

Biennial Convention 2007

# Adventures in Risk

23-26 September 2007 • Christchurch, New Zealand



Institute of Actuaries of Australia



## Private Equity

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## Private Equity – Agenda

- Characteristics
- A private equity bubble?
- What's important

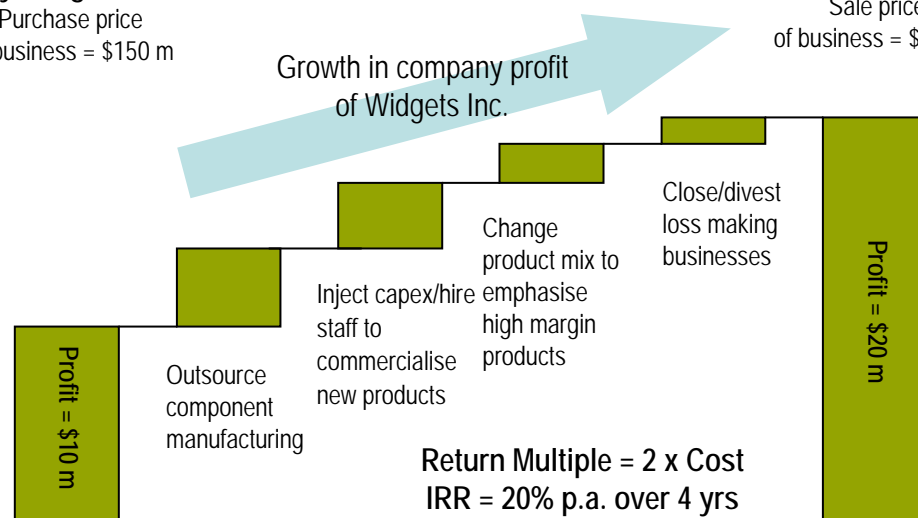


## Private equity is “managed entrepreneurship”

- **Venture capital** fund managers bring capital, contacts, and skills in a potent cocktail to help drive growth in their investments
- **Buyout** fund managers take majority stakes in companies to enact significant strategic and operational change

Buy Widgets Inc.  
Purchase price  
of business = \$150 m

Sell Widgets Inc.  
Sale price  
of business = \$300 m



Return comes from activist value creation not just passive capital investment



## Definitions: Closed End Funds

**Commitment:** Investors commit to investing a fixed amount during the life of the fund.

**Drawdown:** When the fund acquires a business, committed capital is *drawndown*

**Fund term:** Funds have a fixed term, usually 10-12 years and is wound up after that period.

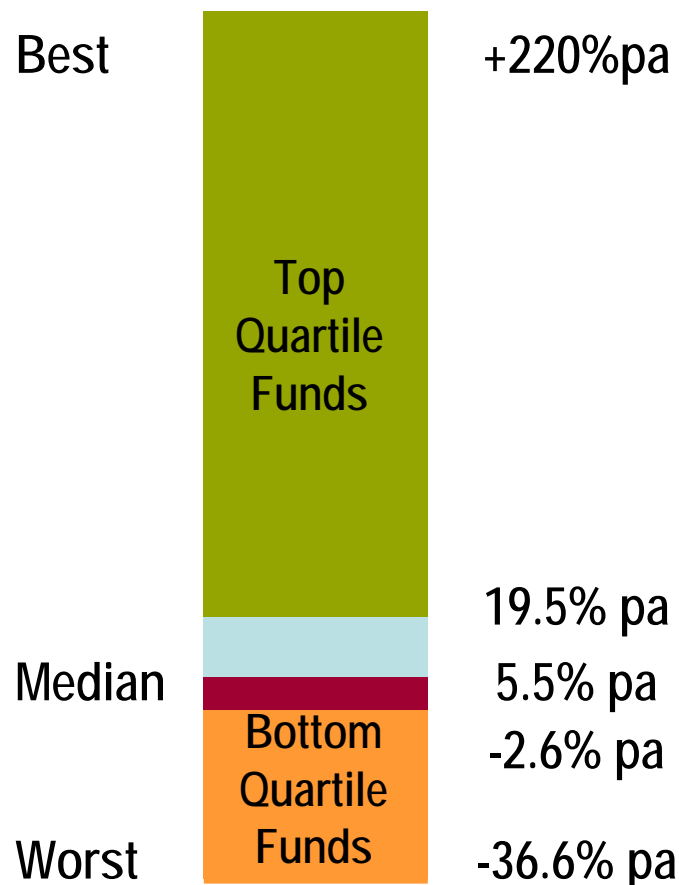
**Vintage Year:** The year the fund was formed. Due to the cyclicity of the asset class, the best comparisons are with other funds of the same vintage year.

