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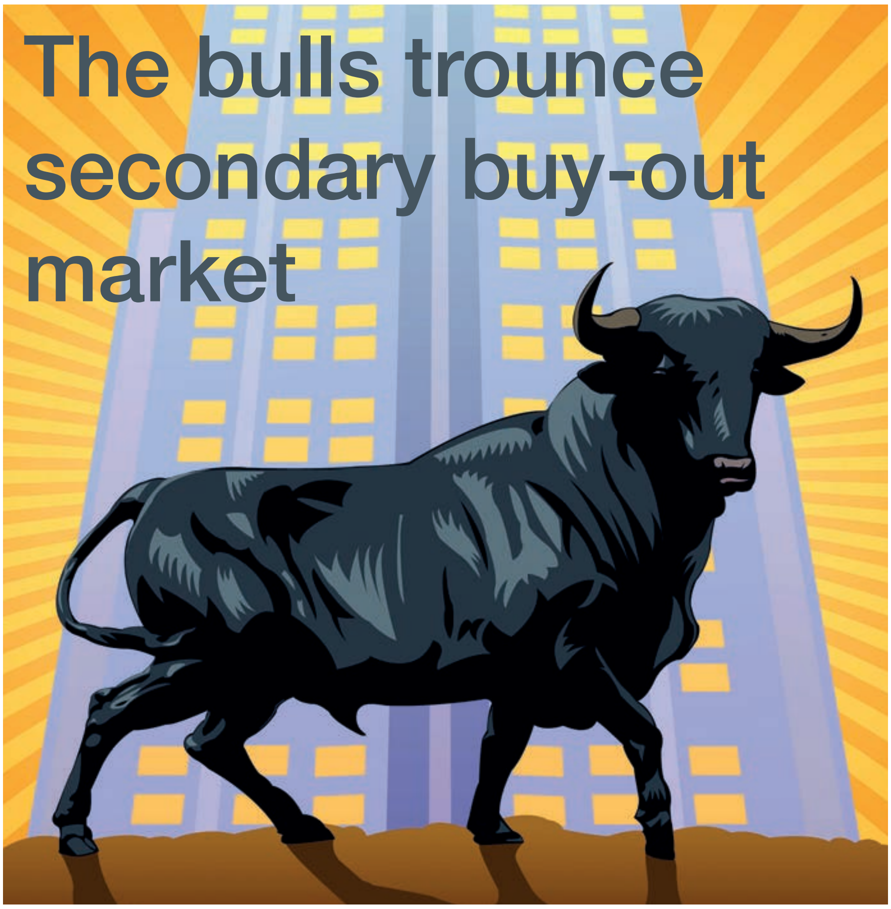
CENTRE FOR MANAGEMENT BUY-OUT RESEARCH NEWS AND UPDATES

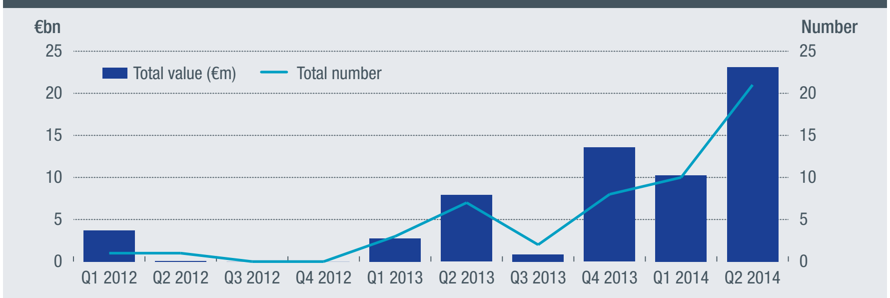
Issued by Equistone Partners Europe Limited, based on data provided by the Centre for Management Buy-out Research (CMBOR). CMBOR is supported by Equistone Partners Europe Limited and Ernst & Young, having been founded in March 1986, to monitor and analyse management buy-outs and buy-ins in the UK and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

SUMMER 2014

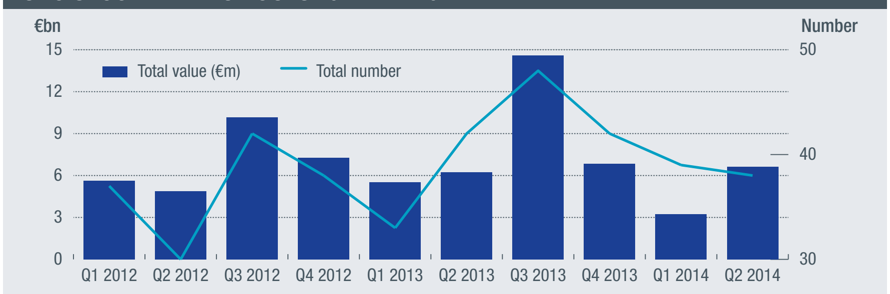
The bulls trounce secondary buy-out market



EURO FLOTATION BUY-OUTS 2012 – H1 2014



EURO SECONDARY BUY-OUTS 2012 – H1 2014



Source: CMBOR / Equistone Partners Europe / Ernst & Young

IPO MARKETS across Europe have flourished over the past year. Given the economics involved, the main European stock exchanges tend to be predominantly interested in companies with market capitalisations over €500m and often over €1bn. Consequently, investors exiting portfolio companies of this size have found public markets increasingly receptive.

