



ACCESS CAPITAL PARTNERS

Private Assets in Europe

GENERAL PARTNERS MEETING SUMMARY

DECEMBER 2013



Market views expressed by General Partners

On December 6th 2013, Access Capital Partners (Access) held its 13th Annual General Partners Meeting. It gathered 71 of its small and mid-market buy-out and special situation General Partners (GPs) and 15 of its private debt fund managers to exchange views on the current state of the market.

With improving macroeconomic conditions and better credit markets across many European countries, fund managers have, since the summer of 2013, been very active exiting companies, but they are still facing challenges to close new investments. Discussions covered the state of the investment, exit, and fundraising markets; as well as strategies implemented to outperform across cycles and optimize portfolio liquidity.



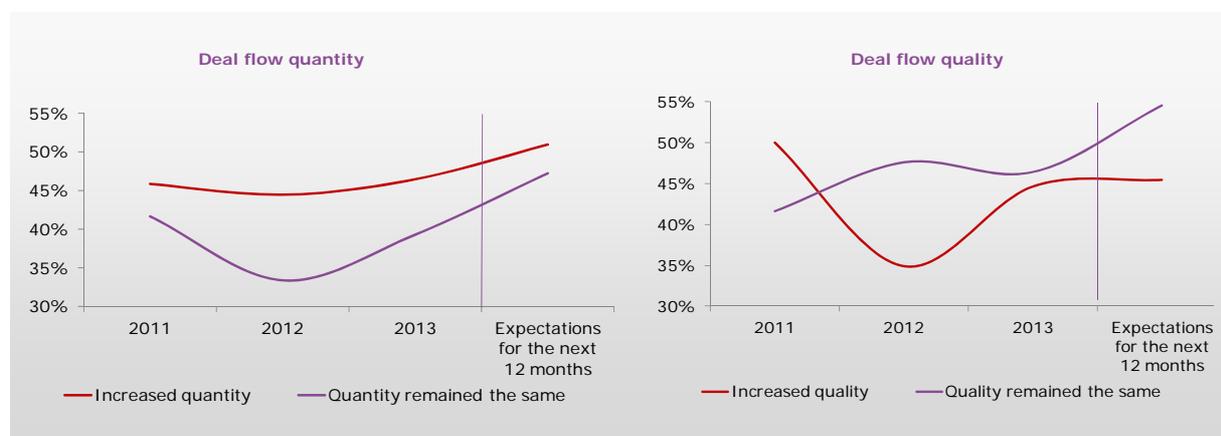
Improved market conditions slowly bring back confidence

Exits are back but deal making activity remains subdued

● Subdued deal making activity despite better market conditions

Despite the improved economic conditions and the reported increase in the quality and quantity of deal flow, the level of completed new investments remained relatively weak in 2013.

Figure 1: Perception of deal flow by General Partners



Source: Access Capital Partners

Investment activity was hampered by the price expectations of sellers, amid rising valuations on public equity markets. Entry prices remained above their long term average of 7.2x Enterprise Value / EBITDA for European mid-market buy-outs¹.

“Resilient companies remain in high demand. There is a premium to pay for the best companies.”

While higher acquisition valuations may be justified for some companies, they are also a cause for concern. As such, Access’ GPs have remained cautious and have tended to concentrate on a reduced number of high quality transactions involving businesses with strong growth potential.

“GPs should not invest at any cost.”

As some participants reported, completing investments was also hindered by a form of reluctance from family owners or entrepreneurs to, in the end, sell their companies, fearing their inability to properly reinvest the proceeds they would have received. As such, they preferred to remain invested in their companies for the time being.

¹ Source: Standard & Poor’s. Average in the period 2000-2013 for buy-out transactions below €250m

In terms of deal financing, the past year saw a resurgence of credit banking for new acquisitions at better terms. More than 80% of Access' GPs considered the availability of debt as sufficient, versus 68% in 2012. This is reflected in the average debt multiples for new acquisitions which increased to 3.0x Net Debt/EBITDA from 2.2x Net Debt/EBITDA in the prior year².

“There is more debt available at better terms than in prior years. Conditions are good.”

