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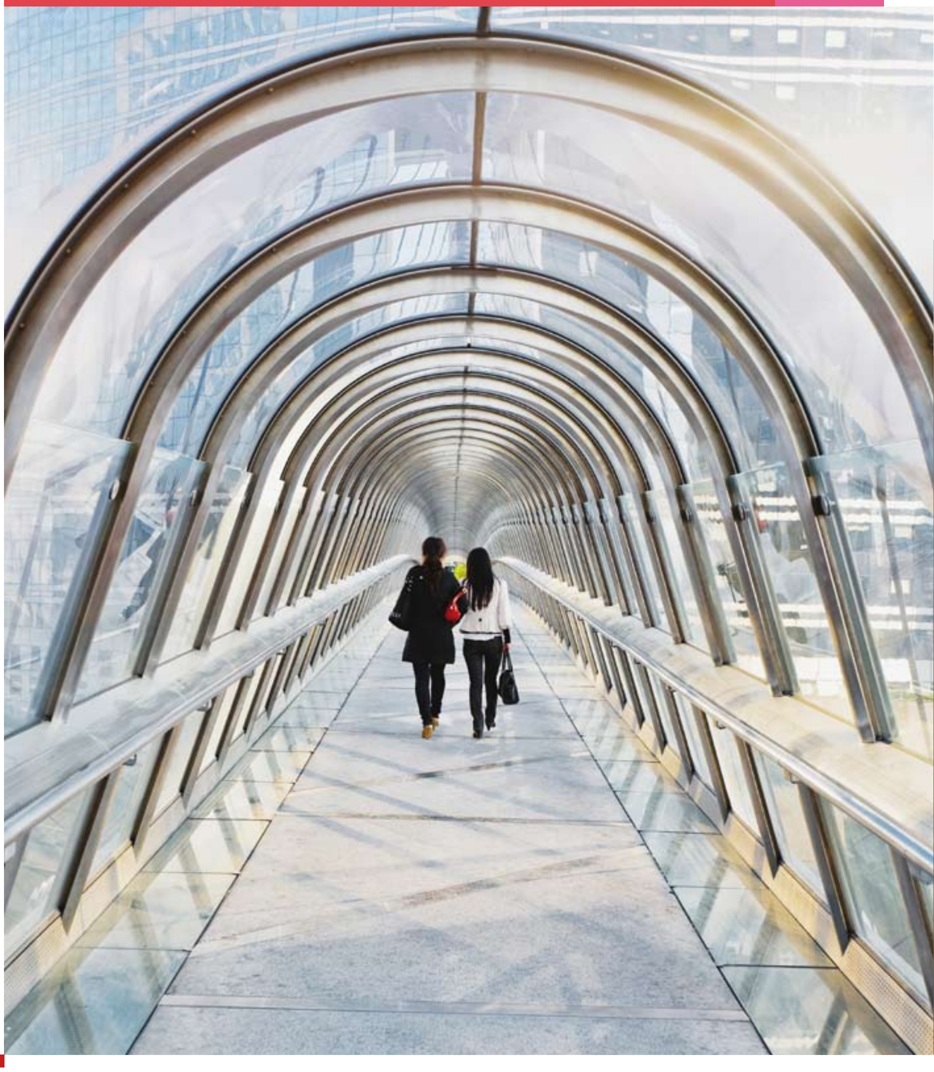
Private Equity Trend Report 2011

Light at the End of the Tunnel

5th annual survey on current developments in German and international private equity investment



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Edited by PricewaterhouseCoopers AG Wirtschaftsprüfungsgesellschaft

By Richard Burton

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Preface

Our latest annual survey of private equity funds was undertaken against the backdrop of some sizeable leveraged buyouts being signed as 2010 drew to a close. As always, our sincere thanks go to all who contributed to this year's survey and shared their opinions.

Last year we predicted that a "rocky road to recovery" would need to be navigated. 2010 indeed proved to be a bumpy ride but the market gathered momentum in the second half as deal activity finally began to pick up. Several large deals were signed in December 2010 and have now been successfully closed in Q1 2011 with syndicated debt financing making a welcome return to the market.

Broadly speaking our survey responses in the Private Equity Trend Report 2011 indicate more optimism in the deal market as the traditional leveraged buyout model regains much needed momentum, encouraged by the availability of bank debt for the higher quality, more resilient assets.

In short, we see evidence of "light at the end of the tunnel" and reasons for a more confident outlook for 2011.

We look forward to working with you in 2011.

Martin Scholich
Advisory Leader

Richard Burton
Private Equity Leader

Contents

Figures

A Executive summary

Almost 200 private equity funds took part in PwC's fifth annual survey of investment trends. Of these funds, 17% were based in Germany and 83% were headquartered outside Germany. 57% of participants manage funds of up to €500 million, 18% between €500 million and €1 billion, and 25% over €1 billion.

The key findings of the survey were as follows:

2010 in retrospect

- Half of the respondents reported an increase in new investments made by their organisation in 2010, with almost one third having stayed the same (29%). A marginally higher proportion of German respondents noted an increase in investment activity (55%) compared to the rest of Europe (50%).
- 4 in 10 stated that the number of exits made by their organisation in 2010 had increased, with a similar proportion claiming that this level had stayed the same.
- While more than half of funds (56%) still reported average debt levels of less than 50% on new investments, a higher proportion of German respondents (41%) managed to secure more than 50% debt-to-equity ratio on new investments compared to non-German respondents (21%).
- Unlike 2009 when the vast majority of respondents reported covenant breaches within their portfolio companies, our 2010 survey highlights that this risk has receded with well over 50% of respondents either reporting no bank covenant issues or that these only affected 10% of portfolio companies.
- 74% of the respondents felt that the availability of credit to fund leveraged buyouts in 2010 was "as expected" or "better than expected".
- Private equity funds were more bullish on developments within portfolio companies and only 7% admitted they were dissatisfied with performance.

Outlook and opportunities

- The anticipated recovery in the European deal market did indeed materialise in the second half of 2010 and an improving outlook is predicted for 2011. Our survey evidenced:
  - expectations of higher levels of investment (7 in 10 respondents);
  - increasing numbers of exits (7 in 10 respondents);
  - German funds being willing and able to obtain higher levels of gearing on new deals;
  - German funds continuing to have clear sector preference for industrial production (68%), whereas international funds target a more diversified range of industries;
  - reduced risks of covenant breaches (a view now held by 88% of German respondents).
- In 2011, 88% of German funds are confident that banks will provide more debt capacity for leveraged buyouts than in 2010.
- Over 90% of respondents reported no significant change to the business models since the global financial crisis, despite predicting such changes a year ago.
- Of those which have experienced change, greater focus on active portfolio management has been the most prominent occurrence.

