The Private Equity Market in Australia

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Abstract

The Australian private equity market has grown significantly for a number of years, particularly as the economy recovered from pandemic-related disruptions. Consistent with this growth, private equity deals involving Australian companies have increased in value, and private equity funds have raised larger amounts of capital from investors. Recently, however, private equity activity has declined substantially as borrowing costs increased. Over recent years, international private equity firms and investors have also increased their presence in the Australian market. This article discusses these developments in the Australian private equity market and considers the implications that a robust private equity market may have on Australian businesses and public capital markets.

Introduction

Australian companies benefit from deep, high-quality capital markets in which they can raise funds to support their operations and expand their business. A key component of this is the Australian equity market, in which companies raise money from investors in return for part-ownership of the company's profits and assets. Companies listed on the Australian Securities Exchange (ASX) are some of the most visible businesses in Australia. Listed companies tend to be large, mature businesses that benefit from having their shares trade in a liquid and transparent public market.

Issuing shares on a public exchange, however, may not be the best way to raise capital for all companies. Some companies prefer to raise private equity capital, which generally involves a smaller number of investors, who therefore obtain more control over the company. This can be a particularly important source of funding for smaller or riskier businesses that may face greater costs and other challenges in raising capital in public markets.

While it remains much smaller than the public market, the Australian private equity market has grown significantly over recent years. Assets under management in Australian-focused private equity funds – an important component of the private equity market – have nearly tripled in size since 2010 to $66 billion (for comparison, the combined market capitalisation of companies listed on the ASX is $2.7 trillion).[1] This has occurred alongside substantial growth in private equity fund raisings and deals with Australian companies.

What is private equity?

Private equity is ownership or interest in a company that is not transacted in a public market. These companies are often small, new, or otherwise riskier businesses.[2] They may not have enough collateral or a track record of profits to qualify for bank financing, and other forms of debt funding may be prohibitively expensive. While internal equity financing through retained profits is often the cheapest source of funds, this can be impractical for companies with negative cashflows or businesses trying to grow quickly.[3] As such, private equity financing is an important source of funding for some companies' operations and growth. While companies can obtain private equity financing from a variety of non-institutional sources – such as friends, family members, and angel investors – the most prominent investors are private equity firms.[4]