Secondary buy-outs no longer dominate European buy-out values.

In Q2 2014, there were 21 IPOs of buy-outs with a combined value of €23.1bn. These are the highest number and value figures ever recorded by CMBOR. Q1 2014 was also active; 10 IPOs with a combined value of €10.2bn went to market.

The past 12 months aside, in the previous decade public markets were all but closed to buy-out firms seeking to exit investments. In part, this is blamed on the general economic malaise of that period and in part on the poor post-IPO performance of a number of high profile former buy-out companies. The latter has given rise to close monitoring of post-IPO share price performance of recently listed former buy-outs. Inevitably not every ex-buy-out has continuously traded above its IPO price. However, these cases are notable exceptions for the time being and the pipeline of buy-out IPO candidates remains strong.

Over the past 12 months, firms exiting mega buy-outs have found IPOs more attractive than secondary buy-outs. As

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The bulls trounce secondary buy-out market

a consequence, secondary buy-outs no longer dominate European buy-out values. Secondary buy-outs equated to just 38% of the total value of buy-outs during H1 2014; their lowest share of the market for five years. In the previous year, secondary buy-outs had reached an all time high; they accounted for almost 60% of the total value. Prior to this (between 2010-2012), secondary buy-outs accounted for around 50% of the value of the buy-out market.

However, the number of secondary buy-outs being recorded only saw a marginal decline in H1 2014. This means that, while secondary buy-out activity levels remain healthy, there is a drop in the number of high value secondary buy-outs being transacted. Many of these larger buy-outs have instead sought an IPO.

Of the 18 buy-out exits that exceeded €1bn in value in H1 2014, 13 were IPOs; of the rest, two were secondary buy-outs and three were trade sales. This compares to 17 exits that exceeded the €1bn plus mark in 2013 where five were secondary buy-outs and nine were IPOs.

Just four buy-outs breached the €1bn plus mark in H1 2014. All four deals were secondary buy-outs. Three out of the four were backed by either large US private equity firms, with current fund sizes of US$8-10bn a piece, or by an Asian sovereign wealth fund.

The ability of European buy-out funds to execute larger European buy-outs has to some extent been limited. Part of the limitation can be blamed on a slow and challenging fundraising market since the financial crisis. Availability of debt, however, has not been an issue given the buoyancy of debt markets during H1 2014 *(see 'Debt markets vibrant')*.

Shift in source of buy-out opportunities

The majority of larger buy-outs seeking an exit have made their way to the IPO markets. This has reduced the number of potential secondary buy-outs.

SECONDARY BUY-OUTS had a combined value of €9.87bn in H1 2014. If this low value of transactions continues, 2014 looks set to record the lowest value of secondary buy-outs in more than a decade. This excludes 2009 when, following the financial crisis, there was depressed activity across all buy-out types. Although values of secondary buy-outs have dropped sharply, the total number has recorded only a marginal drop. Assuming the number of secondary buy-outs continues to keep pace throughout 2014, total numbers of secondary buy-outs will be similar for the past five years.

The reduction in secondary buy-outs is one shift; another is a fall-off in public-to-private (PTP) activity. Like depressed secondary buy-out numbers, fewer PTPs is a consequence of buoyant stock markets. Vibrant public markets typically mean companies already listed have ready access to inexpensive (relative to private equity) funding. Hence there is little incentive to move out of the public markets.

The final notable shift has been in the rise of local divestment. There were 64 local divestments worth €8bn in H1 2014. If local divestment numbers continue on the same trajectory, this will be their healthiest year since the financial crisis. The same is true for local divestment values, although the value for H1 2014 is given a significant boost with the inclusion of Deutsche Telekom's €2bn divestment of Scout24 Holdings.

Whether or not these shifts become entrenched is likely to be determined by how readily Europe's public markets continue to embrace buy-out flotations.

By H1 2014 buy-outs in the retail, property & construction, leisure and healthcare sectors were recording lower than usual values; financial services being the only notable upward swing. To date this is attributable to one-off mega deals rather than a volume increase.