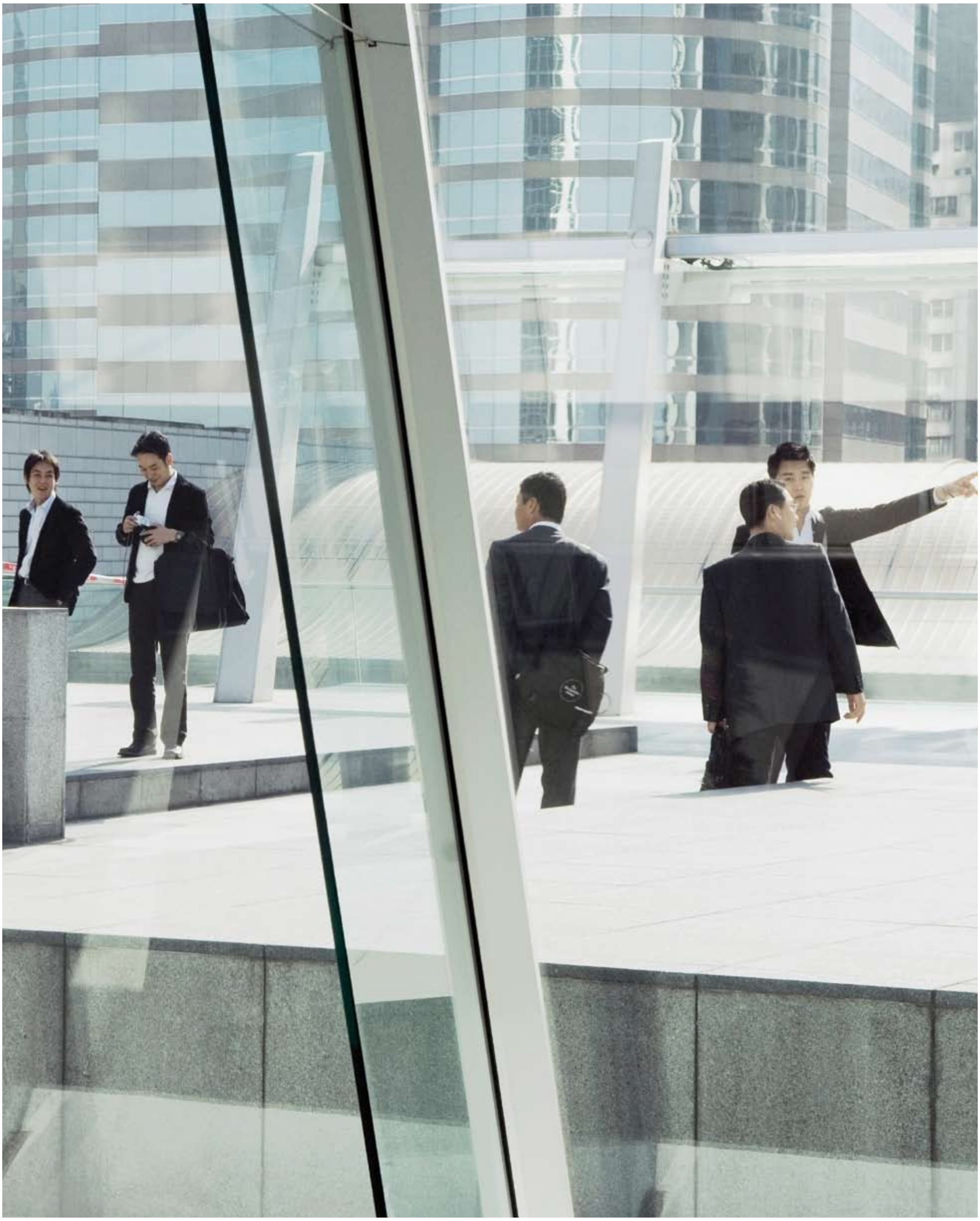
Sustainability issues and compliance

- Sustainability issues are shifting up the scale of importance on deals with only a small and rapidly declining minority (less than 6%) continuing to see this as "not at all important".
- Indeed, close to half of all respondents (45%) have undertaken sustainability assessments within portfolio companies.
- The majority of respondents (56%) expect their organisations to be affected to some extent by the Alternative Investment Fund Managers Directive (AIFMD). This is expected to trigger higher business costs at holding company and portfolio company levels, as more disclosures are required by private equity funds to comply with European legislation. 51% of international funds also fear that their fund raising activities may be adversely affected.
- Dodd-Frank legislation from the United States is also expected to bring higher costs, but this legislation is perceived to have less impact on European funds with 6 in 10 respondents envisaging no effect at all to their organisation. However, over half the respondents feared adverse impacts on fund raising in future.

German and international investment trends

- 56% of respondents currently have investments in Germany. 90% of these funds plan to continue with these investments over the next five years. Whilst the assets expected to be allocated to Germany over the next 5 years have fallen (down from 45% to 36%), it is encouraging to note that, of those not currently investing in Germany, 4 in 10 respondents plan to invest there in the next five years.
- The perception of Germany as an attractive location for private equity investment has continued to improve, with over half of the respondents rating it as "quite good" or "very good".
- In line with last year's survey findings, Europe remains the most attractive region for private equity investment over the next five years, with over half of the respondents citing this view.
- 1 in 4 respondents plan to open new offices in the next five years, with the majority of these to be located in Western Europe.

B More encouraging signs: 2010 in retrospect



Most funds reported a pick-up in deal activity in 2010

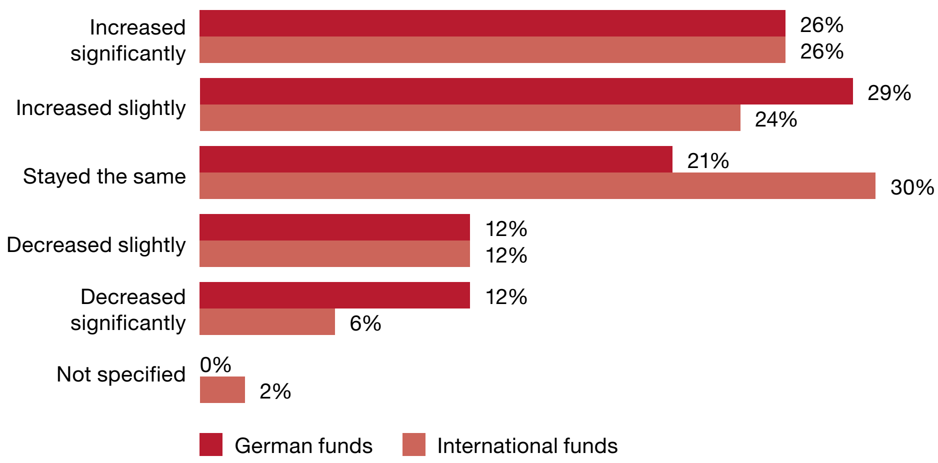
Investment and exit trends

During 2010 there were regular announcements of strong economic growth in Germany, which helped to boost M&A activity in the second half of 2010.

As the results of our survey show, German and international funds alike benefited from the availability of increasing levels of debt finance as banks started to lend more freely and were willing to accept higher gearing in transactions and advance larger tranches of new debt.

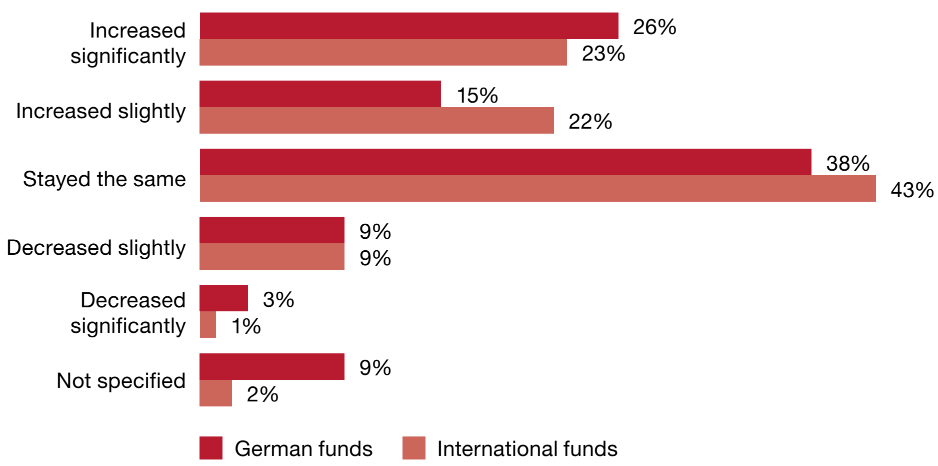
Half of the respondents reported an increase in new investments made by their organisation in 2010, with almost one third having stayed the same (29%). A marginally higher proportion of German respondents noted an increase in investment activity (55%) compared to the rest of Europe (50%).

