



Roland Berger
Strategy Consultants

Master the next 'Buy-out wave': European Private Equity Outlook 2007

Roland Berger Strategy Consultants
Private equity market appraisal

January 2007

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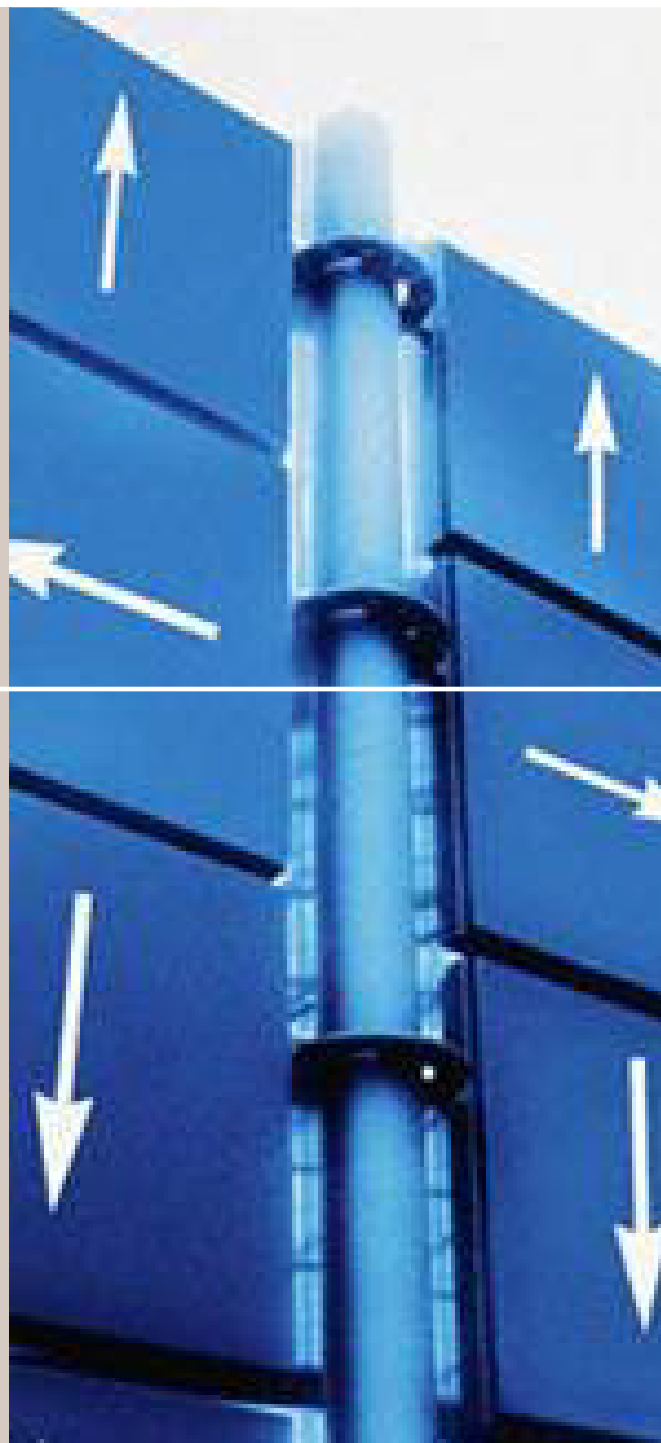
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What comes after the boom?

- B. A call for active PE performance improvement**
A successful fund manager must be a company-dealer and a top manager combined

