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Issued by Equistone Partners Europe Limited, based on data provided by the Centre for Management Buy-out Research (CMBOR). CMBOR is supported by Equistone Partners Europe Limited and Investec, having been founded in March 1986, to monitor and analyse management buy-outs and buy-ins in the UK and continental Europe, in a comprehensive and objective way.

CENTRE FOR MANAGEMENT BUY-OUT RESEARCH NEWS AND UPDATES

WINTER 2016

Down, but not out

UK mega buy-outs disappeared in the second half of 2016, meaning the overall value of European deals finished 34.1% down on 2015.

There were 663 buy-outs worth €58.5bn recorded in 2016, compared to 695 buy-outs worth €89.7bn in 2015.

EUROPEAN BUY-OUTS appeared to be at the start of an upward swing in 2014 (at €70.9bn) and in 2015 (worth €89.7bn). At the outset, 2016 looked set to continue that upward trend. A total of 353 buy-outs worth €33.5bn were recorded in H1 2016. However, H2 did not live up to this promise. Just 310 buy-outs worth €25.1bn were recorded.

Historically, buy-out markets have only recorded lower values in H2 when there has been a major upset. Since records began in 1995, there have only been four years in which buy-outs in H2 were worth less than those recorded in H1. The first of these was in 2001 when the extent of global technology losses of 2000 became clear. The second and third were 2007 and 2008 as the global financial crisis hit home. 2016's H2 slowdown is universally accepted as a consequence of the uncertainty following the UK's Referendum on EU membership in June 2016. Since the vote to leave, some investments have been shelved or have stalled until the terms of the UK's departure (Brexit) become clear. The dip in European buy-out numbers and values is primarily the result of a large section of the UK buy-out market juddering to an uncertain halt over the summer.

France and Germany were solid in the mid-market and Italy experienced a buy-out surge in 2016. In the long term, investor confidence in these markets will no doubt be affected by the terms of Brexit. However, these figures suggest that there was no immediate 'shock to the system' from the Referendum result.

France holding firm

This continued confidence in continental Europe as an investment destination was

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Down but not out

amply demonstrated by the French market. By the close of 2016, France narrowly missed out on its busiest year since the financial crisis. It had recorded 90 buy-outs with a combined value of €11.3bn. Had two mega deals, both in play by the summer of 2016, closed before year-end, France's buy-out value for 2016 would have reached €16.6bn.

The first of these buy-outs to be announced was the divestment of chemicals business Atotech. First round bids for Atotech took place in July with final bids delivered in September. Carlyle looks set to complete this buy-out, valued at €2.87bn, in early 2017. The second mega buy-out was the divestment of software security company, Morpho. By September, Advent International was reported to be the leading bidder. However, the €2.45bn buy-out will not complete until early 2017.

Average German deal size down

In contrast, the value of the German buy-out market in 2016 fell by more than half. In 2016 there were 95 German buy-outs with a combined value of €6bn compared to 81 buy-outs with a combined value of €12.5bn in 2015. While deal numbers remained similar, average deal values fell. Mega buy-outs, in the €1bn+ range, were part of the cause.

In 2016, there was just one mega buy-out; the €1.2bn buy-out of Bilfinger by EQT. 2015 saw four mega buy-outs in Germany with a combined value of €7.85bn. They were: the €2.8bn purchase of Douglas Holding by Advent International; the €2.15bn purchase of Siemens Audiology Solutions by EQT; Synlab Services' €1.8bn buy-out by BC Partners; and the €1.1bn buy-out of Senvion by Centerbridge Partners.

German buy-out values would have returned to 2011 and 2012 levels had Lone Star's buy-out of building materials firm Xella, valued at €2bn, closed in Q4 2016. Although bids went out in September 2016, the transaction is not expected to close until early 2017. A further €1.1bn will be added to 2017's figures when KKR's purchase of Airbus Defence, first announced in March 2016, closes in Q1 2017.

Mid market holds firm

Mid market buy-outs provided a bright spot in 2016. Buy-out investments in the €10-25m, €50-100m and €100-250m ranges increased by number and by value in 2016. Deals in the €25-50m range fell by number and value. There is no clear reason why this value range fell from €2.9bn in 2015 to €2.1bn in 2016. One possibility is that companies in this value range are more reliant on a single country for sales and revenues. This could deter investors in uncertain times. The UK, for example, saw the value of all buy-outs drop over 56% to €12.6bn in 2016, compared to €28.7bn in 2015.

This fall is inevitably driven by a dearth of large deals in H2, attributed by most commentators to uncertainty surrounding the long-term status of the UK outside the EU and potentially the single market. The UK's EU Referendum vote was held on June 23, 2016 and, after this, UK buy-out figures begin to tail off. Q1 registered 42 buy-outs with a combined value of €4.1bn. In Q2, there were 54 buy-outs worth €4.2bn. In Q3, there were 52 buy-outs worth €3.7bn and in Q4 there were just 40 buy-outs worth €1.6bn.

