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CENTRE FOR MANAGEMENT BUY-OUT RESEARCH
NEWSLETTER // SUMMER 2018

French buy-outs provide bright spot

European buy-outs had their strongest start in over a decade. A total of 393 European buy-outs worth a combined €46.9bn were recorded in H1 2018. This value was boosted by a buoyant French buy-out market, which recorded 67 buy-outs worth a combined €11.2bn. This is compares to the €15bn invested in French buy-outs for the whole of 2017.

The French buy-out market has performed consistently over the past five years, after a very slow year in 2012. French buy-outs were worth €11.1bn in H1 2018, €15bn in 2017, €11.7bn in 2016, €11.9bn in 2015 and €10.8bn in 2014. President Macron's election in 2016 has seen more business friendly rhetoric translate to meaningful change; notably lower taxes and more flexibility in the labour market.

In H1 2018, four French buy-outs totalled over €6bn: the €2bn buy-out of French medical diagnostics company Sebia by Caisse de dépôt et placement du Québec from Montagu Private Equity; the €1.5bn secondary buy-out of rental equipment business Kiloutou for €1.5bn by HLD Europe from PAI Partners; the €1.2bn buy-out of packaging group Albea Services by PAI Partners from Sun Capital; and Ardian's acquisition of Les Dérivés Résiniques et Terpéniques, producer of ingredients from plant-based chemistry, from family shareholders and Tikehau Capital for €1bn.

Further afield, Denmark was home to two mega buy-outs in H1 2018. February saw the €4.4bn public-to-private from Nasdaq Copenhagen of payment processing business Nets by Hellman & Friedman. In March, building materials distribution business Stark Group was sold by Ferguson plc to Lone Star for €1bn.

In fact, Nets is the largest European buy-out in 2018. However, it will be eclipsed by Unilever's spinout of its spreads business, which includes brands such as *Flora* and *I can't believe it's not butter*. Total deal volume will be close to €7bn. When the transaction closes, it will fall into The Netherlands' buy-out total. Unilever recently confirmed it is consolidating its headquarters in The Netherlands. Unilever has been co-located between the UK and The Netherlands, but came under pressure to choose a single jurisdiction post-Brexit.

The Netherlands had a strong start with 33 buy-outs worth €4.2bn in H1 2018. This includes the €1.75bn buy-out of compliance and administration services business TMF Group by CVC Capital Partners and the €1.6bn buy-out of juice bottling company Refresco by PAI Partners. TMF Group was a secondary buy-out from DH Private Equity (formerly Doughty Hanson). Refresco was a public-to-private from Amsterdam's Euronext.

When the €7bn buy-out of Unilever's spreads business closes, The Netherlands may rank as Europe's third largest buy-out market, by value, at the close of 2018.

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/continued from page 1.

French buy-outs provide bright spot

The UK and France will, most likely, take first and second place. Germany may yield its usual third place to The Netherlands.

Typically, H2 sees greater buy-out value posted than H1. During H1 2018, Germany's 71 buy-outs had a combined value of €5.2bn on 71 buy-outs. Full year figures for 2017 came in at €18.7bn on 108 buy-outs. However, this was exceptional: German buy-outs in 2017 were boosted by five mega deals including Bain Capital and Cinven's €5.4bn buy-out of pharmaceutical company Stada Arzneimittel and Lone Star's €2bn purchase of building materials company Xella. Whereas 2016 recorded a relatively low €6.5bn across 96 buy-outs, in 2015 Germany had 81 buy-outs worth €12.6bn and in 2014, 81 buy-outs worth €13.1bn.

While the UK buy-out market is broadly level with France, this represents a sharp drop in activity for the UK. There were 103 UK buy-outs worth €10.2bn in H1 2018. This compares to: €31.2bn from 194 buy-outs in 2017; €29.2bn across 221 buy-outs in 2015; and €21.4bn from 247 buy-outs in 2014. Just €14.7bn across 195 buy-outs in 2016 was caused by the EU Referendum/Brexit result in June 2016. Mega buy-outs, which boosted overall numbers in prior years, have largely disappeared from the UK market in H1 2018. There were just two such deals: Iris Software Group and European Vacation Rentals. Iris Software Group, notable for being the largest ever software buy-out in the UK, is, to an extent, a reshaping of its ownership structure. HgCapital and ICG oversaw the €1.15bn buy-out in May. However, HgCapital has been invested in Iris for over a decade, first supporting the business in 2004. HgCapital became a minority shareholder, alongside Hellman & Friedman, in 2007 and was also involved in the 2011 and 2014 buy-outs. European Vacation Rentals is the €1.1bn buy-out of US-based Wyndham Worldwide's UK operation.

