

Australian Private Equity & Venture Capital Journal

 Private Equity Media

 Hallmark Editions

YEAR 19

NO 198

JUNE 2010

INDEX

Companies and organisations in this issue 2

INVESTMENT ACTIVITY

Listed company attracts billion dollar offers 4
 Carlyle offers \$350 million for aviation business 7
 Archer bids for crane hire company 7
 Japanese led consortium buys water company 8
 Riverside invests in healthcare sector 9
 UK backing for oil and gas search team 11
 PEP 'competing for UK landfill gas business' 11
 Energy investor moves on engineering business 12
 Quadrant buys out joint venture partner 13
 IVF Holdings acquires Queensland business 13
 Ironbridge backs UK software acquisition 14
 Catalyst acquires refrigeration parts business 14
 Rio Tinto award to mining equipment parts supplier 18

INVESTEE NEWS

Payment card operations for sale 13
 Drug developer plans ASX float 14
 Clinical test close for brain anaesthesia monitor 17

NEW FUNDS & FUNDRAISING

Broad focused alternative markets vehicle 3
 Global pharmaceutical backs \$250m biotech fund 9

NEWS

COMMENT: Billion dollar bids pose challenges 5
 ATO delays private equity rulings 7
 Mezzanine debt specialist targets Australia 8
 AVCAL claims success on MIT legislation 10
 Blackstone 'here to invest as well as raise capital' 11
 NICTA seeking new chief executive 13
 Private equity executive in \$27 million home sale 15
 Private equity firm takes legal action over debt 15
 Research prizes offered 15
 Turnaround advisor establishes Sydney office 15
 Bill to tax carried interest progresses in US 16
 Manager declares stake in investment business 19

PEOPLE MOVES

Bank expands 'private equity alternative' team 16
 Adelaide firm makes new appointment 16
 New Mercer investment consulting head 16
 Babson Capital appoints sales executive 17
 Alternative assets specialist added to stockbroker's board 17
 Private equity part of new analyst's brief 18

INFORMAL VENTURE CAPITAL

Internet start-up attracts \$1.3 million 17
 Online venture attracts European investment 18

PERFORMANCE

CHAMP Ventures exits in \$40 million float 12
 CVC Asia Pacific to exit Stella 12
 Private equity 'outbid' on pallet business 17

CONFERENCES & ROUNDTABLES

Venture capital industry backs innovation event 19

FEATURES

TAX AND PRIVATE EQUITY; THE LATEST ROUND 20
 STRUCTURING PRIVATE EQUITY DEALS POST GFC 24

SHARES CHART

28

COMING EVENTS

28

[Direct Click Story in Contents \(above\)](#)

[Return to Contents](#) Click on APE&VCJ Folio (bottom left)

Companies and organisations in this issue

A

ABN AMRO Capital
Actrol
Adelaide Equity Partners
Advance Healthcare Group
Aetna
Affinity Equity Partners
AGCO Corporation
Airwork Helicopters
Alliance Airlines
Allegiance Mining
Allegro Private Equity
Allen & Buckeridge
Anglo American Metallurgical Coal
Archer Capital
ASX
AusFirst Angels
AusFirst Eco Investments 567
Australian Cranes & Machinery
Australian Investment Network
Australian Medico Legal Services
AustralianSuper
Australian Taxation Office
AVCAL

B

Babson Capital Management
Bank of Scotland
Barclays Capital
Barclays Natural Resources
Investments
BHP Billiton
Biffa
BioCane Limited
BioPharmacia
Blackstone Group
Booking Angel
Boom Logistics
BPH Corporate
Brain Sciences Institute
Brambles
Bravura Solutions Limited
Brookfield Asset Management
Burrill & Company

C

Calibre Engenium Rail Joint Venture
Calibre Global
Capricorn Mining
Carlyle Group

Catalyst Investment Managers
CHAMP Private Equity
CHAMP Ventures
China International Marine
Containers
Cisco Systems
CLSA Asia-Pacific Markets
CLSA Capital Partners
CNSBio
Coles
Commonwealth Bank
Connect Resource Services
Consolidated Travel Group
Continuity Capital Partners
Contract Aviation Industries
Cortical Dynamics
Covenant Nominees
Crown Parts and Machine
Crushing and Mining Equipment
CVC Asia Pacific

D

DB Capital Partners
Deep Blue Capital
Deutsche Bank
DRE Electrical

E

Eli Lilly
Eli Lilly Australia

F

Facebook
Fisher Funds Management
First Reserve
Fort Street Advisers
Freehills

G

Gilbert & Tobin
Global Infrastructure Partners
Grant Samuel
Gresham Private Equity
Groupon
GSA Industries

H

Harbrew Group
Hastings Funds Management
Hawkesbridge Private Equity
H-E Parts International
Healthscope

Hibernia Capital Partners
Horizon Oil

I

Indophil
Infinis
Innovation Network Corporation of
Japan, The
Investec Bank
Ironbridge Capital
IVF Holdings
IVF Australia

J

Jardan
Jetset Travelworld
JGC Corporation
Jones Day
Jump On It.com

K

Kelso Place Asset Management
Kohlberg Kravis Roberts
KPMG
KrisEnergy Holdings

L

LEK Consulting
Loscarn
Lion Manager
Lion Selection Group
Lodge Partners
Lumiere

M

Manila Water Company
Mantra
Massey Ferguson
Mastermyne
McAleese Group
Melbourne IVF
Mercer
Mitsubishi Corporation
Minter Ellison
Monash University
Montagu Private Equity
Morgan Stanley
Motorcharge
MTR Mining
Multiplex Group
M86 Security

N

nabICS
National Australia Bank
National Cranes
Newmont Mining
Nextec Strategic Capital
National ICT Australia (NICTA)
Nio Petroleum
Normandy Mining

O

OneVentures
Oracle

P

Pacific Equity Partners
Patersons Securities
Perquot Capital Management
Platmin
Principle Advisory Services
Protagonist
Protea Hotels

Q

Quadrant Private Equity
Qantas
Qantas Business Travel
Qantas Holidays
Queensland BioCapital Fund
Queensland Fertility Group
Queensland Investment
Corporation

R

Radiata
Ramsay Health Care
Reef Club
Relevare Pharmaceuticals
Reuters
Retail Decisions
Retail Employees Superannuation
Trust
Rio Tinto
Russell Investment Group

S

Silex Systems
Skype
Southern Cross Venture Partners
Southern Peaks Mining
Spreets

Starfish Ventures
Start-Up Australia
Stella Travel Services
Summerset Retirement Villages
Super Investment Management
Swinburne University of Technology

T

Tenet Healthcare
Terra Firma Capital Partners
Total Risk Management
Towers Perrin
TPG Capital
Treetops Resort

U

UBS Investment Bank
UBS Funds Management
United Utilities
United Utilities Australia

V

Vantage Performance Group
Victorian Funds Management
Corporation

W

Walter Wright Australia
Wesfarmers
Westpac Direct Equity Investments
Fund
Wilshire Associates
Wilshire Private Markets

X

Xstract Mining Consultants

Y

Yunan YinMore Sugar
Note: To locate names in this list in the text of the Journal, when viewed as a PDF, scroll to the top line of the PDF menu bar at the top of the page, click on Edit, scroll down to Find, type or paste name in search box, click on down arrow to right, scroll down to "Find Next in Current PDF", click on far right of two symbols to right ("Find Next"). Further clicks will find further occurrences.

New Funds & Fundraising

Broad focused alternative markets vehicle

A new broad focused alternative asset management firm has been set up by Ovidio Iglesias – who formerly led the Australian operations of Wilshire Private Markets in Australia – and two other former Wilshire executives.

Continuity Capital Partners has its headquarters in Canberra but plans to invest across the Asian region.

The other partners are former director of investment research in Wilshire's Canberra office Bill Humphreys and another Australian, Grant Fleming, who worked in Wilshire's Tokyo office.

All three left the fund of funds business in March.

In addition to the partners, founder of Hastings Funds Management Mike Fitzpatrick is also a shareholder, board and adviser to management.

Mr Fitzpatrick is now chairman of fund management companies incubator, Treasury Group Limited.

Founder and executive chairman of Principle Advisory Services Les Fallick is also on the Continuity board.

Continuity wants to establish itself as the leading illiquid assets advisory and asset management firm in the Asian region and plans to cover a broad range of illiquid assets including private equity, real estate, credit, natural resources and infrastructure.

Ovidio Iglesias said the philosophy was to offer institutional investors opportunities over a wider range of alternative assets than was usual, including natural resources such as timberland. He said he believed that a similar approach to investing in these areas should be able to provide the superior returns targeted in private equity.

The range of investment classes would, however, be built up step by step. The new venture would focus mainly on advisory work to start with and would launch its first fund of fund, an Asian region private equity fund, in a few months time. Other vehicles would follow in time, each focused on specific investment classes so investors would be able to choose to use Continuity in an advisory capacity in particular areas of expertise or to invest in specific asset classes or use its services more widely.

Mr Iglesias pointed out that prior to working with Wilshire he and Mr Humphreys had been involved in wider range of investing so had experience of some of the areas they planned to now offer but private equity would remain at the core of the strategy.

Investment opportunities would be sought across the entire Asian region, Mr Iglesias said, but he anticipated Continuity would seek leverage from the booming by unpredictable Chinese and Indian economies rather than investing directly in either country.

Continuity is basing its services solidly on research and plans to combine insights from academic financial research with quantitative and qualitative data. Quantitative research will be used to understand how returns on illiquid assets can best be generated and the risks such investments involve.

Mr Iglesias began working in illiquid asset markets in the early 1990s at Commonwealth Funds Management where he was involved in research and advising on investment portfolios for superannuation funds. This work involved some of the earlier investments by Australian superannuation funds into single asset infrastructure, opportunistic real estate and private equity funds throughout the Asian region.

In 1995 Mr Iglesias moved to Total Risk Management Pty Ltd (Towers Perrin) where he advised clients on global allocation between liquid and illiquid assets.

AUSTRALIAN PRIVATE EQUITY & VENTURE CAPITAL JOURNAL

Owned and Published by

PRIVATE EQUITY MEDIA

(a Hallmark Editions business)

Level 12, 99 Walker Street North Sydney NSW 2060

Ph 02 8923 8004 Fx 02 8923 8050

www.privateequitymedia.com.au

MANAGING EDITOR

Adrian Herbert

Phone 02 8923 8004

Email adrian.herbert@halledit.com.au

NATIONAL ADVERTISING MANAGER

Philip Thomson

Phone 02 9489 0033

Moblie 0419 757 211

Email pthomson@marketingforesight.com.au

MANAGING DIRECTOR

Peter Stirling

Australian Private Equity & Venture Capital Journal is an independent publication.

The Journal welcomes editorial contributions. All opinions are those of the authors.

All material copyright Australian Private Equity & Venture Capital Journal and individual authors.

ISSN number: 1038-4324

In 2000 he joined US-based Wilshire Associates Inc eventually becoming leader of the firm's Asia-Pacific operations and serving as a member of the global investment committee. The Asia-Pacific investment team committed more than \$3.5 billion to Asian private equity, distressed debt, real estate and infrastructure funds to become one of the region's leading fund of funds.

A former academic, Grant Fleming joined Wilshire Associates in 2001 and worked on building Asian private equity and distressed debt portfolios for a global investor base. He established Wilshire's Japan-based north Asia research team in 2006 and worked there until earlier this year.

Bill Humphreys headed alternative asset research for Russell Investment Group from 2000 to 2006 advising on global private equity, distressed asset and natural resources opportunities. He joined Wilshire in 2006 where he was a senior researcher, working on private equity and distressed debt opportunities in Asia, until earlier this year.

Chairman of Continuity Capital and of the firm's investment committee is Tim Poole, formerly managing director of Hastings Funds Management Ltd. Mr Poole is also a member of the investment committee of AustralianSuper and a member of the LEK Consulting advisory board.

Investment Activity

Listed company attracts billion dollar offers

Private hospitals operator Healthscope (ASX: HSP) is considering two separate private equity syndicate acquisition proposals, each well in excess of a billion dollars.

A third proposal, an indicative trade offer came from Texas-based Tenet Healthcare Corporation (NYSE: THC) but

Tenet announced on June 7 that it had withdrawn from preliminary discussions.