The picture seems to vary according to geographies: the UK witnessed a diversity of local and international banks with a capacity to deliver fast credit approval, in some cases in less than two weeks. In Spain, bank debt was almost only available from the three largest institutions. In the Nordic countries, the banking market appeared quite monopolistic, encouraging fund managers to look for other alternative sources of debt like bonds.

US investment banks were also more active in Europe in the second half of the year, although focusing on larger transactions for which they offered Net Debt/EBITDA multiples of up to 6.0x, well above the average debt multiple in Europe (4.7x in the overall buy-out segment in 2013³).

Looking at 2014, it was generally agreed that the combination of an improved macroeconomic climate with the continued availability of acquisition debt will likely facilitate a strong M&A market. Nevertheless, not all European countries are set to benefit equally from the improvement, as the economic environment as well as the evolution of tax regulation will continue to diverge across countries.

● Diverse types of acquisition debt providers

Debt has come from new sources, not just from the traditional bank players.

For a number of participants, mezzanine debt continued to play a key role in the financing of transactions, although this tends to be the case mostly at the smaller end of the buy-out market. For transactions involving companies with €3m to €8m EBITDA, a strong growth profile and a roll-out strategy, access to leverage continues to prove difficult. Mainstream banks tend to be reluctant to finance companies which have lower absolute levels of EBITDA and high working capital requirements. In this context, mezzanine financing enables fast execution, flexibility and deliverability, and remains less expensive than equity.

“We will look at mezzanine financing for small companies in specific sectors.”

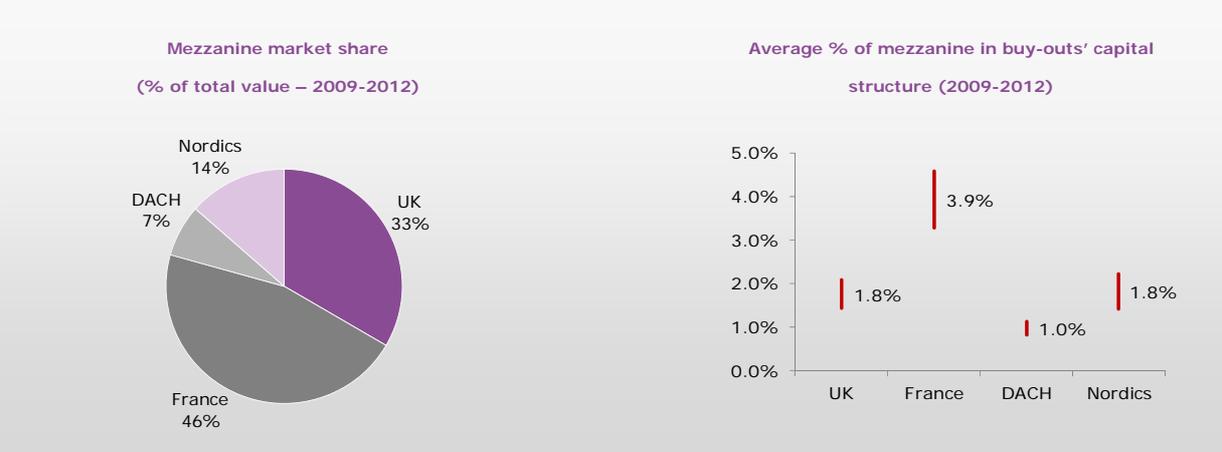
In terms of geography, France accounted for almost half of mezzanine investments in value in Europe over the past 3 years. On average, mezzanine finance had been represented twice as much in French buy-out capital structures (3.9% of the capital structure on average) as in the UK (1.8%) and Nordic countries (1.8%)⁴.

² Source: Access Capital Partners. Statistics on primary buy-out deals across ACF I MMBO, ACF II MMBO, ACF III MMBO, ACF IV GBO and ACF V GBO as of September 2013

³ Source: Standard & Poor's

⁴ Source: CMBOR, average 2009-2012

Figure 2: Mezzanine market share and proportion of mezzanine in capital structures



Source: Access Capital Partners

According to some private debt fund managers, contrary to the UK where the buy-out market tends to be dominated by larger transactions financed by traditional banks, the French market has always been more supportive of mezzanine as the small and mid-market buy-out segment represents a larger share of the buy-out market (67% versus 47% in the UK)⁵. By contrast, the mezzanine market is far less developed in German speaking countries.

