

Australian Venture Capital Association Ltd

The Case for Private Equity

A unique asset class

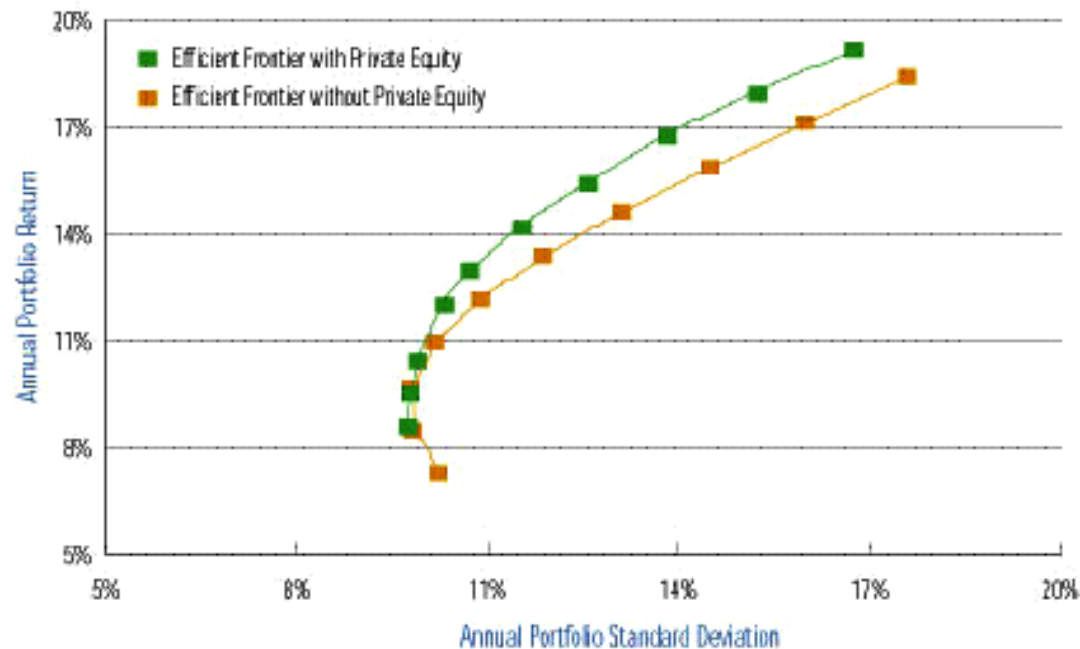


Why invest in PE?

- The primary advantage of PE investment:
 - Inefficient market presents opportunities to buy good assets cheaply
 - Focus on value creation through fundamental growth, not market timing
 - Inefficiency allows good managers to sustain top quartile performance through rigorous and diligent investment process

Why invest in PE?

PE investment shifts the efficient frontier and generates positive Alpha for the portfolio



Gompers P. and Lerner J. (2001) *Private Equity and Asset Allocation: Clues to a Puzzle*. Salomon Smith Barney Private Equity Research Initiative.

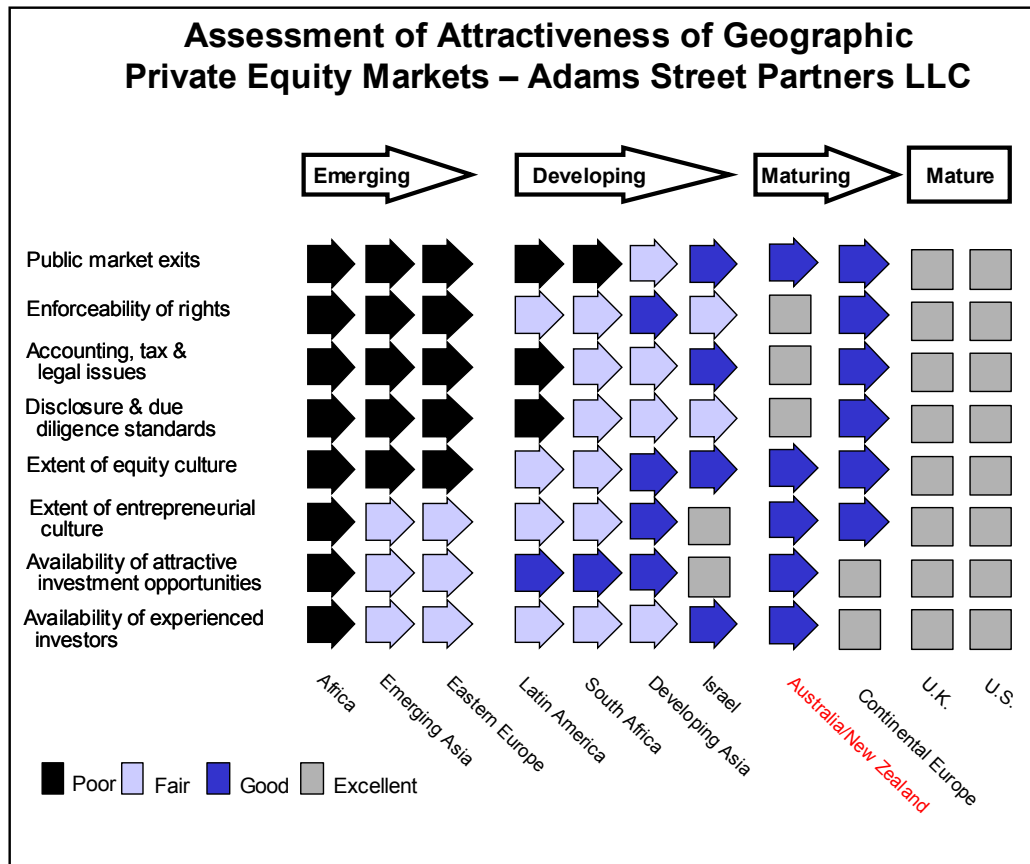
Why invest in PE?