- C. How Roland Berger can support you**

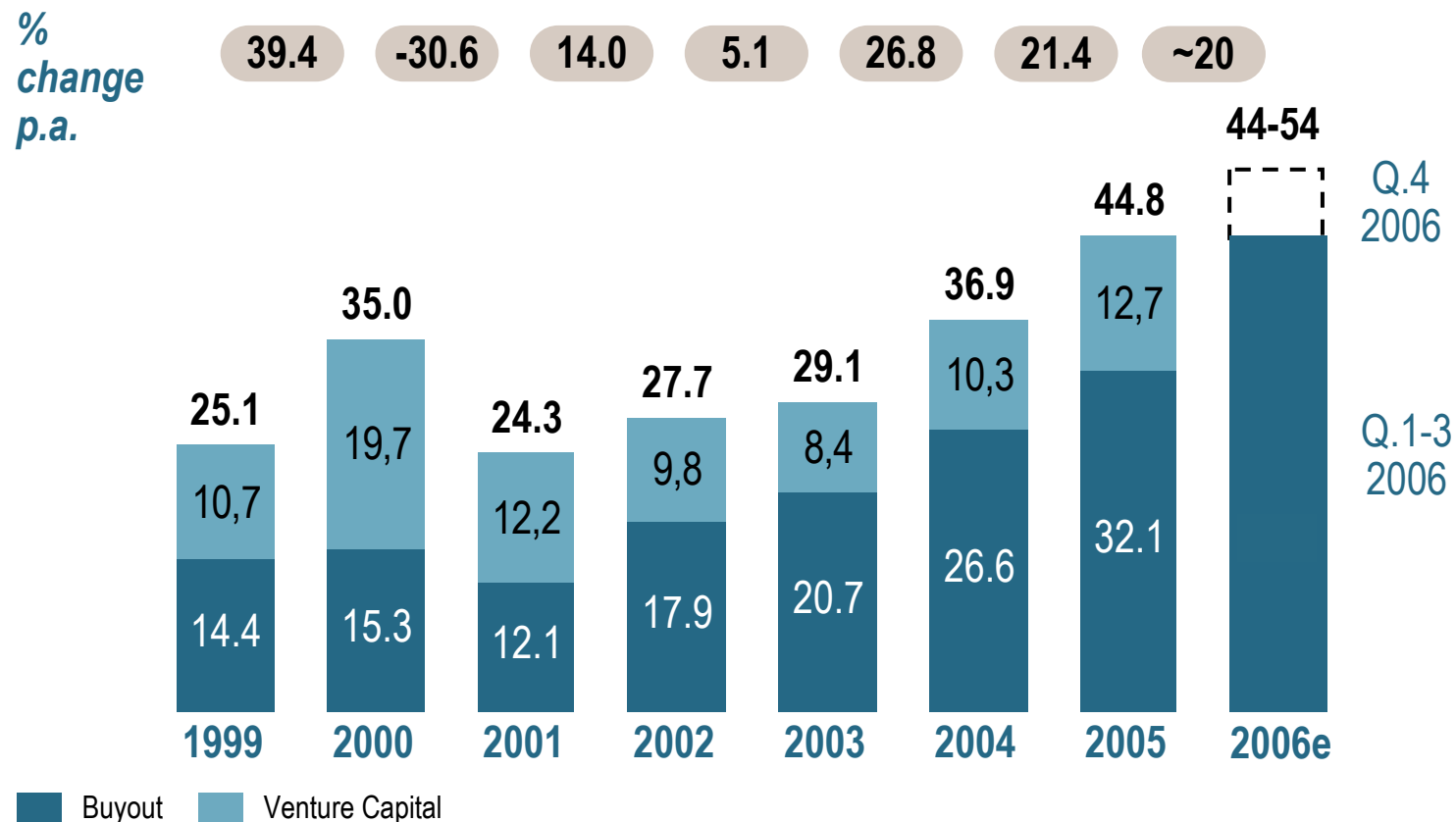
A.

European Private Equity market Overview



European Private Equity market reaches new record volume in 2006 nearing ~ EUR 50 bn

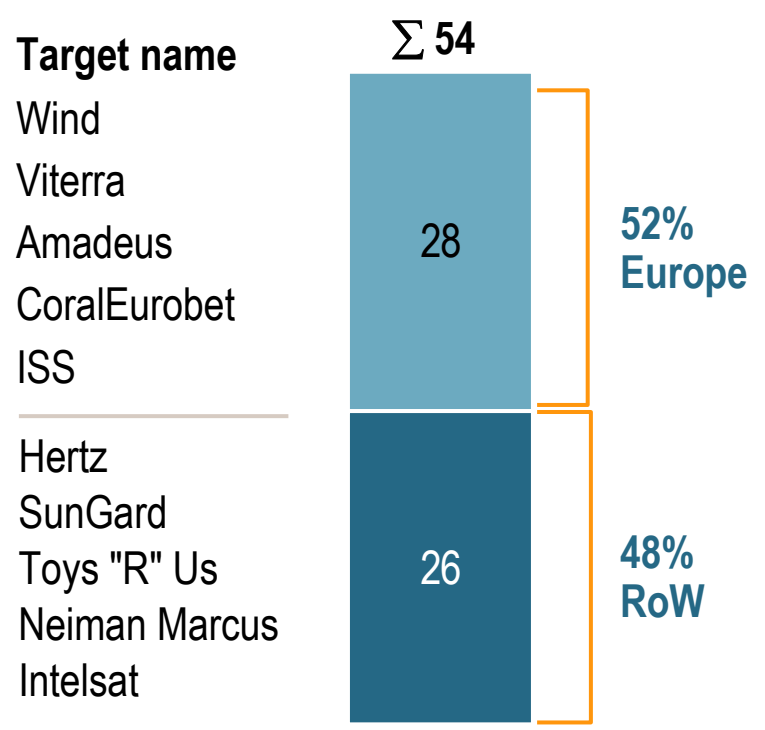
European Private Equity investments [EUR bn]