Moving up the buy-out value range there

Commentators were concerned throughout 2016 that buy-out firms could be paying too much for assets.

Equity component rising

WHILE A buoyant market and an abundance of available debt may have pushed pricing upwards, structures have become more conservative. The equity share of all buy-outs during 2016 rose from 46% to 53%. This is some way short of the 62.3% to 67.4% equity range prevalent in the post financial crisis period 2009 to 2012, but similar to 2013 (50.8%) and 2014 (52%), suggesting a welcome, more conservative, correction.

With this upward shift in equity contribution, financiers feel any pricing froth is being underwritten by buy-out firms rather than debt markets. On the back of four years of fundraising growth, buy-out firms have more capital to draw on.

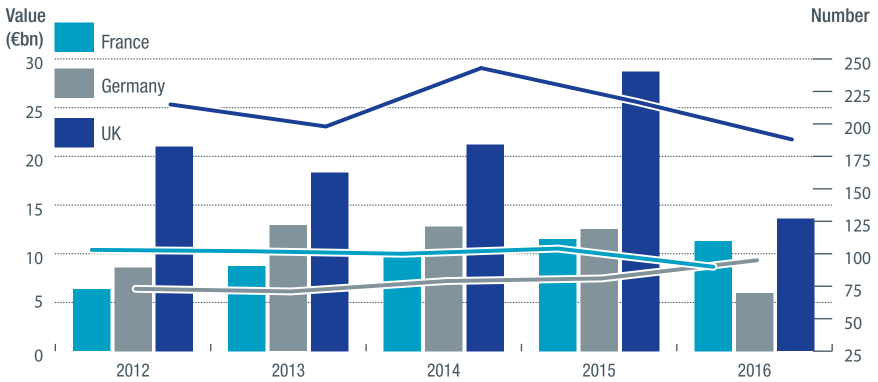
Large buy-outs, with financing structures over €100m, saw equity contributions increase to 46.1% in 2016, up from 41.1% in 2015. This move also suggests an adjustment to a sustainable level. Equity components of large buy-outs have jumped around during the past decade. They went from an over exuberant 34.5% in 2007 to 43.6% in 2008 and then to an unsustainable 63.6% in 2009. This gradually reduced to around 41% during 2013-2015.

FINANCING STRUCTURES ON EURO BUY-OUTS 2012 – 2016

	2012	2013	2014	2015	2016
Equity (%)	66.2	50.8	52.0	46.2	53.6
Mezzanine (%)	3.2	4.5	0.7	1.5	0.3
Debt (%)	28.1	41.9	46.1	49.7	45.4
Loan Note (%)	1.9	1.9	1.2	0.7	0.3
Other Finance (%)	0.6	0.9	–	1.9	0.4
Total financing (€m)	**31,540**	**35,964**	**33,179**	**48,205**	**31,281**
Vendor contribution (%)	0.9	0.5	0.3	0.1	1.2
Management contribution (%)	1.4	0.6	0.5	0.6	0.5
Management share of equity (%)	**28.7**	**27.4**	**32.2**	**31.7**	**28.4**

Source: CMBOR / Equistone Partners Europe / Investec

FRANCE, GERMANY AND UK BUY-OUT VALUES 2012 - 2016



Source: CMBOR / Equistone Partners Europe / Investec

"The market could pick up next year as the dust settles on recent surprise election results and a number of larger GPs have fresh funds to deploy."
Christiian Marriott, Equistone

was a fall of around 29% in buy-outs worth €250-€500m (from €14.5bn in 2015 to €11.1bn in 2016). This became a 20% decrease in the value of buy-outs in the €500m-€1bn range. Mega buy-outs (worth €1bn+) fell from 20 in number during 2015 to just 10 in 2016. Their value also fell by 67%; down from €38.7bn in 2015 to €12.8bn in 2016.

Mega buy-outs suffer

Buy-outs worth €1bn+ took the largest tumble in 2016 with just €12.8bn recorded across 20 deals. This is the lowest level in a decade, with the exception of 2009 when, post financial crisis, a value of just €3.9bn was recorded.

Buy-outs in the €1bn range were broken down as follows in 2016; €1.2bn in Q1, €6.2bn in Q2 and €5.4bn in Q3. Markets and investors largely stalled in Q3 as they attempted to assess the import of a pending hard or soft Brexit. In essence, this meant while completions came out of GP pipeline's in Q3, there were few new deals entering them. As a consequence, there was not a single buy-out valued at €1bn+ in Q4.