“The nature of the mid-market in France has been very supportive of mezzanine.”

In 2013, in addition to mezzanine, European fund managers had diverse credit sources available from non-bank lenders. Notably there was an influx of capital from unitranche providers and from high yield issuance and bonds.

“Unitranche has become a solution for equity sponsors whenever banks are reluctant to provide debt or are not sufficiently reactive”.

Unitranche, which combines senior and subordinated debt into one instrument was created to simplify debt structures and accelerate acquisition processes, thereby avoiding lengthy negotiations with a large pool of lenders. The development of unitranche as a source of leverage for primary acquisitions has therefore threatened the position of banks as the primary source of debt, prompting them to work more closely with mezzanine funds in order to offer compelling solutions to equity sponsors.

In the last two years, fund managers, particularly those active in the Nordic countries, witnessed a booming high yield bond market, offering opportunities to refinance portfolio companies' debt at attractive prices and avoid breaching covenants. However, as bonds include repayment limitations, they are often considered too constraining and slightly more expensive than senior debt. Most bonds are not refundable prior to a certain period (usually 3 years) unless a significant premium is paid.

“Access to high-yield bonds in the Nordics is booming.”

⁵ Source: EVCA/PEREP_Analytics. Data for the period 2008-2012

● **“Equitization” of transactions remains high**

Despite slightly higher debt multiples in buy-out structures compared to 2012, equity cushions still accounted for about 60% of enterprise value on average in 2013. This has favored an increase in co-investment opportunities. As such, the proportion of Access’ fund managers that offered at least one co-investment opportunity in the past three years reached 86% in 2013, up from 68% in 2012. 78% expect to offer more co-investment opportunities in the coming three years.

● **Improved trading figures of portfolio companies**

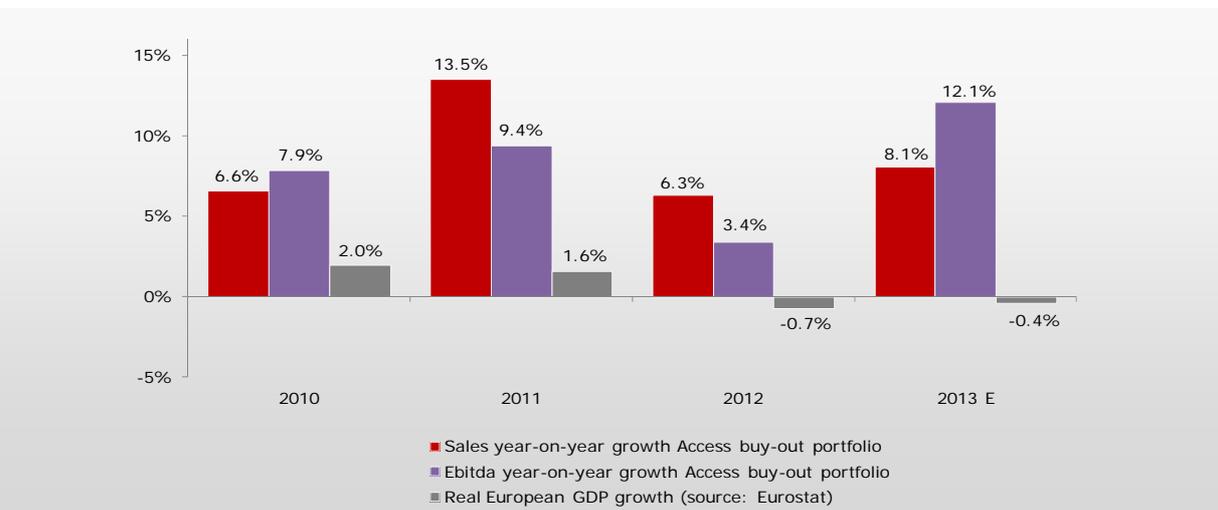
According to current budget figures, the operational performance of Access’ portfolio companies is likely to remain significantly stronger than the performance of the overall European economy in 2013. Sales are expected to be up by 8% and EBITDA growth could reach 12% on average compared to 2012, while GDP growth in the Euro area is expected to be negative at -0.4%.