Healthscope has confirmed that the first preliminary offer was from a private equity consortium but has not named the members of the consortium.

The consortium initially offered \$5.50 per share and later lifted this to \$5.75 per share. This represented \$1.82 billion based on 317,010,025 million issued shares as of June 2.

The consortium was initially reported to include TPG Capital and Carlyle Group. The world's largest private equity firm Blackstone Group was reported to have later joined the consortium. None of these firms has confirmed involvement.

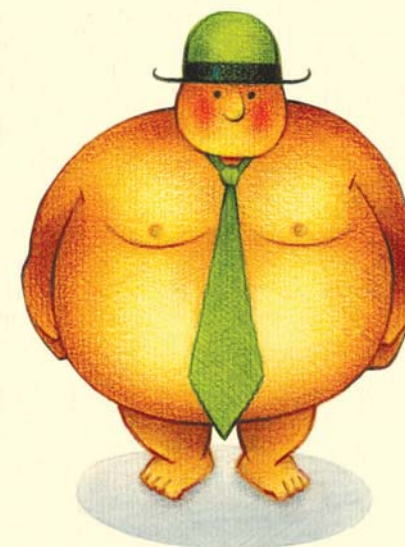
On May 24, Healthscope reported that it had concluded that, based on the revised \$5.75 proposal and subject to negotiation of an appropriate confidentiality agreement, members of the consortium would be granted the opportunity to conduct due diligence.

Healthscope then reported on May 31 that it had received two further indicative and non binding acquisition proposals both at \$5.80 per share (\$1.83 billion). The company gave no details of the potential acquirers.

One of these offers was reported to be from a partnership of Kohlberg Kravis Roberts (KKR) and CVC Asia-Pacific. Neither private equity firm has confirmed involvement.

Tenet confirmed it had made the other offer. The involvement of Tenet, a highly geared business, raised speculation that the company might have been backed by others, possibly including one or more private equity firms.

Healthscope then stated that it had formed the view that each of the later proposals were equal to or superior to the first consortium's proposal and its board had therefore concluded that these parties, subject to negotiation of



Are you exposed?

When your business and directors are appropriately covered, from fund formation through to your portfolio companies, you won't be left exposed.

Call Risk Partners, the specialist Venture Capital and Private Equity insurance brokers, and find out why so many private equity managers are seeking our advice.

Contact Risk Partners now on 03 9929 9800.

www.riskpartners.com.au



appropriate confidentiality agreements, would also be granted due diligence.

The statement added: "In order to ensure that any process operates as quickly and effectively as possible, the board does not intend to make any further announcements unless and until a recommended offer is secured, or unless there is a development which it judges should be disclosed immediately. This process will take several weeks."

The company said it continued to recommend shareholders to take no action.

News

COMMENT: Billion dollar bids pose challenges

Adrian Herbert

In the aftermath of the global financial crisis last year, who would have predicted so swift a return of billion dollar private equity bids in Australia?

Vastly differing rates of recovery across world economies this year quickly appear to be solely responsible for that.

Large fundraisings ensured major private equity firms had plenty of "dry powder" as the global private equity boom headed toward a peak in 2007 but good value opportunities were then becoming increasingly hard to find so much of that capital remained uninvested.

The global financial crisis (GFC) in 2008 then slashed valuations but also turned off the credit tap and investment banking activity remained effectively on hold, even as equity markets recovered after the crisis. As a consequence, it was all but impossible to achieve adequate leverage for large private equity deals.

It took until earlier this year before a few banks were willing to back large deals again and then generally only in syndicates.

By then, the economic landscape had changed dramatically. Australia was one of very few economies that looked healthy and appeared to have good prospects for the immediate future. In addition, many quite large Australian listed companies had valuations well within the target range of major private equity firms. Then May sent local listed values down further via a global correction triggered by sovereign debt problems in Europe.

So the current \$1.82 billion tussle for Healthscope (ASX: HSP) perhaps illustrates that Australia is one of few markets where good deals are currently possible rather than a return to boom times for global private equity.

Similar public to private bids may follow but only for the same reason so the number is unlikely to be large.

Also, the window of opportunity for such deals will inevitably be limited. Even among major private equity firms only a minority are currently likely to be looking for deals. Most are still focused on their current portfolios, which in many cases include assets acquired near the top of the market which are currently valued well below acquisition values.

By the time this changes, Australia's appeal is likely to be diminished by developments in other markets, for example sustained signs of recovery in the US economy.

The Healthscope bids came to light slightly less than three years after Brookfield Asset Management took over Multiplex Group in mid 2007. That \$7.3 billion deal was a record for private equity in Australia and marked the peak of the private equity boom. The boom ended in September 2007 with Carlyle Group and National Hire Group taking over Coates Hire (ASX: COA) in a \$2.2 billion deal. By then, concerns over the knock-on effects of the sub-prime mortgage melt-down in the US were growing.

Billion dollar bids were a short lived phenomenon then, all made in less than two years. There were actually only a

handful of such bids and not all were completed (bids for Coles and Qantas [ASX: QAN] were notable non-completions, the private equity consortia bidding for Coles all dropping out before trade buyer Wesfarmers (ASX: WES) was accepted and the Qantas bid failing on a technicality, which in the light of later events was very fortuitous).

Those bids were essentially the result of capital liquidity flowing to low points around the globe, of which we were the last. By late 2006, good value was becoming hard to find for large private equity deals in the US and in developed European economies. Consequently Australia came into focus.

We are now in focus again for somewhat different reasons.

Challenging economic conditions in the US and Europe mean there are plenty of good value opportunities in those markets but short to medium term prospects for improved corporate performance are poor. And that, of course, is necessary to satisfy the three to five year investment horizons of private equity managers.

Clearly, the private equity firms bidding for Healthscope have been primarily attracted to Australia by the resilience of our economy and its prospects for the next decade.

The relatively small scale of the Australian economy is, however, a negative which will reassert itself once prospects look better in the US and Europe.

Consequently, billion dollar private equity bids can be expected to be a short term phenomena once again, assuming that a Healthscope deal is actually done, which is by no means certain.

For the industry as a whole, billion dollar bids have proven to be a double-edged sword. Large deals, particularly public to private deals, often spark criticism of the industry; fears of businesses being broken up usually being the major driver.

IN DIFFICULT TIMES, EXPERIENCE MATTERS. TALK TO CORRS TODAY.

In a difficult economic environment, the companies that focus on the long-term picture always emerge in the best shape. At Corrs, our highly experienced Private Equity team is committed to delivering commercially focused advice that protects your interests while enabling you to capitalise on the market opportunities at hand. We've assisted a wide range of clients - from global funds with billions under management to much smaller locals. No matter what size the deal, we'll work closely with you to facilitate transactions that add real value to your business.

For more information please contact Richard Lewis, Partner, Head of Private Equity
Tel: +61 2 9210 6540, Email: richard.lewis@corrs.com.au

WWW.CORRS.COM.AU

MAKING BUSINESS
SENSE

CORRS
CHAMBERS
WESTGARTH
lawyers

But big deals also have trickle-down benefits for the industry. Firms involved in such bids, successful or not, often recognise further opportunities in our market and are likely to establish permanent presences here. This makes it far more likely that they will make future investments in this part of the world.

In the meantime, the challenge for the industry will once again be to get across the message that private equity is creative rather than destructive in that it develops more competitive businesses.

News

ATO delays private equity rulings

The Australian Taxation Office (ATO) has delayed two final determinations concerning private equity which were scheduled to be issued on May 26.

An ATO spokesperson said: "The final determinations have been deferred until the government's current review of the policy in this general area has been completed."

The spokesperson said this would be an informal rather than formal review.

The determinations, TD 2009 D17 and D18, deal with the tax treatment of profits of overseas investors from Australian private equity investments and follow the ATO's attempt last year to prevent private equity profits from the Myer Holdings (ASX: MYR) float being sent overseas.

Draft determinations issued late last year heightened industry concerns that the ATO intended to take a simplistic view of whether profits of private equity should be regarded as "in the ordinary course of business" and therefore on revenue rather than capital account. The draft determinations suggested that the ATO was likely to consider the practice of investment capital being collected in tax haven jurisdictions before being invested locally as

being a means to avoid paying tax therefore making it difficult for overseas investors to pay tax only after capital is returned to their home jurisdictions.

In March, assistant treasurer Senator Nick Sherry (APE&VCJ Apr 10), told the industry he was aware of the importance of maintaining tax flow through to other jurisdictions to attract and maintain overseas private equity investment in Australia.

However, he and minister for financial services Chris Bowen were considering the Australian Financial Centre Forum's report on Australia as a financial centre (the Johnson report) and the Henry report on the taxation system and would then take advice from the ATO before deciding whether any policy action would be necessary on private equity investments from overseas. Both reports have now been released.

In his March remarks, Senator Sherry stressed that he did not have the legal capacity to intervene in the ATO's determination process and instruct it what to do.

Overseas investors and the AVCAL have repeatedly expressed concern over continuing uncertainty on the issue.

Investment Activity

Carlyle offers \$350 million for aviation business

Carlyle Group is reported to have made an offer to buy Contract Aviation Industries that values the business at up to \$350 million.

Contract Aviation had been progressing toward an IPO and ASX float but put that plan on hold after Carlyle Group initiated acquisition talks.

The proposed Contract Aviation IPO would involve the merger of two charter and air services companies, fixed

wing aircraft operator Alliance Airlines and Airwork Helicopters.

Hugh Jones, the managing director of New Zealand-founded Airwork, is a major stakeholder in both companies. Queensland-based Alliance Airlines provides fly in-fly out charter services for resources companies.

Carlyle claims to be the global leader in private equity investment in aerospace industries.

Investment Activity

Archer bids for crane hire company

Archer Capital has made a \$240 million offer for crane hire and heavy lifting company Boom Logistics (ASX: BOL).

On June 3, Boom Logistics chief executive Brendan Mitchell responded to a substantial shareholder notice lodged by Archer and "press speculation that Archer Capital and McAleese Group Pty Ltd intended to make an offer for Boom at 52 cents per share".

He said Boom had not received any proposal from Archer or McAleese since Archer acquired a relevant interest in McAleese shares.

"Boom has received a highly conditional, confidential and incomplete proposal from Archer to acquire Boom through a scheme of arrangement, at an indicative price of 52 cents per share. The boom board has not formed a view with respect to the proposal," he continued.

"In line with the recent market announcements, management are in the process of quantifying the impacts of the improved operating environment and the contract wins on the expected financial performance of the business. Once the outcomes of this work are finalised the board will be in a position to assess any proposal."

The Boom board advised shareholder to take no action at this stage.

On June 2, Boom announced two new three-year contracts worth a total of \$41 million, with mining operations of BHP Billiton and Anglo American Metallurgical Coal.

In its June 3 initial substantial shareholder notice, Archer stated it held a 10.488 per cent stake in Boom.

In mid 2009, Boom indicated it was open to investment or merger offers (APE&VCJ, Aug 09). This followed a merger proposal from its largest shareholder Harbrew Group. Through associated entities, including McAleese Investments Pty Ltd, Harbrew then held 12.2 per cent of Boom.

McKay based McAleese Group of companies is one of the largest privately owned businesses in Queensland and includes McAleese Transport and Walter Wright Australia as well as Melbourne companies National Cranes and Australian Cranes & Machinery.

Boom Logistics experienced a severe business downturn in the second half of the 2008-09 financial year.

In mid May this year, Boom shares slipped below 25 cents. They recovered to around 30 cents following announcement of the new contracts and then jumped to around 40 cents after announcement of the Archer offer.

Investment Activity

Japanese led consortium buys water company

A consortium led by Mitsubishi Corporation of Japan is to buy water company United Utilities Australia Pty Limited for about \$225 million.

The acquisition sum will comprise \$176 million cash and \$49 million in debt to be assumed by the consortium.

The vendor is UK listed water company United Utilities plc.

Other members of the consortium are The Innovation Network Corporation of Japan, a public-private investment

organisation set up last year to promote innovation in Japanese businesses, Japanese engineering company JGC Corporation and Manila Water Company of The Philippines, an investee company of Mitsubishi.