⇒ *Difficult to forecast the timing of drawdowns and distributions*



## Key is accessing the best

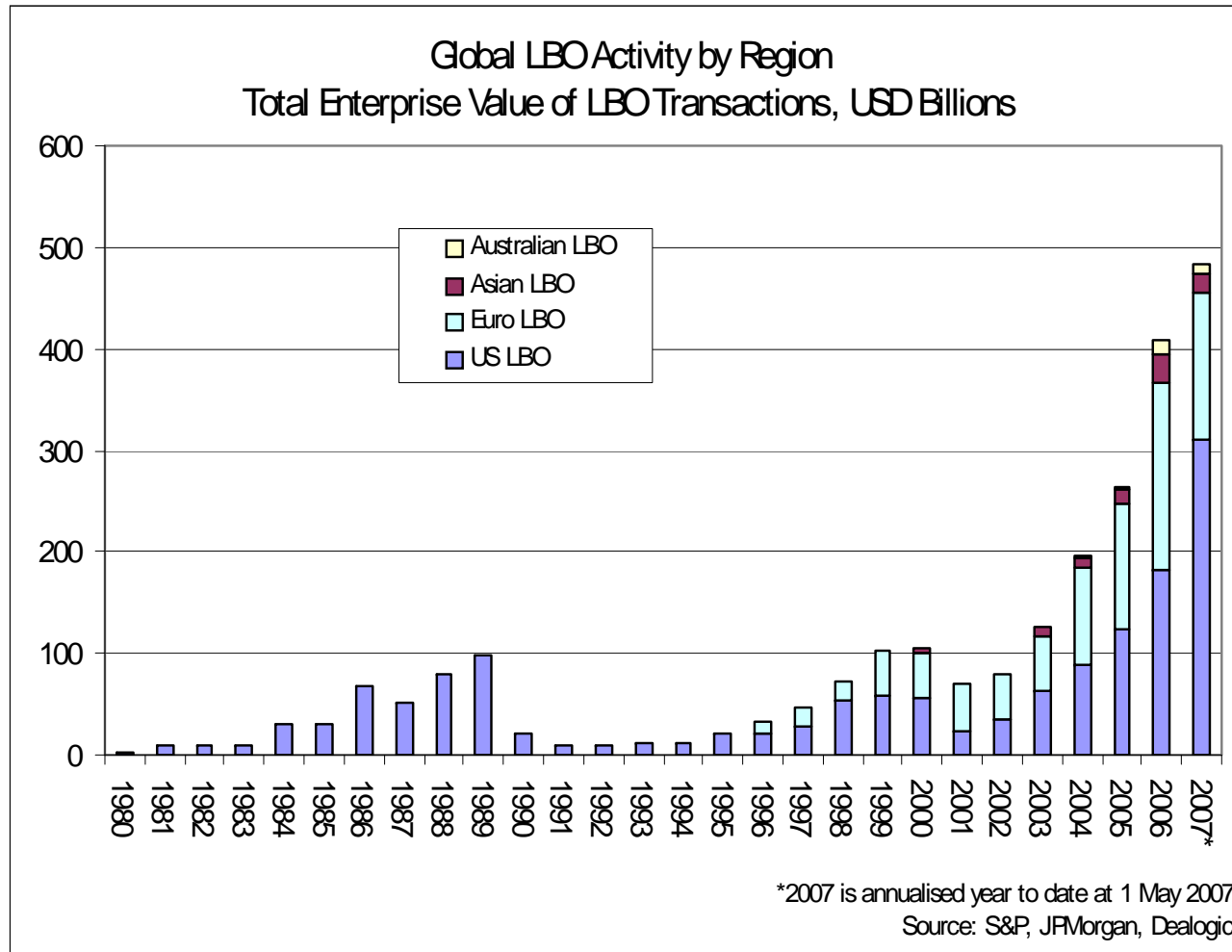
- Wide quartile spreads
- Best deals go to the best managers
- Virtuous circle → persistence
- The challenge is access, not identification



Source: Venture Economics: Simple average of US vintage year returns for funds formed up to 2003 Vintage Year, as at Dec 2006