Fig. 1 Trend in number of new investments compared to 2009



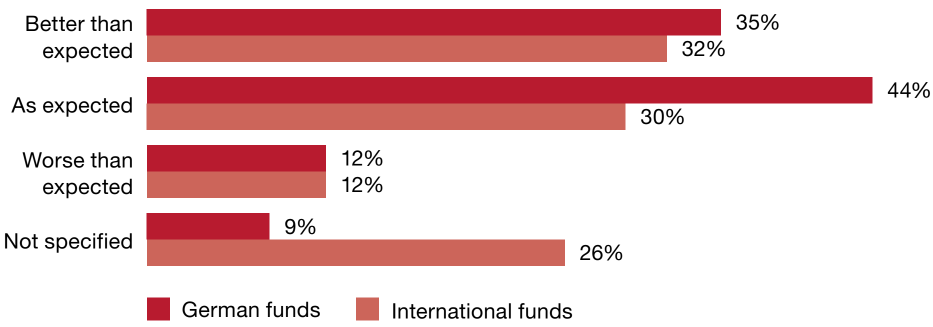
4 in 10 stated that the number of exits made by their organisation in 2010 had increased, with a similar proportion claiming that this level had stayed the same.

Fig. 2 Trend in number of exits compared to 2009



74% of respondents felt that the availability of credit in 2010 was "as expected" or "better than expected".

Fig. 3 Actual availability of credit in 2010

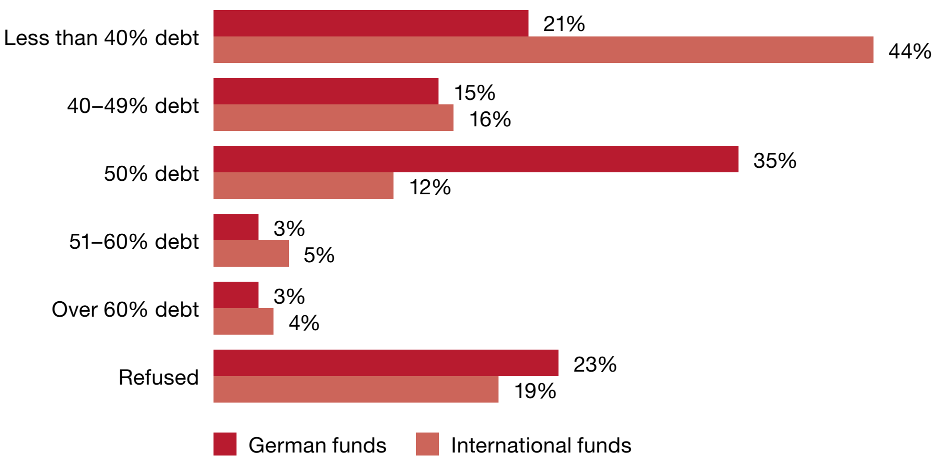


The availability of debt finance improved more quickly than expected

Financing trends

While more than half of funds (56%) still reported average debt levels of less than 50% on new investments, a higher proportion of German respondents (41%) managed to secure debt-to-equity ratios on new investments of 50% or more compared to non-German respondents (21%). In contrast, 44% of international funds reported debt to equity ratios of less than 40% for 2010.

Fig. 4 Average debt to equity ratios on new investments in 2010

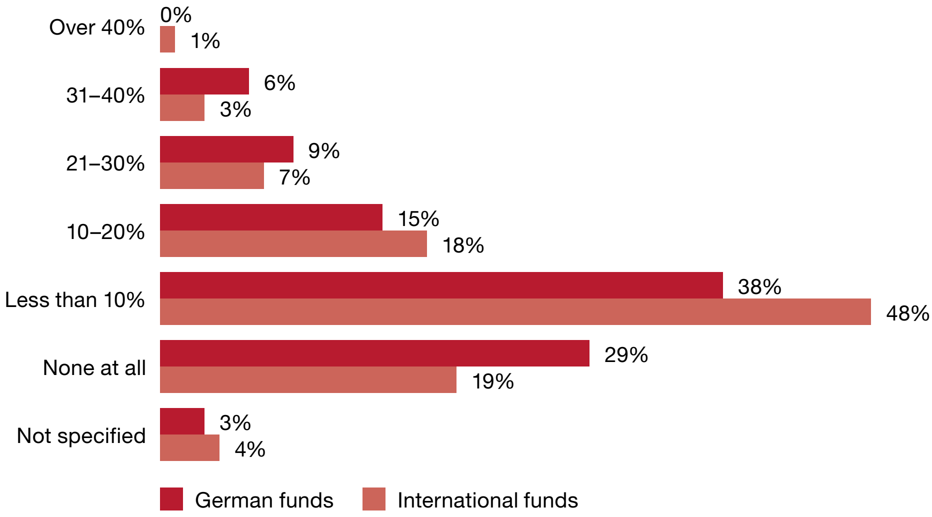


Risk of breaching bank covenants receded in 2010

Banking covenants

Unlike 2009 when the vast majority of respondents reported covenant breaches within their portfolio companies, our 2010 survey highlights that this risk receded with two thirds of respondents either reporting no bank covenant issues or that these only impacted 10% of portfolio companies.

Fig. 5 **Percentage of portfolio companies which experienced bank covenants breaches in 2010**

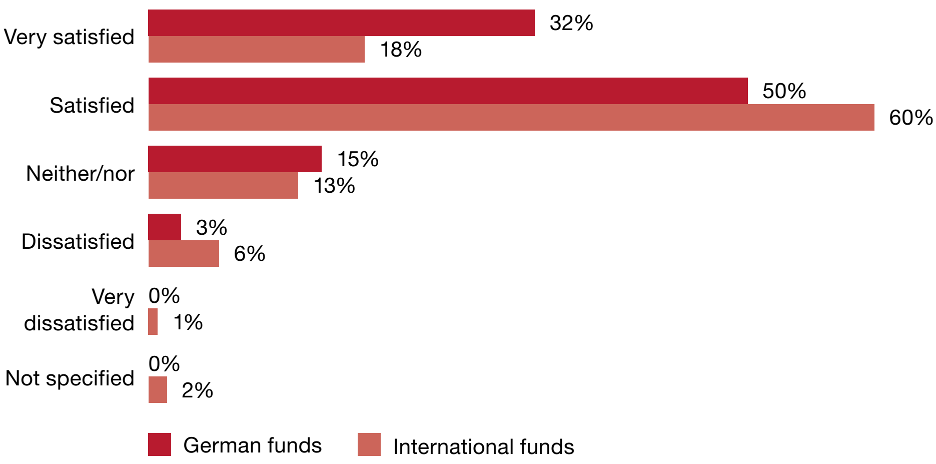


Private Equity funds were more bullish on developments within portfolio companies