SMALL BUT NOT INSIGNIFICANT

Although 2018 started well with 393 buy-outs with a combined value of €46.9bn in H1, the expectation is that FY2018 will not exceed FY2017. In 2017, a total of 709 buy-outs were valued at a combined €100.5bn.

Although H1 2018 is the biggest H1 value in over a decade, typically greater value falls into H2. However, the UK looks set to suffer a similar trend as it did in H2 2016. While the run up to, and fall out after, the June Brexit vote was to blame in 2016, similar uncertainty prevails in H2 2018. When Europe gets back to business after the summer break, the UK will be six months away from its official EU departure. Yet little is known about how the UK will interact with the EU after 29 March 2019. »

H1 2015 – H1 2018 // EUROPEAN BUY-OUT VALUE RANGES

	H1 2015		H1 2016		H1 2017		H1 2018	
	No	€m	No	€m	No	€m	No	€m
<10	165	660	174	701	145	591	178	731
10 – 24	44	794	47	833	64	1,091	62	1,082
25 – 49	24	893	21	779	23	870	45	1,728
50 – 99	26	1,808	29	2,110	36	2,629	30	2,247
100 – 249	30	4,620	27	3,942	22	3,615	38	6,060
250 – 499	22	7,425	17	5,638	15	5,074	17	5,995
500 – 999	11	7,206	14	9,465	9	6,333	10	7,192
>1,000	7	13,871	5	6,438	12	18,703	13	21,841
TOTAL	**329**	**37,277**	**334**	**29,906**	**326**	**38,906**	**393**	**46,876**

Source: CMBOR / Equistone Partners Europe / Investec Specialist Bank

A total of 212 buy-out exits valued at €44.7bn were recorded in H1 2018. This is substantially down on comparable H1 figures for the past five years.

Exits wane

Other than 'shock' years, such as the 2007 financial crisis and Brexit in 2016, buy-out values tend to be higher in the second half of the year, the reverse has been true of exits. During the past five years European buy-out exits have boomed with the bulk of the value falling in H1 and lower values were recorded in H2 from 2014 through to 2017.

If H2 2018 follows suit, the drop in full year exit values will be dramatic. If H2 2018 were to post similar exit values to H1 it will amount to a 30% value reduction on 2017 figures. In 2017, 483 exits were valued at €118.5bn, in 2016 there were 451 worth €100.6bn, in 2015 there were 528 worth €161.5bn (the largest ever) and in 2014 there were 516 worth €116bn.

France, Germany, The Netherlands and Italy have all started strong. All four countries recorded exits already at, or close to, their full 2017 figure by the close of H1 2018. France had 36 exits worth €10.2bn in H1 2018, compared to 65 exits worth €14.2bn in 2017. Germany had 24 exits worth €12.5bn in H1 2018, compared to €15.9bn in 2017. The Netherlands had 14 exits worth €5.1bn in H1 2018, compared to 29 exits worth €5.4bn in 2017. Italy had 16 exits worth €3bn in H1 2018 compared to 35 worth €3.7bn in 2017.

The black spots in activity were the UK exit market and the virtual disappearance of IPOs. The UK has always been the largest European buy-out and, therefore, its largest exit market. But for large deals the market is on hold. Consequently, mainland Europe has proved more attractive. Uncertainty over Brexit for both the UK and the EU may have contributed to a lack of support for private equity-backed IPOs. However, the fact that pricing on

H1 2015 – H1 2018 // EUROPEAN BUY-OUT EXITS BY TYPE

	H1 2015		H1 2016		H1 2017		H1 2018	
€m	No	€m	No	€m	No	€m	No	€m
Creditor exit	30	–	25	–	19	–	9	–
Floatation	46	50,071	21	19,101	27	15,867	6	3,539
Secondary buy-out	213	44,550	197	34,495	223	49,441	112	22,831
Trade sale	239	66,880	208	47,036	214	53,176	85	18,316
TOTAL	**528**	**161,501**	**451**	**100,632**	**483**	**118,484**	**212**	**44,686**

Source: CMBOR / Equistone Partners Europe / Investec Specialist Bank

Until details of this future trading relationship become clear, buy-out investors may find it difficult to price assets so they could sit out the UK market. In theory investors could shift to mainland Europe since large buy-out funds tend to have a pan-European remit. In practice, the structure of these markets limits the available deal flow. Many are dominated by a mix of large multinationals and state-owned enterprises. Investors looking at mainland Europe as an alternative will also be wary that too much competition could push up asset prices.

