Private Equity Market Overview

Deals, valuation, management, corporate governance

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What are PE funds?

- There are funds that invest in entrepreneurial start-ups that have just the germ of a business idea.
- And there are funds that acquire established companies in old industries, with the aim of reviving their fortunes
- But most companies are in between the two extremes – these are ‘small and medium-sized enterprises’. Most private equity investments, around 85%, are into SMEs.
- In Europe, private equity firms are invested in 22,000 SMEs. It sounds like a lot. But there are more than 22 million European SMEs in total.
- So what’s different about the 22,000?

Source: Invest Europe

What PE funds look for

- They are the talent scouts of company investment. They spend ages assessing the potential of companies, to understand their risks and how to mitigate them. They only allocate their private equity funds to companies with the ‘X’ factor.

- That doesn’t mean these companies have to be the best in their field. Usually they are not. Private equity just helps them get there.

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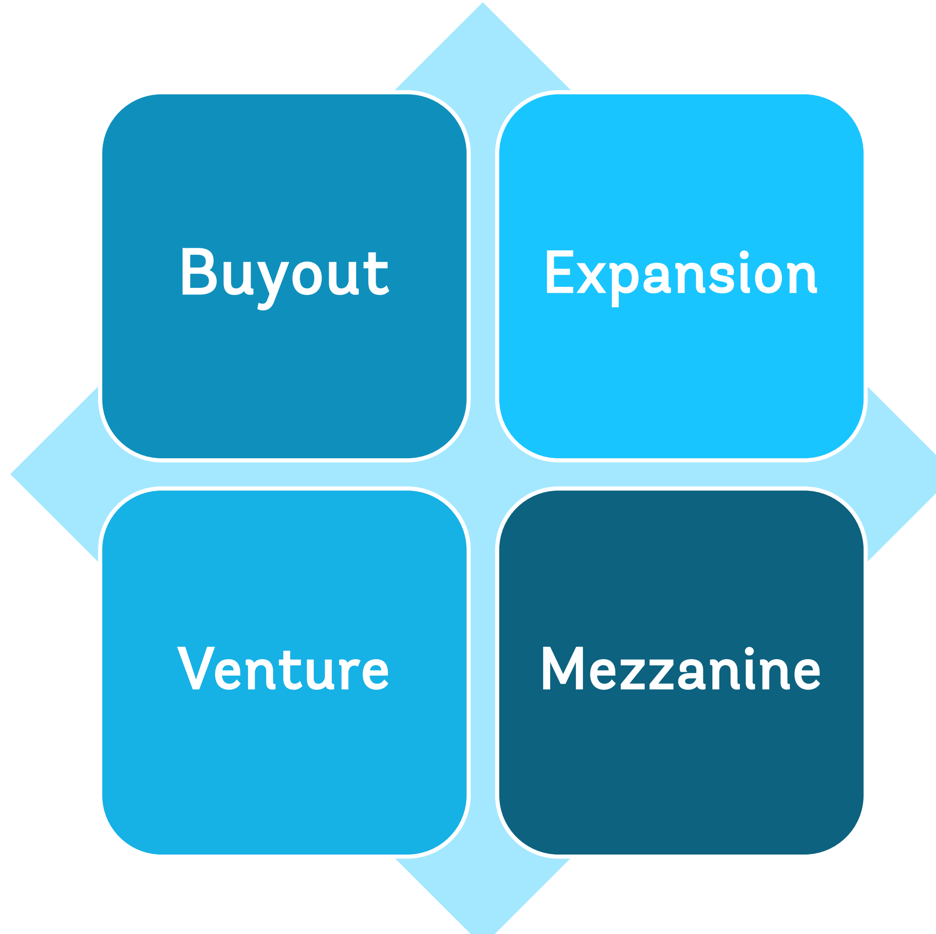
What fund managers look like and what they really do

- Private equity is invested by fund managers. These also come in all shapes and sizes.
- Some fund management firms are made up of just a handful of people, often former entrepreneurs themselves. Others are big institutions with a global network of business contacts and know-how.
- But the idea is the same: to invest in a company and make it more valuable, over a number of years, before finally selling it to a buyer who appreciates that lasting value has been created.
- These buyers might be large conglomerates and corporations, larger financial investors or stock market investors (through an initial public offering or IPO).
- If the company is not much more valuable when it is sold, the fund manager doesn't get their reward.
- This growth is quite difficult to achieve, and many fund managers don't ever manage it.