The transaction is subject to a number of consents and regulatory approvals which are expected to delay its close.

Since it was formed in 1991, United Utilities Australia has established a strong position in the Australian water industry. Activities include project finance, design and construction for new projects, maintenance, asset management, utility services, laboratory testing, and customer services including billing.

The investment consortium already has substantial international investments in the water and wastewater treatment sectors.

Innovation Network Corporation of Japan was initially capitalised at 90.5 billion yen of which 82 billion yen was provided by the Japanese government. The government has guaranteed up to a total of 800 billion yen for the Corporation's investments over 15 years.

News

Mezzanine debt specialist targets Australia

Asia currently offers the greatest potential for private equity mezzanine finance deals and Australia and New Zealand are the most attractive markets within that region, according to Babson Capital Management managing director Mike Hermsen.

Following Babson's assumption in March of the management of a \$200 million mezzanine debt portfolio formerly managed by an affiliate of Babcock & Brown and expansion of its local team (APE&VCJ, April) the US-based firm has become probably the most important player in the

private equity mezzanine debt field in Australia and New Zealand.

In an interview with APE&VCJ, Mr Hermsen, who oversees Babson's Asian mezzanine debt operations from the firm's US East Coast headquarters, said he expected Australia and New Zealand to provide 80-85 per cent of Asian dealflow for the immediate future. However, he added that the market was currently quite slow so he was hoping indications of increased leveraged buyout activity in the second half of the year would prove correct. There was, he said, clearly pent up demand since the market hit its most recent low point in 2008 in the wake of the global financial crisis.

Babson has established relationships with about 15 deal sponsors in Australia including Pacific Equity Partners, CHAMP Private Equity and Gresham Private Equity.

Mr Hermsen said the firm concentrated on mid-market \$75 million to \$500 million enterprise value deals and was generally sounded out by deal sponsors early in the planning of deals. The most common type of deals were leveraged buyouts but expansion capital deals, particularly in situations where a company was seeking to raise capital for an acquisition or to enter a new market, were also considered. About 40 per cent of potential deals involved family-owned companies, often involved in generational change while another 40 per cent were corporations, public or private. Probably only about 10 per cent of potential deals involved public to private transitions as most of these were above the target value range.

To maintain adequate risk levels, Babson looked for senior subordinated debt deals in which the total debt package was less than five times the annual operating cash flow of a business. The coupon rate was then negotiable and was currently very flexible but reflected the higher level of risk compared to first tier debt.

Mr Hermsen said that within its sweet spot of four-point-five to five times annual operating cash flow, Babson was currently being offered substantial proportions of the debt in individual deals as banks were generally prepared only to go up to the “high twos” in ratios of debt to annual operating cash flows.

This reflected the highly cyclical nature of the market, he said. At the last peak, in 2007, companies had been able to borrow six to seven times operating cash flow and banks were prepared to provide most if not all of that. Consequently, mezzanine debt providers largely withdrew from the market.

That ratio range, however, dropped by almost half – to three-point-five to four times – worldwide in 2008 as access to debt dried up.

Mr Hermsen said debt was now more accessible again and mezzanine lenders were able to loan on adequate estimated risk/ return ratios. If banks again lowered required ratios below four times annual operating cash flows, however, lenders such as Babson would withdraw from the market.

“Hopefully, we will not get to that again,” Mr Hermsen said, “but I’ve experienced peaks and troughs three times in my career so I can’t be sure.”

In addition to providing mezzanine debt, Babson often leverages its returns by investing in a “small strip” of equity. Mr Hermsen said.

The firm is also an indirect investor in Australian and New Zealand private equity via investments in local managers.

The other main Asian markets in which Babson offers private equity mezzanine debt are Hong Kong – where it looks for involvement with companies exposed to Greater China – Japan, Singapore, South Korea and Taiwan.

Mr Hermsen said he saw South Korea as the next most attractive market after Australia and New Zealand. Japan also offered potential for strong deal flow but was problematic because of persistently low absolute interest rates and cultural factors which made it difficult for overseas based institutions to break in to the market.

Investment Activity

Riverside invests in healthcare sector

The Riverside Company has completed its second Australian acquisition, Australian Medico Legal Services Pty Ltd.

No value for the acquisition has been announced but US-based Riverside, which established a Melbourne office in April (APE&VCJ, May 2010) generally focuses on small and medium sized enterprises with annual EBITDA of up to US\$30 million.

Melbourne-based Australian Medico Legal Services provides independent medical assessments and related medical advisory services for insurance organisations, corporations and government legal entities. The company has few competitors and claims to be the only business providing these services nationally in Australia.

This investment is the first healthcare acquisition for the Riverside Asia Fund but Riverside has made numerous investments in the sector in the US and Europe over its 22-year history.

The deal was sourced by vice president of origination Ivica Turza of Riverside’s Munich office. Riverside plans to use its established healthcare industry experience and relationships to improve infrastructure and operations to enable the company to add products and services and increase market share.

A new chief executive, Robyn Walsh, has been appointed. Ms Walsh has worked in leadership roles in healthcare businesses in the US including nine years with Aetna.

Founder Dr Nathan Orbach will continue to play an active role in an advisory capacity.

The acquisition was led by Riverside’s Melbourne-based partner Simon Feiglin.

Mr Feiglin said: “The provision of independent medical examinations and affiliated services is quite fragmented within Australia but Australian Medico Legal Services has been able to carve out a niche as a market leader.”

Riverside managing partner Stuart Baxter said: “Australian Medico Legal Services has differentiated itself by supplying its clients with consistent high quality independent medical assessments on a national basis. We hope to further focus on our core customers’ needs to better understand how we can continue to add value as they seek to manage health, safety and income protection for workers in Australia.

The Commonwealth Bank has provided debt financing for the deal, Jones Day legal advice and KPMG financial advice.

New Funds & Fundraising

Global pharmaceutical backs \$250m biotech fund

The Queensland government has secured the backing of global pharmaceutical company Eli Lilly and other US-based strategic investors for a venture capital fund of up to US\$250 million to invest in the biotechnology industry in Queensland and Australia.

The Queensland government will invest \$25 million while Eli Lilly will contribute 20 per cent of the total funding.

The government funding is to be sourced from Queensland’s Future Growth Fund.

Announcing the agreement on May 20, Premier Anna Bligh described it as “a turning point in support for home-grown ideas and innovation”. She said the fund would “provide the financial muscle to bring Queensland ideas and innovation to the commercial stage right at home in our own backyard”.

Ms Bligh said her government had decided to provide the strategic investment because the fund was central to its vision of developing a strong Queensland economy powered by bright ideas.

She said the fund would provide a huge opportunity to drive investment in ideas that would create businesses, and employment, in regional economies such as in the tropical north.

“We have a plan to make Queensland’s biotechnology industry worth \$20 billion and employ 16,000 people by 2025 and today’s announcement is a giant step forward,” she said.

“This fund, which will have its Asia-Pacific headquarters in Brisbane, makes Queensland a key biotechnology hub in the Asia Pacific region. It will be run out of Brisbane but will also invest throughout Queensland, Australia and South-East Asia.”

Ms Bligh said meetings she had with senior Eli Lilly executives during her recent trade mission to the BIO 2010 conference in Chicago had helped secure the deal.

Director of corporate affairs and health economics Eli Lilly Australia, Peter Vermeer said the alliance recognised the many high quality investment opportunities arising from Queensland universities and research institutes.

“We see enormous potential in Queensland’s biotechnology sector,” he said.

“This alliance will bring together leading industry players in Queensland, the US and Asia so that emerging Queensland biotechnology companies have access to the funds, advice

and partnership opportunities they need to advance their technology to commercialisation. We look forward to working closely with the local industry to maximise the full potential of the Queensland biotech sector.”

Eli Lilly and Company is a global pharmaceutical company based in Indiana, US. The company has annual revenues of more than US\$20 billion and employs about 39,000 people. The company’s lines of research include cancer, depression, diabetes, cardiovascular conditions and Alzheimer’s disease.

NSW-based Eli Lilly Australia was established in 1960 and currently employs about 500 people, 100 of whom are involved in R&D. The company invests more than \$35 million in medical projects in Australia each year.

Eli Lilly has existing Queensland links. Through its corporate venturing arm, Lilly Ventures, the company has a strategic investment in St Lucia-based biotech company Protagonist. Eli Lilly Australia also runs a number of drug development and clinical trials programs in the state.

Protagonist is developing novel therapeutics for inflammatory and metabolic conditions. Lilly Ventures led a \$11.9 million Series A financing round in the company in September 2006. Other investors in the round were Starfish Ventures and the Queensland Government backed Queensland BioCapital Funds which is managed by Queensland Investment Corporation.

Start-up Australia is also an investor in Protagonist.

News

AVCAL claims success on MIT legislation

AVCAL is claiming success for its representations to the federal government and Treasury on the treatment of private equity under the new managed investment trusts capital gains tax legislation (MIT CGT).

AVCAL chief executive Katherine Woodthorpe said consultation with assistant treasurer Nick Sherry, his advisers and the Treasury had resulted in AVCAL achieving most of its desired outcomes in the legislation currently before parliament.

“The government has been extremely helpful in its consultation process,” she said.

Dr Woodthorpe said tax partner at Ernst & Young, Ian Scott, assisted by Freehills partner Damien Hazard, had played a critical role in achieving a positive result for the industry.

Mr Scott identified key points of the legislation as it applies to private equity as:

- Private equity funds which are eligible to be MITs will be able to benefit from the irrevocable capital election and reduced tax withholding rules.
- The legislation is retroactive as well as prospective. As such it will apply to the years ended 30 June 2009 and 2010 where the MIT definition is satisfied in those years. It can also apply to prevent the Commissioner of Taxation amending earlier year assessments. It is important to understand that the capital election is also irrevocable for future years.
- The capital election is available to all MITs as defined for the purposes of the tax law. Very broadly, it includes Australian widely held funds and funds taken to be widely held. AVCAL was instrumental in allowing unregistered funds, the principal mechanism for private equity Australian funds, to be eligible for consideration as unregistered MITs and the capital election. The broad definition of a widely held unregistered fund is one with at least 30 members at the time of making its first distribution for the year. Special counting rules apply for the treatment of certain investors, including life insurance companies, superannuation funds, other MITs, and nominees.

It should be noted that the legislation is not yet finalised and some amendments are still likely, however the government is very aware of the need to have the legislation through parliament by the end of June, Mr Scott said.

The legislation allows three months from the date at which it becomes law, however, for tax distribution computation and notification purposes, private equity fund managers will have to make decisions very quickly to ensure they are prepared for the end of financial year distribution process.

Mr Scott said every private equity fund will be unique in regard to the legislation and recommended all managers to consult with their tax advisors.

He said he expected managers would need to communicate with their investors to determine their status, including whether they are themselves MITs (and if so, in which income years) and, if they are a trust, the composition (although not necessarily the identity) of the investors.

News

Blackstone 'here to invest as well as raise capital'

Blackstone Group has said its new Australian office will be involved in investing as well as fundraising.

Speaking in Melbourne on May 19, head of the Sydney office, managing director Philip Levinson, said: "We are establishing a presence here to integrate the firm into the local business community, seeking opportunities to invest and raise capital.

Mr Levinson, who is responsible institutional investor relations throughout the Asia Pacific, was in Melbourne with the company's global strategist Byron Wien.

During a conference call, Mr Wien was asked for his views on the Australian government's plans for a resource super profits tax.

He said he did not expect the tax to result in a mass exodus of mining sector investors from Australia but added: "The government has to be very careful about this because studies show that when you raise taxes too much you don't really get any more revenue."

In February, Blackstone founder and chief executive Stephen Schwarzman used the World Economic Forum in Davos, Switzerland, to warn that the challenge of the Australian Taxation Office to TPG shifting private equity profits from the Myer float out of Australia would "dramatically chill" any private investment in Australia until the matter was resolved.

Mr Wien joined Blackstone in August 2009 as vice-chairman of advisory services. He had previously been chief investment strategist for hedge fund manager Perquot Capital Management and before that was chief and later senior investment strategist for investment bank Morgan Stanley for more than 20 years.

As previously reported (APE&VCJ, May 10) Blackstone has established an office in Macquarie Street, Sydney.

