From left: Wendelin Thönes, Stéphane Perriquet, David Innes, Simon Cottle, Pete Wilson

EUROPE

Keeping their eyes on the prize

As the global political landscape shifts in unpredictable ways, our European mid-market roundtable participants are keeping a cool head and staying on the lookout for good deals, Victoria Robson writes

PHOTOGRAPHY BY JAMES CLARKE

These are unpredictable times for European private equity. The UK's decision to leave the EU astonished many, while upcoming leadership elections in France and Germany herald continued volatility. And beyond the continent, Donald Trump's arrival in the Oval Office in January and speculation about the future direction of US economic policy have markets on tenterhooks.

"There are not many places where there isn't a level of political uncertainty at the moment," says David Innes, Debevoise & Plimpton's London-based private equity group head. However, he notes market dislocation also creates opportunities for private equity.

As funds position themselves to respond to continued macro-uncertainty "you try to understand where the risks sit, what's the probability of them occurring and what's the impact on a particular business", says Simon Cottle, Ardian's London-based managing director, mid-cap buyout. Although at a portfolio-company level Cottle shakes off concerns about Brexit, he says: "Where I do think Brexit has an impact is the inability to predict."

Understanding the possible impact of Brexit is a key challenge, says 3i private equity partner Pete Wilson. However, the Brexit effect has been largely benign and in some cases a positive for the London-listed

SPONSORED BY 3I, 21 PARTNERS, ARDIAN, DEBEVOISE & PLIMPTON firm that invests primarily off its balance sheet.

"[Portfolio] companies at the consumer end are holding up pretty well. For businesses exposed to investment in infrastructure it actually feels quite positive. We're investing in very international businesses and a lot of our profit is euro-denominated, so ironically we have actually seen some foreign exchange benefit [due to the fall in sterling]."

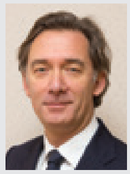
Ardian also appears to have benefited. The French manager collected €4.5 billion for its Ardian LBO Fund VI, one of the largest European mid-cap vehicles to close in 2016. It reached final close in »

It's easy to be a busy fool and spend a lot of time looking at a high volume of deals, but getting your conviction early, making your buying decision early... is critical

Pete Wilson

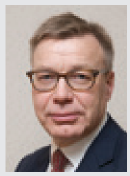
MEET THE ROUNDTABLE

PETE WILSON
partner, private equity
3i
Wilson originates and executes transactions, as well as representing 3i on the boards of portfolio companies. He has a particular focus on the business and technology services sector. Prior to 3i, he worked in the strategy group at Accenture.

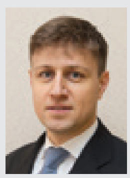


STÉPHANE PERRIQUET
managing partner
21 PARTNERS
Perrquiet joined the 21 Partners group in 2001 and became managing partner in 2011. He spent five years with Siparex Private Equity after having worked as Financial Controller at BFI-IBEXSA, a European electronics component group, and an auditor at KPMG.

SIMON COTTLE
managing director, mid-cap buyout team
ARDIAN
Cottle joined Ardian in 2015 from HgCapital. He began his career as an investment banker at Deutsche Bank and Citigroup, and rowed for Team GB at the 2004 Olympic Games in Athens.



DAVID INNES
partner
DEBEVOISE & PLIMPTON
Innes is the head of the firm's UK private equity group, with a practice that covers a full range of UK and cross-border private equity and M&A transactional work.



WENDELIN THÖNES
director, private equity
ALLIANZ CAPITAL PARTNERS
Thönes focuses on fund investment opportunities and co-investments in the European market and serves on the advisory boards of a number of European buyout. He joined Allianz Capital Partners in 2007 and previously worked at Ernst & Young Transaction Advisory Services.

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>
> Stéphane Perriquet

» September on its hard-cap after just four months in market.

Cottle notes that during the fundraise, limited partners' main concern was not Brexit, but how Ardian would compete in the "tough and competitive" UK market. His response was to flag its extensive international reach, the size of its funds and its flexibility.