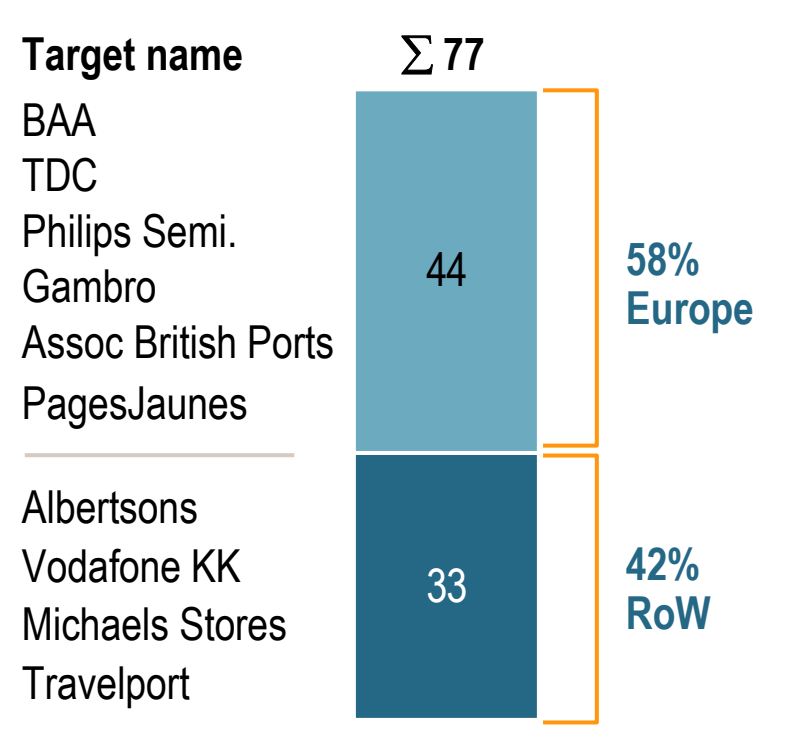
This 'European PE record' is also reflected looking at the global Top 10 PE Buyout deals 2005/06

Top 10 Private Equity Buyouts in 2005/2006 [EUR bn]