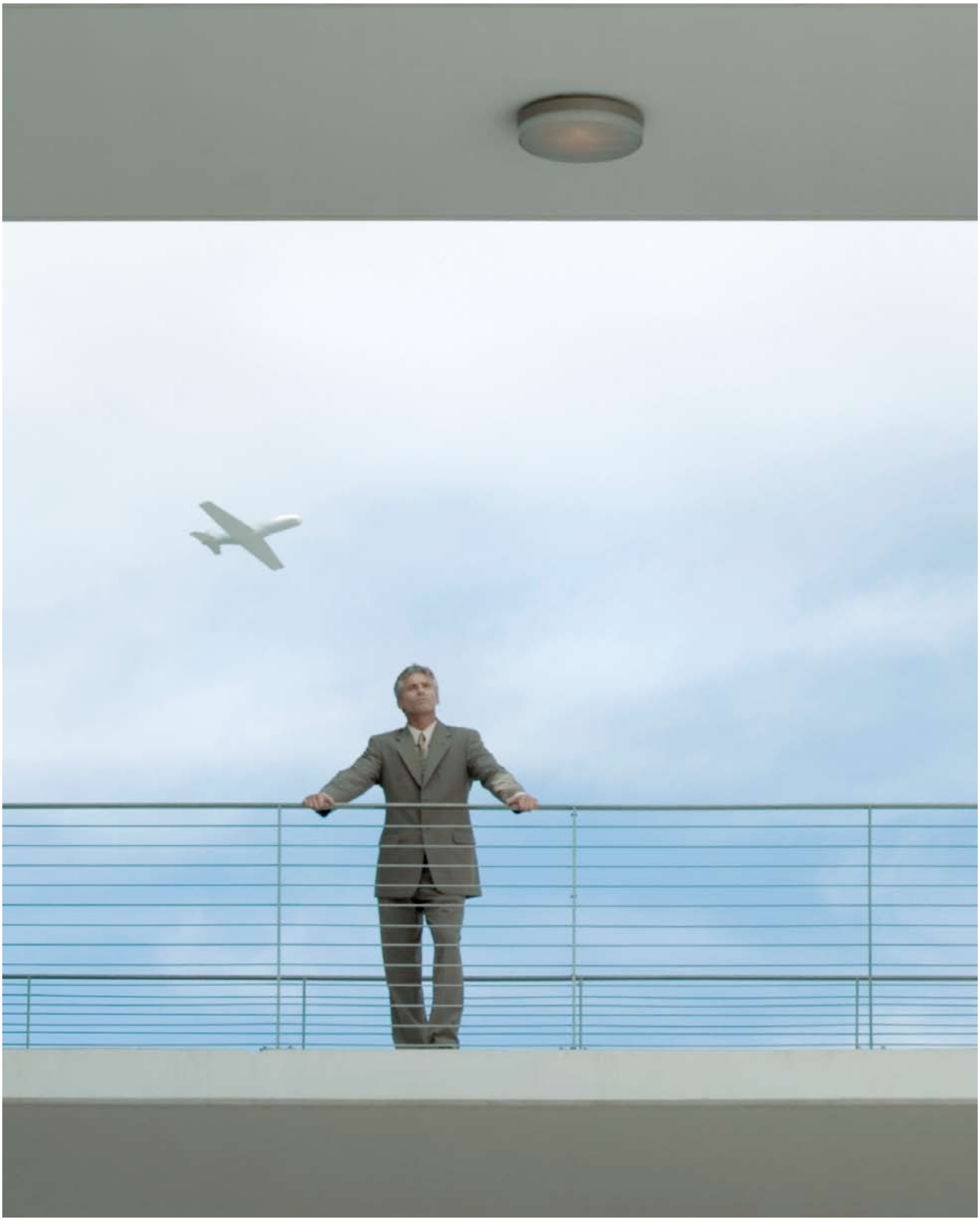
Development of portfolio companies

Private equity funds reported increased levels of satisfaction with developments within their portfolio companies as solvency concerns diminished. The level of dissatisfied responses was negligible (less than 7%).

Fig. 6 **Level of satisfaction with the overall development of portfolio companies**



C The future for private equity: outlook and opportunities



While recognising that it is always difficult to make accurate predictions, we asked the respondents about their expectations for the future.

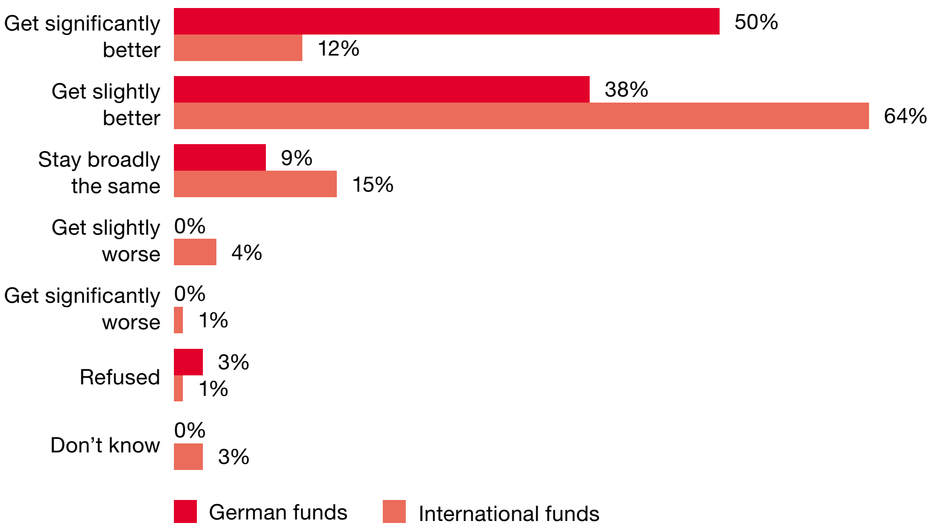
The anticipated recovery in the European deal market did indeed materialise in the second half of 2010 and an improving outlook is predicted for 2011. Whether this current optimism will continue and, in particular, whether banks will indeed make available sufficient new debt to finance the deals coming to market will become clearer as we move through the first half of 2011.

Private equity funds have a more optimistic view of 2011

European M&A market

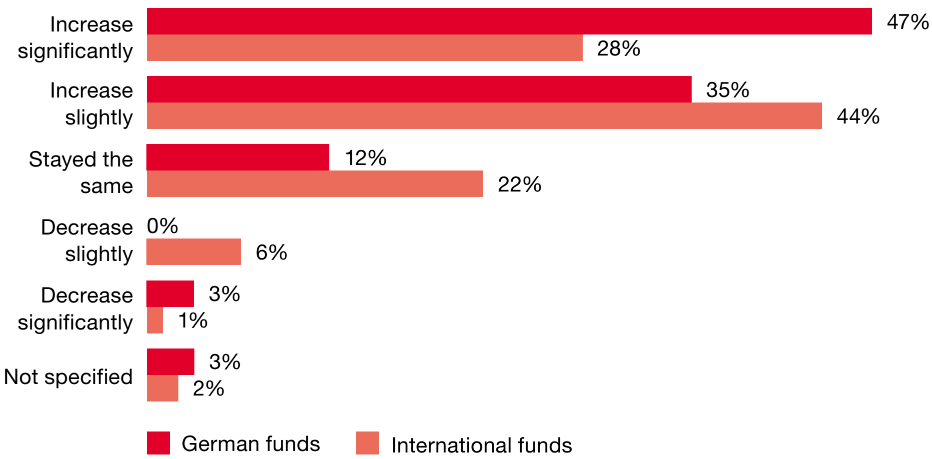
A total of 78% of all funds surveyed look ahead into 2011 optimistically and expect the deal market in Europe to gain momentum in the course of this year. Of these, the German funds were by far the most optimistc, with 50% expecting the M&A market to get significantly better in 2011.

Fig. 7 Expected European deal market development for private equity in 2011



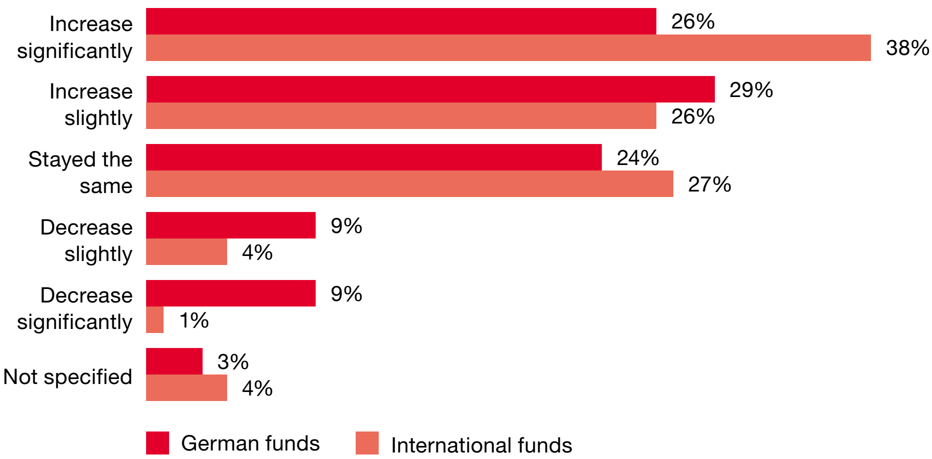
7 in 10 respondents expect their organisations to complete more investments in 2011 compared to the previous year. In the case of the German funds, almost half expect the increase in new deals to be significant.

Fig. 8 Expected number of new investments in 2011 compared to 2010



Similarly, 7 in 10 respondents anticipate an increase in the number of exits in 2011 compared to 2010. In particular, the international funds expect the more significant increases in exit activity.