- High risk : return asset class with equity focus
- Top Quartile performance outstrips all asset classes
- Return dispersions reflect the role of investment selection in driving returns (implication: performance persistence)
- Important component of diversified investment strategy
- Picking good managers is easy – look to their track record.



Australian Performance

Strong fundamentals make Australian Private Equity allocation attractive



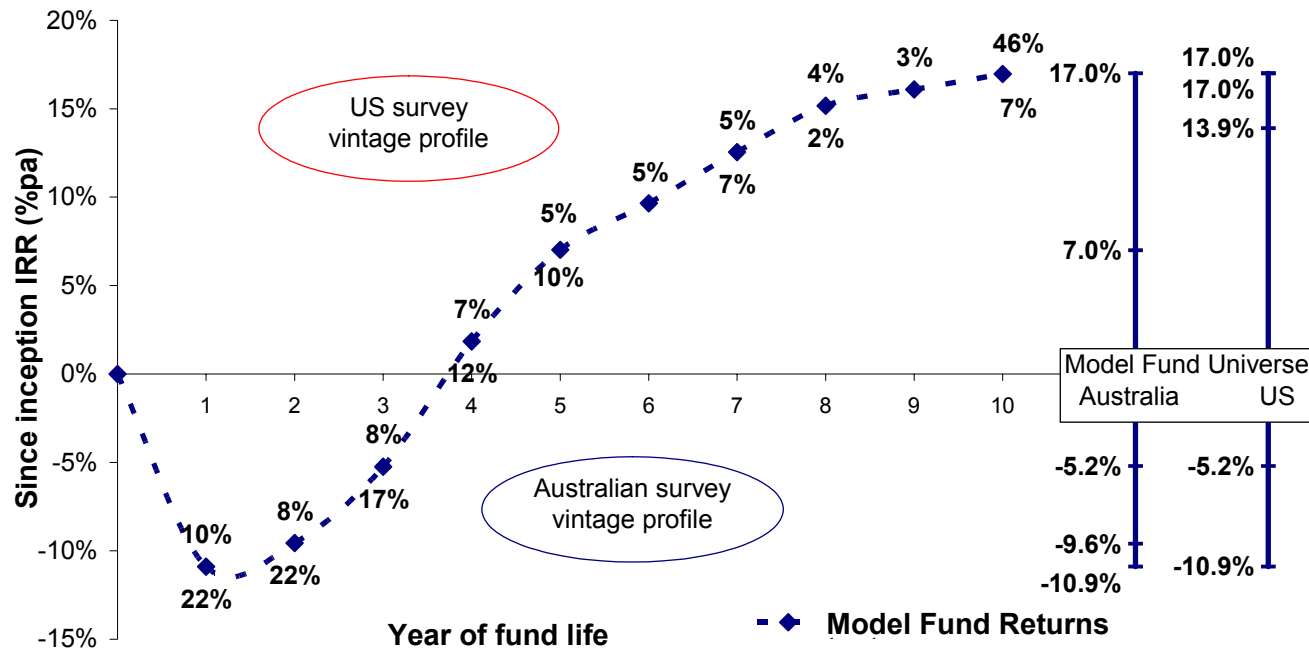
Australian Performance

- The early stage of industry development skews current return profile due to J-curve effects
- However recent performance shows emergence from the J-curve.
- Overall the market is sophisticated and performing well.
- Contrarian investors who have committed to the sector early are now benefiting

Australian Performance

Performance Universe of 17%pa Model Funds

(Proportion of funds for each vintage year from Venture Economics Aust & US surveys is noted. Model US and Aust universe max, top quartile, median, lower quartile & min on right)



Source: Quay Partners



- Age profile of the Australian industry much younger than in the US

Australian Performance

- A well managed, diversified Private Equity portfolio in Australia can do very well.
- Top quartile Australian managers are demonstrating internationally comparable returns.
- Transactions like Repco, Atlas Steels, Village Life, JB HiFi, Sirtex Medical, Tower Technologies, Pacific Brands, Invocare drive high performance



Private Equity is unique for several reasons:

- Fund structure
- Fee structure
- Market inefficiency
- Performance

Fund Structure:

FEATURES

- 10-year fixed life fund
- Blind pool investment
- Capital commitments, drawn down as required
- 5 year investment phase
- Investment in unlisted equity-based assets

IMPLICATIONS

- Transparency
- Illiquidity

Fund Structure – Implications

Transparency

AVCAL has developed valuation guidelines based on the principle of Fair Value.

- They are globally accepted (AIMR, BVCA, ILPA)
- They resolve intergenerational equity issues
- They are objective



Fund Structure – Implications

Illiquidity:

- Information on investee businesses is difficult to obtain.
- This poses both a challenge to find good investments and creates an opportunity to buy them cheaply.
- allows good managers to sustain high performance through a disciplined investment approach.