2005

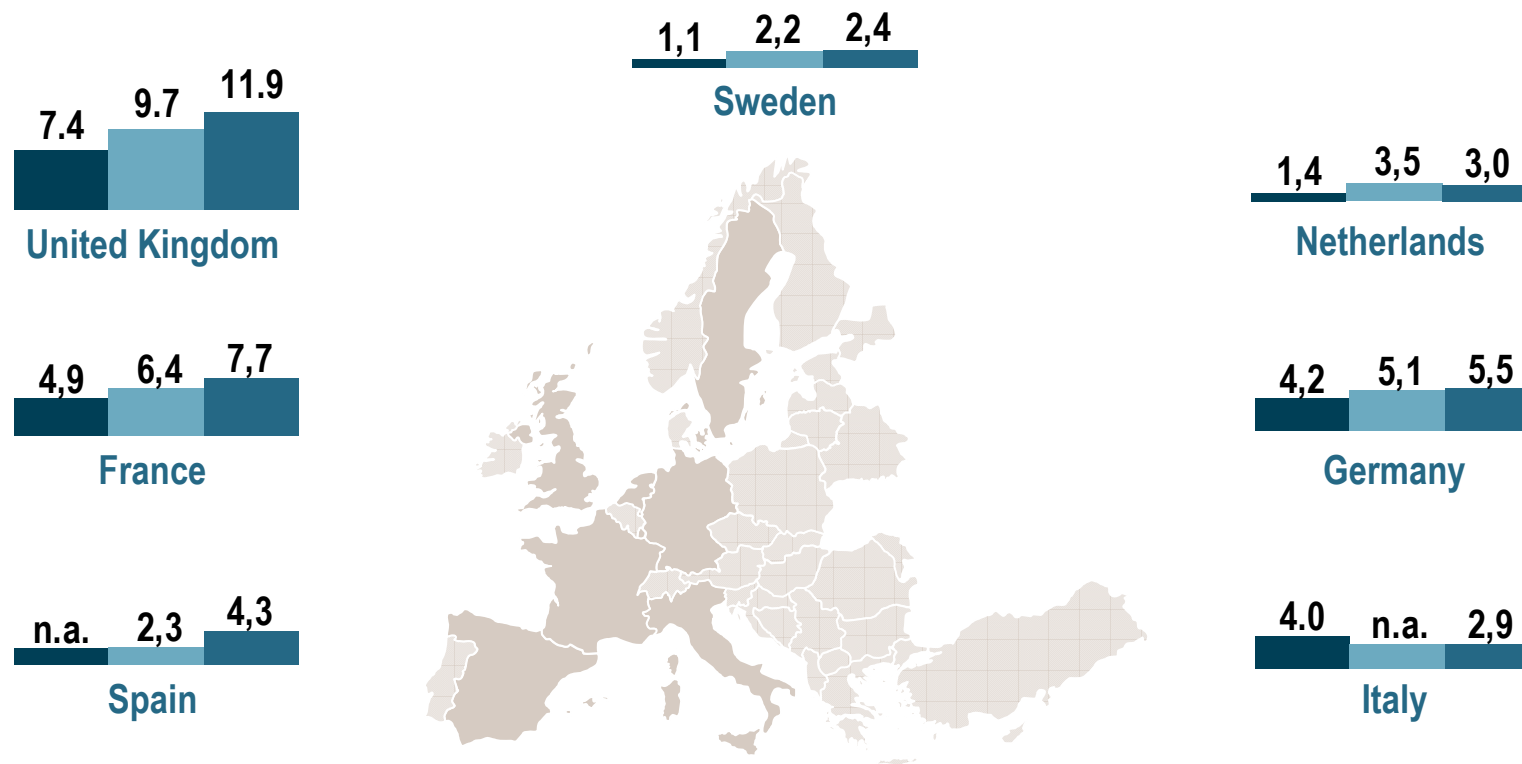


2006



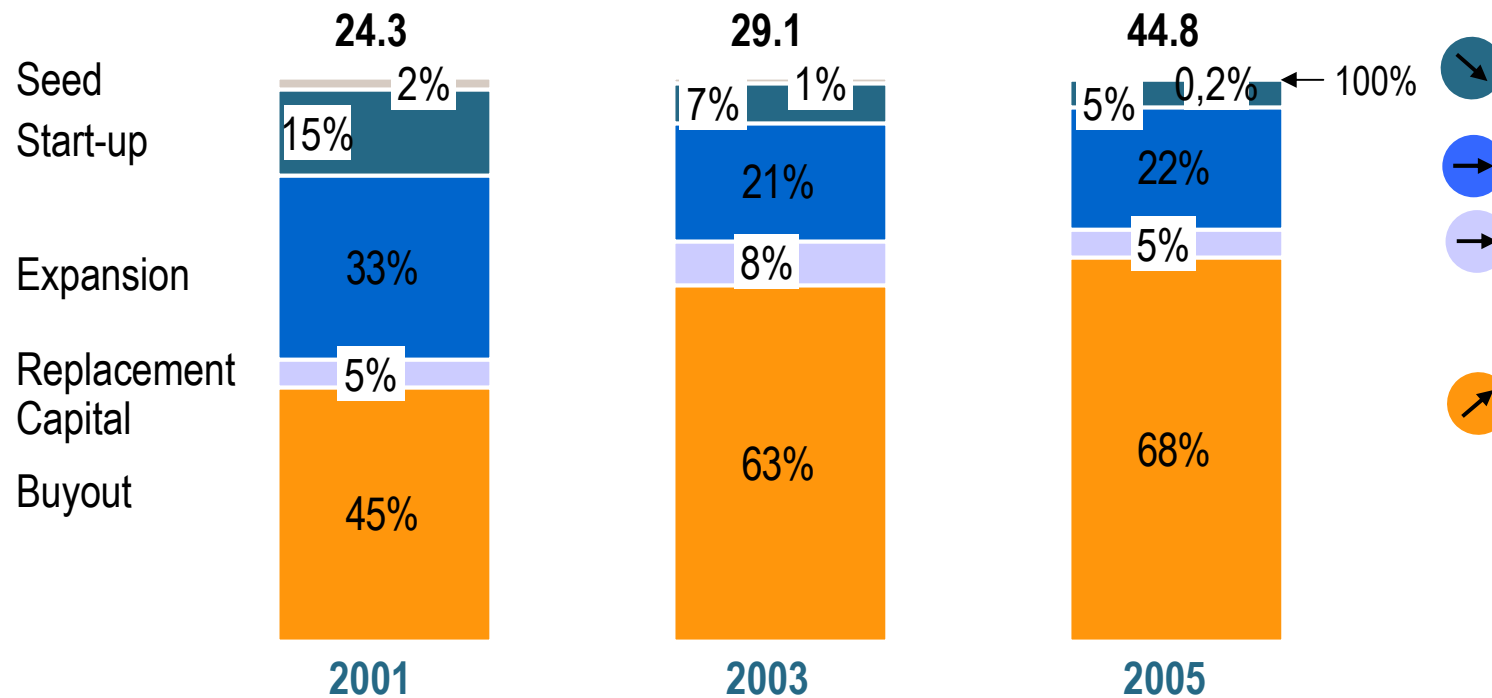
Degree of development of national PE markets across Europe is cause for attention