Fig. 9 Expected number of exits in 2011 compared to 2010



Traditional sources of deals continue to dominate

New deal opportunities

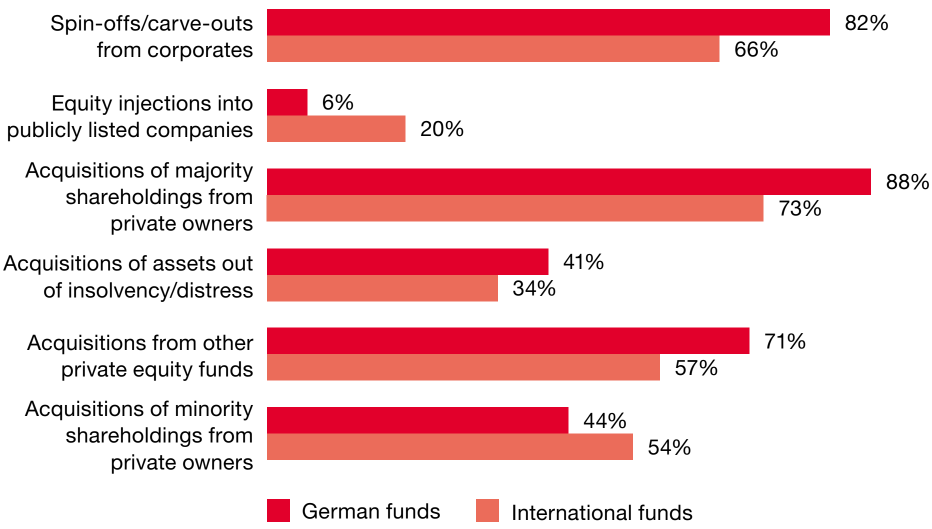
When asked about the likely sources of new deal opportunities for private equity, the most frequent responses in this year's survey were still the traditional sources. In particular:

- Acquisitions of majority shareholdings from private owners (76%)
- Spin-offs/carve-outs from corporates (69%)

However, the majority of funds surveyed (59%) also expect a high level of activity from secondary buy-outs (acquisitions from other private equity funds).

In addition, over half of funds anticipate opportunities to arise for minority shareholdings in private companies.

Fig. 10 Future sources of new deal opportunities



Industrial products remain a key target industry for German funds

Industry trends

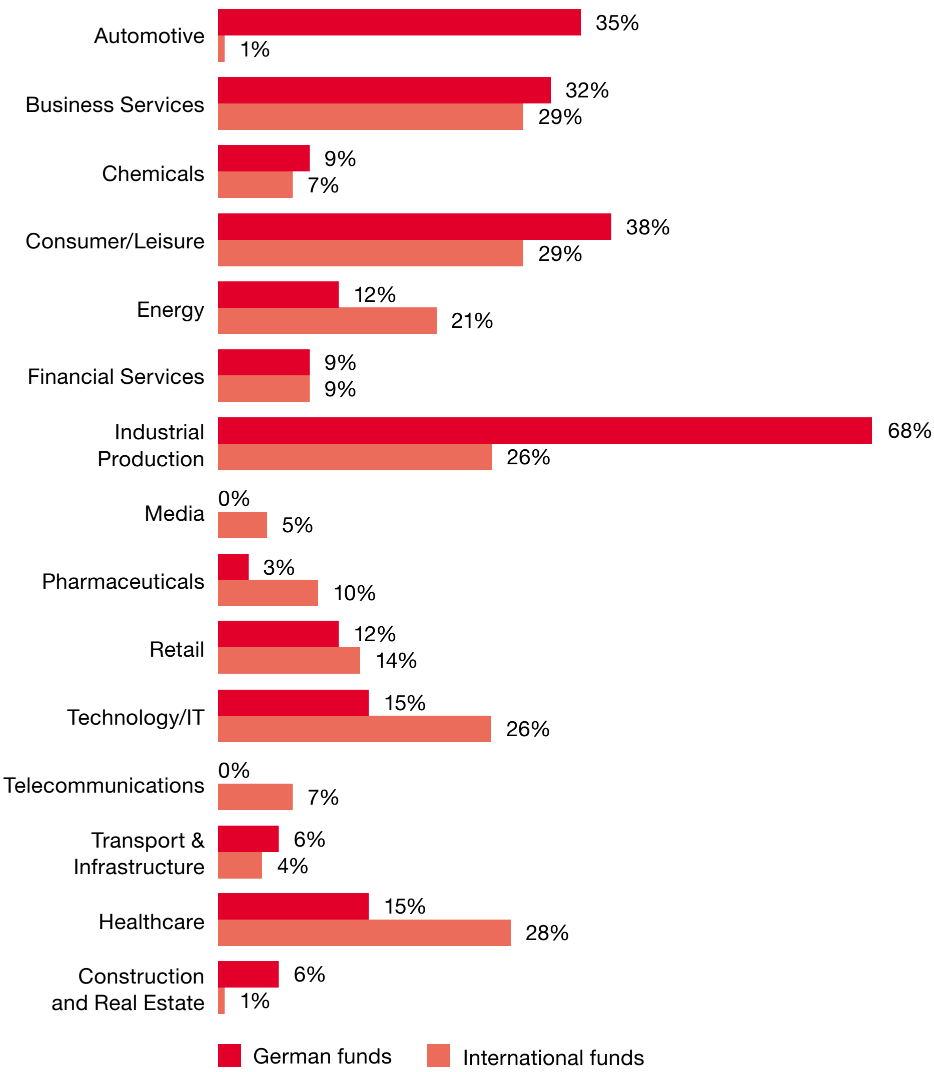
The international funds cited a very diversified range of target industries. The most popular industries were business services, consumer/leisure and healthcare, but even these were only included in their Top 3 target sectors by a third of participants.

German funds, on the other hand, have a clear preference for industrial production (68%) – the companies which have historically driven the country's economic strength – while the consumer/leisure industry (38%) is becoming increasingly popular as a target sector for investment. Automotive, with 35%, remains in focus for the German funds, but is negligible (only 1%) for international funds.

Fig. 11 Top three industries for international and German funds

Rank	International funds	Rank	German funds
1 =	Business services (29%)	1	Industrial production (68%)
1 =	Consumer/Leisure (29%)	2	Consumer/Leisure (38%)
3	Healthcare (28%)	3	Automotive (35%)

Fig. 12 Most popular target industries for future investments

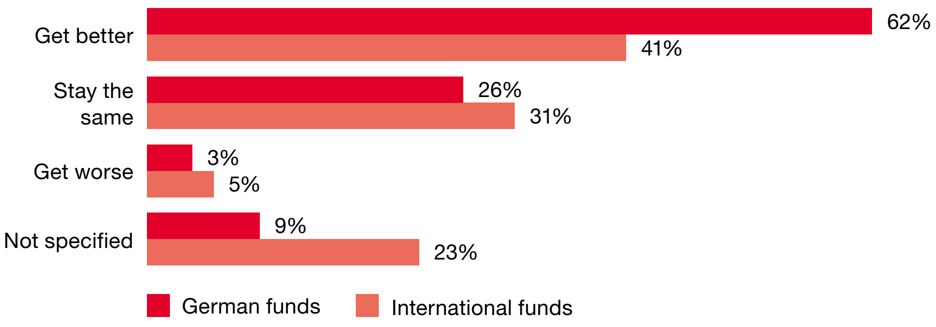


Over 40% of all funds surveyed expect the availability of credit to improve further in 2011

Financing trends

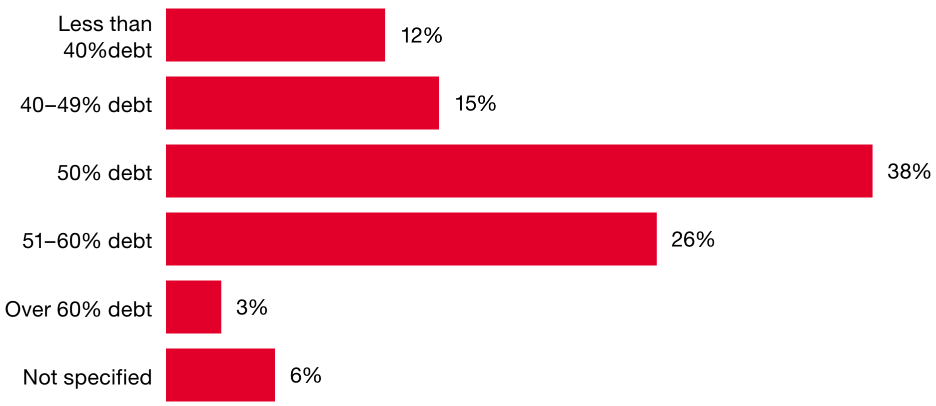
A higher proportion of funds expect the availability of credit to improve further. In particular, 62% of German respondents are confident that banks will provide more debt capacity for leveraged buyouts. Nonetheless, a small minority of respondents (5% of international funds and 3% of German funds) still expect a further deterioration.