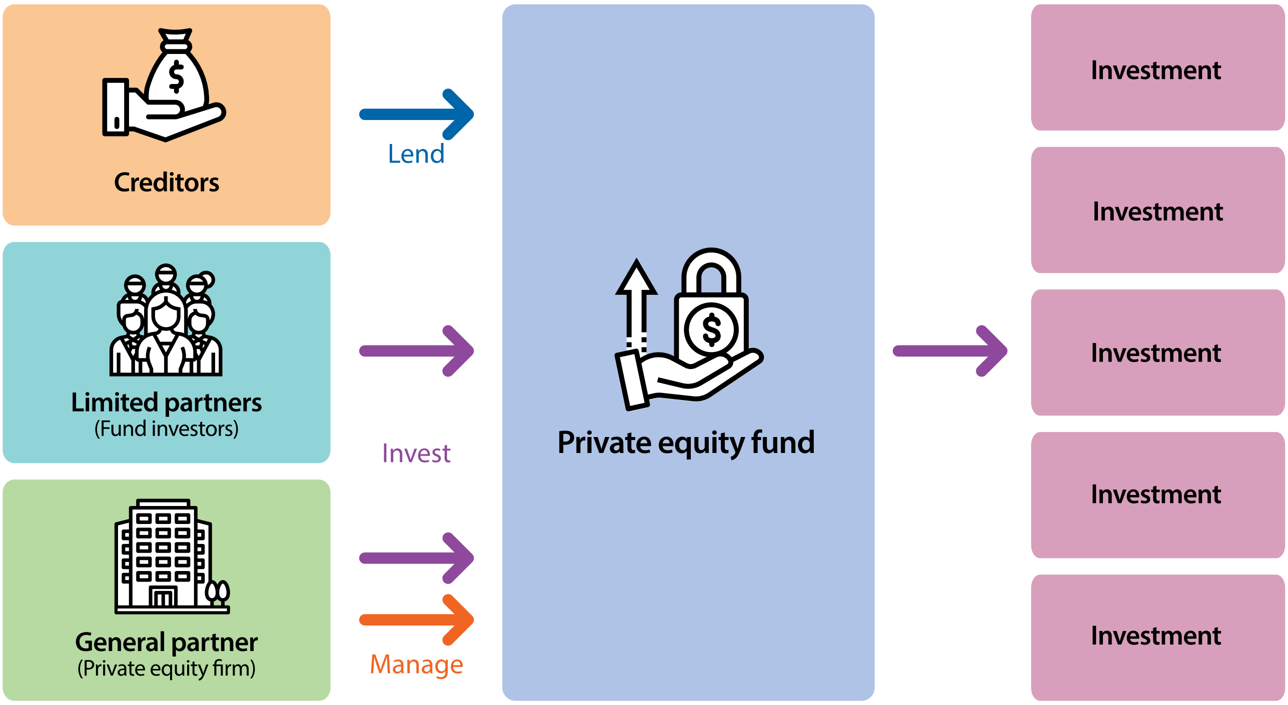
Private equity firms may raise capital for their investments through a combination of equity and debt. The equity component is typically raised from a range of external investors (limited partners) – such as superannuation funds, wealth managers and high net-worth individuals – as well as from the private equity firm itself (general partner) (Figure 1). This equity component may be supplemented with debt financing to increase the total amount of capital available for investment. Private equity firms generally invest in a portfolio of companies and distribute the returns on these investments, after costs, to the investors. The main external investors in Australian private equity funds are institutional investors, particularly superannuation funds and foreign institutions. The prevalence of institutional investors reflects, in part, the fact that private equity funds require a relatively high minimum contribution (subscription) from investors; these investments are also relatively illiquid, with investors typically required to lock their money away for a number of years. Retail investors in Australia nonetheless have some indirect exposure to private equity funds through the funds management industry and listed private equity investment companies.

Private equity firms invest the capital for each fund into a portfolio of companies that satisfies the fund's mandate, such as indicators of growth potential. Investment decisions are normally managed and executed by the general partner of the fund (the private equity firm), with the limited partners (fund investors) paying management and performance fees to the private equity firm for these services. Private equity investments range from a minority stake in a business to buying out an entire company, and can be grouped into three broad categories:

1. **Venture capital.** This involves investment in early-stage or growing companies with strong long-term growth potential.
2. **Buyouts.** These involve the purchase of at least a controlling interest of an established (and often listed) company, often with the intention of improving operations and/or financials before selling the company for a profit. The largest of these transactions are generally leveraged buyouts, which tend to be financed with some equity and a significant amount of debt.
3. **Other private equity.** This involves raising new equity capital to fund further growth opportunities, such as acquisitions, or to improve the company's capital structure.

The objective of a private equity firm is to generate a return on their investments, potentially through selling their equity ownership at some point in the future at a profit. Private equity firms often take some degree of control in the management of a company, with the aim of improving its growth prospects and profitability. Changes may be made to operations and capital structure, staff and management, or the level of investment in research and development to improve a company's

Figure 1: Private Equity Fund Structure



Source: RBA.

products. Upon selling their investments, the firm will distribute net returns to the investors in its fund.

Size of and trends in the Australian private equity market

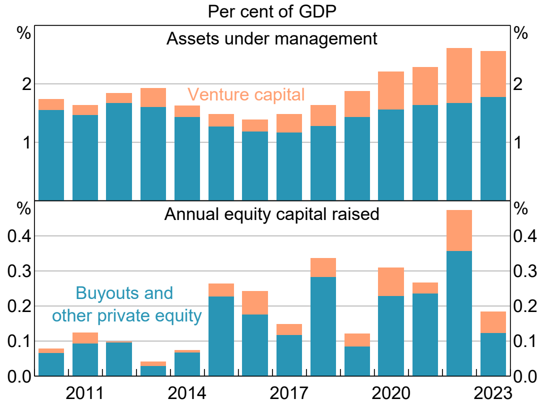
The Australian private equity market has seen significant growth in recent years, particularly as the economy recovered from pandemic-related disruptions.[5] As an indication of market size, private equity funds (both domestic and foreign) with a focus on investing in Australian companies had around $66 billion in assets under management as at June 2023, representing 2.6 per cent of GDP (Preqin and AIC 2024).[6] This comprised around $44 billion in funds already invested in Australian companies, and $22 billion in funds yet to be invested. Nominal assets under management for these funds grew by around 75 per cent from December 2019 to June 2023, with notable growth in venture capital funds (Graph 1, top panel).