EURO BUY-OUTS DEAL SOURCE 2008 – H1 2014

	2008		2009		2010		2011		2012		2013		H1 2014	
	No.	€m	No.	€m	No.	€m	No.	€m	No.	€m	No.	€m	No.	€m
Secondary Buy-out	146	22,663	52	3,886	142	27,927	174	30,770	136	26,944	155	34,057	65	9,787
Local Divestment	133	12,861	101	5,025	115	8,209	105	11,682	99	7,322	115	9,055	69	8,469
Private	371	13,944	175	3,503	245	9,780	243	8,801	247	6,642	200	6,394	127	3,884
Foreign Divestment	54	5,068	36	2,761	45	4,399	49	6,247	53	7,261	55	6,163	34	1,840
Public to Private	29	14,333	17	2,929	21	7,566	14	5,104	19	4,286	5	2,405	4	1,562
Insolvency	17	216	28	1,208	31	345	24	476	37	2,478	25	333	11	174
Public Buy-In	3	1,831	4	181	1	20	4	293	2	35	–	–	1	72
Unknown	21	773	14	171	7	39	13	72	1	4	4	61	1	4
Privatisation	2	240	4	593	2	79	–	–	–	–	1	232	–	–
Total	**776**	**71,927**	**431**	**20,258**	**609**	**58,365**	**626**	**63,446**	**594**	**54,972**	**560**	**58,700**	**312**	**25,792**

Source: CMBOR / Equistone Partners Europe / Ernst & Young

Exits continue to dominate

By the half year point, buy-out exits are already 113% ahead of new buy-out investments.

BEHIND THE 113% figure for the end of H1 2014 are new buy-out investments totalling €25.8bn and exits totalling €55.2bn. The disparity has not been so great in previous years.

2013 ended with the value of buy-out exits 35% ahead of new buy-out investment and a similar disparity occurred in 2011.

In other years there has been greater parity between the two values.

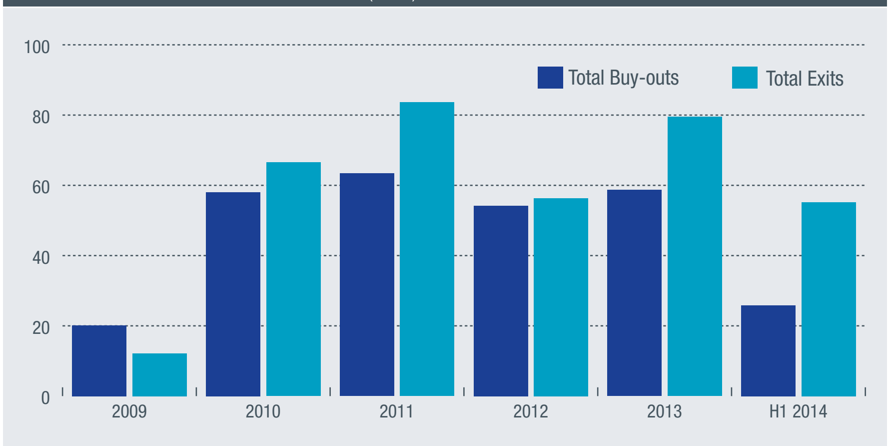
IPOs of mega buy-outs (c. €1bn+) account for the greater disparity recorded in the first half of 2014. The actual numbers of buy-out investment and exits look broadly on track to match recent years. The number of buy-out exits in H1 2014 was 78. From 2010-2013 the number of buy-out exits has ranged from 133-187.

H1 2014 recorded 312 buy-out investments. If the numbers remain similar in H2 2014, buy-out investments for the full year will remain within the range seen over the past five years. Full year figures 2010-2013 have recorded between 560 and 626 buy-outs.

If the largest buy-outs continue to be realised through IPOs, downward pressure will remain on new buy-out investment figures. Of the 68 European buy-out exits in H1 2014 with a value of €100m or more, around 70% left the private equity sphere. There were 30 IPOs, 18 trade sales and 20 secondary buy-outs.

The geographical spread of exits in H1 2014 has not differed greatly from previous years. The notable exceptions are France and the UK. The volume and value of French buy-outs remained depressed. This is as expected given the political and economic uncertainties in France during the past three years. The value of UK exits at the half year point exceeded full year figures for all years since 2008, with the exception of last year's €27.5bn. By H1 2014 the value of UK exits, at €22.1bn, is already close to last year's figure. This jump is due to the predominance of large exits in the UK. Of the 69 buy-out exits valued at €100bn or more, 33 were UK deals.

EURO BUY-OUTS/EXITS 2009 – 2013 (€BN)



Source: CMBOR / Equistone Partners Europe / Ernst & Young

2014 slow for buy-outs?

EXIT VALUES are significantly ahead of new buy-out investment at H1 2014. New buy-out investment looks set to be dwarfed by exits for the year, which suggests the buy-out market is still slow to return to growth.

