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CENTRE FOR MANAGEMENT BUY-OUT RESEARCH NEWS AND UPDATES

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.

SUMMER 2016

European mid-market holds firm

The mid-market reigned supreme in the first half of 2016. European buy-outs worth up to €10m posted the best figures: 174 buy-outs worth €701m.

2016 BEGAN well in the European buy-out market. In the first half of the year there were 334 European buy-outs with a combined value of €29.9bn. This is slightly ahead of activity levels recorded at the half year point over the past five years, with the exception of H1 2015. Last year, 348 European buy-outs with a combined value of €40.5bn were recorded. However, the H1 2015 figures were boosted by the 10 largest buy-outs (four of which exceeded €2bn+) falling into the first half of last year.

Mid-market in the limelight

It was the mid-market that reigned supreme in the first half of 2016. Smaller mid-market buy-outs with enterprise values of between €10m and €25m held strong on both value (€833m) and number of deals (47). The same was true of mid-market buy-outs in the value range from €50m right up to €1bn. Buy-outs in this range fall into four distinct values: €50-100m (29 buy-outs worth €2.1bn); €100-250m (27 buy-outs worth €3.9bn); €250-500m (17 buy-outs worth €5.6bn); and €500m-€1bn (14 buy-outs worth €9.5bn.)

In the market for even smaller deals, European buy-outs worth up to €10m posted the best figures for this market segment for some time. By the close of H1 2016, 174 buy-outs with a value of €701m had been recorded.

Only mid-market buy-outs in the €25-50m value range saw a drop in number of transactions (down to 21) and overall values (down to €779m). The decline in €1bn+ buy-outs had the most marked effect on the overall market.

Mega buy-outs wane

In H1 2016, there were just five buy-outs worth in excess of €1bn, three of which were in Italy.

These three were: the €1.2bn buy-out of software applications provider

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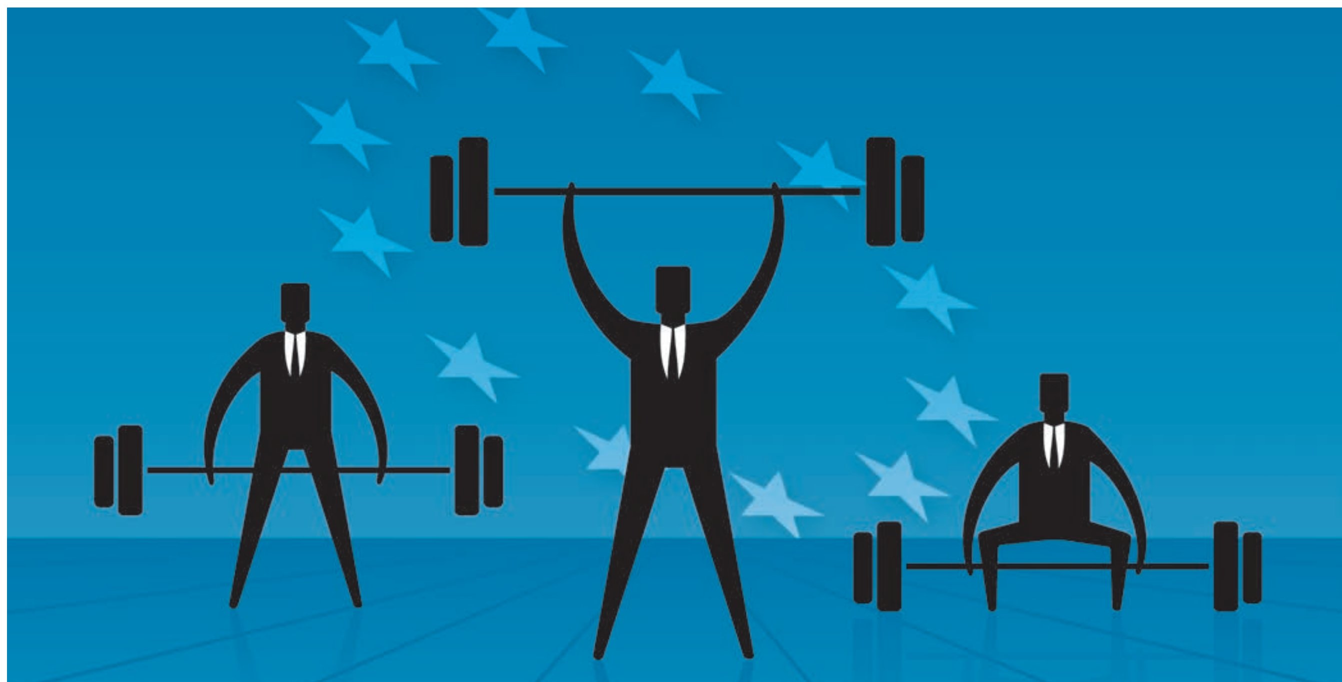