Despite the lack of visibility on what Brexit entails, the UK continues to attract LP interest, albeit with a cautious outlook in the case of Allianz Capital Partners, which invests in primary funds, secondaries and co-investments across 80 fund relationships. Wendelin Thönes, a director in its private equity group, says: "The truth is, if you invest in European private equity, you can't really avoid the UK market because it's so large. We continue to invest [in UK-only funds] but we would probably, at the moment, not seek to increase our commitment much compared to the other geographies, and we follow the developments around the Brexit process closely."

Equally sanguine about the impact of local political events is 21 Partners managing partner Stéphane Perriquet. The outcome of the French presidential elections, which take place in late April and early May, is less of a concern to the lower mid-market manager than the threat of new import tariffs.

"We are more worried about a potential trend of protectionism at a worldwide level, and particularly in the US. Many of our portfolio companies export, notably to the US, so we are quite attentive to what will happen in the coming months on that side."

One thing managers and LPs are certain about is the huge amount of capital flooding the market. According to PEI data, European mid-market funds raised a whopping $124 billion from 2014-2016, and that cash needs to be put to work.

For Perriquet, the impact this has on pricing is the biggest challenge he faces. "Today's prices are sometimes difficult to understand," he says, noting that for good companies in stable markets offering M&A possibilities, prices can reach 10 to 12 times EBITDA. That can rise to more than 12 times if the company is growing organically at a high rate, he adds.

IS THE PRICE RIGHT?

The availability of finance on good terms, including from alternative credit providers, contributes to the ability of buyers to pay high prices when they need to, Innes says. "In the current market, if it's a good business it will go for a premium price."

Wilson agrees there is a "flight to quality", but notes not all sellers can get the price they demand. "We were looking at a company recently where the advisors had indicated not to bother unless you were at a certain price. The management team were equally robust [on the price]. The process fell over because the multiple they were offered was more than three turns off that price."

Price isn't everything: putting in the hours pre-deal is increasingly important, the GPs agree.

Perriquet notes: "We have to work prior to the process, to meet with management teams, to build our investment thesis, to identify add-on acquisitions that will be completed shortly after the deal is completed."

In the French market, securing early access to management teams is critical, Perriquet adds. "Our origination work relies primarily on getting access to management teams for which we have identified a potential deal in the future. In the lower mid-market you can still find situations where you are in direct discussions with the management team with no competition, or very limited."

And in that sector you have to be local, he added. "That is also a barrier to entry. It's key if you want to avoid large auctions. You can't manage a French deal in the mid-market from London. If you want to do direct deals at attractive prices, you must be in local networks and you need a local platform, a local team."

Management teams often fail to differentiate between what potential owners are offering in terms of value creation, which means in a deal process much hinges on "personality and listening to management teams [as] opposed to talking at them, which I think a lot of people still do. If you have that emotional engagement, the conversation becomes a lot easier. It's the softer skills that are increasingly important," says Cottle.

Innes agrees: "Management teams during processes often have very firm views over which bidders they would like to partner with going forward. Beyond price, a lot of it comes down to whether they feel a buyer understands the business, and whether the personal chemistry is there. Particularly if they have been through a private equity deal before, management teams are very sophisticated about what they are looking for, what went right last time, what they didn't like about it last time and are looking for someone who approaches the business in the right way."

But Wilson cautions: "It's easy to be lazy and assume that you're the nice guy and will automatically get lots of access, but actually there's some smart ways of achieving this, such as doing the outside-in work yourself earlier – that you don't need access to the company for – which can help inform your views and mean you are one step ahead when you do interact with management. It demonstrates to the company that you've got an interest and passion for their business and you're people they want to work with."

Clarifying plans early in the process is key. Wilson notes that "it's easy to be a »

"Where I think Brexit has an impact is the inability to predict

Simon Cottle

» busy fool and spend a lot of time looking at a high volume of deals, but getting conviction early, making your buying decision early, really knowing how you're going to add value to the business, and how you're going to grow it, I think is critical, more critical than I would have said three or four years ago."