H1 2014 saw 312 deals worth €25.8bn. If activity levels in H2 2014 generate similar values, 2014 could record the lowest full year value since 2009. In 2009, post the 2007/08 financial crisis, the lowest value for more than 20 years was recorded.

Although value is down, deal numbers in Q2 2014 are the highest since Q1 2012. This suggests the absence of mega deals is depressing the market; many potential secondary buy-outs have instead exited by IPO. Debt liquidity has been healthy so is not a factor *(see table on page 4)*.

Some of the IPO exits (the top five ranged in value from €2.47bn to €4.3bn in H1 2014) are arguably too large to be secondary buy-out candidates. Even so, many European buy-out funds don't have the firepower they had pre-crisis. The four largest buy-outs in H1 2014 ranged from €1.1bn to €2bn and only one was acquired by a European buy-out firm.

EURO BUY-OUTS & BUY-INS BY QUARTER 2011 – H1 2014

				2011				2012				2013		2014
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Buy-out No.	44	51	26	34	54	46	38	33	31	25	30	31	20	41
Buy-out Value (€m)	1,393	1,979	2,234	889	5,085	2,420	1,710	1,274	1,271	734	588	689	640	2,667
Buy-in No.	111	114	132	114	114	93	108	108	108	115	113	107	133	118
Buy-in Value (€m)	13,233	13,738	15,849	14,133	9,067	9,520	13,206	12,690	13,433	8,203	20,064	13,718	14,065	8,421
Total No.	**155**	**165**	**158**	**148**	**168**	**139**	**146**	**141**	**139**	**140**	**143**	**138**	**153**	**159**
Total Value (€m)	**14,626**	**15,717**	**18,082**	**15,021**	**14,152**	**11,941**	**14,916**	**13,964**	**14,704**	**8,937**	**20,652**	**14,407**	**14,704**	**11,088**

Source: CMBOR / Equistone Partners Europe / Ernst & Young

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Debt markets vibrant in H1 2014

EUROPE'S LEVERAGED loan market got off to a good start in the first half of 2014. Debt was in abundance. Senior debt made up 44.6% of loan packages in H1 2014, up from 42.1% in 2013. This edges the debt component of buy-outs to the closest they have come to their pre financial crisis level of around 50%.

Increased activity in the European leveraged loan market looks likely to continue.

The equity component of buy-outs, however, remains a relatively conservative 53.8%. This is significantly higher than the typical pre financial crisis equity investment of around 40%.

Debt and equity ratios remain broadly similar for all buy-outs, including those with financing structures over €100m. However, larger buy-outs saw management's share of equity fall to 16.5%; the lowest in ten years.

Increased activity in the European leveraged loan market looks likely to continue. This is primarily because the fundamentals that fostered its growth are here to stay. New lending regulations have increased the cost of capital for banks, which has forced lenders to restrict their bilateral lending to corporates. Consequently, many sponsors and companies have turned to the institutional debt markets, often for the first time.

The increased issuance of European leveraged loans began to gain momentum in 2013. This has continued during the first half of 2014. As the European leveraged loan market has grown, it has attracted a range of global investors seeking to deploy large amounts of capital.

The increased volume of European leveraged loans combined with the greater breadth of global investors has created a genuine secondary market. It is this latter development that practitioners expect will see the European leveraged loan market continue to gain serious critical mass. An active secondary market helps investors price new issues. To be able to readily trade in and out of loan positions also gives investors flexibility and comfort.

The number of European buy-outs with values large enough to access the European leveraged loan market has been lower than expected in H1 2014, but this leveraged loan market is keen to fund good assets and supply is strong; all of which should prove positive for buy-outs seeking debt in H2 2014.

FINANCING STRUCTURES ON EURO BUY-OUTS 2008 – H1 2014

	2008	2009	2010	2011	2012	2013	2014
Equity (%)	49.1	66.1	66.2	62.9	65.6	51.3	53.8
Mezzanine (%)	4.8	1.4	1.3	2.6	3.3	4.8	1.4
Debt (%)	40.9	30.0	29.4	32.1	28.6	42.1	44.6
Loan Note (%)	3.4	1.2	0.9	1.8	1.9	1.0	0.2
Other Finance (%)	1.8	1.4	2.1	0.5	0.6	0.8	–
Total Financing (€m)	**43,160**	**7,874**	**34,969**	**42,830**	**31,483**	**34,271**	**10,971**
Vendor Contribution (%)	2.3	1.6	0.9	0.7	1.0	0.5	–
Management Contribution (%)	2.9	1.7	1.4	0.9	1.4	0.6	–
Management Share Of Equity (%)	**30.8**	**33.1**	**31.2**	**33.1**	**30.2**	**27.4**	**30.0**

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