While some of this growth stemmed from the returns on the investment portfolios, fund raising has also been a driver in recent years. Aggregate capital raised by private equity funds that have an Australian focus was a record $11.7 billion (0.5 per cent of GDP) in 2022 (Graph 1, bottom panel). This is significantly higher than the $4.1 billion annual average (inflation-adjusted to 2022) over the prior decade. It also greatly exceeded the amount of capital raised on the public equity market through initial public offerings, which, at roughly $1 billion in 2022, was well below the $9.8 billion annual average (inflation-adjusted to 2022) over the prior decade.

Graph 1

Australian-focused Private Equity Funds*

Per cent of GDP



* Private, closed-end funds that predominately focus on Australia. Final AUM observation is as of 30 June 2023.

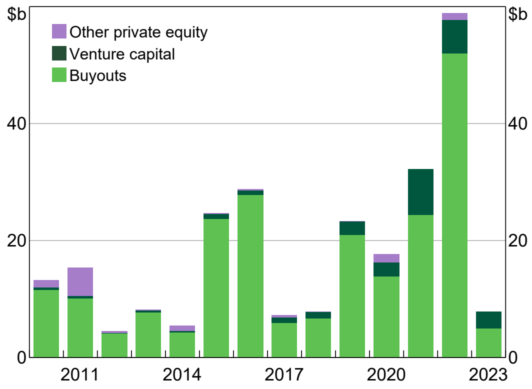
Sources: ABS; Preqin; RBA.

Consistent with the growth in private equity funds with a focus on investing in Australian companies, the value of private equity deals involving Australian companies has increased to a record high in recent years. The total value of private equity deals was $57 billion (2.3 per cent of GDP) in 2022 (Graph 2). This growth was primarily driven by a small number of large leveraged buyouts, in which private equity firms take on more debt to purchase a controlling stake in an established Australian company. Since 2023, however, private equity activity has declined, partly due to higher debt servicing costs.

Graph 2

Australian Private Equity Deals*

In 2023 dollars



* Values include both equity and debt components of deals involving Australian companies. Observations are adjusted using CPI growth.

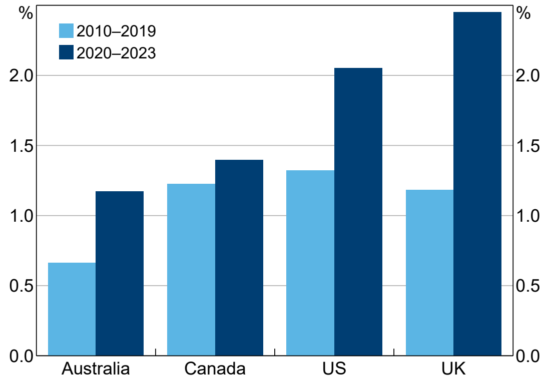
Sources: ABS; LSEG; RBA.

The earlier strength and most recent decline in the Australian private equity market has mirrored private equity activity in other developed equity markets (Graph 3). Earlier strength occurred against a backdrop of rapid economic expansion during the pandemic recovery, low interest rates and strong company balance sheets, including elevated cash assets. Despite this growth, the Australian private equity market remains smaller than some other developed markets. Like Australia, international markets have also seen a decline in private equity activity from heightened levels during the pandemic recovery (Bain and Company 2024).

Graph 3

International Private Equity Deals

Per cent of GDP



Sources: LSEG; LSEG DataStream; RBA.