However, European investments in the sub €10m buy-out market have surged. In H1 2018 there were 178 buy-outs worth €731m. This compares to 273 buy-outs worth €1.1bn in 2017, when sub €10m buy-outs equated to 1.2% of all European buy-outs by value. In H1 2018, the share of the sub €10m buy-outs jumped to 1.6%.

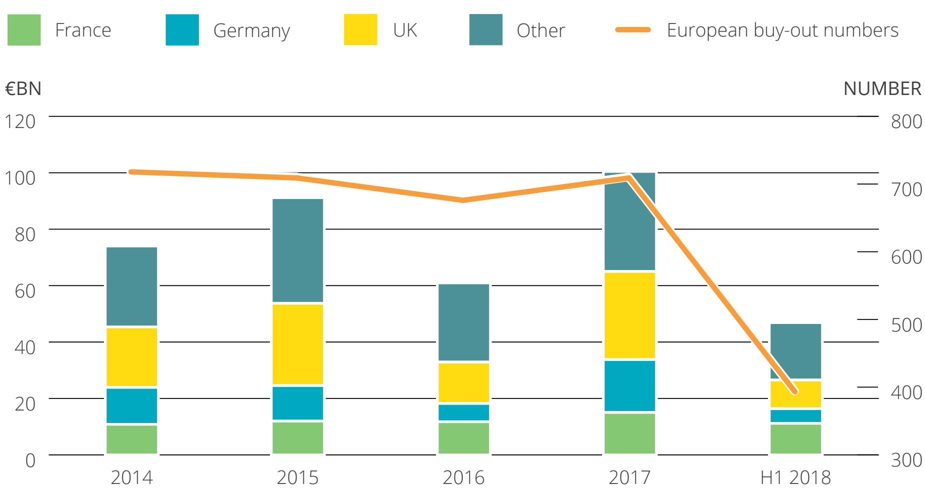
While seemingly a drop in the ocean today, a good proportion, if not the majority of these €10m buy-outs, will be recycled into larger buy-outs in 5-10 years' time. Observers expect this trend in the sub €10m category to continue, in the UK at least. Following the Brexit vote in June 2016, some UK GPs found access to EU funds either delayed or denied. Consequently, the UK government restructured and injected fresh capital into British Business Bank, which has £2.5bn to invest in SMEs through a variety of capital structures.

SECTOR ACTIVITY

The business support services, financial services and food & drink sectors remained buoyant during H1 2018. Business support services had 67 buy-outs worth €8bn; this compares to 81 worth €12.2bn in 2017. Financial services was lower in number (15), but its value was pushed up to €7.2bn by the €4.4bn public-to-private of Danish payments processing business Nets. This compares to €11.6bn across 44 buy-outs during 2017. Food & drink saw 14 buy-outs worth €3.4bn in H1 2018, compared to €1.8bn across 35 in 2017.

Leisure, property & construction and retail did not fare as well. Leisure was down from €6.8bn across 30 buy-outs in 2017 to €2.7bn across 25 in H1 2018. Property & construction recorded just 9 buy-outs worth €260m. This is down from 22 worth €1.9bn in 2017. Retail had 9 buy-outs worth €521m in H1 2018; this compared to 26 worth €4.2bn in 2017.

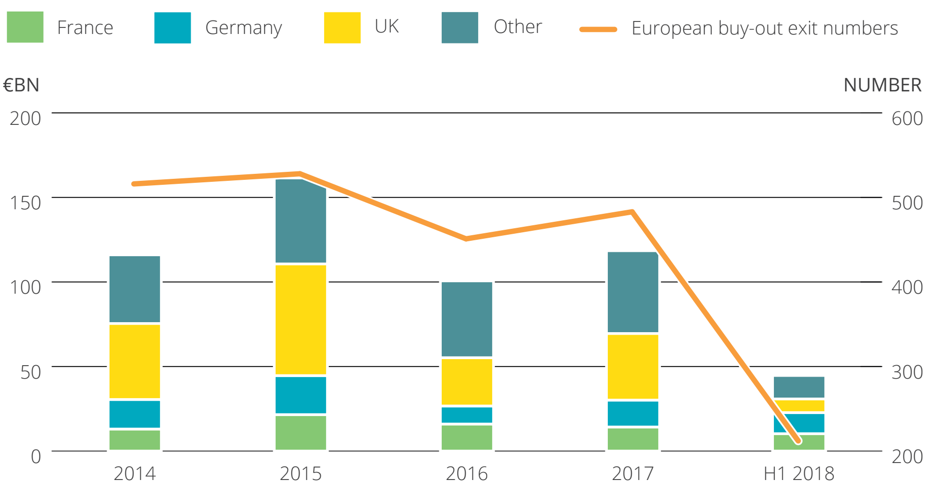
2014 – H1 2018 // EUROPEAN BUY-OUT VALUES



