Mergermarket

Pemba Capital gets granular in Australia’s lower mid-market

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Proprietary

by Tim Burroughs

- Recent AI reassessment underpinned by systematic approach to sector coverage
- Early moves into software, animal health, accounting influenced by global PE models
- Fund sizes creeping upwards, but GP committed to sub-AUD 10m EBITDA entry point

Pemba Capital Partners took its team off tools earlier this year for a deep dive into artificial intelligence (AI). This led to a rewiring of the traffic-light system that underpins 1,000 niches within five target sectors: amber to green in areas seen as beneficiaries of AI-enabled efficiencies, and green to red where once-attractive niches are likely to be torn apart by automation.

“It took three weeks to re-prioritise and align on the investment strategy, given the impact of AI. Speaking to our LPs, it doesn’t seem like many firms have gone through this exercise,” said Tom Matthews, a managing director at the Australia-based mid-market private equity firm.

“Some areas we were targeting in professional services, for example, are now red-lit. Think about actuarial consulting, parts of legal services, traditional management consulting, and certain information and data consulting businesses – there’s likely to be a significant impact. Equally, some niches where AI-enabled firms have the potential to disrupt relatively tech backwards markets have been green-lit.”

A similar process played out across technology, healthcare, financial services, and education. In financial services, AI can make providers of warehouse facilities to lending organisations more efficient: green light. Insurance broking will see its competitive moats

break down further: red light. In technology, mission-critical software verticals are set to thrive, while horizontal players struggle.

Those 1,000 niches are the product of a systematic approach to deal sourcing. Pemba is organised by sector team – each one comprising a lead partner, a support partner, dedicated and supporting transactors, and a dedicated originator – that breaks down sub-sectors and niches, debates the relative merits of each, and identifies potential targets.

“Teams meet on a weekly basis, overlaying our key investment criteria against niches to see if they fit,” said Matthews. “Once we build conviction around a thesis within a niche, we map every company in the niche that’s headquartered in Australia and New Zealand, and we reach out to the owners.”

The overriding objective is to secure early access to defensive growth niches, supported by high barriers to entry, resilience in the face of recession, clear visibility on revenue streams, and industrial fragmentation that enables buy-and-build strategies.

Inspiration offshore

Pemba has always been a buy-and-build investor, willing to take founder risk and scaling risk. The bulk of Australian middle market PE players favour more mature, corporatised businesses, often filtering out anything with EBITDA below AUD 10m (USD 7.2m), according to Matthews. Pemba’s coverage starts much earlier, which in turn filters out most of the competition.

“Buying companies with zero to AUD 10m in EBITDA; even a AUD 300m fund in Australia wouldn’t go that deep,” added a source familiar with the firm. “Getting in small and early translates into an average entry valuation of 6.7x EBITDA, which is very low for developed market buyouts.”

That data point applies from Fund I, when the firm completed its transition from captive to manager of third-party capital. Pemba began in 1998 as RMB Capital Partners, a private equity operation established under the Australian investment banking unit of South Africa’s FirstRand Group. A management buyout in 2009 made the business independent, and then FirstRand sold the portfolio in 2016.

PEMBA CAPITAL PARTNERS - AT A GLANCE	
Offices	Sydney
Employees	35
Funds	Pemba Capital Partners Fund I (2016) AUD 650m* Pemba Capital Partners Fund II (2021) AUD 400m Pemba Capital Partners Fund III (2023) AUD 625m ** AUD 400m in new capital, AUD 250m to take out positions held by former parent*
History	Founded in 1998, manager became independent in 2009 and raised third-party capital from 2016; around 50 platform investments, plus more than 200 bolt-on acquisitions
Assets under management	More than USD 1.5bn

This was achieved through a secondary transaction whereby a HarbourVest Partners-led group acquired the existing positions for around AUD 250m and provided another AUD 400m for the team – which later rebranded as Pemba – to pursue new investments. The LP base for this fund, and those subsequent, entirely comprised offshore institutional investors.

Around the same time, the firm replaced its sector-agnostic approach with defensive growth, drawing inspiration from other markets.

"We spend a lot of time looking overseas at best-of-breed overseas private equity models, particularly buy-and-build, in deeper private equity markets like the UK, Europe, and the US. We think about how we can tailor those unique aspects to the Australian market," said Matthews. "It helps that our managing director cohort has international backgrounds."

Matthews, who joined Pemba from UK-based Sovereign Capital, is one of three cohort members that predate Fund I. The others are Mark Summerhayes, who co-led the spinout in 2009, and Magnus Hildingsson, formerly responsible for Nordic coverage at Cinven. Mark Bryan arrived in 2020 from local asset manager Wilsons, while Robert Haybittel has risen through the ranks at Pemba.

The firm claims to have been an early mover on software and cybersecurity in Fund I, backing ReadyTech, which listed in 2019, and Open Office, Bepoz, and Ampion, all sold to strategic investors between 2021 and 2023. ReadyTech and Open Office generated returns of 5x and 4x, respectively, helping the fund – now nearly fully exited – to 2.2x and a 28% net IRR, said the source familiar.