Definition of private equity

- "Investing in securities through a negotiated process"
- Investment mainly in unquoted companies
- Transformational, value-added, active investment strategy
- Specialised skill set required
- Sub skill sets as a function of type of PE



How funds can specialise

- **Instrument**: Ordinary equity, preferred equity, mezzanine, other debt, majority, minority.
- **Stage**: Seed, early stage, growth, mature, distress.
- **Sector**: Agri, telecoms, financial services, etc.
- **Geography**: Region, country.
- **Situation**: Distress, privatisation, pre-IPO, successsion.
- **Returns objectives**: Social impact, financial return, blended objective.

- ✓ In developed markets, funds need to specialise
- ✓ In Emerging markets, some degree of focus
- ✓ In Frontier markets, more generalist
- ✓ Funds will specialise according to 2-4 of the criteria shown

The investment cycle in private equity

Finding investments	Making investments	Managing the portfolio	Exiting investments
Getting the investor known in the community Developing a pipeline of investments Effective initial screening	Valuation Deal structuring Managing negotiations	Implementing reporting and other systems Leveraging the investor's network to add value Management: board representation to operational intervention	Knowing the options: trade sale, IPO, sale to management, secondary exit Integrating an exit strategy into the deal structure and the management of the investment Managing an exit transaction

Forces driving the search for private equity investors

1. Driving the company

Growth: financing organic growth or acquisition

Financial: financing debt restructuring

Ownership: seeking value from change in ownership

2. Driving the ownership

Positive motivation: vision for the growth of the company

Neutral motivation: succession, disengagement

Negative motivation: distressed ownership, conflictual ownership, non core asset disposal

BOTH drivers necessary for a transaction to be feasible

Double Vision

A PE investor ultimately looks to EXIT

Your EXIT is someone else's ENTRY

- A PE looks 3/5 years to exit point
- Who buys will also look 3/5 years
- SO ➔ take a second look at what a future buyer will see then

Valuation of financial instrument

- Any investor's interest in a company is held through a financial instrument;
- Therefore we must ultimately value the financial instrument;
- Financial instruments in PE will include ordinary shares, preferred shares, mezzanine, options and debt; or a combination of these;
- IPEV guidelines are an important source of guidance for valuation in PE.

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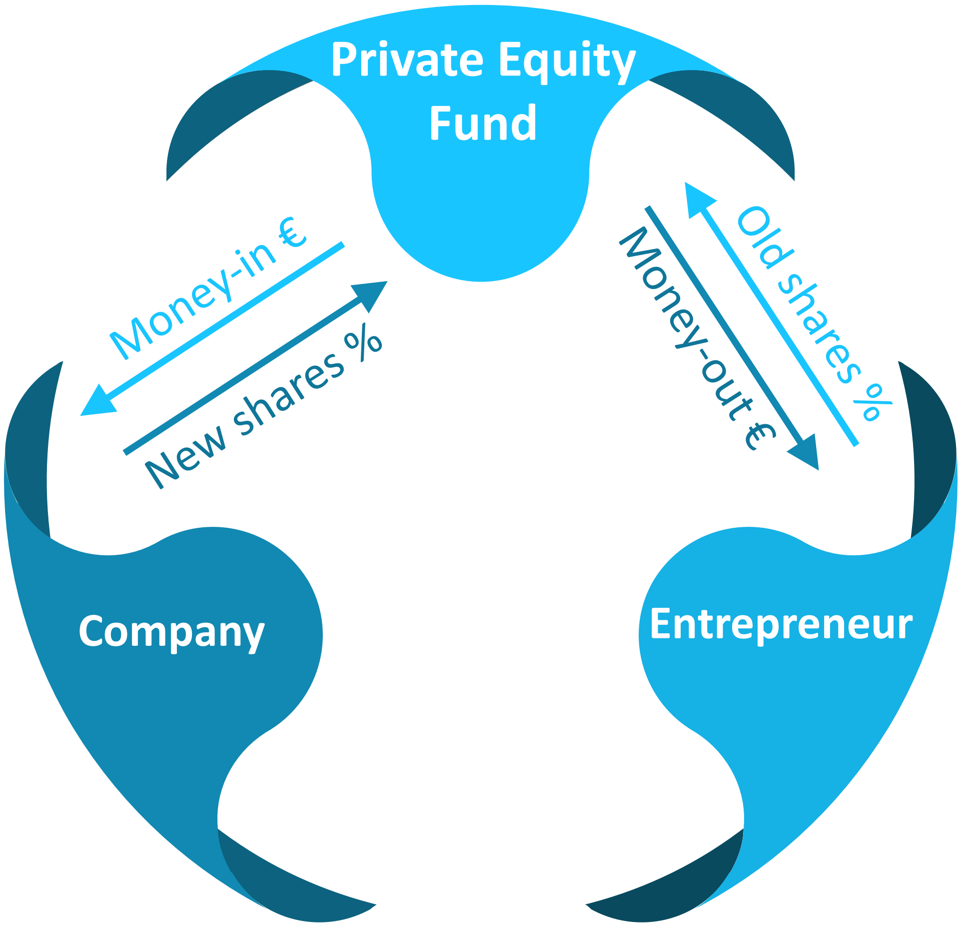
Impacts from structuring

