

# Market truths with a smile

At the recent AVCJ Forum in Sydney, the Founder and Chairman of Principle Advisory Services spoke candidly about challenges, opportunities and why Australia's "no bullsh\*t" culture is good for investors

**Q: What are the top two challenges the private equity and venture capital industry is facing as we look forward through 2011?**

**A:** Here in Australia we are facing challenges on the deal side and challenges on the capital raising side. And, these are the two most important components of any private equity fund.

On the deal side, because the economy is booming and because there's a lot of mining money around, by international standards we are very prosperous and very bullish. The prices of acquiring businesses are high and expectations of what private equity can add are low. So it's very difficult to buy well and add value; and that's always a challenging dynamic for private equity.

Globally many economies are depressed, which means that there is probably better buying outside Australia in the mid-market and large buyout space than there is inside Australia at this point in time. Money will still be made but there will be challenges.

**Q: And what about on the capital raising side?**

**A:** On the fundraising side, the real issue is that there's been a little bit of a structural shift in investor sentiment about private equity, partly driven by fees, and partly driven by the euphoria of the period 2002-2008, when private equity was flavour of the month. Lots of investors loaded up very heavily [with commitments to the asset class] without necessarily understanding the illiquidity and risk involved.



Now that the economy is in a different place than it was when those commitments were made, it's taking longer to deliver returns, and those returns may be down a little bit. A number of important private equity LPs are disenchanted, and it's certainly the case that the advisor community is disenchanted, so raising money is hard.

**Q: Every market has a distinct reputation where strategy, market dynamics and managers are concerned. What would you say is the hallmark of Australian GPs that make them compelling as an investment proposition?**

**A:** I made my first PE investment in 1994, and the hallmark has changed significantly since then – particularly over the past 5-6 years. Australia now has a very well developed group of experienced deal doers that are tough, single-minded, hard-headed and very commercial. As a consequence, the distinguishing characteristics

of the market now are that we have a solidly based, no-nonsense, commercial outlook. Australians are very direct; it's a no bullsh\*t country. People here want to get to the point and they want to do good business.

This personality is very good for investors. It's also very good for the businesses that are partnering with private equity, because you get a partner who is realistic, straightforward and transparent.

**Q: As someone whose job it is to help firms raise money from global investors, how significant a hurdle is the taxation issue? What else is complicating the fundraising landscape?**

**A:** It doesn't help, but there are always taxes. The tax issue is frankly not as big as the management expense ratio (MER) issue in the minds of [domestic] LPs. They are looking for low-cost fees and private equity can't really deliver that in the way that investors want. In effect that means we are being measured on cost of inputs

rather than the net returns to investors. So, the tax isn't helping, but it's not the biggest issue right now.

**Q: Apart from your contributions to the private equity industry here, you have a long history in social activism and charity. Can you talk about that?**

**A:** I'm the Chairman of a large, Australian charity called the Fred Hollows Foundation, [an international development organization focussing on blindness prevention around the world, and Australian indigenous health domestically]. I was in Nepal two weeks ago, I'm in Vietnam next week. I encourage everyone to look at the website and maybe even make a donation, because we do wonderful work.

**Q: If you weren't in private equity, what would you be doing today?**

**A:** I'd be running an art gallery. I have a little problem with art buying, as everyone knows. People who go to our website or visit our office can see that I'm spending a little bit too much time on my art collection. ■

*\* For more information or to donate, please visit [www.hollows.org.au](http://www.hollows.org.au)*

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– Les Fallick