Fig. 13 Expectation for availability of credit in 2011 compared to 2010



The German funds anticipate a substantial improvement in their debt: equity ratios in 2011. Two thirds expect to be able to finance 50% or more of deal value with debt, compared to only 41% who succeeded in doing this in 2010.

Fig. 14 Expected average debt-to-equity ratio in 2011 – German funds

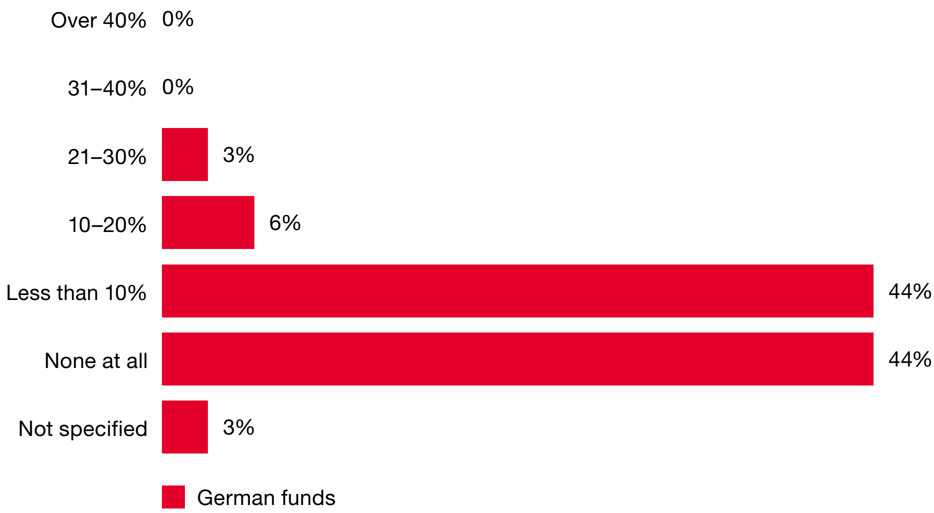


The majority of funds expect to face fewer bank covenant issues in 2011

Banking covenants

Almost 90% of funds anticipate a more benign environment for their portfolio companies in 2011, with either no covenant breaches at all or such issues affecting less than one in ten of their portfolio companies.

Fig. 15 Percentage of portfolio companies expected to break one or more bank convenants in 2011 – German funds



Increased bank lending has re-established the traditional leveraged buyouts in the marketplace

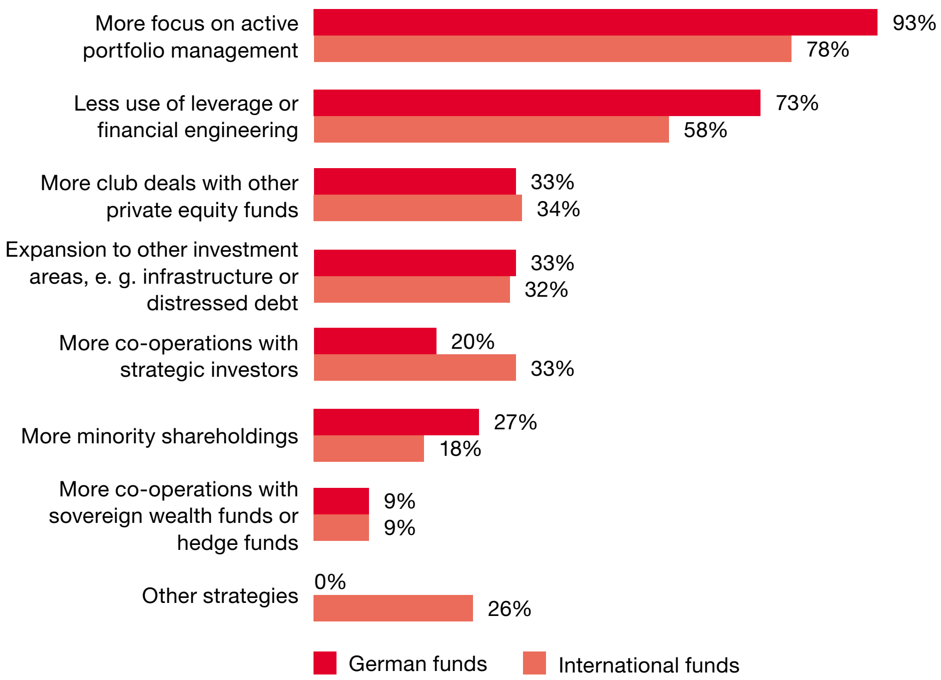
The future of private equity

Over 90% of respondents reported that there has been no significant change to the business model of their organisation since the global financial crisis.

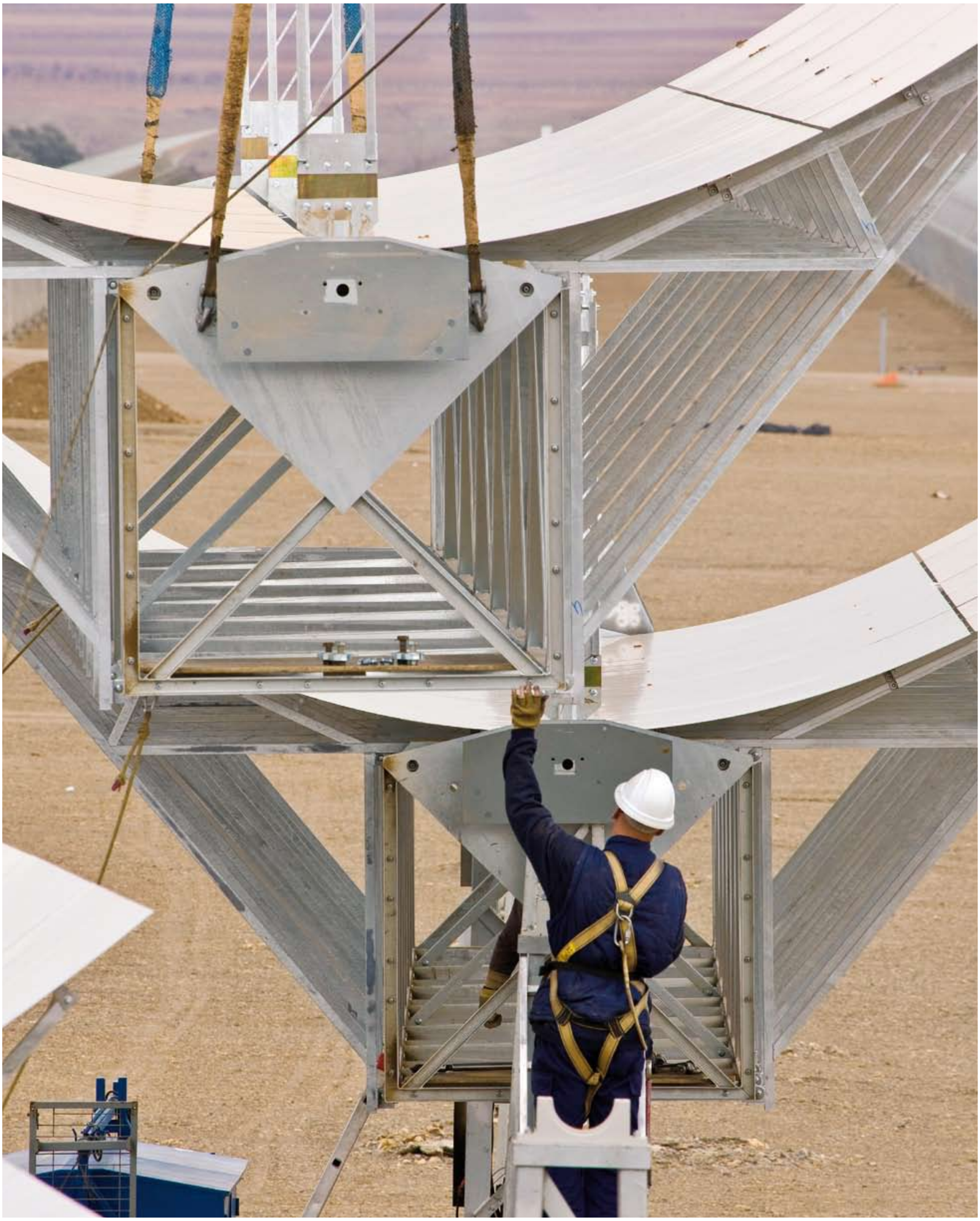
This compares to 90% of respondents in last year's survey who anticipated such changes would be necessary in the future.