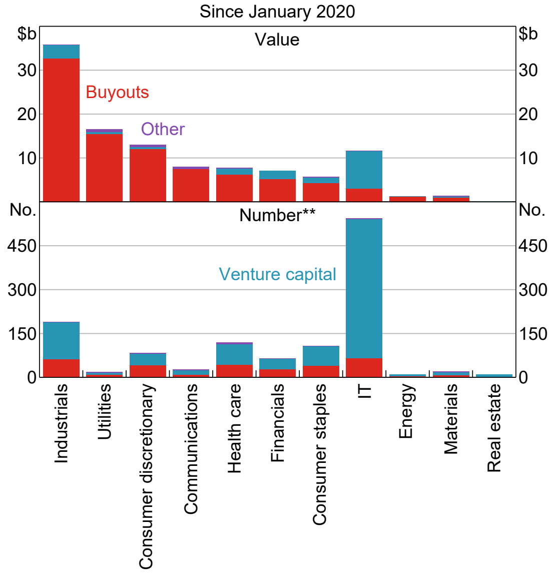
Recent private equity firm investments in Australian companies

In previous episodes of rapid growth in Australian private equity, investments were mostly concentrated in the information technology (IT) sector.[7] While the IT sector has recently attracted the greatest number of private equity deals (primarily driven by investments from venture capital firms), these deals only account for 8 per cent of the total value of private equity activity since 2020 (Graph 4). By contrast, private equity investment in other sectors have been driven by a small number of large buyouts.

Graph 4

Australian Private Equity Deals*

Since January 2020



* Data is to 31 December 2023. Values include both equity and debt components of deals involving Australian companies.

** Includes deals with undisclosed values.

Sources: LSEG; RBA.

Since the start of 2020, the value of private equity buyouts has been highest in the industrials and utilities sectors, with a relatively small value in IT companies. Industrial and utility companies often have stable cash flows and lower risk profiles. This makes them attractive targets for leveraged buyouts from private equity firms as the less volatile cash flows of the acquired company can be used to service debt. Significant deals in industrials include the approximately $25 billion acquisition of Sydney Airport and a large investment in DP World Australia ($6 billion), a prominent shipping terminal and supply chain operator. The utilities sector has also had several significant buyouts, notably AusNet ($10 billion) and Spark Infrastructure ($5 billion), both of which own and manage electrical infrastructure assets. Other notable recent buyouts include the $9 billion acquisition of Crown Resorts – the dominant transaction in the consumer discretionary sector – and the $3.5 billion deal to take telecommunications company Vocus Group private.

Unlike buyouts, the majority of recent venture capital activity in Australia has been concentrated in the IT sector. This is consistent with international venture capital investment, as developing IT companies typically have potentially strong but uncertain growth prospects that rely on high levels of initial research and development – that is, they are relatively risky investments. These companies may also remain unprofitable or generate negative cashflows for some time. To mitigate risk, venture capital firms often diversify their investments across a range of developing companies.

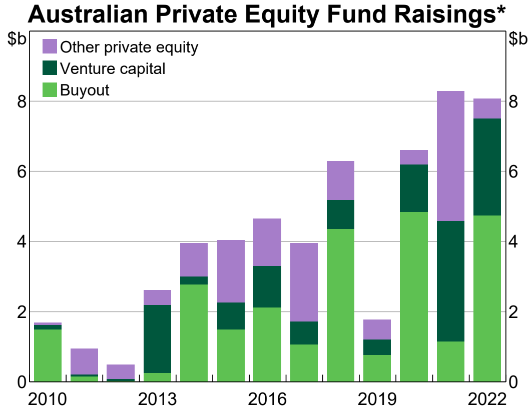
Since 2020, there have been nearly 500 venture capital deals worth a collective $8.5 billion in the Australian IT sector. This includes several later-stage funding deals for companies seeking further growth or to develop new products, such as software company Simpro ($500 million) and Canva ($450 million). The industrials sector has also seen some interest from venture capital firms, resulting in over 100 deals since 2020. The largest among these deals were concentrated on funding for companies providing technical services to support business logistics and operations.

The composition of Australian private equity fund raisings

Private equity funds based in Australia have raised significant capital in recent years (Graph 5). These funds can receive capital from both domestic and foreign investors and can invest in both domestic and foreign companies. While buyout funds generally raise the most capital, there has been a growing interest recently in venture capital and other private equity funds.