European PE investments by country 2005 [EUR bn]



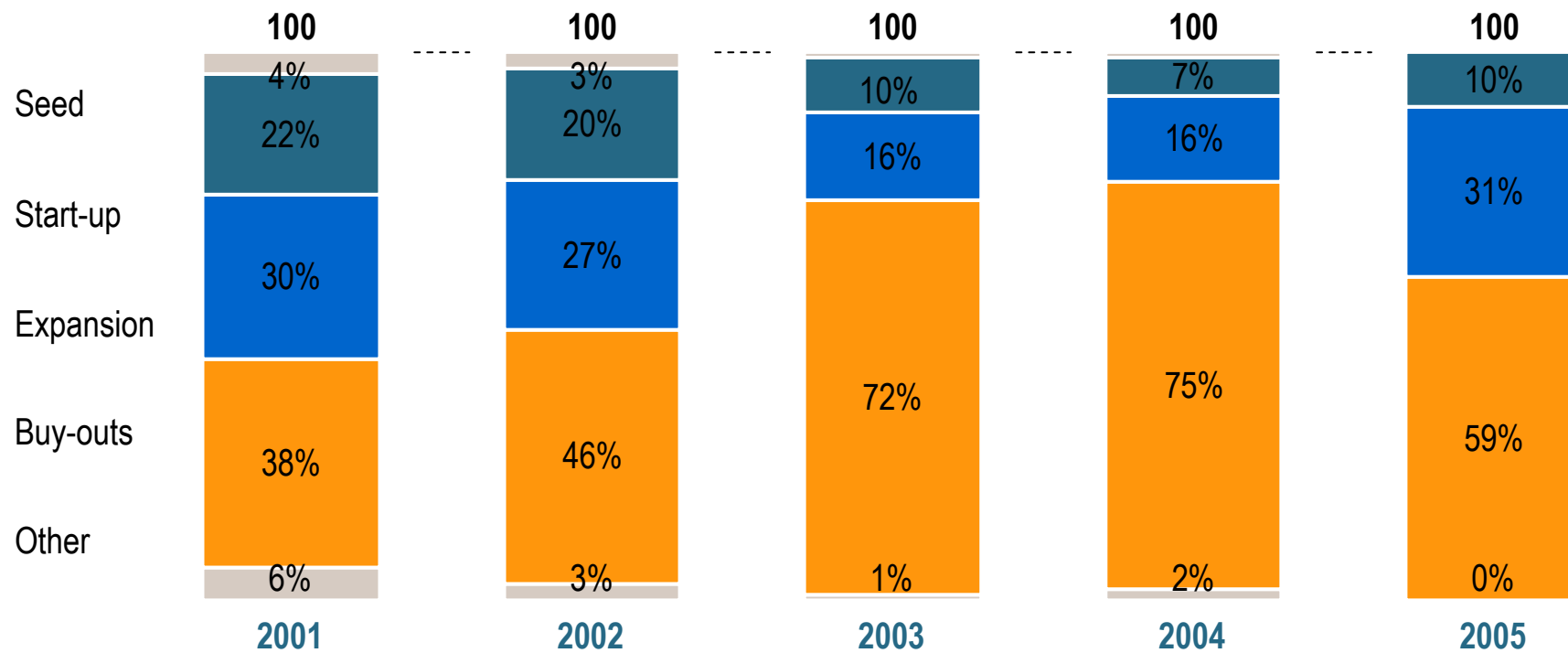
Strong focus remains on late stage buyout financing – now and in the future