Of the changes to the business model which have occurred since the financial crisis, 80% reported an increased focus and active portfolio management, with 60% making less use of leverage or financial engineering. Other changes such as more cooperations with other funds or strategic investors as well as an increased willingness to take minority shareholdings were also mentioned by a number of participants.

Fig. 16 Changes to the business model since the financial crisis



D Emerging issues: sustainability and new compliance legislation



45% of the international funds and 41% of the German funds surveyed attach importance to sustainability issues

Sustainability

We asked the survey participants to grade the importance their organisations place on sustainability issues on a scale from 1 to 10, where 1 denotes "not at all important" and 10 "very important". 45% of international funds graded the importance of sustainability as 7 or higher, compared to a slightly lower percentage of German funds (41%). At the other end of the scale, 30% of German funds and 23% of international funds believed the issue to be relatively unimportant to their organisations (score of 3 or less).

Fig. 17 Importance placed on sustainability by funds

Note: 2% of international funds did not know or refused to answer

Sustainability issues within portfolios are shifting up the scale of importance

It appears that higher importance has been placed on sustainability compared to last year's survey, 45% of international funds and 44% of German funds have now undertaken an assessment of sustainability issues within their existing portfolio. Nevertheless, this means that over 50% of funds have not yet performed such an assessment.

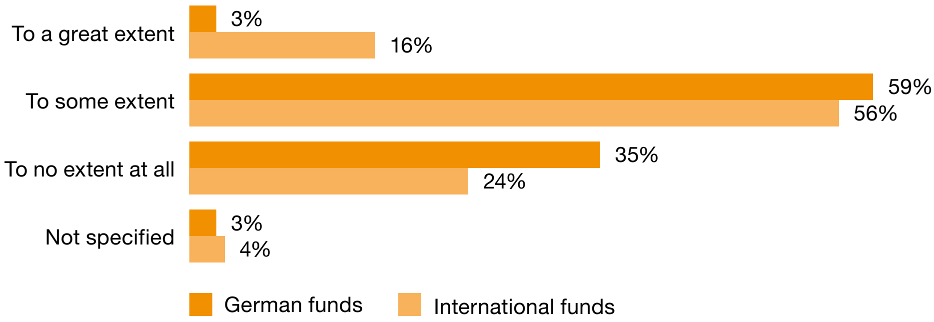
One third of all respondents attributed a rating factor above 8 (scale of 1 to 10) to the importance placed by their organisation on assessing climate change, energy use and other sustainability issues when assessing new investments.

New compliance legislation: AIFMD and Dodd-Frank

Compliance

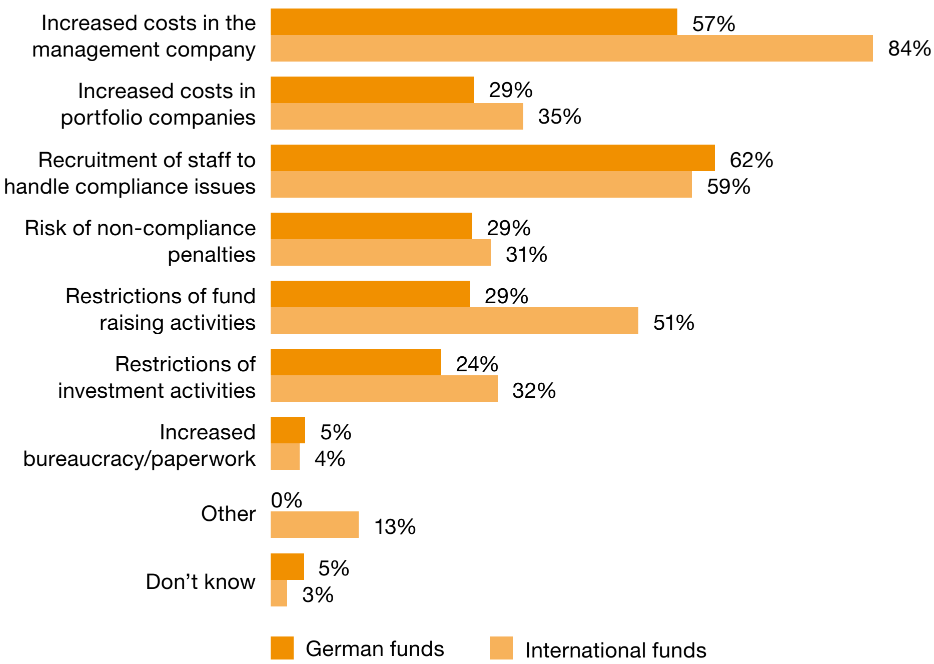
The majority of respondents (71%) expect their organisations to be affected to some extent by the Alternative Investment fund Managers Directive (AIFMD). 16% of international funds believed that the impact on their organisation would be substantial.

Fig. 18 Extent to which funds will be affected by AIFMD



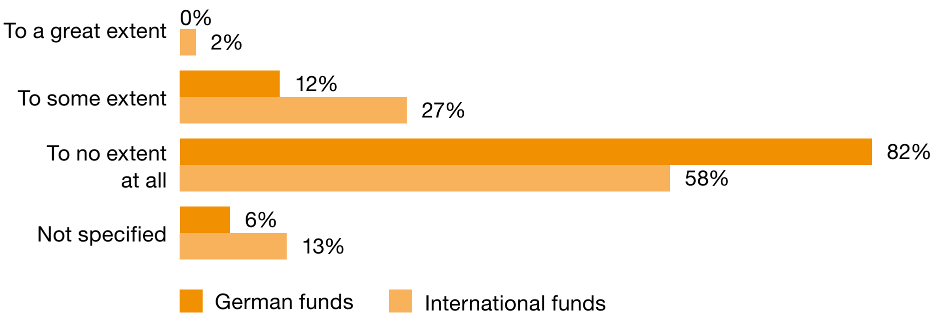
While the majority of funds expect the legislation to impact their cost base and to require recruitment of specialist staff to handle compliance issues, a significant proportion (51% of international funds) also expect their fund raising activities to suffer restrictions.