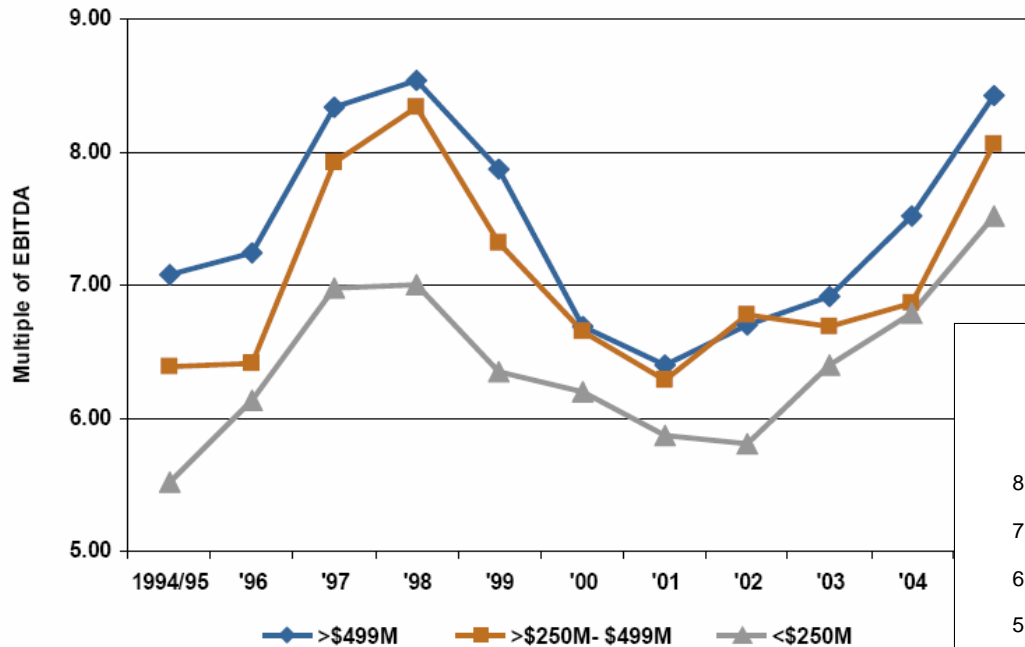


## A private equity bubble?



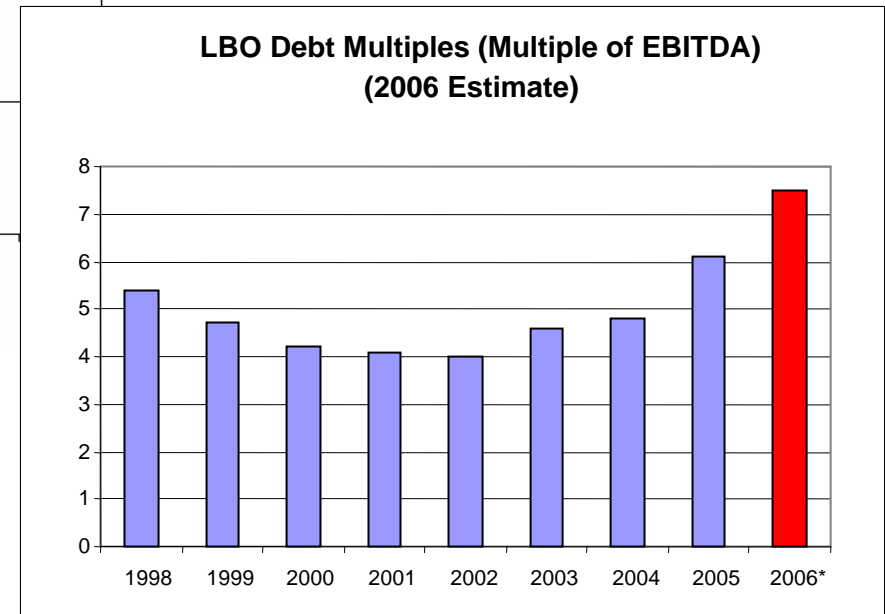


## Rising purchase prices and debt levels



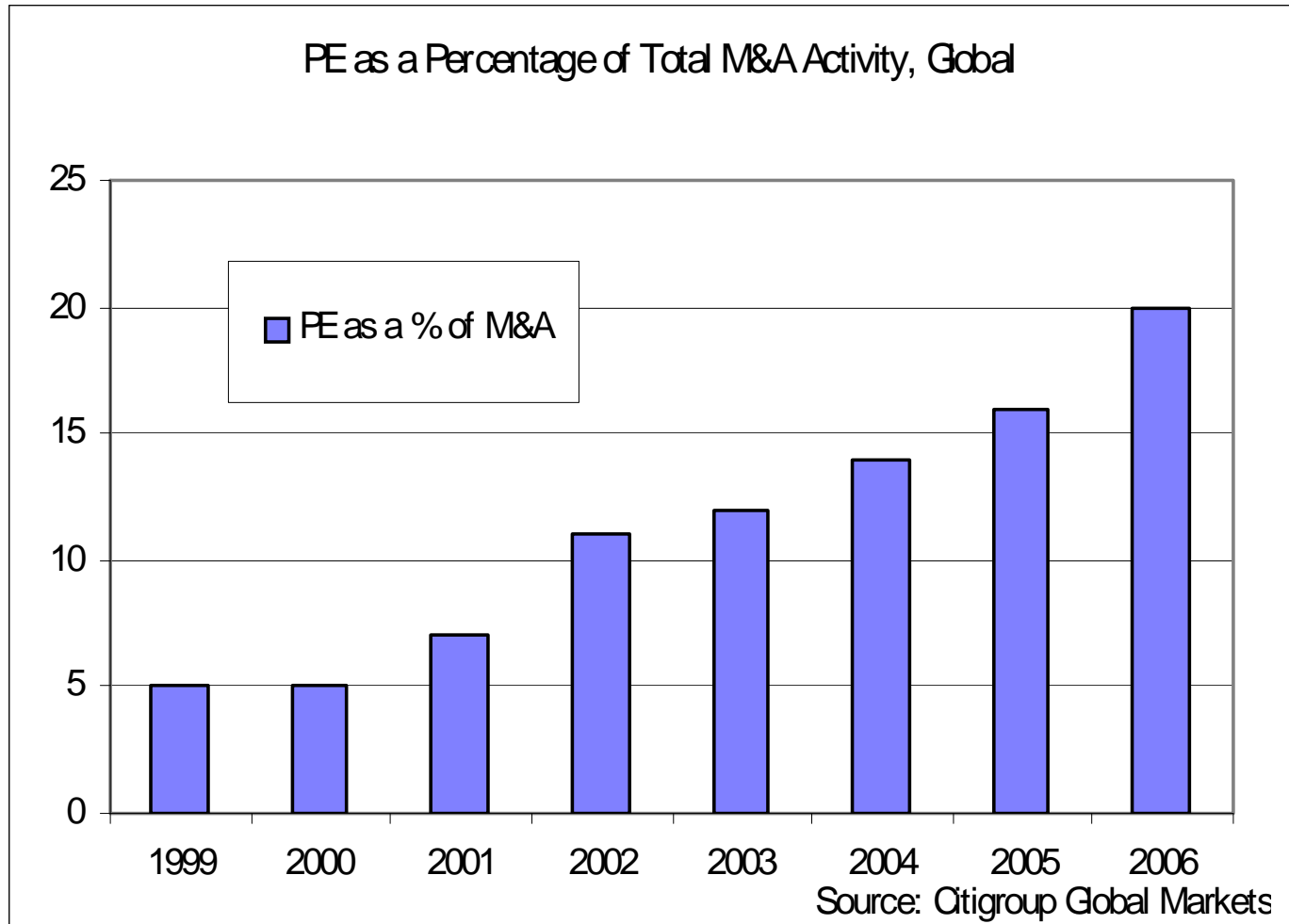
Prices paid  
(multiple of EBITDA)