European PE investments in terms of investment stage [EUR bn and %]



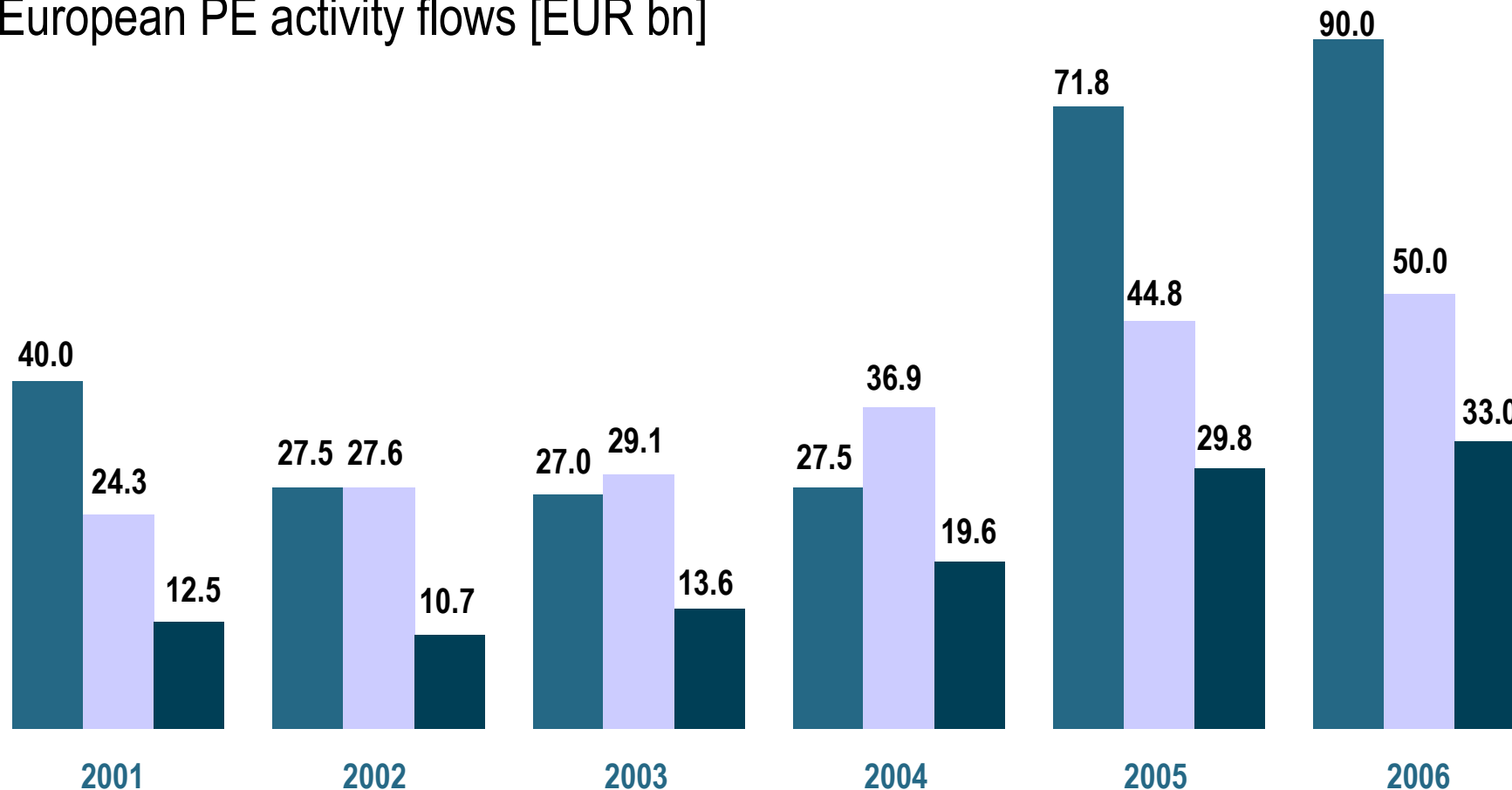
The German PE market with largest share in the buyout segment reflects this trend