- Some PE investments may have complex structuring with different groups having different rights, impacting valuation
- Valuation should take into account the impact of future changes in investment structure
- Changes may happen by choice of fund, automatically based on trigger events, or at option of another party
- Rights should be reviewed on regular basis
- Valuer should make rational assumption: if benefit of exercising superior to cost, right will be exercised

Money-in versus Money-out



Use of funds table

ITEM	EXAMPLES	ISSUES OF CONCERN TO PE INVESTOR
CAPEX	Funds are used to purchase plant and equipment, also intangible assets such as licenses or franchises	• That there is no "gold plating"; excessive investment for unnecessary state of the art equipment • That procurement is transparent
WORKING CAPITAL	Funds are used to invest in inventory, finance receivables and cover operating losses	• That costs are kept under control and not relaxed in anticipation of funding • No excessive inventory build up • That investment does not trigger claims
DEBT REDUCTION	Funds are used to pay down bank debt	• That some debt could be used to finance the company rather than all-equity • That the equity injection does not trigger bank demands for repayment

Why Bolt-on in mid cap private equity?

- Based upon historical experience, there is strong justification to persue a bolt-on strategy of rolling up comparatively smaller businesses whose business models are then rolled out to new markets and augmented with innovative products and services. If executed well, returns can far exceed those of big transactions.

- The investor will, however, be very disappointed if he believes that to succeed in this it merely takes clever dealmaking followed by delegation of responsibility to ordinary administrators.

Why do you conduct a due diligence?

- Essential to determine the hidden risks which are attached to the transaction
- Unearth the secrets which every business tends to have
- To assess the company Corporate Governance

What is sell side due diligence?

- Seller takes a critical look at its own financial position and assesses the opportunities and risks the company faces prior to seeking investor;
- Areas of focus of sell side dd will mirror the objectives of the buyer side due diligence;
- Typically includes analysing historical earnings, credibility of forecasts, working capital requirements, tax risks, key customer, suppplier and other relationships;
- Sell side due diligence is performed early in the investment process; buy side due diligence is one of the final steps of an investment process;
- Sell side due diligence report may be provided to potential investors to assist them in understanding and provide a road map for efficient buy side due diligence.

A signal to the market

- Commissioning a sell side due diligence sends a signal to the market that the company is serious about the process and wants to be transparent;
- A sell side due diligence can reduce significantly the time and costs of the investor‘s due diligence;
- The sell side due diligence will allow the Advisor to go to the market with more enthusiasm and confidence that the deal will go through.

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How PE funds approach deal structuring

don't be afraid to make it complicated

- The investment is a partnership, not transactional. Needs to be a "win-win" and sustainable;
- Looking to deploy unlimited flexibility in structuring which many other types of investors cannot do;
- Looking to align management's economic interests with theirs;
- Ability to deploy customised financial instruments and/or more than one financial instrument;
- Looking to "turbo charge" the influence of their stake;
- Structure to take into account the different scenario outcomes – upside and downside