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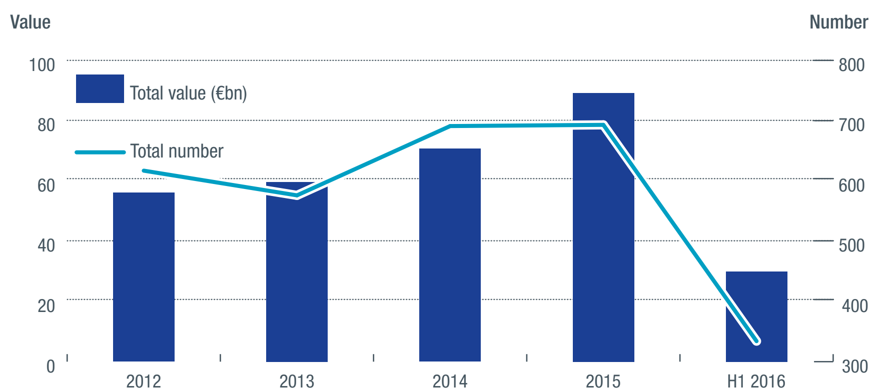

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TeamSystem (HgCapital sold to Hellman & Friedman); the €1bn buy-out of baby and healthcare products company Artsana in which Investindustrial bought a majority stake from the founding Catelli family; and the €1bn buy-out of gaming and payments operator Sisal, sold by Apax Partners to CVC Capital.

The other two buy-outs in H1 2016 to breach the €1bn barrier were the sale of UK motoring company RAC and the take private of Swiss tour operator Kuoni. RAC was sold by The Carlyle Group to CVC Capital Partners for €1.9bn while EQT Partners' acquisition of Kuoni had a value of €1.3bn. Three of these five €1bn+ deals were secondary buy-outs.

Declining market sentiment

The figures for H1 2016 belie the sense of unease that has permeated the European buy-out market since 2016 began. The year started on a wave of deals and debt was initially plentiful. However, an expectation that the economic cycle was due to move from growth to a recessionary dip hung in the air. Equity market volatility seemed to underpin a fear that a cyclical downturn was coming.

This unease was borne out with the release of the European Commission's European Business Cycle Indicators Q1 paper. It found that five of the seven largest European economies (Germany, The Netherlands, Italy, Spain and the UK) deteriorated with France stable and Poland seeing a slight improvement. Concerns over China's slowdown, deteriorating credit market liquidity and a possible Brexit combined to suggest a worse H1 for 2016 than materialised.

Brexit clauses, giving buyers/investors a no-penalty opt out were added to transaction documentation, notably in infrastructure and real estate related investments. Conversely, markets also reported a surge in leveraged finance packages eager to conclude prior to the UK's Referendum on EU membership.

France was the stalwart of the European buy-out market in H1 2016. French buy-outs accounted for 48 deals with a combined value of €5.96bn. This is the best H1 value in five years. There were five French buy-outs in the top 20 buy-out deals, which helped bolster overall value. They

Leverage levels

ACROSS ALL financing structures debt remained consistent at 50.2%. The debt component of buy-out financing was 50.3% in 2015, having steadily climbed from the post-2008 crash low of 28.7% in 2010. Overall the contribution of equity rose to 48.9% across all financing structures. This was up from 45.5% in 2015 and consistent with 2013 levels.

