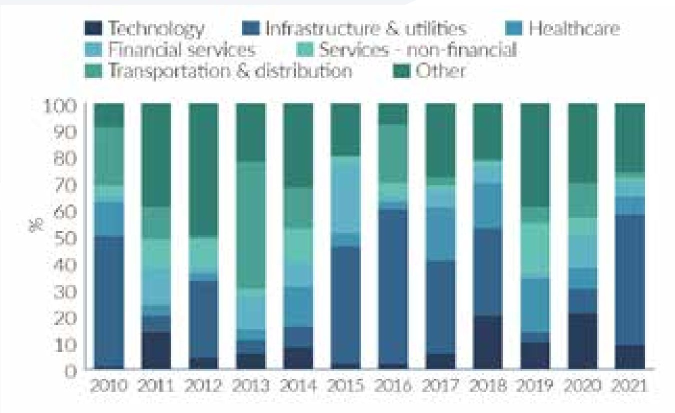
Source: AVCJ Research

Investment volume by strategy



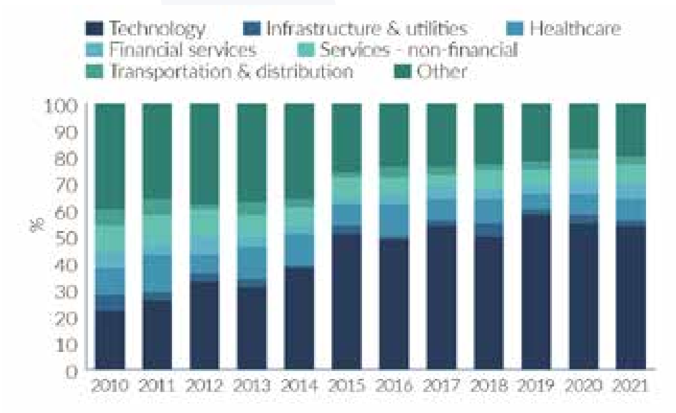
Source: AVCJ Research

Investment value by industry



Source: AVCJ Research

Investment volume by industry



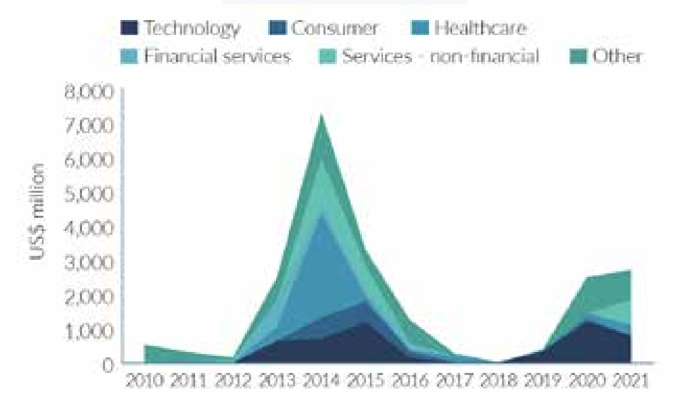
Source: AVCJ Research

Largest private markets deals, 2016-2021

Year	Investee	US$m	Industry
2021	AusNet Services	12,942	Infrastructure & utilities
2016	Ausgrid	12,315	Infrastructure & utilities
2016	Asciano Group	9,047	Infrastructure & utilities
2021	Sydney Motorway	8,072	Infrastructure & utilities
2016	Port of Melbourne	7,273	Transportation & distribution
2018	WestConnex	6,738	Infrastructure & utilities
2017	Endeavour Energy	5,622	Infrastructure & utilities
2021	Spark Infrastructure	3,695	Infrastructure & utilities
2021	Vocus Group	3,609	Telecom
2019	Healthscope	3,138	Healthcare
2020	Queensland Curtis LNG	2,500	Mining & metals
2020	Virgin Australia Holdings	2,392	Transportation & distribution
2018	Kestrel Coal Mine	2,250	Mining & metals
2019	Vodafone New Zealand	2,243	Telecom
2019	Arnott's Biscuits Holdings	2,200	Consumer

Source: AVCJ Research

PE-backed IPOs by industry



Source: AVCJ Research

AVCJ

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- Blackstone
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ENQUIRY

REGISTRATION: Anil Nathani
T: +852 2158 9636 E: book@avcj.com

SPONSORSHIP: Darryl Mag
T: +852 2158 9639 E: sponsorship@avcj.com

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