Main obstacles to successful deals

and their mitigation

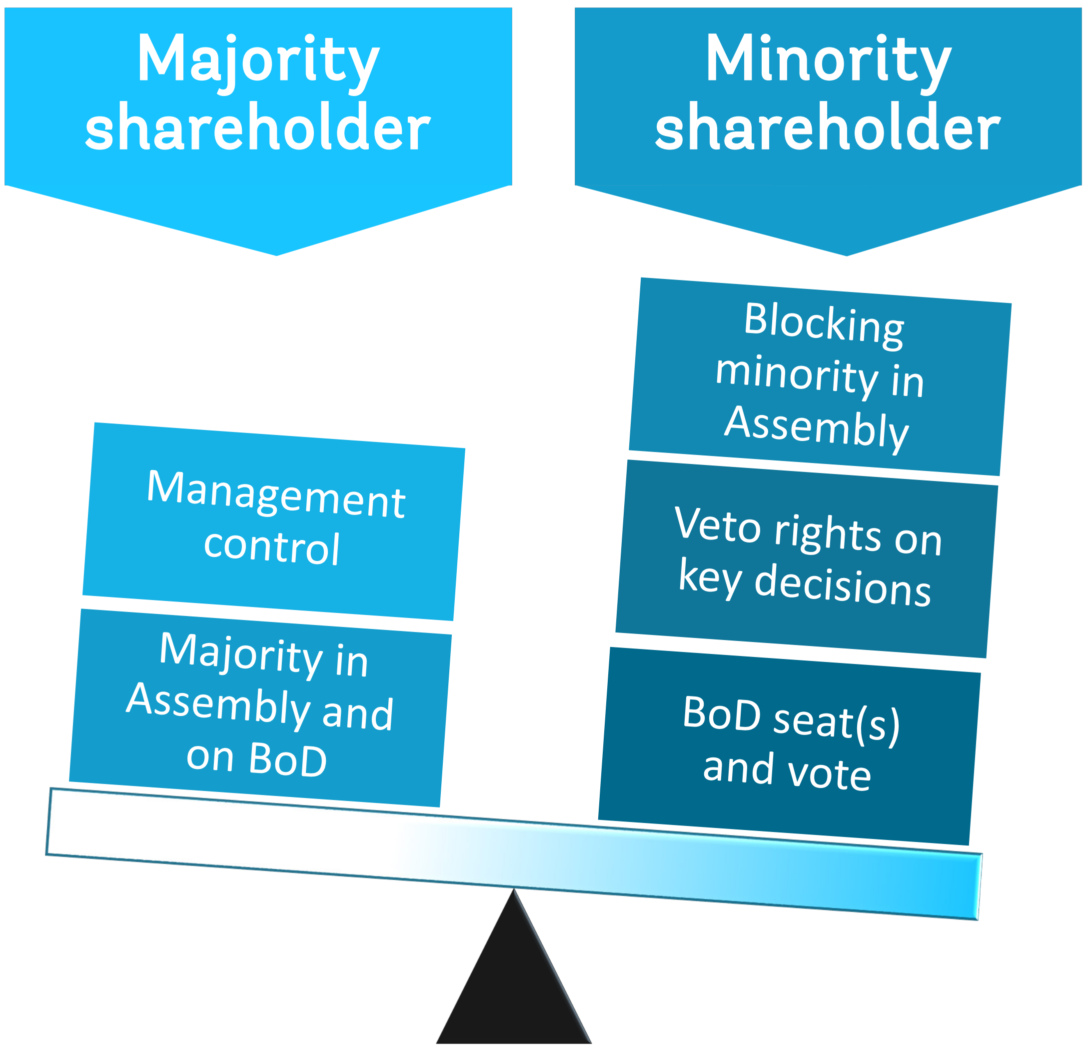
Valuation	Control	Image
unrealistically high valuation expectations from seller	seller will not give up control	seller concerned with "losing face"
A deal can be structured around a high valuation via ratchet mechanisms, preference shares, option structures.	Structuring for sharing control is the expertise of a PE investors, via BoD seats, veto rights, dual reporting.	Often it can be a question of image rather than substance, PE fund manager should have sensitive cultural and emotional antennae.

Exit concerns	Complication in deals	Questionable business practices
A deal can be structured around a high valuation via ratchet mechanisms, preference shares, option structures.	A big part of PE skill is communicating and educating parties less familiar with PE structures	In some markets, business is done with less transparency. Key is to manage transition to better governance rather than abrupt change.

