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The smart money's on artificial intelligence

PEP co-founder Tim Sims has seen investment and technology fads come and go, but he is certain that the latest is here to stay and will revolutionise the workplace as we know it.

By DAMON KITNEY June 4, 2023

Pacific Equity Partners co-founder Tim Sims: 'AI has grown faster than any other consumer product in history'. Picture: John Feder

Over a quarter of a century as one of the country's most successful and longest-serving members of the lucrative private equity industry, Tim Sims has seen many investment and technology fads come and go.

But the co-founder and managing director of Australia's largest private equity fund, Pacific Equity Partners (PEP) is certain that the latest – and most controversial – is here to stay and will revolutionise the workplace as we know it.

“Since their release, AI and Large Language Models or LLMs (such as ChatGPT) have grown faster than any other consumer product in history. Unlike previous technology revolutions, they will not so much reshape manual labour as the ‘mind labour’ jobs, which ironically, is often the more highly paid and credentialed employment in today’s economy,” Mr Sims told The Australian in a wide-ranging interview as PEP celebrates its 25th birthday this year.

“According to the early evidence, tasks will be completed faster, at higher quality and with more job satisfaction than before. It has been suggested that this will add 7 per cent to GDP growth over the next 10 years. That’s an opportunity that must be addressed by private investors, as we look to improve the performance of our businesses and produce high returns.”

Indeed Mr Sims believes there are not only obvious applications for these technologies in improving productivity in private equity portfolio companies, but also in the deal selection and diligence processes.

“They are already an increasingly relevant part of the process. But I’m an old-fashioned guy. My view is that there will always be a place in a skills-based system for judgment, experience, and frankly, for trusted human relationships,” he said.

His comments come at a fascinating historical inflection point for the evolution of artificial intelligence (AI), as last week more than 350 global CEOs, experts, scientists and celebrities outlined the existential risk posed by the advancing technology.

In a joint statement, they called for the mitigation of AI risk to be a “global priority” alongside pandemics and nuclear war.

The success of ChatGPT has raised concerns among experts, policymakers and the public about the potential uses of AI.

Last week the federal government released a report on the emerging technologies by the National Science and Technology Council and a discussion paper on how to achieve “safe and responsible” AI. The government is considering a ban on “high-risk” uses of artificial intelligence and automated decision-making.

Mr Sims said that with all technology advances, there was the potential for huge benefits but also substantial misuse and abuse.

“On average 25 per cent of all industry employment is exposed to replacement by automation, with legal, office and admin at close to 50 per cent. On the other hand, it is worth remembering that the clear pattern we have seen repeated over time –

with for example, the ‘Industrial Revolution’ and the violent angst of the Luddite rebellion – is that new technologies do bring new jobs,” he said.

“Disruption is real and requires retraining and astute policy support, but is soon replaced by a new and more prosperous system. Already, nearly a million new jobs right now are being advertised for AI in the US.” Mr Sims was speaking after addressing the 14th annual Family Office Congress of the Private Wealth Network, a closed-door forum in Sydney attended by a host of rich-listers and top family office executives.

Founded in Australia by Richard Milroy and Alan Duncan, the deeply private PWN is a global membership community for individuals and families of significant wealth, with activities across Australia, New Zealand and Singapore and connections to Asia, Europe and the US.

One of the key speakers at the Congress was Smorgon family scion Peter Edwards, executive chairman of the Victor Smorgon Group, who discussed how to structure and run an enduring family business.

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Tim Sims, co-founder Pacific Equity Partners

One topic discussed at the forum by Mr Sims — and a key reason he attended — was the growing allocation of family offices to alternative asset classes, including private equity.

Over its 25-year history PEP has delivered an average 23 per cent return to its investors and a close to zero loss ratio across all its funds from 37 major corporate deals and 150 bolt-on transactions.

“Traditionally families have been significantly under-allocated relative to sophisticated institutions. The good reason for that has been the mechanics of how you select and how you engage with private equity have not been straightforward. PE often presents as a mystery industry with high minimum investment tickets and challenging selection and access processes. What we are seeing, though, increasingly, as people reflect upon the volatile market experience that we have had in recent years, is that they are increasingly aware of the limitations of traditional investment strategies. The best of private equity product streams look very attractive," Mr Sims said.

"At the same time as families have been looking and saying, 'Hey, those returns look pretty attractive', private equity has been working towards being more accessible. We are interested to establish relationships and dialogue with private investors because they can be a very rich source of wisdom and deal flow."

PEP started raising capital last year for its newest arm, known as PEP Gateway, targeted at high net worth investors and self-managed superannuation funds.

The international fund of funds offering has been marketed as a one-stop-shop for wealthy clients to get into trophy deals struck by other global PE managers in addition to PEP's own buyouts.

Mr Sims said the strategy had been underpinned by PEP's "very cosmopolitan background and DNA".

"We've worked in all major economies in most major industries already. There's also a degree of sameness, at least conceptually, about private equity in any geography," he said.

PEP Gateway was the fourth strategy in the firm's stable. The others include buyouts, secure assets (infrastructure-like investments) and capital solutions, which invests across the capital structure.

Mr Sims said he expected private equity deal-making to return to historic activity levels in the year ahead, revealing the number of transactions reviewed by PEP last year fell slightly to 109 from an average of 117 per year over the previous five years.

"In recent times, things have been more constrained. We believe that is because many of the potential vendors are reluctant to show their companies, given the unusual recent history and an environment which they perceive to be one where they won't necessarily achieve full value," he said.

"Of course, the irony is that the market is much less damaged than many potential vendors believe. In the local market a typical 'leveraged buyout' or LBO deal may run at 50 per cent gearing, which is similar to the blended average of the public market sectors."

He stressed LBOs were not being "distinctively penalised" by the rapid rise in global interest rates over the past 18 months.

"While interest rates have gone up steeply and while the cost of leverage has increased accordingly, we are only going back to historic norms. For essential goods and services – that is, non- discretional goods and services – customer demand continues to be robust. In fact, there are some sectors where demand is more than in the past as people express new post-lockdown habits," he said.

While Mr Sims has long stressed that PEP's analysts are not macroeconomic specialists, he said the firm expected inflation to be tamed more easily by the world's central banks than some market commentators believed.

"If you actually look at some of the key drivers in the system, you can see that many of the supply chain constraints which were a key element in igniting inflationary pressures turned the corner in June of last year," he said.

"We tend to invest in companies that may not necessarily be inflation-proof, but are inflation-resilient. So my only comment on inflation would be that we think it is likely that inflation will be tamed more easily than some commentators – particularly in the US – suggest. There the debate has essentially become a political issue."

While the private equity sector has been a prime candidate for healthy scepticism ever since the colourful and infamous story of Barbarians at the Gate 35 years ago, Mr Sims said "slash and burn" strategies were not typical of the private equity industry.

"Historical attribution analysis, which looks at PEP's value creation patterns over the last 25 years, clearly shows that the largest part comes from adding new products and services," he said. "The ready access to capital for new programs and the immediate presence of integrated experienced resources alongside excellent management.," he said.

"We are in fact a highly tuned management service firm with capital."

DAMON KITNEY

COLUMNIST

Damon Kitney writes a column for The Weekend Australian telling the human stories of business and wealth through interviews with the nation's top business people. He was previously the Victorian Business Editor ... Read more