German PE investments in terms of investment stage [in %]



Overall, funds raised reached a new record of EUR 90 bn in 2006 – backlogging the actual investments by far

European PE activity flows [EUR bn]

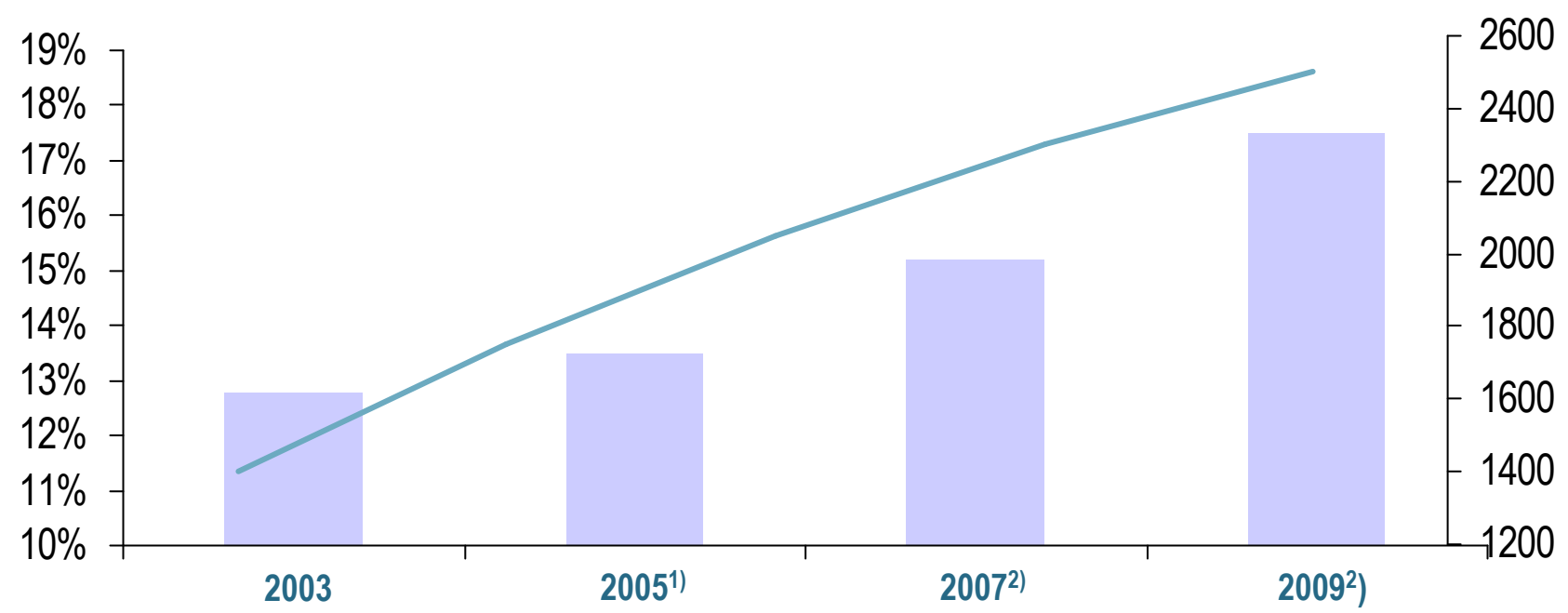


This trend will continue – Private Equity funds keep on growing

Capital under management at the top ten PE firms

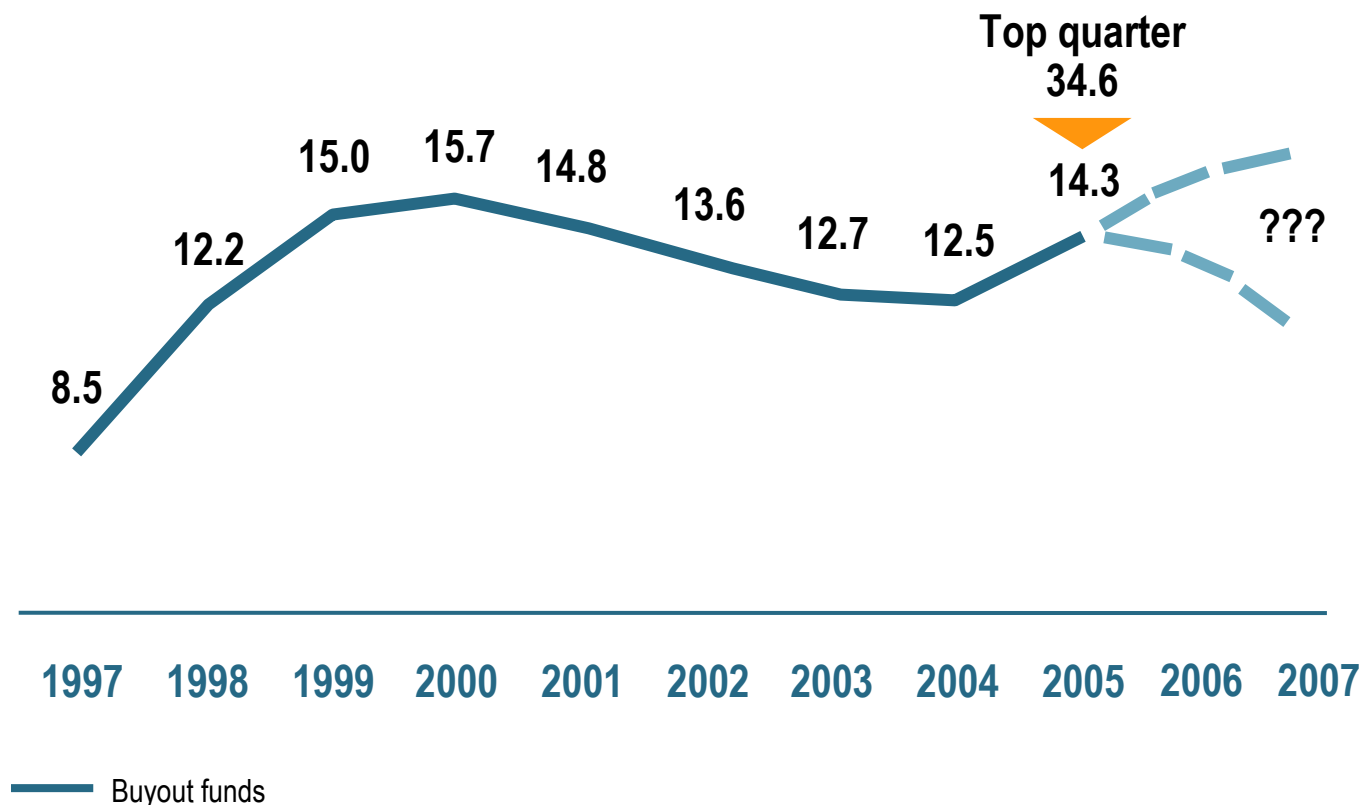
% of total capital

Average fund size [EUR m]



The questions is: Will profit grow along the same lines – or is a downturn to be expected?

10-year rolling IRRS (European Private Equity funds) [%]



REMARKS

- > Only top funds manage to meet the high demands by investors
- > Private Equity funds need to take a close look on available levers for value creation

Worse to come: Are cases like Kiekert, Kabelnetz NRW or TMD more likely in the future?

KAUF DURCH PE INVESTOR

- > Permira übernimmt **Kiekert** 2000 für 530 Mio. EUR
- > 2003 Börsen-Delisting

- > Callahan übernimmt 55% des **Kabelnetzes NRW** für 2,5 Mrd. EUR

- > Montagu kauft **TMD Friction** für 776 EUR im Jahr 2000

OPERATIVER CRASH

- > Massiver Umsatzrückgang des Hauptkunden Ford
- > Verzicht auf 145 Mio. EUR Kredit und alle Firmenanteile

- > Zu hoher Kaufpreis aufgrund Interneteuphorie, Geschäftsmodell rechnet sich nicht

- > Mitte 2006 fehlen 50-60 Mio. EUR für fällige Zinszahlung und notwendige Neuinvestition

WEITERVERKAUF/ INSOLVENZ

- > je 20 Mio. EUR „frisches“ EK und Kredite durch u.a. Deutsche Bank, Morgan Stanley

- > 2 Jahre später meldet die Dachgesellschaft Callahan NRW Insolvenz an

- > TMD geht an Gruppe von Gläubigern

Judging by macro indicator developments, potentially more difficult PE environment ahead