Fig. 19 Effects of AIFMD identified by respondents who expected to be affected



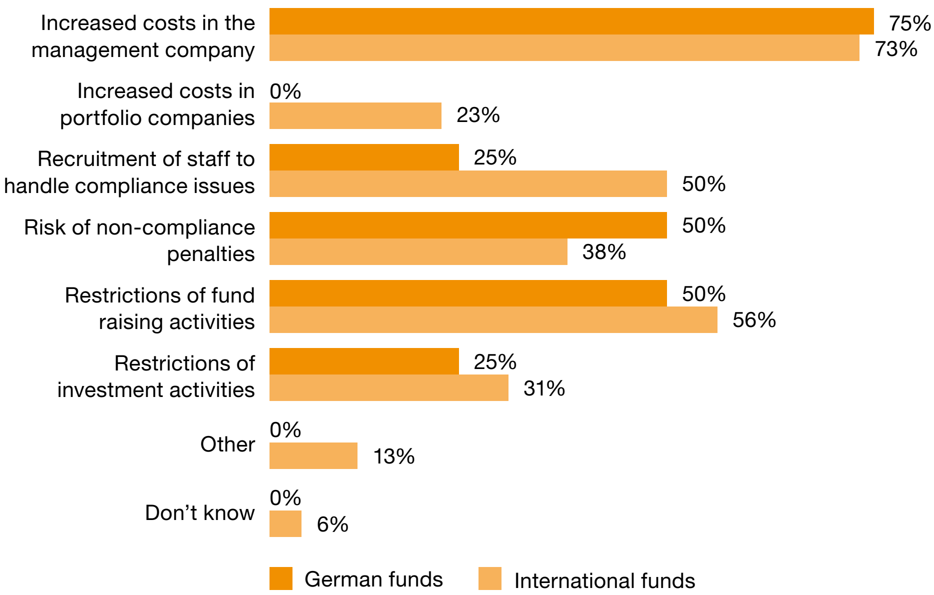
The Dodd-Frank legislation is also expected to bring higher costs, but this legislation – originating in the United States – is perceived to have less impact on European funds with 6 in 10 respondents envisaging no effect at all on their organisation.

Fig. 20 Extent to which funds will be affected by Dodd-Frank legislation



As with AIFMD, the main impact is anticipated to be increased costs and a need to recruit compliance personnel but significant concerns were also expressed over restrictions on fund raising and investment activities.

Fig. 21 Effects of Dodd-Frank identified by respondents



E German and international investment trends

As part of the annual barometer for private equity trends in Germany, PwC asked the international funds participating in the survey to assess Germany as an investment destination for private equity and name their top countries for private equity investments in future.

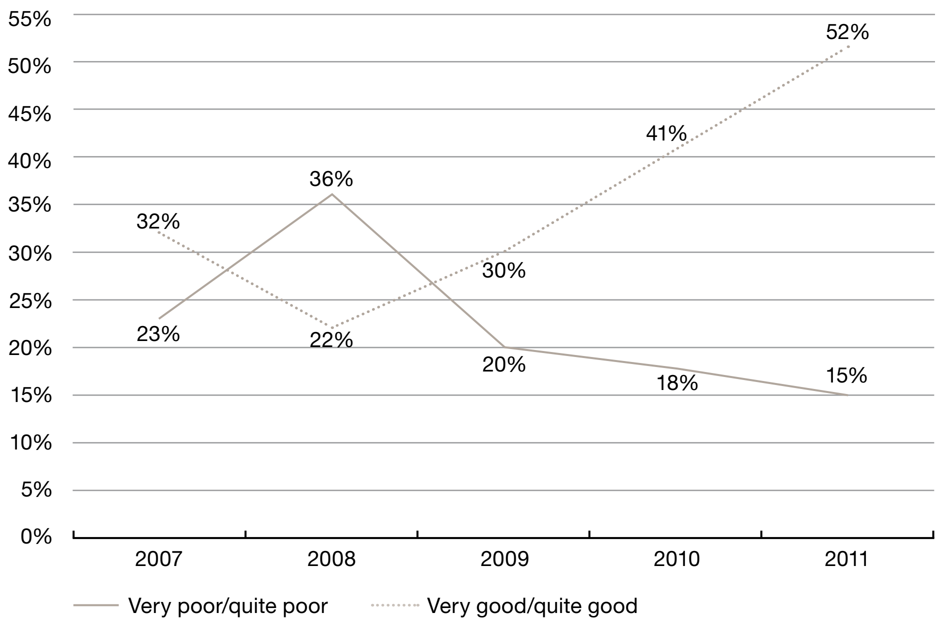
International funds plan to significantly increase investments in Germany by 2015

Germany as an investment destination

The key trends identified included:

- At the time of the survey, 56% of the international funds surveyed already held investments in Germany.
- 90% of these funds confirmed that they intended to continue investing in Germany over the next five years.
- 36% of the funds currently investing in Germany expect to increase the assets that they allocate to the country by 2015, while 54% expect allocations to remain the same and only 6% plan a decrease.
- 44% of the international funds that currently do not invest in Germany plan to start making investments there in the next five years.
- Altogether, a total of 70% of all international funds surveyed plan to invest in Germany in the next five years, indicating a significant inflow of capital in future.
- 52% of the funds surveyed consider the attractiveness of Germany as a location for private equity investment to be very good or quite good, which represents a further improvement compared with last year, when only 41% thought this was applicable, and also previous years.

Fig. 22 German attractiveness for private equity funds – development since 2007



China, CEE, Germany, France and India will become more attractive to private equity in the next five years

International flows of capital

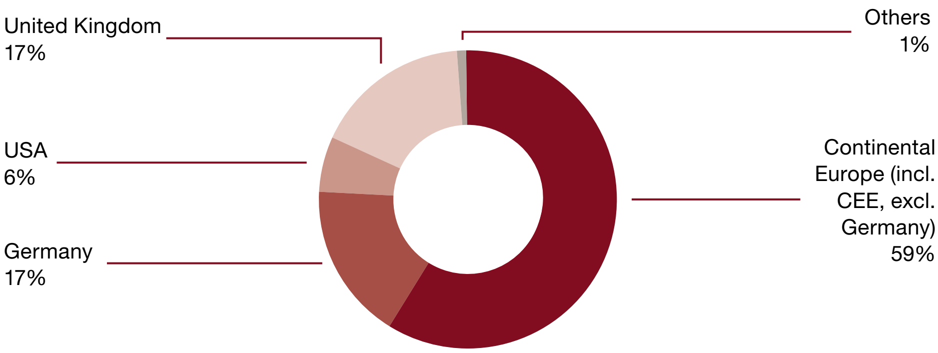
The funds surveyed continue to rate Western Europe (53%) as the most attractive for future investment, followed by Asia (35%), Central and Eastern Europe region (CEE) (30%), Latin America (16%), USA (6%) and Africa (6%). More specifically, participants rated China as a destination which will gain in attractiveness for private equity investment in the next five years (22%), followed by Germany (16%).

Almost one in four funds plans to open new offices over the next five years, with China, France, Switzerland, Germany and the US recording the most mentions.

F Background information and methodology

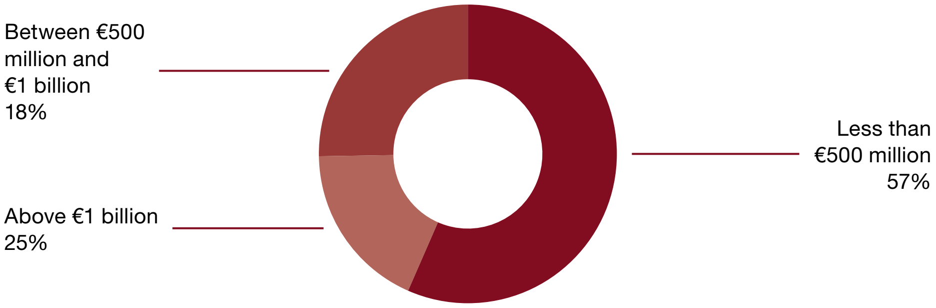
Between 12 November and 4 December 2010, PwC's International Survey Unit interviewed 199 top management representatives of international private equity funds. A total of 59% of them were headquartered in Continental Europe (excluding Germany), 17% of them were based in Germany, 17% had their headquarters in the UK and 6% were based in the US. In this survey, "international funds" refers to all funds whose headquarters are based outside Germany.

Fig. 23 Respondents by headquarters



At the time of the survey, the majority of the survey participants (57%) had up to €500 million capital under management, 18% of them manage funds of between €500 million and €1 billion, and a further 25% of them had over €1 billion capital under management.

Fig. 24 Respondents by total global fund volume (capital under management)



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