Investment Activity

UK backing for oil and gas search team

Barclays Natural Resources Investments (BNRI) has partnered with an oil and gas management team to create an oil resources development company which will focus on undeveloped discoveries and developed assets in Australia and surrounding areas, according to Dow Jones.

The team is headed by Paul Nimmo, until mid last year an executive director of Horizon Oil (ASX: HZN).

BNRI is a division of Barclays Capital and has an Australian office in Sydney. Barclays Capital is the investment banking division of the UK-based bank.

BNRI typically commits between US\$50 million and US\$100 million to each management team it backs.

Late last year, BNRI established a similar development company, Nio Petroleum, to focus on South-East Asia.

Recently, BNRI announced it was backing a predominantly Peru-focused mining management team to establish Southern Peaks Mining Ltd. This business will focus on acquiring operating and close to operating small to medium-sized base and precious metal assets.

Robert J. Champion de Crespigny joined the advisory panel of BNRI earlier this year. Mr Champion de Crespigny founded Normandy Mining which was Australia's largest gold company when it was merged into Newmont Mining in 2002.

Investment Activity

PEP 'competing for UK landfill gas business'

Pacific Equity Partners (PEP) is reported to be competing with local private equity firm Terra Firma Capital Partners to acquire the landfill gas operations of UK waste management business Biffa.

PEP controls Energy Developments Limited (ASX: ENE), an Australian company that has landfill gas interests in the UK.

Terra Firma owns the UK's biggest waste to energy business Infinis.

Both private equity firms have prepared bids, according to Reuters.

Biffa is owned by UK firm Montagu Private Equity and New York-based Global Infrastructure Partners.

According to Reuters, the Biffa unit is likely to be valued at around £210 million, six times its annual EBITDA of £35 million.

Following a bid late last year, PEP gained control of Energy Developments but was unable to proceed to compulsory acquisition (APE&VCJ, Mar 10).

Investment Activity

Energy investor moves on engineering business

Private equity investor in the energy and natural resources sector First Reserve has taken a majority stake in Perth-based resources sector engineering company Calibre Global.

Brisbane-based resources sector services investment and consulting firm Connect Resource Services has invested alongside First Reserve. First Reserve is an investor in Connect Resource Services.

No value for the transaction has been announced but Greenwich, Connecticut, based First Reserve claims to be the world's leading private equity investor in the energy and natural resources sector. In September, First Reserve committed to invest up to US\$500 million in KrisEnergy Holdings Ltd, a newly established oil and gas company which is focused on building a portfolio of exploration, development and production assets in Asia.

Executive chairman and co-founder of Calibre, Ray Munro retains a substantial shareholding in the business and remains executive chairman. The current senior management team under managing director Rod Baxter will remain.

Co-founder Dave Walker has sold down all of his interest in the company and has resigned from the board but will remain a consultant to the business.

Mr Munro and Mr Baxter will be joined on the board by two nominees from First Reserve and three from CRS.

Performance

CHAMP Ventures exits in \$40 million float

CHAMP Ventures has exited mining services company Mastermyne as a result of a corporate restructure, IPO and listing on the ASX on May 7.

CHAMP Ventures held 32.7 per cent of the company at listing.

The remaining 67.3 per cent was held mainly by Andrew Watts and Darren Hamblin who founded the company in 1996. The majority of these shares, were to be retained in voluntary escrow at least until the company reported after the end of the current financial year.

Under the IPO, 54.9 per cent of the company was offered to investors as 40 million shares at \$1 a share to raise \$40 million.

Mastermyne Group Limited (ASX: MYE) listed at \$1 a share giving the company a market capitalisation of \$72.9 million. At the close of the first day's trading – during a market downturn – the shares were trading at \$1.10.

CHAMP Ventures bought into Mastermyne in August 2005 investing \$7.1 million in an \$8.3 million recapitalisation and management buy-in.

The Mackay-based underground coal mining contractor operates in the Bowen Basin area in Queensland and in NSW, in the Illawarra and Hunter mining regions.

Performance

CVC Asia Pacific to exit Stella

CVC Asia Pacific and investment bank UBS are planning to exit their investments in Stella Travel Services Holdings Pty Ltd through a planned merger with listed Jetset Travelworld Limited (ASX: JET).

The deal, which Jetset has described as "a merger of equals", will result in Stella shareholders being issued with 50 per cent of the expanded capital of the merged entity.

CVC Asia Pacific will hold approximately 26.9 per cent of the stock and UBS approximately 17.9 per cent. Qantas (ASX: QAN), Jetset's largest shareholder, will hold 29 per cent and interests associated with Consolidated Travel Group founder Spiros Alysandratos 12.6 per cent. The

current Stella management team will hold about 5.2 per cent.

Chief executive of Stella, Peter Lacaze will become chief executive of the merged entity. Mr Lacaze is a previous chief executive of Qantas Holidays and Jetset. The current chief executive, Peter Collins, who was appointed following the merger of Jetset with Qantas Holidays and Qantas Business Travel, will return to the Qantas Group.

Based on the last closing price prior to announcement of the merger on May 12, the post merger Jetset will have a market capitalisation of \$439.2 million.

Stella chairman Andrew Cummins, the chairman of CVC Asia Pacific's advisory board, said: "Both Jetset and Stella have emerged strongly through recent years and this transaction creates an opportunity to build a business of genuine scale... Consumers will enjoy enhanced innovative and competitive products and services currently offered by both companies."

Jetset shareholders are to vote on the merger proposal in August. Jetset directors have said they intend to vote in favour and Qantas has indicated it will also vote support the move.

The proposal is subject to approval from the ACCC, ASIC and FIRB.

Jetset is being advised by Deutsche Bank, Grant Samuel, Minter Ellison and Freehills. Stella is being advised by Fort Street Advisers, UBS and Gilbert & Tobin.

CVC Asia Pacific bought a 65 per cent stake in the Stella Group from the then ASX-listed Gold Coast based financial group MFS (later renamed Octaviar) for more than \$400 million in February 2008. The deal involved a larger sum of finance.

Late that year, Stella's holding company Global Voyager Holdings, belatedly reported a \$42.7 million annual loss. CVC Asia Pacific lodged a \$249 million warranty claim over

the transaction. This resulted in a NSW Supreme Court action which was settled with CVC Asia Pacific acquiring the 35 per cent of Stella Group it did not already own.

Since then, debts of \$575 million have been converted into equity, resulting in the UBS stake, and CVC Asia Pacific has injected a further \$47.5 million cash into the business.

During its ownership of Stella Group, CVC Asia Pacific offloaded a number of assets including three Queensland tourism properties, Lumiere at Labrador and the Treetops Resort and Reef Club in Port Douglas, and a significant stake in Protea Hotels of South Africa.

The private equity firm also spun out the Mantra resorts business from Stella and retains this business.

Investee News

Payment card operations for sale

Private equity controlled Retail Decisions Australia Pty Ltd is seeking to divest most of its operations.

The payment cards and fraud prevention business, formerly known as Motorcharge, is owned by UK business Retail Decisions plc.

London-based private equity firm Palamon Capital Partners bought Retail Decisions plc in 2006 in a public to private deal for about £200 million.

The fraud screening operations of Retail Decisions Australia Pty Ltd are to be retained.

Investment Activity

Quadrant buys out joint venture partner

Quadrant Private Equity has moved to 98 per cent ownership of Summerset Retirement Villages.

Quadrant previously owned 49 per cent of the North Island, New Zealand, business and has acquired a further 49 per

cent from its joint venture partner AMP Capital Investors. The remaining 2 per cent is held by Summerset management. The transaction closed in April.

Quadrant has also recently contributed additional equity capital to fund Summerset's strategy of developing new retirement villages and care facilities across New Zealand.

Since Quadrant's initial investment in Summerset, the business has opened new retirement villages at Warkworth and Hastings, a new aged care facility in Manukau and has acquired land in Hamilton and Dunedin for future village developments.

News

NICTA seeking new chief executive

National ICT Australia (NICTA) is seeking a new chief executive.

The Australian government funded centre of excellence has laboratories in Sydney, Melbourne, Canberra and Brisbane and is Australia's national centre of excellence for innovation in information and communications technologies.

NICTA is seeking candidates with experience in leading a research organisation which has an international profile, strong connections to the ICT sector and an understanding of NICTA's interaction with government, the university sector and other research organisations. Candidates should also be familiar with global commercialisation of new technologies, entrepreneurship and accessing early stage capital.

NICTA's current chief executive, Dr David Skellern, was appointed in 2005. A former radio telescope researcher and academic, he was one of the founders of wireless LAN chip development company Radiata in 1997. The company was acquired by Cisco Systems in 2000.

Dr Skellern is to leave when his contract ends in March 2011.

A notable NICTA commercialisation success under Dr Skellern has been the spinout of Audinate Pty Ltd. The digital media and networking company has attracted venture capital investment of at least \$8 million from Starfish Ventures, Innovation Capital and others.

For more information on NICTA visit: www.nicta.com.au

Investee News

IVF Holdings acquires Queensland business

Quadrant Private Equity investee IVF Holdings has acquired infertility treatment business Queensland Fertility Group.

The transaction closed in October.

Medical staff and management shareholders have reinvested in the enlarged IVF Holdings Group which now claims 33 per cent national market share and is the largest IVF group in Australia.

Quadrant says integration of Queensland Fertility Group is achieving improved performance for the business as a whole. IVF Holdings plans to continue to expand organically as well as through possible further acquisitions.

In April 2008, Quadrant invested in NSW-based IVF Australia. In November 2008, IVF Australia acquired Melbourne IVF and the enlarged business was subsequently renamed IVF Holdings.

The former private equity manager ABN AMRO Capital Advisory (Australia) invested in a similar business, Monash IVF, in Victoria, in December 2007. Allegro Private Equity, which took over management of the ABN AMRO portfolio in September 2008, exited the business in September 2009.

Investee News

Drug developer plans ASX float

Queensland Investment Corporation (through the Queensland BioCapital Fund) and Monash University investee Relevare Pharmaceuticals Ltd is planning an IPO and listing on the ASX to raise at least \$20 million. This would provide the company with a market capitalisation above \$45.5 million.

The offer is to be fully underwritten by stockbrokers Lodge Partners.

Relevare, which specialises in developing drugs for severe pain, recently changed its name from CNSBio Inc.

Relevare's lead drug candidate CNSB015 (flupirtine) has been developed from research by Professor Colin Goodchild, of the centre for pain medicine at Monash University. The company plans to hold a Phase IIb/III clinical trial in Australia and Europe this year and follow this up with a 12-month extension study. After that it plans to file an investigational new drug (IND) application with the US Food & Drug Administration.

The company was established in 2003 and has offices in Melbourne and San Francisco.

Relevare's chief executive Mark Blumling is a former director of San Francisco-based life sciences venture capital firm Burrill & Company.

The company's chairman is Pat Grier former managing director of Ramsay Health Care Limited (ASX: RHC).

Investment Activity

Ironbridge backs UK software acquisition

Ironbridge Capital is to invest a further \$8 million in Bravura Solutions Limited (ASX: BVA) and underwrite a \$23 million rights issue by the company.

Interests associated with Ironbridge already control around a 45 per cent stake in the wealth management software business following Ironbridge underwriting a rights issue last year.

The new investment will be made through exercising options for 53.3 million new shares at 15 cents per share.

New Zealand-based Fisher Funds Management Limited, which also has a significant holding in Bravura through a number of its equities funds, is a sub-underwriter to 20.4 per cent of any shortfall of shares under the rights issue.

The one for 1.82 rights issue is to be used to help fund a £20 million acquisition of Mutual Fund Technologies Limited (MFT), a UK-based company which provides specialised software used by some of the UK's largest financial services companies.

The acquisition is expected to enable Bravura to improve its position in the transfer agency space in the European market.

Bravura says the acquisition will be on an attractive multiple of 3.4 times MFT's forecast EBITDA for the current financial year.

Chairman Brian Mitchell said: "The acquisition of MFT presents an excellent strategic opportunity for Bravura to further establish a leadership position in one of our key markets – transfer agency solutions in Europe. The resultant benefits to Bravura will include the acquisition of an additional blue chip client base, increased market share, improved predictability of earnings and a broader product base creating development and support efficiencies."