Going forward, fund managers are confident that their portfolio companies will continue to grow at a similar pace, as the visibility on a sustained recovery of the European economy has improved since the summer of 2013, and may improve further in 2014.

“In 2014, operational performance should continue to progress at a similar rate as in 2013.”

Nevertheless, trading conditions will differ from one region to another. In countries still facing a relatively challenging economic environment, such as France or Spain, companies active only in their local market are likely to struggle more than those which are globally active. However, companies in the fastest growing economies such as Germany, Nordic countries or the UK, should benefit from the improved economic climate regardless of whether they are nationally or globally active.

Figure 3: Operational performance of Access’ underlying portfolio companies



Source: Access Capital Partners

- **Buy-and-build, complex situations and sector focused strategies: various routes to generate growth**

In order to maintain strong trading performance across cycles, Access' GPs often employ the buy-and-build model, pursue complex situations and/or focus on specific industry sectors where they can apply their expertise.

Buy-and-build acquisitions enable them to capture market share, benefit from synergies and provide EBITDA multiple expansion at exit. The latter can prove particularly beneficial given that entry prices for platform investments remain relatively high. In order to implement buy-and-build strategies efficiently, some GPs have become very research oriented and have built strong internal origination teams to help source high quality strategic acquisitions that will extend platform companies' service offering and geographic coverage.

Thanks to their in-depth knowledge of specific industries, sector focused managers tend to benefit from a strong natural deal flow. Sector knowledge also helps identifying bolt-on acquisition targets and implementing an internationalization strategy across or outside Europe.

"Making bolt-on acquisitions outside Europe is a pre-requisite for growth for specific niche businesses."

Acquisition of add-ons outside of Europe is seen as a good way to internationalize portfolio companies. In periods of challenging economic environment, such strategies have proved particularly helpful to secure growth, especially in the case of niche businesses with limited potential for further development in their home market.

Complex transactions typically involve companies with solid underlying dynamics but facing certain challenges such as loss making lines of business or poor management. They may also involve sale process complexities relating to multiple owners, family vendors, corporate divestitures or bank led disposals. Complex transactions can often be completed at much lower EBITDA multiples than traditional buy-outs, and offer good value creation opportunities once the key issues faced by the underlying company are unlocked.

"Solving problems at entry is key to achieving performance and positive outcomes. It is about bringing a solution to a problem quickly to create value."

The ability to work around an identified issue requires a strong hands-on approach as well as a good understanding of where and how the company needs to be restructured.

While many GPs focusing on buy-and-build acquisitions tend to favor non-cyclical businesses in order not to be impacted by changes in the overall economic environment, those looking at complex situations try to capitalize on the cycles and look for companies that can actually benefit from it. Nevertheless, Access' GPs agreed that the key to successful investments lies in discipline.

"Disciplining yourself acts better than your ability to read the cycles."

“At the end of the day, we tend to be opinionated investors and it is important to forget a bit about the cycle and think about whether you can implement your views.”

Fund managers’ value creation strategies continue to include organic growth, internationalization of portfolio companies or strategic repositioning of activities. In addition, GPs insisted on the importance of proper incentivization of management teams to ensure the alignment of interest between the fund and the leadership of the company.

“Although a good exit plan allows for further upside, most of the value creation comes down to actions taken prior to the exit.”

Further, driving digital excellence into portfolio companies has become increasingly important. Some fund managers, who strongly believe in the transformative power of digital technology to add real value to the companies, reported that hiring a digital director to accelerate the pace of digital evolution amongst investee companies could prove beneficial.

“The digital dimension is important.”

● Exits are back

Since the summer, the exit activity has significantly improved in the European small and mid-market space, with more than 200 companies exited in 2013 versus 163 in 2012⁶. About 73% of Access’ GPs reported at least one divestment in 2013 (69% in 2012), and the average number of delayed exits decreased from 1.2 in 2012 to 0.8 in 2013, leading to an increase in the number of exits per fund manager from 1.7 in 2012 to 2.0 in 2013⁷. Time to exit tended to reduce, as 57% of GPs’ reported exit processes to be on-time or faster than planned, compared to only 26% in 2012.