Board representation

- Investor may be given seats on Board, in proportion to investment %
- In addition possibility of veto rights
- In EM BoD members in place for variety of reasons:
  - Represent their shareholder interests
  - Technical experts
  - Reward for political service
  - Family members
- Question of BoD representative being from investor or independant director
  - From investor more simple and role clearer, to protect investor interests
  - Independant opportunity to bring to bear greater expertise, reach out to others

Protection & control mechanisms



Documentation sequence

DEAL SOURCE	Non disclosure agreement	Preliminary Letter of Interest
PRELIMINARY DUE DILIGENCE AND NEGOTIATIONS	Term Sheet	
FORMAL DUE DILIGENCE	First drafts of final agreements	
FINAL NEGOTIATION	Sale and Purchase Agreement	Other related agreements
CLOSING	Final documentation	Corporate articles amendments

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The Term Sheet

- Also known as „Heads of Agreement“ or „Letter of Intent“
- Basic preliminary agreement setting out key terms and modus operandi to closing
- Usually non binding except for exclusivity and confidentiality clauses
- PE fund and seller use the Term Sheet to make sure there is a general agreement on the terms to be included in the final documentation
- Term Sheet allows parties to start regulatory and government approval processes
- Also allows to approach other finance providers such as banks, mezzanine providers, other PE funds, Co-investing LPs

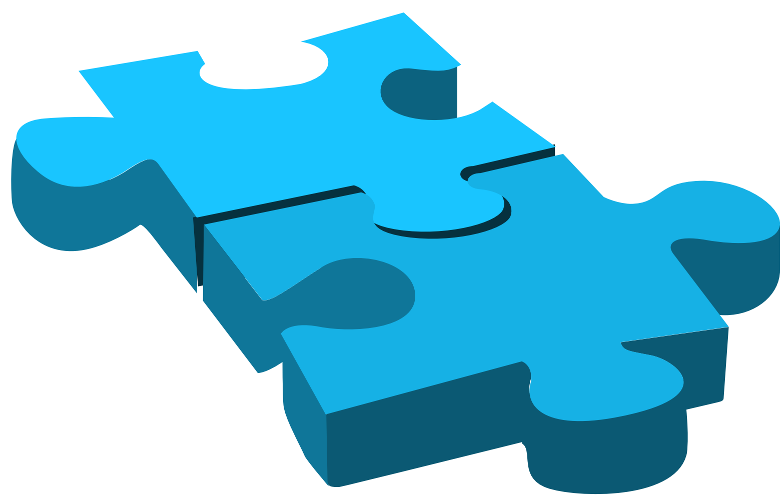
Critical features of PE ownership

both major minority and majority

Ownership concentration	• Large block of shares giving influence • Veto and other rights enhance the influence
Ownership rationality	• Analytical rigour and a strategic approach
Ownership closeness	• The PE shareholders' job is to get involved • Activist approach to different extents and in different ways
Building value	• Necessity to create value for exit • Drives an agenda to increase value of company
Management incentives	• Aligning management interest with increasing company value • Encouraging middle management
Action and decisiveness	• Action in face of weakness • Rooting out of personal agendas blocking progress • Little tolerance for bureaucracy

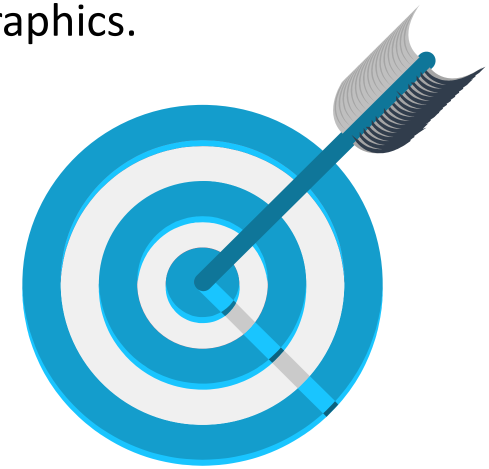
Management Approach

- Likely that PE investment will result in accounts being audited
- Possible a new CFO will be selected as part of transaction
- Dual reporting line from CFO to CEO and also to PE representative
- Strong rights of inspection by PE representatives



The objectives of a teaser

- Opportunities are competing for the attention of investors;
- First look of an investor is to:
    i. establish what the opportunitiy is
    ii. determine if it is worth taking a further look;
- Limited attention span of reader;
- Impact of well designed but not too slick layout and graphics.



What is an elevator pitch?

- The elevator pitch is referred to as such because the idea is to be able to convey your business idea or pitch in the time it takes to get from one floor to the next in an elevator or lift.
- An elevator pitch must be clear and comprehensive and should include your unique selling proposition, or what makes you different.

Please Watch the Video

What is an “Elevator pitch”