Mr Mitchell, a former Oracle senior vice President Asia Pacific, was elected chairman in February, soon after joining the board. This followed the company reporting a December half-year loss (APE&VCJ, Mar 10) and the departure of co-founder Iain Dunstan as joint group chief executive.

The MFT acquisition will be by way of a £19 million cash payment and two deferred cash payments of £500,000 each subject to the business reaching relevant revenue hurdles.

Bravura shares slipped from around 28 cents in October to around 8 cents in May before announcement of the rights issue and planned acquisition sent them briefly up to around 16 cents.

Investment Activity

Catalyst acquires refrigeration parts business

Catalyst Investment Managers has made a 100 per cent acquisition of refrigeration and air conditioning parts distribution business Actrol Parts.

The vendor was private industrial group GSA Industries (Aust.) Pty Ltd (GSA Group).

Actrol general manager Brendan Howard will continue to lead the business and offers of employment have been made to all current employees.

Blackburn, Victoria, based Actrol has annual turnover of over \$110 million and has 49 branches across all states and territories. The business has been operating in Australia for over 70 years.

Catalyst investment director Nick Speer said: "Actrol is a high quality business operating in an attractive market segment with long term valued supplier relationships. Catalyst is keen to build on the organisations' strong customer-led service culture and support the management team in further developing Actrol's market presence. The business has a broad range of growth opportunities."

Catalyst managing director Simon Dighton said Actrol was an exciting investment opportunity as the business had high quality management and a record of sustained profitable growth.

The undisclosed equity stake in the investment will be provided by the 2008-vintage \$438 million Catalyst Buyout Fund 2. Debt funding was provided by Commonwealth Bank and Westpac.

Mr Howard said GSA Group had been a strong owner and had supported Actrol to achieve substantial growth over the past five years. He said management were now looking forward to working with the Catalyst team as their new partners.

Catalyst generally makes investments in excess of \$20 million. The manager seeks market leading businesses with excellent management, robust cash flows and strong growth prospects. Catalyst has completed 35 MBOs in Australia and New Zealand over a wide range of industries including retail, services, building products and packaging.

News

Private equity executive in \$27 million home sale

Private equity executive Patrick Keenan and his wife Elizabeth have sold their Vaucluse, Sydney, home for about \$27 million.

The six-bedroom, five-bathroom, Carrara Road property has spectacular harbour views. The European villa style house was bought by the Keenan's for \$22.3 million in 2006 and was listed for sale at \$30 million.

Mr Keenan is a partner of London private equity firm Kelso Place Asset Management. Prior to that, he was with Dublin-based Hibernia Capital Partners.

Mr Keenan is also a non-executive director of California-based software company M86 Security. M86 Security, which has a research facility in New Zealand, claims to be a leader in web and email security technology.

News

Private equity firm takes legal action over debt

Hawkesbridge Private Equity is funding NSW Supreme Court examinations of two companies in liquidation.

Deep Blue Capital and Covenant Nominees, owe Hawkesbridge \$11 million for the purchase of shares in Advance Healthcare Group.

The examinations by liquidator Grahame Hill are seeking to determine whether the companies traded while insolvent and whether director of both, Michael Boyd, breached his duties as a director.

Mr Boyd is the founder of Sonic Healthcare (ASX: SHL).

Hawkesbridge Private Equity sold shares in Advance Healthcare Group to Deep Blue Capital in a transaction that was guaranteed by Covenant Nominees. The two companies collapsed in September 2008.

The court was told that Mr Boyd transferred ownership of an entity called Jordan to his wife Donna Boyd in December 2008 for no consideration. Jordan held shares in Advance Healthcare and Silex Systems (ASX: SLX).

The examinations were adjourned on May 18 to resume in July.

Hawkesbridge was the largest shareholder in, then ASX-listed, Advance Healthcare Group in March 2006 when it advanced the company a working capital facility of \$10 million through a convertible note deed.

News

Research prizes offered

AVCAL has introduced two prizes to encourage high quality research on issues of importance to the private equity and venture capital industry in Australia.

The prizes will also recognise efforts to increase knowledge and understanding of the industry. Submissions are invited from academia and the industry.

The prizes, each of \$2,500, are: AVCAL Private Equity Research Prize and AVCAL Venture Capital Research Prize.

The prizes will only be awarded subject to suitable submissions being received.

For further information, contact AVCAL research manager Dr Kar Mei Tang: karmeitang@avcal.com.au

News

Turnaround advisor establishes Sydney office

Turnaround specialist advisory firm Vantage Performance Group has expanded to Sydney.

The Brisbane-based firm has appointed corporate performance improvement consultant Jeremy de Constantin to establish the new practice.

Managing director of Vantage Performance, Michael Fingland, said the expansion would help service a client base which was growing quickly as increasing numbers of private businesses recognised they needed turnaround advice. These businesses were not necessarily those in decline; rapid growth without adequate attention to funding expansion costs was a common cause of problems as was inadequate succession planning.

Mr Fingland said Australia was still well behind the US in take-up of turnaround services but, as awareness increased, businesses were recognising that seeking advice early could greatly improve the outcome.

He said Vantage Performance was well equipped to assess situations and quickly institute corrective actions ranging from performance improvement programs through to complete corporate and financial restructuring.

“The key,” he said, “is to recognise that a company is underperforming rather than wait until it is close to the precipice. Underperformance is inevitably a slippery slope toward insolvency. We can quickly institute a turnaround by providing experienced operational people to work within the business to get it back on track.

“Unlike the accounting or legal firms who are usually the initial sources of advice to businesses, we have access to people with experience as general managers, or in other senior management roles, who can step in and get the situation under control.

“At the same time, we can organise refinancing or raise additional capital to fund the turnaround or growth strategy.”

Mr Fingland said Vantage Performance worked with “skin in the game”. The firm operated on a business model of retainers plus success fees. Success fees were based on clear performance measures such as improvements to EBIT, execution of a particular transaction or a capital raising.

This appealed to business owners and their advisers and also to potential equity investors, including private equity fund managers.

Mr de Constantin has operated a performance improvement consultancy specialising in healthcare for 17 years.

He said his decision to join forces with Vantage had partly been driven by an increase over the past 18 months of businesses presenting as distressed.

The combined practice offered:

- Turnaround assistance (for businesses in financial distress or facing succession or shareholder issues)
- Performance and profitability improvement (businesses underperforming but not in distressed situations)

- Capital raising and readiness (businesses seeking debt or equity capital)

Mr de Constantin’s performance improvement technology platform ScoreTrak[®], which has been implemented by private and public acute care hospitals in NSW and SA, will now be offered by Vantage Performance with the aim of tracking turnaround plans and improvement initiatives for Vantage clients.

News

Bill to tax carried interest progresses in US

The US House of Representatives has passed a bill under which private equity general partners will be taxed 75 per cent of carried interest as ordinary income at a rate of 35 per cent and the balance as capital gains at 15 per cent.

The bill now goes to the Senate.

People Moves

Bank expands ‘private equity alternative’ team

National Australia Bank’s private equity alternative (nabICS) team has recruited two new members.

Michael Hoffman has been appointed a director in the Melbourne office. Mr Hoffman was previously a director with Investec Bank’s growth and acquisition finance team where he specialised in providing hybrid equity and mezzanine financing to medium sized businesses.

The Sydney team has also been enlarged with two appointments. Mark Thomas has been recruited as an associate director. Mr Thomas previously worked in London with the Bank of Scotland’s leverage finance team.

Daniel Masters has also joined the Sydney team as an

investment manager. Mr Thomas previously worked with Westpac’s Direct Equity Investments Fund.

Founded in 2007, nabICS now has a team of 11 headed by Graham Reid.

nabICS supports the growth strategies of small to medium sized businesses through the provision of hybrid capital to assist with a range of requirements including expansion capital, replacement capital or buyout opportunities.

Investment capital provided through nabICS effectively serves as an alternative to private equity and is primarily offered to existing nab banking customers but is also available to new customers entering into nab banking relationships.

People Moves

Adelaide firm makes new appointment

Dion Silvy had joined Adelaide Equity Partners as a senior adviser.

Mr Silvy has been a senior adviser with the ASX in Adelaide for the past four years.

In his new position, Mr Silvy will focus on providing equity and debt advisory services including IPOs and other capital raisings as well as general corporate advice on mergers and acquisitions, investor relations and transaction management.

People Moves

New Mercer investment consulting head

Mercer has appointed Graeme Mather as head of investment consulting for Australia and New Zealand.

Mr Mather succeeds Simon Eagleton who is to relocate to Singapore as the firm’s Asia Pacific Region head of

investment consulting. Mr Mather will continue to be based in Sydney.

Prior to relocating to Australia in January, Mr Mather managed Mercer's London investment consulting office.

People Moves

Babson Capital appoints sales executive

Private equity mezzanine debt specialist Babson Capital Management has recruited a Melbourne-based sales and investor relations executive.

Sue-Ellen O'Keefe has joined the US-based firm, which recently expanded its investment team including four appointments in Sydney (APE&VCJ, Apr 10).

Ms O'Keefe is attached to the firm's global business development group and is responsible for servicing and maintaining existing client relationships in addition to business development in Australia and New Zealand. She reports to Sydney-based Babson managing director Duncan Robertson.

Ms O'Keefe was previously with Super Investment Management Pty Ltd, the wholly-owned fund management division of the Retail Employees Superannuation Trust. Ms O'Keefe has also worked for the Victorian Funds Management Corporation and UBS Funds Management.

Performance

Private equity 'outbid' on pallet business

Affinity Equity Partners has agreed to sell pallet company Loscam Ltd to China International Marine Containers (Group) Co (CIMC), the world's largest manufacturer of shipping containers, according to Reuters.

An Affinity spokesperson, however, said the sale process was ongoing but declined to give further details.

Banking sources said a number of private equity bids had been received by Affinity but the trade bid from CIMC had been accepted. The sources said private equity bids had been around nine times EBITDA of US\$64 million so close to US\$600 million.

Loscam makes and leases out wooden and plastic pallets and is a competitor of Brambles (ASX: BXB), the world's leading supplier of pallets.

Based in Australia, Loscam has depots throughout Asia.

Affinity acquired Loscam in August 2005 for about \$250 million. The vendor in that deal was the now defunct private equity firm DB Capital Partners.

People Moves

Alternative assets specialist added to stockbroker's board

Western Australia-based Patersons Securities Limited has appointed an alternative assets specialist to its board.

Richard Pyvis, executive chairman of Hong Kong-based CLSA Capital Partners, the alternative asset management arm of CLSA Asia-Pacific Markets, has been appointed a non-executive director.

CLSA Capital Partners has US\$2.5 billion in funds under management in private equity, property, mezzanine finance, transport and water and clean resources. CLSA is majority owned by French banking group Crédit Agricole.

West Australian-born Mr Pyvis has more than 25 years experience in Asian banking and investment including debt restructuring and private equity.

Paterson executive chairman Michael Manford said Mr Pyvis' appointment was part of the firm's ongoing development as a diversified financial services group "building value-adding services around our core stockbroking business".

Investee News

Clinical test close for brain anaesthesia monitor

BPH Corporate Limited (ASX: BPH) investee Cortical Dynamics Limited has completed an in-house end-to-end trial of the components of its Brain Anaesthesia Response (BAR) monitor system.

The BAR monitor measures brain activity to assist medical professionals assess the effectiveness of anaesthesia administered to patients undergoing surgery or being held in a coma.

The Cortical Dynamics team, led by neuroscientist Professor David Liley of the Brain Sciences Institute at Swinburne University of Technology, Victoria, plan further testing of the system before production and distribution of a first batch of monitors.

A test and calibration trial involving healthy subjects taking a single dose of benzodiazepine is to be held by Swinburne University later this year.

BHP Corporate, formerly BioPharmacia Limited, is commercialising a portfolio of Australian biomedical technologies developed in universities, medical institutes and hospitals.

Informal Venture Capital

Internet start-up attracts \$1.3 million

A consortium of individual investors led by Roger Allen of venture capital firm Allen & Buckeridge and including clients of advisory firm Nextec Strategic Capital have invested \$1.3 million in an internet start-up business.