Debt levels  
(multiple of EBITDA)





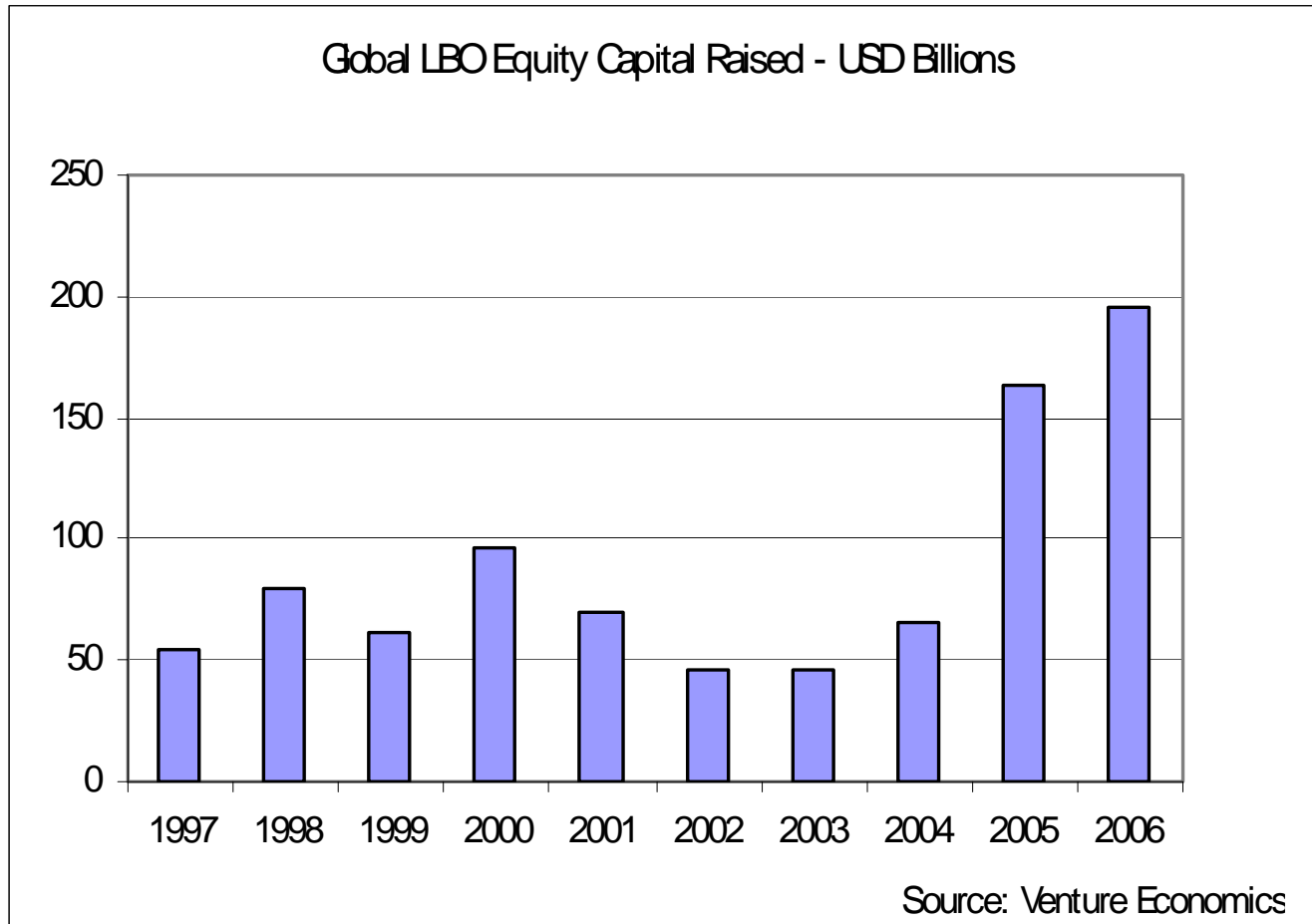
## Quadrupling of private equity's share of M&A