Funds II and III closed on AUD 400m and AUD 625m in 2021 and 2023, respectively, and each has made about eight platform investments. Once again, Matthews points to established PE-driven consolidation trends in the UK being replicated in Australia, notably in animal health and accounting and advisory.

Growth stories

TPG NewQuest recently endorsed the animal health trend, anchoring a USD 255m continuation vehicle (CV) for veterinary clinic platform Vets Central. This has delivered a 5x return, helping Fund II move to 1.6x and a 17% net IRR and pushing distributions to paid-in (DPI) past 1x, the source familiar added.

The transaction also resolved the issue of how to drive growth in a business that, even after expanding from six clinics to more than 80 in five years, still had much to give. Pemba found that no strategic investor was willing to pay a premium for Vets Central that reflected this unrealised upside, while Fund II didn't have the resources to continue supporting it.

"There's a big tail of clinics to consolidate. There are 4,600 clinics across Australia and New Zealand, and only 15% are owned by corporates, whereas in the UK, over 50% of the market is corporates," said Matthews, noting that Sovereign Capital rode this wave in the UK with CVS Group, which listed in 2007.

"We thought the most likely ultimate buyer would be an overseas trade player that has run out of growth in their core market and wants to expand internationally. But the timing must align with the strategic roadmap, and we didn't have the level of interest to go down a full exit route at the time. So, rather than sell to a competitor, we found a way to continue to ride the upside."

TPG NewQuest had been studying Pemba's portfolio as it looked toward Australia – mid-market control positions in healthcare and business services are of general interest – and recognised the opportunity. Vets Central could feasibly double in size given another five years; the question was whether Pemba, which is used to managing companies of a certain size, would be stepping outside its comfort zone.

"If we are underwriting growth to 160 clinics, we want to know that the team is adequately resourced. Can the business model in its current form be replicated, or would things need to be done differently?" explained Desmond Lee, a partner at TPG NewQuest.

“For a business services company that has grown on the back of a domestic client base to double it scale, it might have to go offshore. With Pemba, we saw good partners with the commitment and expertise, and believed in this instance, they just needed the opportunity to continue doing what they have been doing successfully for the last five years, consolidating the space in Australia.”

Pemba made its accounting and advisory debut in late 2024, buying Melbourne-based Stannards, with a similar mindset. There were dozens of PE-backed buy-and-build efforts in the UK to work from and an iron-clad domestic expansion story within Australia. Other investors have since followed.

M&A is expected to take three forms: tuck-ins, where client books are folded into the core business; capability-led deals intended to add new verticals and facilitate cross-selling; and interstate acquisitions that take the current Victoria footprint and extend it nationwide.

“There is strong organic growth in the SME [small and medium-sized enterprise] accounting market and then there’s huge fragmentation. Succession issues will necessitate ownership changes in many of our bolt-on targets as individuals pass retirement age,” said Matthews.

Size matters

While Stannards is a Fund III investment, the opportunity is large enough for accounting and advisory to be a prevalent theme in Fund IV as well. Fund IV recently launched with a target of AUD 900m, the source familiar said, adding that there are plans for a more diversified investor base in terms of LP type and geography.

Matthews declined to comment on Fund IV specifically. However, he emphasised the importance of maintaining the lower middle market focus that is woven into Pemba’s DNA, from sector teams to value creation team. Raising, deploying and returning to market more frequently – or intermittently tapping LP co-investors – is preferable to marshalling uncomfortably large pools of capital.

Australian private equity firms have a historical tendency to scale up, ascending the tiers of the middle market and leaving voids behind them. Pemba operates in one of those voids, its entire origination model predicated on a lack of competition and intermediation.

"If a target company has EBITDA above AUD 10m, you typically find they are well covered by the advisors. Some private equity firms get a lot of early looks at deals from certain advisors, and there is reciprocity by way of fees paid," said Matthews.

"The landscape of target companies with EBITDA below AUD 10m tends to be less intermediated, so we need to knock on a lot of doors. Pemba was one of the first firms to introduce direct origination to the lower mid-market, and we have the largest direct origination team across the whole market."

Pemba's five originators each sit with a different sector team. They participate in niche analysis and target identification, and then they are the ones responsible for initial outreach. Modes of engagement span phone calls, emails, LinkedIn connection requests, even direct marketing that elicits inbound enquiries. What happens after that is reasonably consistent: a drawn-out courtship.

The goal is to establish multiple touchpoints with a founder, understand their pain points, and present solutions by drawing on Pemba's value creation resources. Recruitment support, operational efficiencies, developing new revenue lines, and devising and executing M&A plans come up often.

The origination process is labour-intensive – Matthews describes it as the antithesis of the quick hard sell – but this channel is responsible for more than 90% of the firm's deal flow.

"It's about building trust and rapport with the founder, trying to understand their needs and objectives, so that when the time is right for them to think about some sort of liquidity event, we are front of mind," he added. "In one of our Fund III investments, [cyber security business] Ctrl:cyber, from initial outreach to inking a deal took eight years."

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