Jump On It.com (JumpOnIt.com) is a group buying site that offers discounted exclusive deals on activities and purchases in Australia's major cities on a "deal of the day"

basis. Consumers have 24 hours to secure discounts which may be as high as 90 per cent.

Buyers sign up individually but only when enough people “jump on it” is a deal activated and coupons emailed. The business model therefore combines the advantages of group buying with a strong incentive for word of mouth promotion.

The structure enables business operators and merchants to link discounts to volume sales. This can be done at no risk and without upfront costs as the website simply takes a percentage of the revenues which flow through.

The company, which recently pitched to angel investors at Australian Investment Network presentations, has as its chief executive serial internet entrepreneur Colin Fabig. Other members of the executive team are James Gilbert and Adam Rigby. All three have stakes in the company. Roger Allen is chairman.

At the time this item was compiled, Jump On It Sydney was offering a 51 per cent discount on \$100 worth of food and drink at a Darlinghurst restaurant.

Mr Fabig said businesses that had already committed to use Jump On It included The Observatory Hotel, Sydney; Hoyts cinemas and Sheraton Hotels.

The concept is similar to US operation Groupon and already has at least one other local rival, Spreets (see separate item this issue).

People Moves

Private equity part of new analyst's brief

Global advisory business Russell Investments has appointed a new research analyst to focus on private equity as well as property fund managers in Australia, New Zealand and the Asian region.

Samantha Steele, who is based in Sydney, is working closely with Russell's director of Asia-Pacific real estate investment Martin Lamb. Mr Lamb's major focuses are private real estate and property fund investment.

According to Russell, Ms Steele's appointment is part of the firm's commitment to providing investors with increased exposure to alternative investments such as unlisted global property.

Ms Steele will also work with Nicole Connolly, Russell's newly appointed director of alternatives consulting, to bolster the firm's alternative assets investment consulting capabilities in Australia and New Zealand.

Russell's alternative investments team undertakes due diligence on alternative investment strategies including fund of funds, as well as working with Russell's clients on formulating and implementing alternative investment programs.

Ms Steele's background is in property fund management in Europe.

Investee News

Rio Tinto award to mining equipment parts supplier

CHAMP Ventures Private Equity investee Crushing and Mining Equipment has won an award from Rio Tinto (ASX: RIO) for excellence in provision of goods.

Perth-based Crushing and Mining Equipment is a division of H-E Parts International LLC.

Atlanta, Georgia, based H-E Parts is the world's largest independent supplier of parts to the mining and heavy construction industries. The company acquired Crushing and Mining Equipment in early December.

The acquisition was principally financed by H-E Parts' existing private equity investor Chicago-based Frontenac

Company and by CHAMP Ventures which invested prior to the deal.

Crown Parts and Machine of Billings, Montana, was also acquired soon after CHAMP Ventures invested. In addition to its US operations, Crown has a significant centre in Antofagasta, Chile, as well as warehouses or sales offices in 16 other locations internationally.

H-E Parts International was founded in 2006 by J-P Richard, the former chief executive of Massey Ferguson and AGCO Corporation (NYSE: AG), backed by investment from Frontenac. The company had made five significant acquisitions prior to CHAMP Ventures investing.

Rio Tinto's award to Crushing and Mining Equipment was in recognition of pioneering work in extending the life of crusher liners – crushing being a critical process in the operations of hard rock mines and quarries.

Crushing and Mining Equipment chief executive David Davenport said the award was a reflection of the close working relationship the company had built up with Rio Tinto over ten years.

Informal Venture Capital

Online venture attracts European investment

Spreets, which claims to be the first online group buying site established in Australia, has attracted \$2 million in funding from two European investors.

Spreets says the two investors are Klaus Hommels – whose investments include Facebook and Skype – and Oliver Jung.

According to Spreets, the two investors are currently focusing their investing on group buying sites around the world.

Spreets, which launched early this year (www.spreets.com.au), is based on the concept established by US start-up Groupon (www.groupon.com) which is now valued at US\$250 million based on its most recent funding round.

Deals are offered on Spreets at substantial discounts to normal retail prices but only become available once a sufficient number of people commit. The threshold numbers for the offers to become active are not revealed.

Deals are currently being offered in Sydney, Melbourne, Brisbane, Adelaide, Perth, Hobart, Canberra and Darwin.

The men behind Spreets are founder of restaurant booking system Booking Angel (www.bookingangel.com) Dean McEvoy, Phil Morle and Justus Hammer.

Another similar venture, Jump On It.com has launched more recently (see separate item this issue).

Conferences & Roundtables

Venture capital industry backs innovation event

Venture capital industry leaders are strongly supporting this year's Innovation 23, an event which celebrates Australian innovation.

Applications to be selected as one of 23 young companies to be showcased at the event close on June 25.

Selected companies will present before an audience expected to be in excess of 400 in Sydney on August 19. Prizes will be provided by government and corporate sponsors.

Panels of industry experts will be on hand to advise entrepreneurs. In addition, the event will provide networking opportunities for investors, many of whom are expected to be successful former entrepreneurs, as well

public sector research organisations, R&D organisations, government innovation and commercialisation agencies and venture capitalists.

Venture capital figures who have already confirmed they will be attending include Roger Allen, director and co-founder of Allen & Buckeridge; Bill Bartee, managing director, Southern Cross Venture Partners; Chris Beare, director, NICTA; Michelle Deaker, managing partner, OneVentures.

Innovation 23 is sponsored by the NSW Government Department of Industry & Investment and Australian Technology Showcase.

For more information including entry form visit: <http://www.tech23.com.au/>

News

Manager declares stake in investment business

Lion Manager and associates have declared ownership of 9.1 per cent of mining investment company Lion Selection Group (NSX: LSG).

Lion Selection Group invests in funds managed by Lion Manager.

Lion Selection Group is a successor business to the former ASX-listed Lion Selection which also invested in funds managed by Lion Manager. Lion Selection was delisted from the ASX last year after \$160 million in capital was returned to investors via a shares buyback following the liquidation of investments in Platmin, Allegiance Mining and Indophil.

Shareholders of Lion Manager are Robin Widdup, Tim Markwell, Heldley Widdup and Damon Rhodes.

Lion Selection Group announced on May 10 unaudited net tangible asset backing of 88 cents a share as at April 30.

TAX AND PRIVATE EQUITY; THE LATEST ROUND

*Toby Eggleston**

The month of May saw the release of a number of tax announcements including the release of the Henry review, the Government's response to the Board of Taxation review on the taxation of trusts, the 2010 Budget, a paper on the proposed "Investment Manager Regime", the ATO's apparent deferral of the final rulings on private equity and the latest iteration of the definition of a Managed Investment Trust (MIT).

This article outlines how these announcements may impact the structure of existing and future private equity funds in Australia.¹

In summary, the new definition of a MIT opens the door for a number of private equity funds to qualify as a MIT and make a "capital account" election, providing certainty of taxation treatment to those funds and their investors. Credit should go to the considerable efforts of AVCAL and its advisers in encouraging Treasury to allow a wider array of entities to benefit from these reforms. However, for those funds that do not qualify there will be continuing uncertainty.

Current private equity fund structures

Private equity funds are usually structured as either trusts or limited partnerships under the Venture Capital Limited Partnership (VCLP) or Early Stage Venture Capital Limited Partnership (ESVCLP) regime.

The trust structure generally allows flow through of income and capital gains to the investors. The benefits of this structure include:

- For capital gains on assets held for at least 12 months, superannuation fund, trust and individual investors are able to reduce the amount of the gain under the "CGT discount" provisions; and
- "Fixed trusts" being able to "flow through" the CGT exemption for non-residents on the disposal of shares which are not "Taxable Australian Property".²

The benefit of the VCLP structure is that non-residents are exempt from Australian tax on income and capital gains made by the VCLP on disposal of qualifying investors. All investors in an ESVCLP are exempt from Australian tax on income and capital gains made by the ESVCLP. In addition, any distribution of carried interest received by the general partner of a VCLP or ESVCLP is deemed to be a capital gain and can therefore be reduced under the CGT discount. This is of particular relevance given that it is proposed that the carried interest of a manager of a MIT will be deemed to be assessable income of the recipient.³

Current ATO position on private equity

The ATO was expected by the end of May to release its finalised rulings on whether the profit on the sale of the shares by a private equity entity would be included in

assessable income of the vendor and the application of the general anti-avoidance provisions to 'treaty shopping'.

However, on 26 May it was reported⁴ that the rulings would be deferred until the "government's current review of policy in this general area had been completed". Presumably, the policy referred to by the ATO is the ability of qualifying MITs to make an election to tax profits on the sale of passive investments as capital gains rather than ordinary income under proposed Division 275 of the ITAA 1997.

This came as somewhat of a surprise as the Assistant Treasurer had previously stated that the ATO "process should be allowed to run its course" and would consider the "advice from Treasury and the ATO before deciding what action, if any, may be needed."⁵

On 7 May the Government released its response to the Board of Taxation's review of the taxation of MITs. The Board of Tax recommended that there was no need to carve out private equity or hedge funds from qualifying as a MIT. The Government accepted this recommendation.⁶

While the new MIT CGT rules will assist existing and new funds that qualify as MITs, the decision not to finalise the draft rulings leaves VCLPs, non-qualifying funds and offshore investors without the ATO's final, considered views on the topic of whether a gain made by a private

equity entity is assessed as ordinary income rather than a capital gain or, for foreign investors, the issues relating to 'treaty shopping'.

MIT capital treatment election

The Government has previously enacted a new regime for MITs which provides for a 7.5 per cent withholding tax rate on distributions of Australian source income to foreign investors.⁷ The Government has now enacted legislation to enable MITs to make an election to treat the gain on disposal of passive investments as capital gains rather than ordinary income.⁸ These provisions will apply to existing qualifying funds and require them to make an election no later than 2 September 2010.⁹ However, given the election applies retrospectively in respect of disposals that occurred in the 2009 and 2010 income years and a trustee's notification obligations a decision as to whether a fund qualifies as a MIT and will make the election may need to be made as soon as possible.

The original definition of a MIT was somewhat ambiguous and, in the ATO's view¹⁰ at least, was limited to registered managed investment schemes. This meant that almost all private equity funds were excluded from qualification as a MIT.

The latest proposed definition draws a distinction between registered and unregistered managed investment schemes (MISs). Most Australian PE trusts are structured as unregistered schemes.¹¹ To qualify as a MIT for the purposes of making the CGT election¹², an unregistered scheme needs to satisfy the following requirements:

- (a) The trustee is an Australian resident or the central management and control of the trust is in Australia;
- (b) The trust is a MIS as defined in the *Corporations Act* ¹³;
- (c) The trust is managed or operated by an AFSL holder;

- (d) The trust only carries on an 'eligible investment business' as defined in Division 6C of the ITAA 1936;
- (e) The trust has at least 30 wholesale members of the trust – see further comments below;
- (f) The trust does not have more than 20 retail members and those retail members control no more than 10 per cent of the interests in the trust at any time;
- (g) At no time did 12 or fewer persons directly or indirectly hold 75 per cent or more of the interests in the trust – see further comments below; and
- (h) No foreign individual holds a direct or indirect interest of 10 per cent or more in the trust.

Applying the membership requirements of the MIT definition

For the purposes of calculating (e) above, certain investors are deemed to count for a number of members calculated by multiplying their percentage interest in the trust by 50.¹⁴ These investors are:

- Life insurance companies;
- Complying super funds or foreign super funds that have at least 50 members;
- A pooled superannuation trust with at least one member who has at least 50 members;
- A MIT; and
- An entity that is regulated under a foreign law as a collective investment vehicle that has at least 50 members.

(In this article, I refer to this class of investors as 'qualifying members').¹⁵

For example, if a complying super fund with 100 members holds a 30 per cent interest in the trust, that super fund will count as 15 members (ie 50 x 30 per cent) for these

purposes. Accordingly, provided qualifying members hold at least 60 per cent of the interests in the trust, it will meet the requirement in (e) above. If the fund as a whole cannot satisfy this membership requirement, it may be preferable to split the investors into 2 trusts – one with qualifying members which qualifies as a MIT and the other with other "non-qualifying members" which does not qualify as a MIT.