2015 was an abundant period for the leveraged finance markets and buy-out investment value was boosted by a large number of higher leveraged mega (€1bn+) deals. If the trend for less mega buy-outs continues through H2, the equity component across all financing structures could rise above 49% by year end. Any rise is likely to fall well short of the 62.5% to 66.9% debt range seen across all buy-outs between 2009 to 2012.

Buy-out financing structures over €100m have seen stable equity contributions since 2013 ranging between 40.1% and 41.5%. In H1 2016 equity contribution for these larger buy-outs was 41.4%. Debt remained comparable with 2015 (58.4%) in H1 2016 recording 58.2%. Debt levels have not been this high at the larger end of the buy-out financing market since 2007 when debt reached 58.7%.

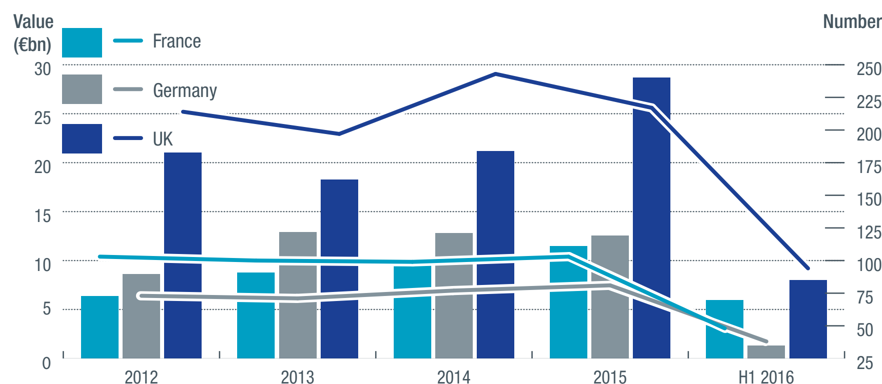
As H1 2016 drew to a close and the UK voted to leave the EU, debt, equity and currency markets repriced globally. Despite much scaremongering about both the future of the EU and the UK, inside a week markets had stabilised and repriced for Brexit and leveraged finance markets remain open to buy-out business.

FINANCING STRUCTURES ON EURO BUY-OUTS LESS THAN €100M 2012 – H1 2016

	2012	2013	2014	2015	H1 2016
Equity (%)	66.2	50.8	52.0	45.5	48.9
Mezzanine (%)	3.2	4.5	0.7	1.6	0.7
Debt (%)	28.1	41.9	46.1	50.3	50.5
Loan Note (%)	1.9	1.9	1.2	0.7	–
Other Finance (%)	0.6	0.9	–	1.9	–
Total financing (€m)	**31,540.0**	**35,964.0**	**33,179.0**	**47,773.0**	**17,558.0**
Vendor contribution (%)	0.9	0.5	0.3	0.1	–
Management contribution (%)	1.4	0.6	0.5	0.6	–
Management share of equity (%)	**29.5**	**27.4**	**32.9**	**31.8**	**29.8**

Source: CMBOR / Equistone Partners Europe / Investec

FRANCE, GERMANY AND UK BUY-OUT VALUES 2012 - H1 2016



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> "There is an increasing stock of private equity-owned companies in the economy, so secondary buy-outs are naturally going to be more prevalent."
> **Christiian Marriott, Equistone**

were: B&B Hotels sold by The Carlyle Group to PAI Partners for €792m; call centre operator Webhelp was sold by Charterhouse to KKR for €700m; InfoPro Digital, the B2B information services provider, was bought from its founders by TowerBrook Capital Partners and Apax Partners for €700m; Novacap was sold by Ardian to Eurazeo and Mérieux Développement for €654m; and Saverglass was sold by Astorg to The Carlyle Group for €560m. Notably, four out of five of these larger deals were secondary buy-outs.