Graph 5

Australian Private Equity Fund Raisings*

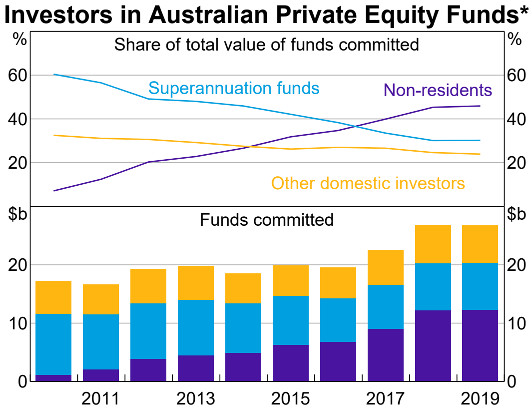


* Capital committed to Australian private equity funds from Australian and offshore investors. These funds may invest in domestic or foreign markets.

Sources: LSEG; RBA.

The share of capital committed to Australian private equity funds from foreign investors rose steadily to 45 per cent in 2019, compared with less than 10 per cent in 2010 (Graph 6). Most of this foreign capital is likely to have come from North America, though Asian investors are an increasingly large source of non-resident funding (Preqin and AIC 2024). Over this period, the Australian superannuation industry has gone from being the dominant investor class in Australian private equity to accounting for one-third of capital committed. Further, superannuation funds have reduced their exposure to unlisted equity over recent years from around 12 per cent of total assets in 2013 to 5 per cent in 2023 (APRA 2023).

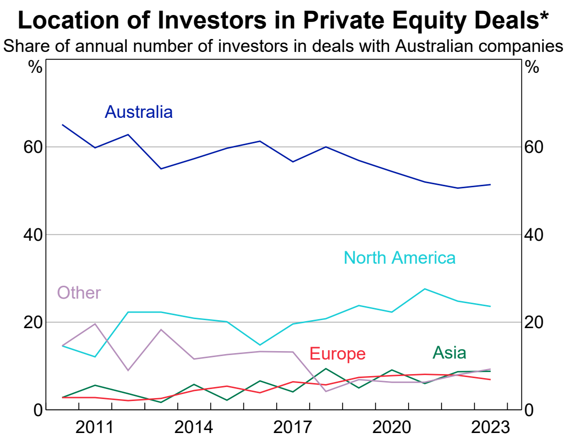
Graph 6



* Capital committed to private equity funds based in Australia.
Sources: ABS; RBA.

Historically, most private equity investments in Australian companies were by Australian private equity funds investing domestic institutional money. However, offshore private equity funds have increased their Australian presence in recent years. In 2023, offshore private equity funds accounted for around 50 per cent of the total number of investments over the year, compared with around 35 per cent in 2010 (Graph 7).[8] This was primarily driven by investments from private equity funds based in the United States. Indeed, most of the largest deals in recent years (such as the acquisitions of Sydney Airport, AusNet and Crown Resorts) have had significant – if not sole – contributions from foreign private equity funds based in the United States or Canada.

Graph 7



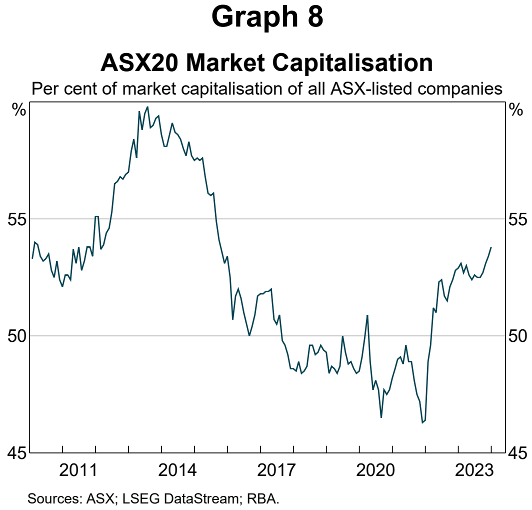
* An investee company can receive funding from multiple private equity funds in each round.
Sources: LSEG; RBA.