The requirement in (f) above may cause a trust to not qualify if the entitlement to carried interest is attached to units held by 'retail' investors. To solve this, it may be necessary to structure the carried interest as a fee payable to the carry participants rather than as a trust distribution entitlement attached to units. As the carried interest in a MIT is to be taxed as ordinary income¹⁶ there should be no downside for the carry participants from structuring the carry this way. However, this would result in some GST "leakage" for the fund as it would only be able to claim a reduced input tax credit for the fee. In addition, full utilisation of any tax deduction for such a fee may be problematic if the profit on sale is treated as a capital gain.¹⁷

Alternatively, the units which have an entitlement to carried interest could be held by a trust (ie a sponsor trust) which qualifies as a wholesale investor¹⁸ where the carry participants are the beneficiaries of that sponsor trust. As the MIT CGT election effectively applies retrospectively, existing PE funds may not be able to meet this requirement without restructuring. Any restructuring of the carried interest entitlement could itself open up potential adverse tax issues.¹⁹

For the purposes of calculating the "closely held" test in (g) above, the 'qualifying members' are not counted among the 12 or fewer persons. Accordingly, the trust will satisfy this condition provided 'qualifying members' hold at least 26 per cent of the trust, as 'non-qualifying' members will hold less than 75 per cent.²⁰

In general, wholly owned sub-trusts of Australian qualifying members should generally satisfy the MIT definition.²¹

Requirement to only carry on an 'eligible investment business'

To qualify as a MIT the trust must not carry on a trading business or control an entity that carries on a trading business for the purposes of Division 6C of the ITAA 1936.

Under Division 6C public unit trusts which carry on or control a trading business are taxed as companies and effectively lose their flow through status. Accordingly, they are unable to flow the benefit of the CGT discount and the CGT exemption for non-residents.

A 'trading business' is any business which is not an "eligible investment business". In summary, that term is defined to mean investing in land primarily for the purpose of deriving rent and investing in various financial instruments including shares.

Control for these purposes means "positive" control (ie the ability to appoint greater than 50 per cent of the board of the investee) and "negative" control (ie the ability to control the business through the exercise of veto powers)²². Private equity funds are often been structured as two or more entities with the shareholdings in, and veto powers in respect of the business operations of, an investee split between those entities so that neither entity could be said to control the investee on its own. In addition to other commercial rationale for such structures, this also mitigates the risk of the trust being taxed as companies under Division 6C.

In its report on the taxation of trusts the Board of Tax made a number of recommendations in respect of Division 6C, including to:

- Require all transactions between MITs and related parties to be on arm's length terms;

- Allow MITs to own a wholly owned subsidiary company which would carry on a trading business; and
- Allow a 10 per cent de minimis allowance for 'trading' income.

Unfortunately, at this stage, the Government only decided to adopt the recommendation in relation to the arm's length terms on transactions between related parties. The concerns with allowing a trust to own a wholly owned subsidiary which carries on a trading business are unclear given that the subsidiary would be taxable on its profits and any ability to strip profit up to the trust would be addressed under the arm's length rule.

Structures for offshore funds

It appears that based on the current proposed legislation an Australian trust wholly owned by a foreign collective investment vehicle will not meet the requirements to be an MIT. If the legislation is enacted in its current form one alternative may be for investors in the foreign fund to establish an Australian trust which qualifies as a MIT²³ as a parallel fund for Australian investments. That is, the investors in the foreign fund would divert part of their commitment from that fund into a parallel Australian trust. Many foreign funds would have provisions allowing them to establish such alternative investment vehicles. However, the establishment of an alternative investment vehicle as an Australian trust may require some education of foreign investors, as most are not familiar with an Australian trust.

An Australian trust set up as a parallel fund in this way could qualify as a MIT provided it meets the other membership and licensing requirements of the definition. Of particular relevance would be to ensure that no foreign individual (ie a natural person) holds a direct or indirect interest of 10 per cent or more in the trust.

The future for VCLPs?

At this stage a VCLP, being a partnership rather than a trust, cannot qualify as a MIT and therefore cannot make the CGT election. This has created the somewhat unusual scenario that:

- Assuming an election is made, the gains made by a MIT are deemed to be on capital account but the carried interest is assessed as ordinary income; but
- The gains of a VCLP are assessed under existing case law, which in the ATO's view could be treated as ordinary income, but the carried interest is assessed as a capital gain.

A VCLP is still a viable fund structure for non-resident investors. However, in order for VCLPs to have a future as an investment vehicle for domestic investors, it will be necessary to allow VCLPs to make a capital account election. Otherwise it will be difficult to envisage that domestic investors would allow a manager to invest through a VCLP rather than a MIT. The paper on the Investment Manager Regime contemplates that the role of VCLPs may be expanded in the future so hopefully some action will be taken in this regard.

Conclusion

Taxation of distributions will be much simpler for those funds that qualify as a MIT under the new definition. To fall within this definition will still require that the relevant trust does not control an investee. Thought will also need to be given as to how to structure the carried interest to ensure that the fund satisfies the requirement that retail investors hold no more than 10 per cent of the interests in the fund at any time.

The position is still unclear for offshore funds although they may be able to establish a parallel Australian trust to hold the fund's Australian investments. Finally, the use of VCLPs

will be limited unless VCLPs are also able to make a CGT election.

***Toby Eggleston is a director of Greenwood's & Freehills. Mr Eggleston thanks the following for their assistance in reviewing this article: Ben Davey, Kon Mellos and Damien Hazard of Freehills and Josh Cardwell and Richard Hendriks of Greenwood's & Freehills.**

Notes

1. This article is based on law and announcements as at 6 June 2010. It contains general comments only and does not constitute advice.
2. Under Division 855 of the ITAA 1997 a non-resident investor in a 'fixed trust' is not assessed on capital gains on the sale of shares in companies provided the shares were not Taxable Australian Property. For these purposes Taxable Australian Property relevantly includes a 10 per cent or greater interest in a company where more than 50 per cent of the value of the company arises from direct or indirect interests in Australian real property.
3. Proposed section 275-200 of the ITAA 1997.
4. The Australian Financial Review, 26 May 2010, page 4.
5. Senator Nick Sherry, Address to the Asian Venture Capital Journal Private Equity and Venture Forum, 4 March 2010.
6. Recommendation 15 of the Board of Tax's report on the Review of the Tax Arrangements Applying to Managed Investment Trusts and the Media Release of Senator Nick Sherry on 7 May 2010.
7. Sub-division 12-H of Schedule 1 of the *Taxation Administration Act 1953*. This does not apply to distributions of interest and dividends.
8. 275 of the *Income Tax Assessment Act 1997*.
9. A trust that qualifies as an MIT prior to 1 July 2009 has to make an election within three months of royal assent to Tax Laws Amendment (2010 Measures No. 1) Bill 2010, which occurred on 3 June 2010. Failure to make an election will mean that any gain on an asset will be deemed to be ordinary income and not a capital gain – section 275-120.
10. ATO Interpretative Decision 2009/150. This view has now been confirmed in the Explanatory Memorandum to the proposed legislation.
11. Accordingly, I have only focussed on the unregistered scheme part of the MIT definition. Further lobbying is being undertaken in relation to registered schemes.
12. There is an additional requirement to qualify for the MIT withholding tax rules that the trust's investment management activities are carried out in Australia.
13. This condition does not need to be satisfied for wholly owned sub-trusts of Australian 'qualifying members'.
14. An alternative way to consider this test is that the qualifying member interest in the trust's percentage is grossed up by 5/3 – ie. a 30 per cent qualifying member counts for 50 per cent (30 per cent x 5/3) of the 30 members.
15. Further lobbying is being undertaken to expand this class of investors to include, among others, sovereign wealth funds and government pension schemes.
16. Pursuant to section 275-200 of ITAA 1997.
17. An expense incurred in deriving a capital gain is not deductible under s.51AAA of the ITAA 1936. A deduction may be available over 5 years under s.40-880 of the ITAA 1997 however this may be of limited benefit if the payment is made towards the end of the fund's life.
18. For example, because it pays more than \$500,000 to acquire that interest or the trust is an AFSL holder.
19. Such as re-settlement or value shifting on a restructure of the entitlement to a fee, or realising a gain on disposal of the units which have the carried interest entitlement to a sponsor trust.
20. The 'widely held' requirement does not need to be satisfied in the first and last year of the trust's existence.
21. Assuming that the 'residency' and AFSL licensing requirements are satisfied. See below for comments on wholly owned sub trusts of non-resident qualifying members.
22. See ATO Interpretative Decision ATO ID 2003/162.
23. In order to be a MIT the trust must be a managed investment scheme (MIS). It is generally accepted that a trust cannot qualify as an MIS if it only has one investor. Accordingly, this condition is not required for the purposes of the CGT election if the trust is wholly owned by a 'qualifying member'. However, for these purposes the 'qualifying member' does not include a foreign collective investment vehicle. Another alternative may be for all but one of units to be held by the foreign fund and a nominee to hold 1 unit as bare trustee for the foreign fund.

STRUCTURING PRIVATE EQUITY DEALS POST GFC

Nick Humphrey*

The private equity industry globally has been through a very challenging period over the last 18 months with leverage in short supply (for both existing portfolios and new deals), limited exit opportunities and high levels of distress in portfolio companies.

Whilst 2010 has seen better market conditions which has driven increased deal activity, investors are unlikely to forget the difficult lessons from the Global Financial Crisis (GFC) and target companies can expect to see tougher structures both on the acquisition side and also post deal in relation to stakeholder arrangements.

Acquisition finance is also still relatively elusive, with investors showing innovation in deal structuring to bridge the funding gap including use of earn-out structures and partial exits.

Size of buyouts likely to be smaller

The first trend is that buyouts are likely to be smaller than pre-GFC. In 2009, not only did the global number of PE deals fall (deal activity by PE funds fell by 36 per cent to 1,612 acquisitions) but the average size of deals fell 37 per cent from \$158m down to \$100m.¹

The key drivers in Australia are that:

- Bid multiples have been reduced on private acquisitions generally, as the expectations of private sellers have been reset to match the public markets;

- Acquisition finance has become scarce, with very little debt for new deals;
- Foreign funds are less interested in Australia due to uncertainty around tax treatment post the ATO decision in the Myers / TPG IPO, the high Australian dollar and finally they are otherwise focused on their underperforming portfolios.

It is also interesting to note that according to Moody's the top 10 US mega deals over the last 5 years have all performed worse than the other PE deals (40 per cent of them were in default of debt arrangements, versus 18.6 per cent for the industry generally).²

Loan value ratios to shift

As a result of the reduced availability of acquisition leverage and increased default rates, the loan to value ratio (LVR) on deals post GFC is shifting. Before the crisis, large buyouts were structured with senior debt as high as 75 per cent to 85 per cent (although mid mark deals generally were around 65 per cent level). Ratios depend on industry volatility, house rules, interest coverage, multiples paid and so on.

It seems a number of funds are being forced by debt providers to inject more equity into their troubled portfolio companies to bring LVR down to 50 per cent.

Reconciling the value gap

Investors are being forced to explore new funding models given the difficulty of implementing a traditional leveraged buyout (LBO) style deal, where the fund acquired 100 per cent of the target using a high level of leverage.

A key trend is the increase in minority investments and staged exits. A staged exit

is where founders sell down only a portion of their equity (retaining say 50 per cent or 60 per cent). This allows them to take some money off the table and de-risk whilst still having the incentive of a second exit (such as IPO) down the track.

In 2009 minority investments as a percentage of total acquisitions rose from 45 per cent to 50 per cent of deals.³

Increase in earn-outs and deferrals

Post GFC, we have seen an increased use of earn-outs in PE deals and also the use of vendor finance, with part of the consideration deferred for 12 months or more.

