



October 3rd 2008

Dear Investors,

Given the importance of recent events in the financial markets (an even deeper crisis, one year after the subprime problem came to the surface in the summer of 2007), we thought it appropriate to give you Access' view on its market segment, looking at threats and opportunities.

Let us first look at the more challenging end of the picture.

Acquisition debt availability is seriously contracting this time, even for smaller deals

Whereas we had seen a significant slowdown in mid-market deals (EV of € 100 to 250m according to our own definitions) since the summer of 2007, it was business as usual in the small deals segment (EV < € 100m) with many transactions taking place in our portfolio. We now anticipate that even the small deals segment will be affected and that we could see a temporary contraction in the number of transactions.

Over the mid-term we still remain confident that there will be sufficient debt availability from banks operating in the small and mid-market to fund a reduced but significant number of new high quality deals for our portfolios, although debt pricing may continue to go up.

We also believe that the buy-out model will be adjusted to reflect the lower availability of debt and the more risk-averse attitude of banks. Indeed General Partners may need to structure their transactions differently to get deals done with a higher component of quasi-equity and mezzanine, but also a higher recourse to vendor financing. Better times will come to re-finance these deals with debt as it starts to become available again later in the cycle.

The sharp fall in stock market comparables is pushing the valuation of Private Equity portfolios down

June 2008 valuations have shown the first serious impact of the stock market crisis on Private Equity portfolios with fair market values going down across the industry. One can anticipate that September and December 2008 will continue this trend down.

One should nevertheless distinguish between temporary fluctuations for solid assets that continue to perform well in sales and EBITDA terms and more fundamental adjustments for under-performing or over-paid and over-leveraged assets.

At the moment, the bigger the deal, the more chances it has to fall in the over-paid and over-leveraged category for vintages 2005, 2006 and 2007.



## The slowdown of the European economy will challenge many portfolio companies

Under-performance of buy-out assets due to the softening of demand particularly in the retail sector, and increases in the prices for raw materials is a common theme these days. Deals in our portfolio acquired during vintages 2005, 2006 and 2007 have on average not been over-leveraged or over-paid. They have on average increased their sales by 9.7% in 2007<sup>1</sup> and, for the vast majority they continue to trade on budget in 2008. Even if some of these companies see their growth slowing down in the second half of 2008 and in their anticipations for 2009, most of them remain solid assets with good upside.

We will undoubtedly see an increase in covenant breaches as EBITDA targets are not met and banks apply little flexibility given their own constraints. This may take some companies down but we do not expect a significant increase in total deal failures compared to our historical average<sup>2</sup>.

In general terms, lower debt levels at acquisition and the quasi absence of bullet re-payments (debt is usually amortized over time) in our portfolio should provide better protection against softer trading and tougher banks than in the larger buy-out segment. For instance, 2006 vintage deals in our portfolio have already seen their average debt to EBITDA ratio come down from 3.5x to 2.7x given their debt repayment and their increase in EBITDA.

### Exits are harder to pull

The fall in the stock price of trade buyers and the difficulty for larger funds to raise acquisition debt is undoubtedly putting pressure on the exit market. Many exits that had been foreseen for 2008 are now postponed to 2009 or later. We should therefore be prepared for a prolonged slowdown in distributions from underlying funds.

In the meantime, we fortunately continue to enjoy several exits at this very moment. Companies such as Micromania (L Capital portfolio, distribution of video games, acquired by GameStop) or Score (Abenex portfolio, catering services, acquired by

<sup>1</sup> The 165 unrealised buy-outs in the Access portfolio (ACF MMBO II and III) acquired before July 2007 have on average grown their sales by 9.7% in 2007vs 2006

<sup>2</sup> Out of 236 fully realised deals in Access' portfolio, 21 have been fully written off (8.8% by number and 5.7% by cost). Despite these write offs, the 236 deals produced a 2.84x cost multiple.



Sodexo) in France and BWA in the UK (Close Brothers PE portfolio, water additives, acquired by UIB of Bahrain) have been sold in the last two weeks at money multiples in excess of 3x. These exits prove that the appetite of strategic buyers for key assets in their markets continue to happen despite the financial turmoil.

## Fundraising has become a challenge for most General Partners

We have unfortunately entered a period of artificial increase in the Private Equity exposure of many institutional investors (as Private Equity measured against total assets increases mechanically when other more volatile asset classes such as listed equity lose value). This phenomenon combined with a slowdown in distributions from underlying funds and a general bearish sentiment may lead to a contraction in the appetite for new Private Equity commitments.