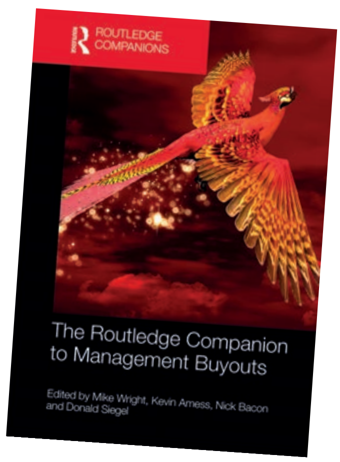
Source: CMBOR / Equistone Partners Europe / Investec Specialist Bank

many recent IPOs remains underwater may be deterring investors. Of the three buy-out exits via IPO in H1 2018 that account for nearly all the value (€3.54bn), two are currently below their issue price. Similarly eight buy-out exits account for the majority of 2017s €15.4bn IPO exits and five of these are underwater. Of the three in H1 2018; two are trading more than 30% ahead of their IPO price and one around 5% ahead. Doubtless this reflects investors' wider market experience, nevertheless it is not an aid to new private-equity backed IPOs.

2014 – H1 2018 // EUROPEAN BUY-OUT EXIT VALUES



Source: CMBOR / Equistone Partners Europe / Investec Specialist Bank



Routledge companion

To mark the 30th anniversary of the Centre for Management Buy-Out Research, *The Routledge Companion to Management Buyouts* will be released on 12 September. The book has been edited by CMBOR veteran Mike Wright, alongside editors, Kevin Amess, Nick Bacon and Donald Siegel.

Pre-orders can be placed against ISBN No. 978-1138713840.

H2 2018 uncertainty

Quite where Brexit will end up, and its impact on UK buy-outs, remains unknown. Despite being at the tail end of exit negotiations, little, if any, progress has been made on future trade arrangements.

Investors need the cost, terms and ease of trade between EU countries and the UK quantified. They also need to know the extent to which the UK will be free to trade with non-EU countries, particularly the USA. While the formal departure date is 29 March 2019, a 'transition' period, to last until December 2020, has been agreed. However, with limited understanding of what is being transitioned to, this has done little to encourage investors. Key dates in H2 2018 are 18 October and 13-14 December, when the European Council meets. A 'no-deal' Brexit is still unlikely, but is being talked about increasingly.

While Brexit is undoubtedly a concern, it is being played out against the backdrop of yet more uncharted territory. This is the gradual unwinding of a decade of global quantitative easing programmes. As of September 2017, the US Federal Reserve began to unwind its quantitative easing programme. Rather than selling, it stopped reinvesting when assets reached maturity. Not reinvesting was capped at $10bn a month when the programme started in September 2017. This $10bn a month cap increases by $10bn each quarter until it reaches $50bn in October 2018. In 2014 the Federal Reserve first announced plans to reverse its quantitative easing programme. Bond markets plummeted and stock markets globally suffered significant drops.

All central banks are wary of announcing reversal programmes, as a consequence. The European Central Bank (ECB) has only recently confirmed plans to stop its quantitative easing programme. This has dropped to an average of €30bn a month between January-September 2018, having been at €60bn a month between April to December 2017 and at €80bn a month for 12 months prior. From October-December 2018 the programme will climb down to €15bn a month before ceasing.

At some point the ECB will unwind its €2.5tn commitment. The UK's Bank of England has indicated that its frozen quantitative easing programme will not be reversed until interest rates reach around 2%. At the time of writing the Bank of England interest rate was 0.5%, but was expected to rise to 0.75% in August 2018. The Bank of Japan's programme, although declining, is ongoing. It dwarfs both that of the US Federal Reserve and the ECB. If those three programmes reverse, just at the conservative $50bn a month cap set by the Federal Reserve, $150bn a month (c$2tn p.a.) of liquidity will disappear from the financial system. To give this context, global GDP is estimated at around $80tn p.a.

Investors will monitor this carefully since access to liquid global capital markets is key to the successful functioning of private equity investments and exits.

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