While little was added to the pipeline of the €1bn+ size buy-outs in Q3, Q4 saw this segment of the market begin to move. In October, Philips entered talks with Apollo to sell its lighting components business Lumileds for €1.89bn after losing a trade buyer earlier in the year. In November, Blackstone was announced as the preferred bidder to spend €1bn on Belgian chemicals company Acetow. Another Belgian company, aluminium supplier Corialis, announced in December that it was to be sold in a €1bn secondary buy-out transaction by CVC. All three of these deals are expected to close in Q1 2017.

Looking ahead at 2017

The UK, historically Europe's largest buy-out market, voted in the June 2016 EU Referendum to leave the EU (Brexit). This left more questions than answers in its wake.

THE ALL important question was, and will remain, probably throughout 2017, under what terms the UK will continue to trade with EU countries after it has formally exited?

Uncertainty results in unquantifiable business risk and investors typically sit out a market until risk can be quantified. Mega deals in the UK are likely to remain depressed throughout 2017. After this the UK's future relationship with the EU as a trading block will hopefully be clearer.

That said, buy-out firms are ultimately pragmatic and opportunistic. As such they are more likely to change direction than stay out of the market for 18 months. Those with a remit only to invest in the UK could shift their focus to more predictable and resilient sectors focused on the domestic economy.

Commentators anticipate that continental European buy-outs will continue to attract investors. However, some have pointed to the forthcoming French and German elections in 2017 as cause for instability in the continental buy-out market. This is because of the possibility that these elections could lead to right wing, more protectionist heads of state on the European continent.

Historically, while elections are often touted as game changers, in fact changes of government have had little impact on private equity investment activity in general. In the absence of such an election leading to another EU net contributor, or large debtor nation, wishing to leave the EU, continental Europe should continue to offer certainty. Therefore expect the climate to be largely business as usual.

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Exits lose top billing

Exits in 2016, relative to 2015 figures, dropped even further than new buy-out investments.

THERE WERE 39% fewer buy-out exits in 2016 (at €98.6bn) than in 2015 (at €160.1bn). However, exit values continue to beat new buy-out investment figures and have done consistently since 2010.

2015 was the best year for buy-out exits ever recorded. That year included 42 mega exits ranging between €1bn and €6.48bn in value and worth a combined €98.9bn. This compares to 25 mega exits in 2016 ranging between €1bn and €5.76bn in value and worth a combined €45.3bn. Of these 8 were IPOs with a combined value of €13.7bn (compared to 15 IPOs worth a combined €37.1bn in 2015); 12 were trade sales worth a combined €24.5bn (compared to 17 trade sales worth a combined €41.2bn in 2015) and five secondary buy-outs worth a combined €7.2bn (compared to 10 secondary buy-outs worth a combined €20.6bn in 2015.)

The value of buy-out exits has dominated the headlines since 2010 when exit values surged ahead of new buy-out investments for the first time. Following the global financial crisis of 2007/08, liquidity dried up leaving the private equity fundraising market severely constrained from 2009 to 2012. (See table.)

With limited fundraising prospects, buy-out firms tend to concentrate on existing portfolio companies and returning capital to investors by way of exits. Hence buy-out exit values became higher than new buy-out investment figures once the European fundraising market largely dried up in 2009.

From 2011, there were good levels of liquidity in debt markets, trade buyers were back and public stock markets buoyant. Consequently, the value and number of exits climbed. Buy-out firms were well positioned to sell portfolio companies held since the financial crisis and those acquired on more favourable terms in the immediate aftermath of the crisis.

There is likely to be less of a gap between new buy-out investment and exit figures going forward. However, a mature market should return more money to investors than it takes in over time. Without this, investor appetite is unlikely to sustain future investment. As exit values began to climb from 2013 (€80.7bn), 2014 (€115.2bn), 2015 (€160.7bn) and 2016 (€98.6bn), much of the capital returned to investors appears to have been recycled back into new buy-outs fundraisings. From its 2009 low of €10.8bn, European buy-out fundraising came back in 2013 (€45.4bn), 2014 (€36.3bn), 2015 (€33.6bn) and last year rose to an estimated €66bn.

EURO BUY-OUTS, EXITS AND FUNDRAISING - €BN 2007 – 2016

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Buy-out value	172.8	72.3	21.2	59.7	65.3	56.1	59.9	71.0	89.7	58.5
Exit value	123.5	47.7	12.8	67.2	85.5	57.5	80.7	115.3	160.7	98.6
Fundraising *	58.6	64.8	10.8	13.4	26.9	16.7	45.4	36.3	33.6	**66

Source: CMBOR / Equistone Partners Europe / Investec
* Fundraising data sourced from Invest Europe
** Estimated value

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