Similarly, of the five UK buy-outs that made it into the top 20, three were secondary buy-outs. They were: The Carlyle Group's sale of RAC to CVC Capital Partners for €1.9bn; 3i Group's sale of Element Materials Technology (testing for aerospace, defence and energy industries) to Bridgepoint for €900m; and Bridgepoint's sale of LGC, the life sciences company, to KKR for €792m.

The fourth buy-out, Photobox, was originally a venture rather than buy-out backed investment. Index Ventures, HarbourVest, Insight Venture Partners and others aborted the planned IPO of Photobox leaving the way for Electra and Exponent to buy-out the business for €528m. The fifth UK buy-out to make it into the top 20 was the Long Products Europe division of Tata Steel. Family office Greybull Capital invested €506m in that business.

Although the UK continued to feature at the top end of the buy-out market, the combined value of UK buy-outs dropped dramatically. In total there were 94 UK buy-outs in H1 2016 with an aggregate value of €8bn. While the number of buy-outs has dipped slightly, the fall in combined value is dramatic. Even if the pace of UK buy-out investments were to continue through H2, UK values look set to fall back to 2011 levels. However, it is expected that the UK may suffer a state of inertia in H2 as the economic realities of Brexit begin to be realised. This suggests year-end figures could be much lower than 2011.

The value of Germany's buy-out market in H1 dropped dramatically with just €1.3bn of value being recorded against 38 deals. During the past five years Germany has recorded between 71 and 81 deals, but their combined value has ranged from €8.6bn to €12.9bn over the full year. With such a low value H1 it seems likely Germany will record lower than usual deal values by year end. There is no discernible reason for this drop in value of transactions.

Business as usual?

MACROECONOMIC FACTORS that unsettled investors and buyers at the start of 2016 remain. These include: a slowing China; tightened credit markets; and a belief that a market correction, leading to a mild recession, was overdue. An Italian banking crisis, continuing Greek woes and managing an orderly Brexit will continue to put pressure on the EU.

Against these macroeconomic uncertainties, continental European mid-market buy-outs continued to perform well. There is no immediate reason to believe these activity levels will not remain until year end. Buy-out fund managers cannot sit out the market for long. They are mandated to invest throughout the cycle and are expected to assess and plan for all risks when making investments.

Past experience shows that in uncertain times there is a flight to quality. This in turn has led to buy-out investors making some of their most lucrative investments at the bottom of the cycle. Identifying companies with the resilience to weather a market downturn and paying the right price are the challenges.

While the continental European buy-out market (outside the mega €1bn+ segment) continued apace, the UK proved the exception. It should be expected to stay that way until there is clarity on what Brexit means. When that clarity comes, investors can reshape their strategies to operate effectively within that new environment. However, with the post-Brexit sterling correction devaluing the pound by around 10%, investment in export-driven companies could receive an immediate fillip.

Private equity fundraising is an immediate casualty of uncertainty. However, with so much dry powder and the pace of buy-out investment slowing, this should not cause concern in the short term.

Exit value still ahead

Exit values fell in H1 2016, totalling €46.7bn for 212 transactions. However, this was still ahead of new buy-out activity (of €29.9bn) by 36%.

THE EXIT story dominated the European buy-out market throughout 2014 and 2015. The value of exits eclipsed new buy-out investment during those years. €155bn of exit value was recorded in 2014; 38.5% higher than new buy-out activity (€70.7bn). There was €160.4bn worth of exits in 2015; equating to 44.4% more than new buy-out activity (€89.2bn).