The failure of certain mega-buy-outs in the near future could also affect, if widely publicized, the image of the buy-out industry as a whole and have a knock-on effect on the appetite of newer, less sophisticated investors in the asset class.

Raising funds will take longer and many may not reach their target size. Although some funds may have sub-optimal sizes as a result, we are of the opinion that the more attractive funds will be of a more reasonable size, which is certainly healthy given the disproportionate inflation in fund sizes in recent years.

This may also be an opportunity for long term investors such as Access to capture additional space in the most sought-after funds.

**Fortunately, this crisis is also bringing fantastic buying opportunities.**

## Entry valuations should now come down more substantially for new deals

With an historic average entry point of 6.4x EBITDA for Access' buy-out portfolio over ten years, we base our return model on vintage diversification. While the period 2006-2007 saw our average entry point rise above 7x EBITDA, the years 2009 and 2010 should see the return of an average entry valuation at 6x EBITDA or below.

## The significant exposure we have built to "turnaround" General Partners should pay off

In anticipation of harder times, we had started to build a significant exposure to turnaround funds in the last three years. This exposure which does not rely on the



debt markets and takes advantage of failed buy-outs is now proving particularly relevant as it allows Access to deploy significant capital in the down cycle at low entry valuations with a strong upside potential.

## We are shifting our short to mid-term focus more towards secondary opportunities

Access has always been an opportunistic buyer on the secondary market for buy-out funds. Having done several successful deals in the past, we had kept out of the market between early 2006 and the summer of 2008 as the pricing of buy-out assets still commanded a premium while the economic outlook was putting portfolios at risk and was delaying exit horizons. We are now back in investment mode as the market offers an unprecedented number of buying opportunities with many distressed or strategic sellers and pricing going down sharply.

We therefore expect to close several transactions in the next few weeks and see a continuous buyer's market for at least the next two years.

## We are building a contra-cyclical dimension in our portfolios

When whole sectors of the economy become out of favor and the going gets tough for businesses in these sectors, a buying opportunity opens up for sector specialists with the right industrial skills. The retail sector, the financial services industry or Media/advertising are perfect examples of sectors where a contra-cyclical approach can create substantial gains over time. We are therefore committing capital at the moment to experienced teams that will be able to shape businesses they will acquire at low valuations.

## **Our mid-term return model should not be fundamentally affected**

### General partners will need to go back to basics

In a move back to basics, emphasis will again be on fundamental value resulting from operational improvement and profitable growth, much less on leverage which becomes a scarce resource.

Private Equity will hopefully concentrate again on its core mission: select potential market leaders, bring necessary managerial changes, expand internationally, invest in new products, new facilities, make acquisitions, etc. This will continue to create champions that become obvious targets to trade buyers or IPO candidates.



General Partners who have shown their ability to create their own deals, taking the time necessary to convince shareholders and entrepreneurs that they bring much more than money, should dominate the industry in the coming years. Those who were mostly dependent on M&A firms and secondary/tertiary buyouts should have a hard time.

The investment philosophy that Access developed over the last ten years traditionally favored growth and hands-on management over financial engineering. It should be even more relevant in the down cycle.

It may take longer to create value in traditional buy-outs...

We kept telling our investors that the IRRs seen on the market during the last few years were not sustainable. Average holding periods had come down to a mere three years since leverage was abundant and multiple arbitrage almost a given. General Partners will probably need one to one and a half year more on average to produce their target multiples but should inevitably see their target IRRs go down as a consequence.

...but secondaries and turnarounds should provide faster returns

With up to 30-35% expected exposure in ACF III and ACF IV to secondaries and turnaround funds, the cash flow profile of these funds of funds should not be fundamentally affected by the lengthening of the deployment and exit patterns of the more traditional buy-out exposure. Both secondaries and turnaround funds should produce faster cash flows.

With less debt available, more selectivity from bankers (at last), less competition, less pressure to close deals, the Private Equity industry should regain some "serenity". Taking aside the excesses of some mega-buy-out funds, the industry's behavior in this crisis builds a solid case for Private Equity being considered one of the safer asset classes, particularly through a fund of funds model. This should also help those who are building or about to start a private equity allocation, to progressively consider it as a main stream asset class.

We strongly believe that with its existing portfolios and its market positioning, Access is well poised to continue out-performing in the years to come, with a limited amount of risk due to its diversification and active portfolio management. Taking the last crisis as a point of reference shows that vintage 2002 and 2003 deals in Access' portfolio have outperformed the rest of our deal sample. We should therefore look forward to vintages 2009 and 2010.

The Partners

# Access Capital Partners

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