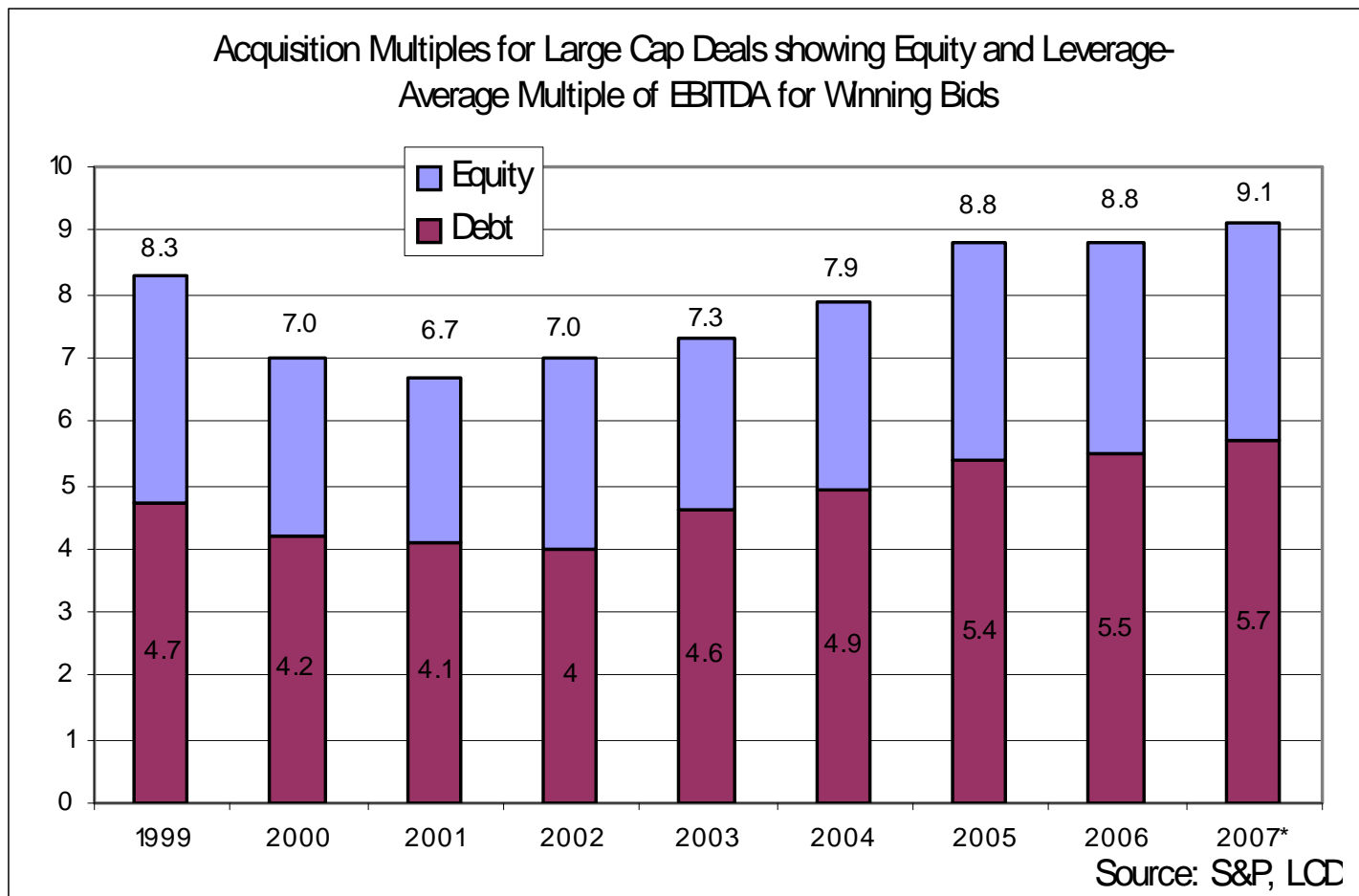


## A wall of capital to looking for deals



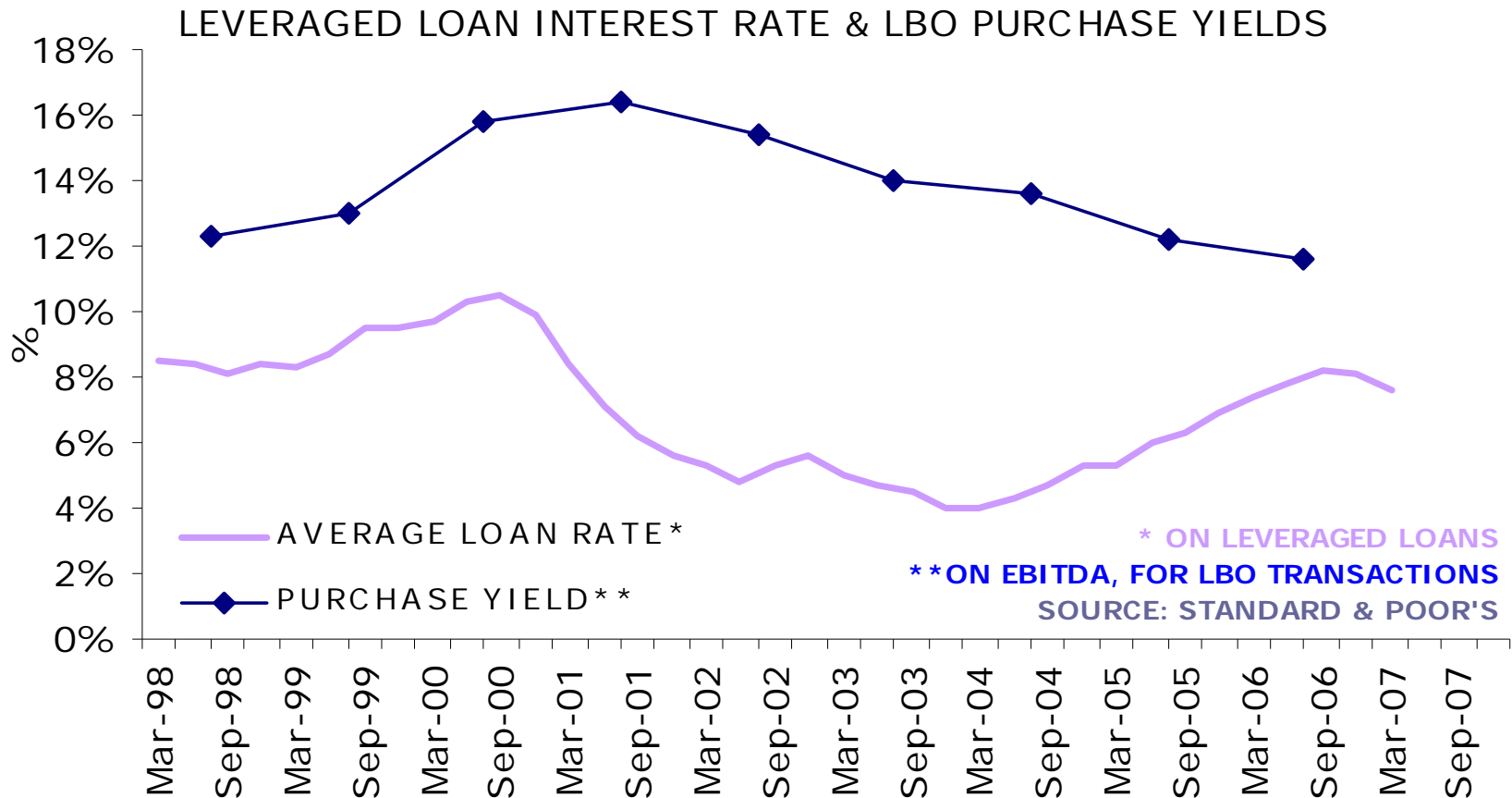


## Higher prices funded by leverage





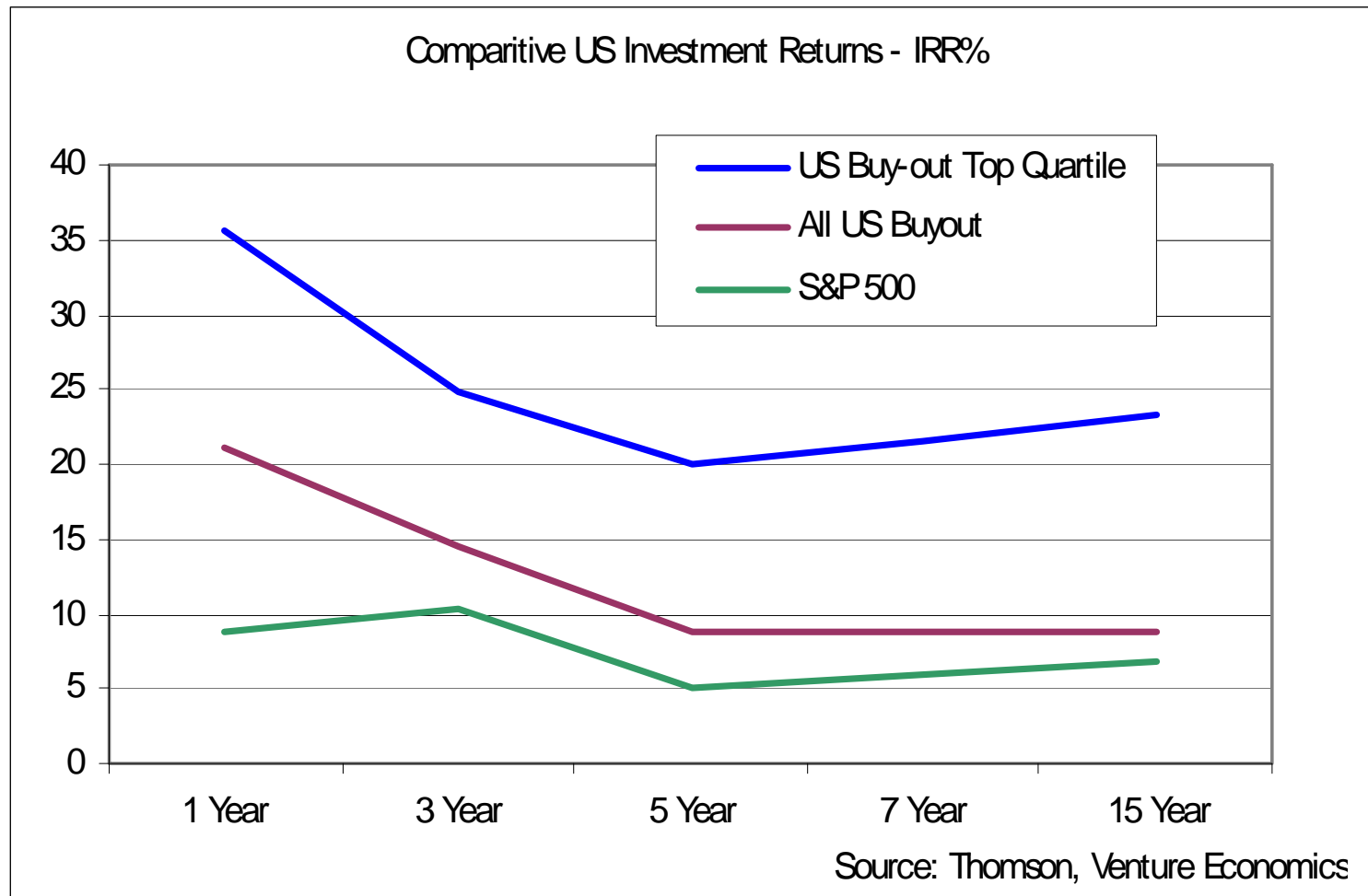
## Margins ain't what they used to be



Source: Morgan Stanley