The implications of a larger private equity market

There are both benefits to, and costs of, a larger private equity market. In particular, there are upside and downside risks to economic growth and capital efficiency.[9] In Australia, the private equity market remains primarily focused on smaller companies. This is despite some sizeable deals in recent years, with the level of assets under management in Australian-focused private equity funds being less than 3 per cent of listed equity market capitalisation. Further, some of the recent growth in private equity may eventually be absorbed into the public equity market.

The private equity market plays an important role in supporting the efficient allocation of capital to companies.[10] New, innovative businesses and products often seek external capital investments at a time when their growth prospects and earnings potential are highly uncertain. Venture capital firms are among the private equity firms specialised in assessing early-stage funding. Underperforming companies may also be targeted by private equity investment, which can bring expertise and experience to help maximise growth. The threat of takeover, including through buyout by private equity firms, can also discipline existing management to improve company performance.[11]

Some research, however, also indicates that the public equity market is more efficient at allocating capital than the private equity market – partly because unlisted firms are generally subject to less stringent public reporting and governance obligations.[12] Removing companies from public listing lowers transparency and may make it more difficult for investors to compare company and management performance to make informed investment decisions. Heightened levels of private equity buyout activity may reduce the diversification of the public equity market. Private buyouts of large companies have removed equity capital from the Australian public equity market at a time when there were limited inflows of new listings and initial public offerings. This has contributed to a greater concentration of the biggest companies in the public equity market, although only to around the average of the past 14 years (Graph 8).



Conclusion

The private equity market is an important source of funding for many Australian companies, particularly for smaller or riskier businesses that have difficulty raising capital in public markets. The Australian private equity market grew over several years to 2022 before declining in 2023, mirroring a heightened period of private equity activity in other developed markets. Growth was supported by broad-based economic expansion during the pandemic recovery, historic low interest rates (which makes leveraged private equity more attractive) and other accommodative policy measures. International private equity firms and investors increased their participation in deals involving Australian companies, and Australian private equity firms sourced around half of their capital from foreign investors.

A large, competitive private equity market can contribute to promoting an innovative, efficient and dynamic business sector in Australia. This is true for both companies that receive private equity investment, and for peer companies where the possibility of a takeover can provide more discipline on existing management. However, greater private equity market size and activity could also reduce the size and diversification of the public equity market. Despite some larger deals in recent years, the Australian private equity market remains small compared with international markets. It is also much smaller than the public equity market.

Endnotes

[*] The authors completed this work in Domestic Markets Department. They would like to thank Ed Tellez and Iris Chan for their help with preparing this article. While every effort has been made to ensure the quality of the data used in this article, different data vendors may use inconsistent methodologies and some details about specific private equity transactions are undisclosed. As such, the values reported in this article should be treated as estimates.

[1] Assets under management in Australian-focused private equity funds represent only a portion of the total stock of private equity financing for Australian businesses. The value of private equity financing from other sources, such as friends, family members, and angel investors, is often undisclosed.

[2] Though some private equity investments may be in large, mature companies that are seen to be underperforming, poorly managed or undervalued.

[3] For further discussion on internal and external business finance in Australia, see Connolly and Jackman (2017).

[4] In this article, 'private equity' is used as an umbrella term that includes venture capital.

[5] The Australian private equity market encompasses both domestic and foreign private equity investments in Australian companies. Private equity firms based in Australia are discussed separately below.

[6] The scope of assets under management and fund raising data as shown in Graph 1 includes only private closed-end funds that predominantly focus on Australia, regardless of manager headquarters.

[7] For discussions on previous episodes of Australian private equity market growth, see Connolly and Tan (2002) and RBA (2007).

[8] Individual private equity deals often involve multiple private equity funds, with the value of each fund's differing contributions often undisclosed. As such, it is difficult to precisely measure the proportion of aggregate private equity deal value that is sourced from foreign private equity funds.

[9] For a broad review of academic research on the effects of private and public equity markets, see Bernstein (2022).

[10] For further discussion on the positive influence of private equity investment on economic growth and innovation, see Samila and Sorenson (2011).

[11] For more information on the positive spillover effects of private equity investments on peer companies, see Aldatmaz and Brown (2019).

[12] For further discussion on the capital allocation efficiency gap between public and private equity markets, see Sanati and Spyridopoulos (2024).

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