

# AUTO M&A TICK

With the automotive sector on the cusp of big change, Brian Bollen explores the drivers behind 3i's private equity investment in German process and testing firm Formel D - and how its future lies in new geographies

**€255m**

2016 turnover of Formel D - double its 2012 sales

**7,000+**

number of staff Formel D employs in 19 countries

The automotive industry is facing unprecedented and unpredictable change. The next decade will see the widespread adoption of electric vehicles and driverless technology, while new business models will emerge such as 'mobility as a service'. Navigating the strategic landscape has never been more difficult for either manufacturers or investors (see the *Corporate Financier* cover story, 'Fuelled by the future', June 2017).

Private equity investors with a three-to-five year cycle are particularly exposed to changes in consumer, manufacturer and market demand. Get the direction of travel, or timing, wrong and it means losing money or holding for a long IRR-reducing period. On the other hand, PE ownership is particularly effective when companies are undergoing change, whether it is due to investment, restructuring or entry into new markets.

It is this opportunity that attracted London-listed private equity firm 3i to Formel D - a developer of quality assurance and process optimisation solutions

for automotive customers - based in Troisdorf, near Cologne, Germany. Ulf von Haacke, partner and head of industrial at 3i in Germany, described Formel D as a highly cash-generative business requiring little in the way of capital expenditure. "It has traditionally done well, and should continue to do well even if the auto industry were to experience a downturn. Major international businesses are very dependent upon stability when deciding where to manufacture and assemble, and OEMs are more prone to outsource. This is a challenge for the entire industry, but not one that will harm it."

Through its range of testing and inspection services for individual parts, systems and vehicles, Formel D is an integral part of the automotive value chain. Its touch points range from development through production to aftersales. Customers include premium automotive manufacturers BMW, Daimler, VW and Audi. With over 7,000 employees, it operates more than 80 facilities in 19 countries, with 50% of revenues generated in Germany, 25% in Europe (excluding Germany) and 25% in the Americas and Asia. In 2016, its turnover was around €255m, more than double the sales in 2012 (€124m), when German PE firm Deutsche Beteiligungs AG (DBAG) invested in it.

## TWO YEARS IN THE MAKING

3i first took a look at Formel D more than two years ago. "We were very attracted to it as it sits within a sub-sector of the automotive space, which 3i knows well - testing and inspection," explains von Haacke. "It touches two of 3i's core sectors: business and technology services, and industrial - it falls in our sweet spot in terms of experience and track record."

He says the M&A process was competitive, but smooth. Investment bank Rothschild ran the auction for seller DBAG. It took just three months from initiation to the signing of a purchase agreement in May 2017. Price was a matter for negotiation, of course, but the final discussions were wrapped up in one night.

3i put in place a financial structure comprising a debt package, revolving credit and working capital facility. The debt component amounts to less than half the total price, the balance being equity. Embedded within the debt is the availability of further funds should they be needed to finance future acquisitions, which seem certain to take place.

"Success to date has been purely by organic growth, but we have a clear M&A strategy," says von Haacke. "While it has already built a presence, 75% of revenue still comes from within Europe, so there is clear potential for the business to grow with its existing clients in the US and Asia, in particular China. In this fragmented market we see ample growth."

## THE ROAD AHEAD

The vendors were satisfied with an investment that went almost exactly to plan. DBAG's investment thesis had been to expand the business by adding new customers, developing new services and taking



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**Ulf von Haacke,**  
head of industrial,  
3i Germany



"3i is the ideal partner for us at this point in our development"

**Juergen Laakmann,**  
managing director,  
Formel D

them to market and starting to expand into new geographic markets.

"In the past four years, Formel D's management has very successfully driven the process-related and organisation changes that have enabled the company's strong growth," said Dr Rolf Scheffels, member of the DBAG management board. "Formel D is an excellent example of how a financial investor with the necessary sector experience can contribute within the scope of a family succession arrangement."

While the price had to be right, 3i was able to sell its international credentials to the management team, with Dr Juergen Laakmann, Formel D managing director in charge of Germany and the Americas regions, saying: "3i has a long track record of helping businesses to expand internationally and we feel it is the ideal partner for us at this point in our company's development."

The deal received the necessary regulatory approvals in July, allowing 3i to syndicate €72m of the equity investment to CITIC China Capital Partners. Headquartered in Hong Kong with offices in Shanghai, Beijing, Shenzhen, Tokyo and New York, CITIC has completed over 50 investments over the past years in China, Japan, the US and Australia. Formel D marks its first foray into Europe. CITIC Capital manages \$4.8bn of committed capital.

"We take a four- or five-year investment view but will be prepared to hold for longer if appropriate," says von Haacke. "We are very focused on making it attractive to trade buyers in due course. In the meantime, we are very happy to have bought Formel D as it plays to our strengths: internationalisation, growth and margin improvement." ●

## HERE'S THE DEAL

3i Group has agreed to invest up to €247m in Formel D along with management to acquire the business from Frankfurt-listed Deutsche Beteiligungs AG (DBAG), and DBAG Fund V, a private-equity fund managed by DBAG.

The purchase agreement was signed in May 2017, completing in July 2017, whereupon 3i introduced CITIC China Holdings as a co-investor. Its first European investment, the Chinese fund worked with 3i on the transaction.

3i's legal advisers were Willkie Farr & Gallagher. Sector specialist investment bank, Robert W Baird & Co was a financial adviser. 3i is a longstanding client of Baird. Thomas Fetzter, head of investment banking for the DACH region at Baird, said: "For the Formel D transaction, we provided 3i with buy-side M&A advisory and debt

advisory services. This included tactical M&A and valuation advice, as well as support in structuring the debt financing for the acquisition."

PwC looked after accounting, tax, HR and IT issues. McKinsey wrote a commercial buy-side due diligence report. Rothschild advised DBAG on the disposal.

3i will have two partners on the board, Ulf von Haacke and Andre Perwas. Formel D's management team, led by managing director Claus Niedworok, will remain as shareholders.