The increased use of deferred consideration raises some complex legal issues:

- Lapsing: should the buyers obligation to pay be subject to automatic lapsing and set-off (e.g. for breach of warranties or breach of restraint);

- Security: how does the deferral become secured (e.g. if on the sell side – consider escrow accounts, fixed and floating charge, parent guarantee);
- Acceleration: from a sellers perspective, should the buyers obligations to pay accelerate if, for example:
 - there is a change of control of buyer;
 - insolvency event in relation to the buyer;
 - if the buyers fails to “operate the business like the sellers”;
- Normalisation: when preparing the earn-out accounts, is there any normalisation required, for example to remove the costs of implementing the deal, increased overheads arising from the introduction of the investors (such as audit fees, non-executive director fees or any management fees payable to the fund);
- Exclusions: similarly, do the earn-out accounts need to provide for excluded earnings, for example, such arising from for asset sales or post-completion acquisitions.
- According to the American Bar Association, most private M&A deals in the US before the GFC did not use an earn-out (in 2006, 81 per cent of deals did not use whereas in 2008, only 71 per cent did not use). (4)

Club deals performing well

Co-investment, consortia bids or club deals are gaining increasing popularity in the US and appear to have outperformed the PE sector generally. For example, default rates at 15.6 per cent are lower than the sector overall at 18.6 per cent.⁵ One theory, according to Moody's, is that when funds collaborate on a deal they tend to be less aggressive with leverage.

On the downside, structuring consortia bids raises difficult questions around governance and conflict between the co-investors (for example, how do drag along clauses work

amongst the funds? How do are board deadlocks resolved?)

Club deals also increase the risk of anti-competitive conduct claims. Investors need to avoid collusions with respect to bidding on assets in tender sales or breaching confidentiality undertakings.

Warranty & indemnity insurance

While the market for warranty & indemnity (W&I) insurance in Australia is not as developed as Europe or the US, it is becoming more common.

Over the last six months the majority of exits we have advised on have used W&I insurance. The driver for this trend appears to be two-fold:

- The premiums have been reduced substantially over the last year or so making it more viable as a means for both buyers and sellers to get protection on warranties in M&A deals.
- Increased risk aversion amongst stakeholders in the aftermath of the GFC (with numerous buyout targets having gone insolvent or been in serious distress, buyers are far more cautious about taking on the risk of undisclosed liabilities)

It is important that you seek specialist advice before obtaining W&I insurance. Generalist insurance groups or brokers are unlikely to have the knowledge or experience to deal with the complex insurance issues associated with M&A transactions.

The broker/ insurer will need to become involved early in the deal to get comfortable with the due diligence process and breadth of the warranties. They will need to see the due diligence reports, disclosure letters, get access to the dataroom and review the sale agreements.

Buyside insurance means the buyer can sue the insurer directly to recover for a breach of warranties (the policy will mirror the underlying sale agreement for caps, claim period, limitations etc).

Completion accounts back in favour

Pre-GFC, the “locked box” mechanism, became popular in many tender sale processes, particularly in the UK. Buyers however now are increasingly requiring completion accounts.

The locked box is more seller-friendly as it gives certainty about price, with limited opportunity for the buyer to claim after completion. The onus is on the buyer to conduct detailed financial due diligence before signing the deal.

The locked box is a mechanism through which the parties agree a price payable for the target company based on accounts (often unaudited) drawn up to a date prior to signing. The “box” is then locked by the sellers who give covenants not to pay dividends or extract any other form of value from the company prior to completion. (6)

Completion accounts on the other hand, are more buyer-friendly, allowing the buyer to review the accounts in the period after the completion date for fluctuations in working capital (or in some cases, the full balance sheet). The buyer can then bring a claim if items have changes from the assumed or reference financial position.

According to the American Bar Association, in 2008, 79 per cent of private M&A deals used completion accounts up from only 68 per cent in 2006; it also worth noting that 77 per cent of adjustments were based on working capital. (7)

Warranty claim regimes are tougher

During the boom times, the warranty claim regimes in private equity deals become more seller friendly, driven by high levels of competition amongst buyers to acquire

assets (in turn, fuelled by strong public markets and availability of leverage).

Whilst there is always going to be a spectrum of regimes, depending on deal size, industry, and bargaining power (eg, distressed assets), Table 1 sets out some general trends.

Material adverse change

Another trend is the inclusion of “material adverse change” (MAC) as a condition precedent. These MAC provisions are also broadly drafted, potentially including a forward looking element (like prospects or “could reasonably be expected to”) and market disruptions rather than narrowly covering events specific to the target.

Broad based MACs are also increasingly required in those deals where external financing has been obtained to finance the acquisition. Buyers need to ensure they can back-to-back the sale agreement (there is no point signing up to buy a company if your bank has a broad MAC as a condition precedent to drawdown and your MAC with the seller is not as favourable.)

Pre-GFC, buyers were generally required to take “financing” risk, with sellers unwilling to accept any execution risk around the buyer’s ability to finance the transaction.

Tougher stakeholder arrangements

Another important trend is that the private equity funds will be seeking to impose a stricter regime in their shareholder agreements. For example:

- Good/bad leaver: regimes governing termination of MBO team are likely to be more aggressive with larger discounts and longer vesting periods.
- Termination of senior executives: the ability for the investor to do this will be more streamlined. Many investors have had to terminate CEO’s as part of work out programs during GFC.

	Pre-GFC	Post-GFC
Caps on Warranty Claims	<ul style="list-style-type: none"> • Caps less than purchase price for non-title warranties particularly in large transactions or competitive tender sale transactions (as low as 10 per cent); • Caps in US: 90 per cent had cap less than purchase price.¹ 	<ul style="list-style-type: none"> • Caps now moving back to purchase price for all claims paid (potentially the cap may include value of target group debt assumed or refinanced by the buyer); • Exclusions from claim cap for fraud, title, wilful non-disclosure, tax, environment.
Claim Period	Periods reduced to as low as 6 months but typically 12 to 18 months (in US only 15 per cent of deals had period over 18 months in 2007) ²	<ul style="list-style-type: none"> • Periods extended, such as 18 months to 36 months • 5 years or longer for tax (no collar for Part IVA)
Earn Outs	Deferral or earn outs less likely (in US only 32 per cent of deals in 2007).	Some element of deferral in most deals.
Completion Accounts	Locked box increasingly common in UK and US in larger deals.	Most deals requiring adjustment for working capital fluctuations.
Basket	The Basket (being the aggregate threshold of claims before you can recover) was higher and in some cases, like large tender sales, more than 2 per cent.	Baskets reducing to 1 per cent or less for aggregate of claims.
Shield for disclosure	Seller friendly regime of any disclosure, including data room or in writing common.	Buyer friendly so shield limited to documents contained in an index or in some cases the US style only if in the disclosure letter.

Table 1

¹ ABA, 2009

² ABA, 2009

- Pre-emptive regimes: investors will want to ensure they can inject further equity quickly, and dilute those who do not participate, without unnecessary red tape.
- Financial and operational difficulty (“FOD”): the inclusion of FOD means that if certain KPIs such as EBIT targets are not met, then the investor will have the right to get board control, hire and fire senior executives or appoint workout experts.
- Drag alongs/sunset: a greater focus on ease of exit for the investor including an unfettered drag along over management and minority shareholders and; less willingness to concede founders matching rights in an exit context.

Summary

While it appears that the private equity industry is over the worst of the challenges of 2008 and 2009, it is important that the hard learnt lessons of the GFC are factored into new deals, to ensure that investors can recover for breaches of warranties as seamlessly as possible, have the ability to claw back for fluctuations in working capital and finally to pull out of the deal if there is a material adverse event with respect to the target.

***Nick Humphrey is a partner with Norton Rose Australia and Head of Private Equity.**

Notes

1. Ernst & Young, 2010 Global Private Equity Watch: New Horizons Emerge April 2010
2. Moody's Global Corporate Finance, \$640 Billion & 640 Days Later: How Companies Sponsored by Big Private Equity Have Performed During the US Recession, November 2009
3. Ernst & Young, April 2010

4. ABA, December 2009

5. Moodys, November 2009

References

American Bar Association, Private Target Mergers & Acquisitions Deal Points Study, December 2009.

Ernst & Young, 2010 Global Private Equity Watch: New Horizons Emerge, April 2010.

Norton Rose, Jill Gauntlett, A reflection on deal trends in cross-border M&A - the Asia-Pacific perspective, February 2010.

Moody's Global Corporate Finance, \$640 Billion & 640 Days Later: How Companies Sponsored by Big Private Equity Have Performed During the US Recession, November 2009.

SHARES CHART

AUSTRALIAN LISTED PRIVATE EQUITY FUNDS													
Last sale at end of month													
Investors/ Month	\$	MAY-10	APR-10	MAR-10	FEB-10	JAN-09	DEC-09	NOV-09	OCT-09	SEP-09	AUG-09	JUL-09	JUN-09
PRIVATE EQUITY AND VENTURE CAPITAL FUNDS													
Acrux		1.95	1.985	2.23	2.04	2.02	2.15	2.43	1.93	1.705	1.32	1.19	1.135
Authorised Investment Fund		0.055	0.05	0.04	0.03	0.03	0.03	0.03	0.033	0.027	0.03	0.03	0.027
Options Mar 2010					0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.01
Options Feb 2013		0.016	0.016	0.016									
Biotech Capital		0.24	0.22	0.2	0.21	0.3	0.3	0.27	0.275	0.24	0.225	0.2	0.16
BPH Corporate Limited		0.067											
China Century Capital		0.053	0.059	0.052	0.058	0.065	0.074	0.093	0.097	0.075	0.083	0.085	0.06
CVC Limited		0.91	0.8	0.8	0.745	0.77	0.78	0.76	0.65	0.575	0.57	0.58	0.525
Cytopia	delisted (merged)					0.13	0.1	0.094	0.1	0.12	0.1	0.069	0.073
Eircom Holdings (ex B&B Capital)	delisted						0.545	0.535	0.52	0.51	1.22	1.15	1.145
First Opportunity Fund		0.65	0.55	0.42	0.42	0.425	0.46	0.46	0.42	0.42	0.435	0.44	0.45
Grandbridge		0.14	0.195	0.195	0.14	0.125	0.125	0.125	0.125	0.14	0.17	0.04	0.045
LinQ Resources		0.605	0.71	0.635	0.6	0.63	0.62	0.63	0.585	0.6	0.61	0.6	0.55
Lion Selection Group (NSX: LGP)	ex ASX Dec 09	0.46					1.93	1.93	1.7	1.74	1.52	1.36	1.33
NSX Limited		0.19											
Oceania Capital Ptnrs (ex Allco Equity)	delisted			2.56	2.68	2.79	2.78	2.75	2.66	2.87	2.93	2.6	2.14
Souls Private Equity		0.89	0.097	0.098	0.096	0.11	0.11	0.1	0.096	0.093	0.95	0.083	0.077
Strategic Pooled Development		0.1	0.16	0.13	0.14	0.145	0.11	0.1	0.125	0.145	0.145	0.14	0.12
Techniche Limited		0.038											
BUYOUT FUNDS													
HGL	no longer PE							1.2	1.095	1.08	1	0.865	0.81
FUNDS OF FUNDS													
ING PEAL		0.245	0.27	0.275	0.3	0.3	0.295	0.29	0.215	0.21	0.21	0.19	0.17

COMING EVENTS

- **25 June:** VaR Modelling in Turbulent Markets. Sydney CBD. Macquarie University Applied Finance Centre. Web: www.mafcmq.edu.au/executive_training.htm
- **17 June:** Bio SA Networking Spectacular. Adelaide. Bio SA. Speakers: Dr Leanna Read, managing director TGR BioSciences; Dr Meera Verma, director, site operations, Hospira, Adelaide; Dr Don Plowman, deputy chief executive, Food & Wine, PIRSA. Web: www.bioinnovationssa.com.au
- **19 August:** Innovation 23. Sydney. Event showcasing 23 innovative young companies. Slattery IT. Web: www.tech23.com.au
- **31 August - 3 September:** Clean Technology World. Shangri-La Kowloon, Hong Kong. Terrapinn. Web: www.terrapinn.com/2010/cleantechasia/
- **10 September:** VaR Modelling in Turbulent Markets. Sydney CBD. Macquarie University Applied Finance Centre. Web: www.mafcmq.edu.au/executive_training.htm
- **5-17 September:** Capital Creation 2010. Monte Carlo. Worldwide Business Research. Web: www.wbresearch.com/capitalcreationeurope/
- **22-23 September:** AVCAL 2010. Gold Coast. AVCAL. Web: www.avcal.com.au
- **14&15 October:** Strategic Risk Management. Sydney CBD. Macquarie University Applied Finance Centre.