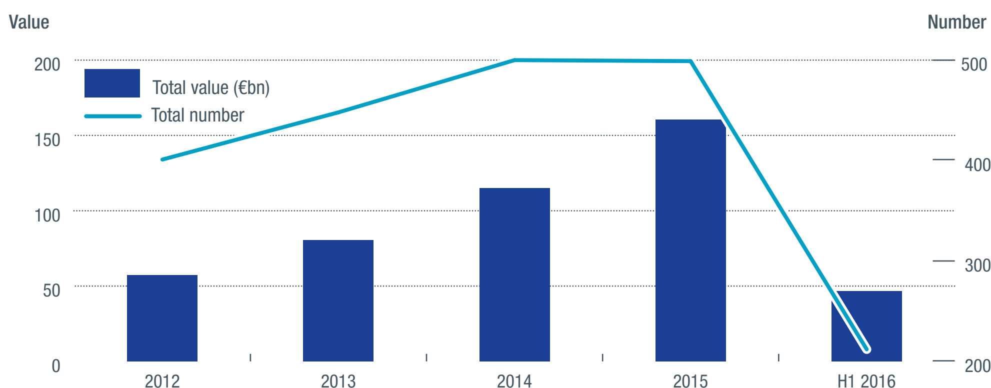
Full year 2016 levels look likely to fall back to somewhere between 2012 and 2013 levels; at €57.3bn and €80.5bn respectively. European buy-out values have tended to be stronger in the second half of the year. The only exceptions to this, since European buy-out records began in 1995, are periods of crisis. They are H2 2001, post the dot.com bust, and H2 2007 and 2008 when the financial crisis hit.

However, the picture is mixed for exits and is therefore less predictable. In 2012 (€23.6bn vs €33.6bn) and 2013 (€32.7bn vs €47.8bn) greater values were recorded in the second half of the year. Whereas 2014 (H1 €57.2bn, H2 €57.8bn) was evenly spread. And 2015 saw less exit value in H2 (€75.5bn vs €89.9bn in H1). Given the uncertainty in some segments of the European buy-out market, exit activity will probably fall over H2.

Secondary buy-outs saw a resurgence in H1 2016. Secondary buy-outs had diminished in relative importance as an exit source by the first half of 2013-2015. In H1 2012 private equity-backed secondary buy-outs had accounted for 45% of all exit activity. However, this prevalence began to fall away in H1 2013 (37%), H1 2014 (19%) and H1 2015 (23%). But in H1 2016 once again secondary buy-outs leapt to the fore accounting for 42% of exit activity.

Private equity firms are consistent buyers with both the desire to make investments and the capital at their disposal. Hence the rise of the secondary buy-out in the current climate of uncertainty that has seen IPOs judder to a halt and trade buyers disappear. Corporate inertia has a knock-on effect on both buy-out investments and exits. The former is affected by lower corporate divestments and the latter by fewer acquisitive companies.

EURO BUY-OUT EXIT VALUES 2012 - H1 2016



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EQUISTONE

OFFICES

Birmingham
Bank House, 8 Cherry Street
Birmingham B2 5AL, UK
t +44 (0)121 631 4220
f +44 (0)121 631 1071

London
Condor House, St Paul's Churchyard
London EC4M 8AL, UK
t +44 (0)20 7653 5300
f +44 (0)20 7653 5301

Manchester
55 King Street
Manchester M2 4LQ, UK
t +44 (0)161 214 0800
f +44 (0)161 214 0805

Munich
Maximilianstrasse 11
80539 Munich, Germany
t +49 (0)89 24 2064 0
f +49 (0)89 24 2064 33

Paris
Centre d'affaires Paris-Trocadéro
112 avenue Kléber, 75116 Paris, France
t +33 (0)1 56 69 43 43
f +33 (0)1 56 69 43 44

Zurich
General Guisan Quai 34
8002 Zurich, Switzerland
t +41 (0)44 289 80 90
f +41 (0)44 289 80 91

www.equistonepe.com

THE CENTRE FOR MANAGEMENT BUY-OUT RESEARCH

The Centre for Management Buy-Out Research
Imperial College Business School
Tanaka Building
South Kensington Campus
London SW7 2AZ
t +44 (0)115 951 5493
f +44 (0)115 951 5204
e bs.cmbor@imperial.ac.uk