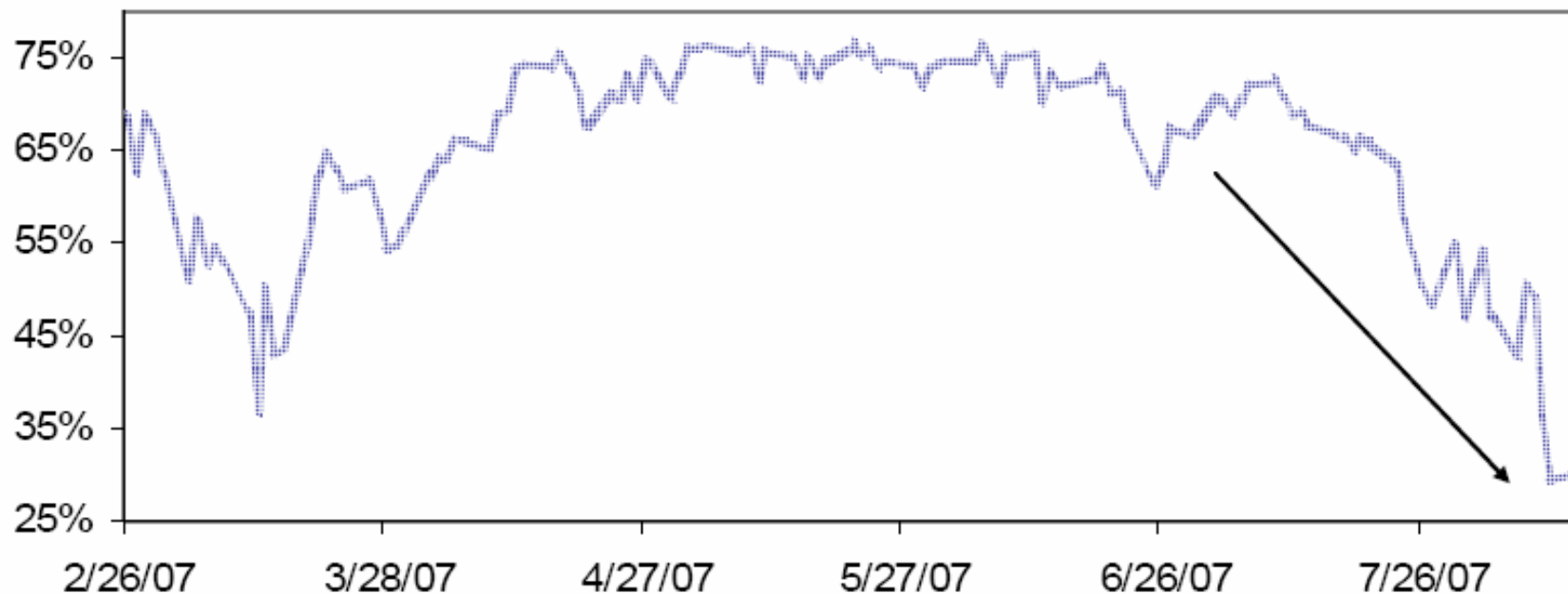
## 20 is today's 30





## The bubble has now been pricked!

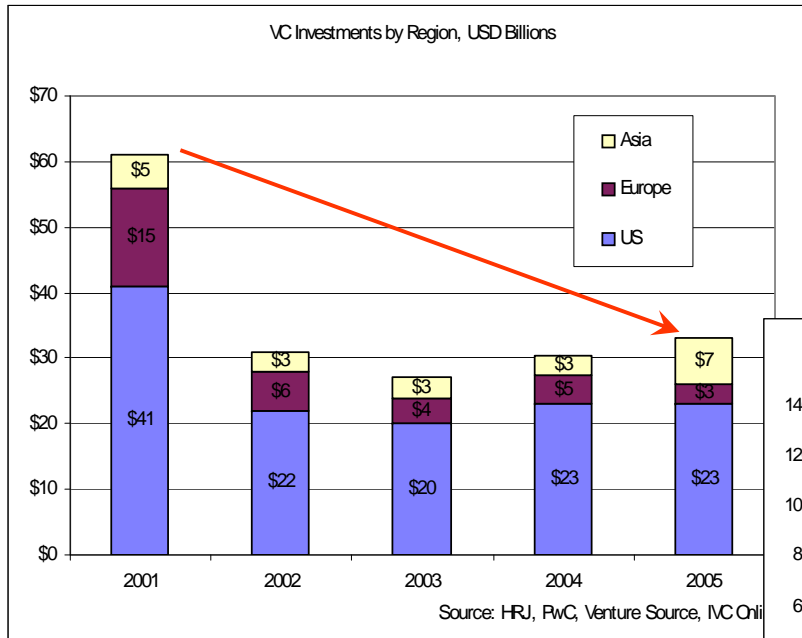
Probability of M&A Deal Going Through



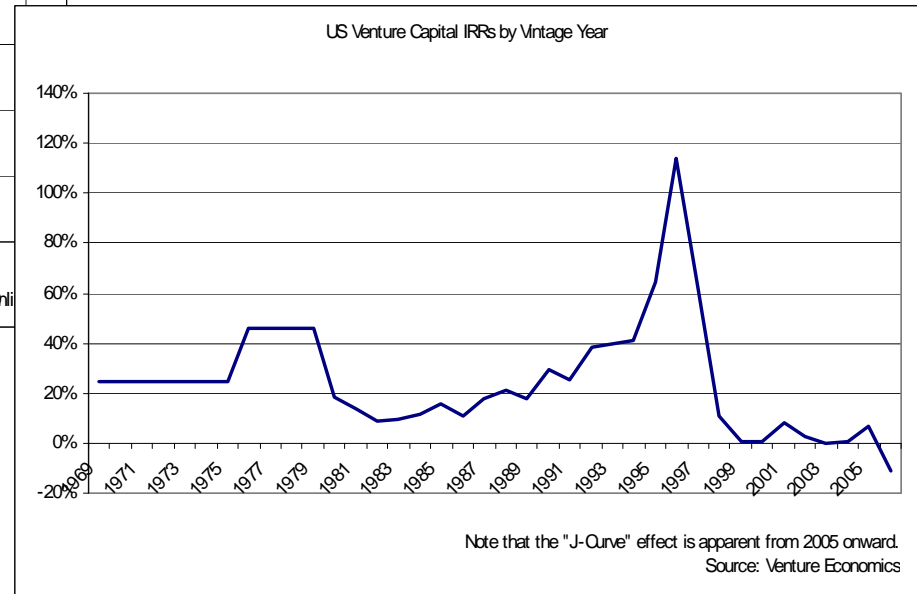
Source: Bridgewater® Daily Observations 21 August 2007



## Venture Capital – ugly sister or opportunity?



And returns evaporated



VC investments halved since 2001



## What's important...

- Access to top tier managers is key
  - Sophistication, discipline, consistency, quick decisions
- Vintage year diversification
  - Today's commitments invested over 1-3 years
  - You can't time the cycle
- But be prepared to say no
- Today?
  - don't confuse leveraged luck for skill
  - look for fundamental value creation

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