As an example, he cites Audley Travel, which 3i developed a relationship with over a five-year period before it acquired the UK-based tailor-made travel provider at the end of 2015. The firm identified an opportunity to expand the business significantly in the US and used its US relationships and local network to position itself as the right buyer, Wilson says. "We try and play to our strengths. In the core mid-market, we think our European-US axis and track record of supporting our portfolio companies to deliver international growth are genuinely unique."

Since 2010, 3i has completed 169 bolt-on acquisitions across its portfolio and expanded its investee companies into 27 new geographies, he says. While there are still opportunities for multiple arbitrage, the focus of value creation clearly shifted some time ago to building better businesses, he adds.

Innes notes: "To find value, sponsors are prepared to do more complicated deals. Buy and build strategies, minority stakes, carve-out transactions, teaming with strategic buyers – these have always been around, but they are becoming more common."

For Thönes, the ability to transform a business is what he is looking for in a fund. "We are probably not at the bottom of the cycle in terms of pricing. Of course we are concerned about multiples, you still want to get your returns, which means it must come from somewhere else."

REACHING DOWN

At the upper end of the market, mid-cap funds face competition not only from their peers but also large-cap buyers encroaching on their space. The final six bidders for Envision Pharma Group, acquired by Ardian and GHO Capital last July, included a mix of large-cap and upper mid-market funds.

Cottle says: "Some of these [large-cap] firms are so incredibly impressive in terms of the resources they can bring to bear. They can bring the chief operating officer of [a company like] Microsoft to talk to a mid-market company to try and win the deal. It's very powerful."

A large-cap player buying a smaller business has options, notes Thönes, including buying a second business of equivalent size and merging the two "which is not possible for all players that are usually looking at mid-market targets".

But deals in Cottle's space are not scarce, he says. The fund identified 307 opportunities in the last year that it has whittled down to 12. "There is a lot out there in our size range, which is admittedly very large. That

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> David Innes

> *If you are good, there will be space for you*
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> **Wendelin Thönes**

gives us an opportunity." For Cottle and his "young and smallish team" the challenge is not finding deals, but time allocation.

With managers able to set their own terms, LPs want to know they can stay disciplined. One response is for investors to stick with trusted managers, which might take the form of a side product, says Thönes. "Some larger-cap firms are opening up mid-market funds, or technology-focused funds for instance, just because LPs are asking them to do that. Is that always great? Not sure. But in some cases it might make sense."

Is Thönes concerned about the amount of funds in the market overall? "If you are good, there will be space for you," he says. "You will find investment opportunities. We always find good mid-market GPs." ■

GETTING TO KNOW YOU

While the dynamic is still that LPs chase co-investment and GPs oblige to keep them happy, the relationship seems to be getting easier

Limited partner appetite for co-investing in the European mid-market remains unsated. Ardian's latest €4.5 billion mid-cap vehicle included an additional hefty €500 million set aside for co-investment. "We certainly have demand all the time," says Cottle.

For 21 Centrale Partners, the French arm of 21 Partners, which is currently fundraising for its fifth buyout vehicle targeting €400 million, Perriquet adds that "a lot of investors come into funds to get co-investment opportunities and what they like is to be offered the same amount of investment that they have invested into the fund".

As managers and investors build up a history of working together, arriving at an agreement appears to be less problematic than it once was. "Co-investment is a regular part of the private equity deal landscape and the whole process has become much slicker," says Innes.

GPs continue to differ in the terms and amount of co-investment they offer, while LPs vary in the amount of control they seek. But Allianz, which used to run a direct private equity business, now takes a more passive approach to co-investing. "Some situations don't go as you expect and you have bankruptcies, or at least difficulties, in your portfolio companies, and then you have to restructure and that is obviously easier for a private equity firm than for a large insurance company," Thönes says. ■