Figure 4: Previous and expected exit activity by Access’ GPs



Source: Access Capital Partners

⁶ Source: Mergermarket. Exits in the range €10-250m

⁷ Source: Access Capital Partners

The sense of optimism that prevailed in the exit market in the second half of 2013 is expected to continue in 2014. Fund managers are convinced that market conditions will remain favorable for exits as the overall macroeconomic environment continues to improve; company valuations stay high; dry powder still has to be deployed; and leverage remains available at attractive conditions.

● **Managing liquidity efficiently requires responsiveness and openness**

In line with last year's meeting, participants insisted on the importance of exit planning for portfolio companies whilst continuing to be responsive to unsolicited offers or other options to generate liquidity. Exit windows are sometimes short and fund managers should try to be in a position to consider all opportunities.

Fund managers tend to favor trade buyers over financial acquirers, as they usually conduct shorter due diligence and can be much faster in their decision making process. Having said that, GPs must also pay attention to "non-obvious" buyers who may be willing to diversify outside of their core-business. As they may be difficult to identify, hiring high quality advisors can prove useful.

Amid good credit market conditions, many GPs used more dividend recapitalizations in 2013 to generate liquidity from their portfolio companies and maximize IRR. Others preferred distributing the cash available in their portfolio companies, thereby avoiding paying fees to banks. A few managers favored selling part of their equity stakes to another financial buyer while benefitting from the remaining potential upside of the portfolio company.

"It is now a great time to benefit from the large amounts of liquidity available in the debt market."

Fund managers should remain aware of the risks they take by not maximizing the windows of opportunity arising in the market. In particular, funds that do not perform well enough should rather try to secure returns for their investors when an exit option is available.

While postponing an exit may prove beneficial to the fund and its investors when the macroeconomic environment is unfavorable (as was the case in 2009), deferring a company sale based on a lack of performance, could run the risk that the company's operations do not improve as expected and that market conditions later deteriorate.

"It is not the same if you are not selling because the company is not performing well or because market conditions are not favorable."

● **Fundraising remained challenging in 2013 but conditions could ease**

The polarization of the fundraising market increased further in 2013, with some GPs raising funds quickly while others struggled to reach their target size. Over the next twelve months, the fundraising route is likely to be particularly busy, with more than half of Access' GPs raising a fund.

It is anticipated that the recovery in stock markets will result in some investors being under-allocated to the asset class, prompting them to increase their investment activity again. Further, the beginning of a recovery of the European economy has started to bring back US investors who are committing again to European funds.

Fund managers who faced the need to extend their investment periods, need to remain disciplined on next fund size. Investment period extension is not seen as an issue when the manager keeps the trust of its investors. Nevertheless, such situations should remain the exception.

“The timing of fundraising is less important than the amount raised. Keeping discipline in fund size helps to limit risks of facing deployment issues.

Conclusion

As we enter into the sixth year following the financial crisis, Access sees a few reasons to be optimistic in 2014 on the back of the positive developments observed in 2013.

Exits clearly picked up in the second half of the year, and the availability of credit favored dividend recapitalizations which helped generate further liquidity to investors. GP meeting participants expect this favorable exit environment to continue, which could also help when exiting some of the more challenged portfolio companies.

The same conditions that have boosted the exit market have also made investments into new companies more challenging, as entry prices stayed relatively high. However, Access' GPs reported improvements in both the quality and quantity of deal flow, which is promising for the coming year.

Fund managers continued to show their ability to outperform across cycles, with growth in sales and EBITDA remaining significantly higher than growth in the overall economy. This comes as a result of well implemented investment strategies focusing primarily on buy-and-build acquisitions, investments into complex situations and / or sector specialization, but also using the same basic ingredients being disciplined pricing, moderate leverage, high quality management teams and hands on involvement

The fundraising market remained difficult in 2013, but is expected to improve in 2014 as distributions to investors continue to increase. Also, on the back of the more benign environment, US investors are coming back, fuelling European funds substantially.