CURRENT SITUATION

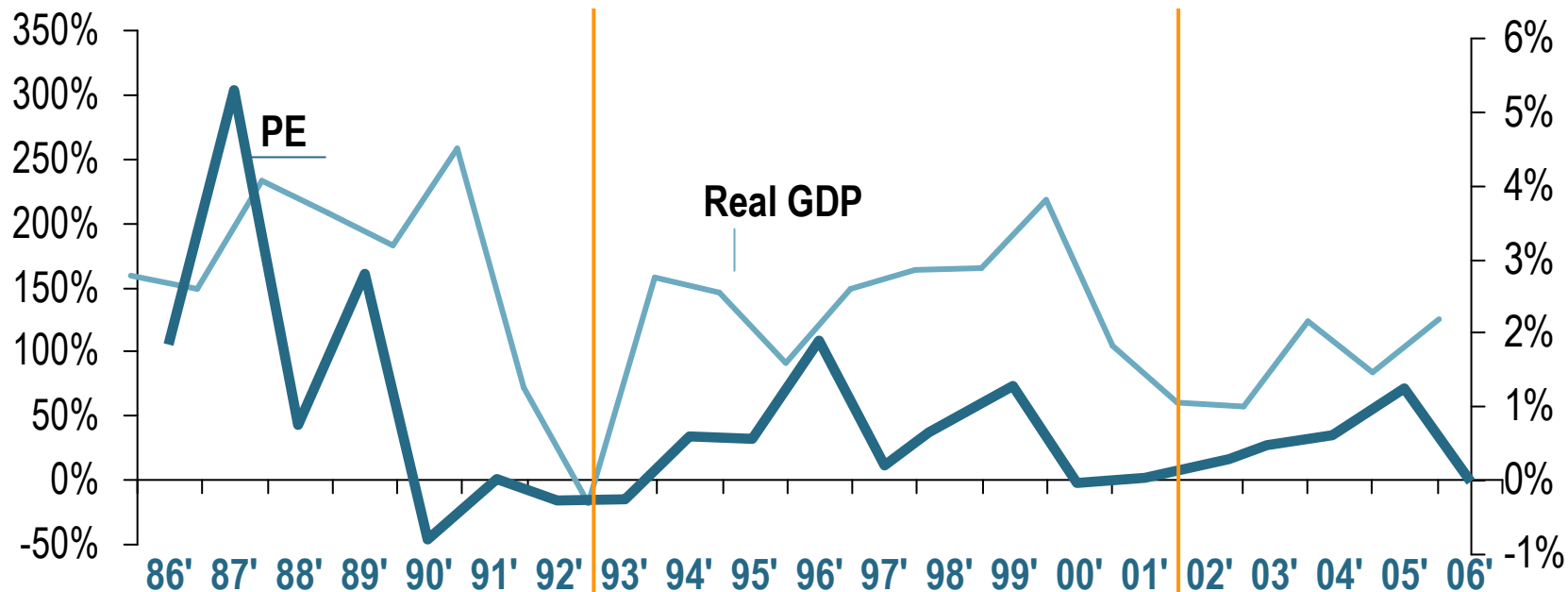
- > **Prices** for investments **rise** (valuations 30% higher than 3 years ago) as **opportunities** are **rare**, sales methods improve and **liquidity** is **high**. EBITDA multiples reached values over 6 and leverage is high (30-35%)
- > 25-30 bn EUR credits are said to **turn bad** in the next **2 years** in **Europe**
- > **Many investments** of PE houses are **ready to go public**
- > **Profit outlook not as stable** anymore

Will these trends continue ? – Outlook 2007

So, where is PE market headed? Looking from a macro perspective – economic growth is needed ...

PE development

Economic development



1. wave: 80ies
Disintegration
conglomerates

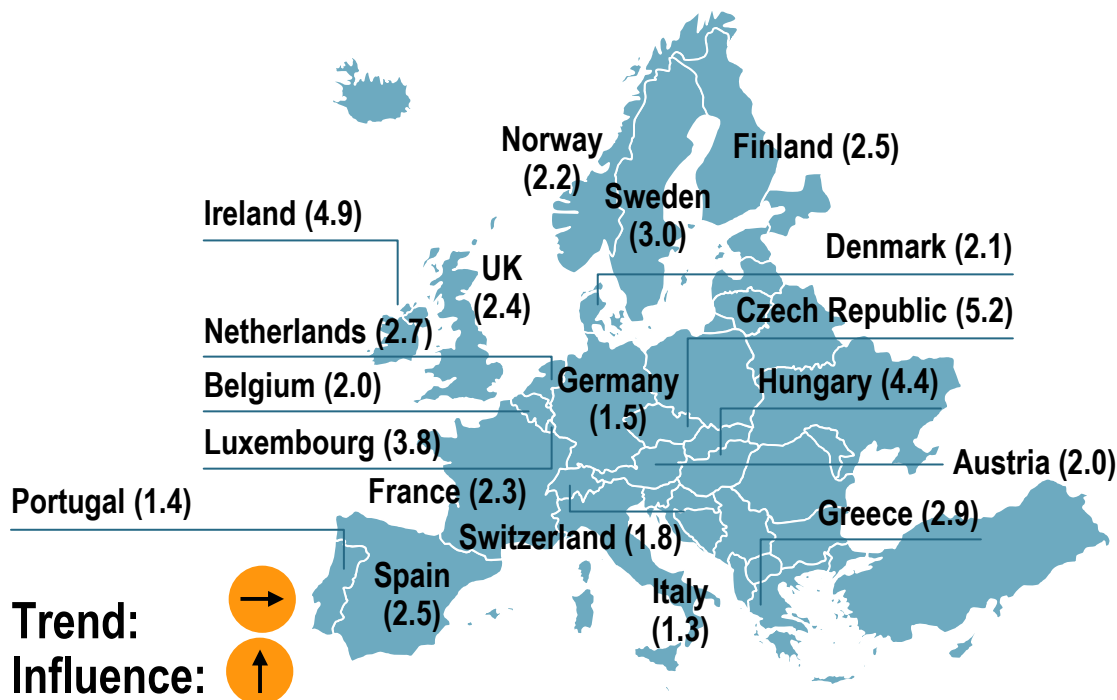
2. wave: 90ies
Bull market and crash

3. wave: today
PE-Funds-Bubble?

The influence of a strong economy is high – the outlook is at least stable

Forecast data 2007 – GDP change p.a.

EU economies

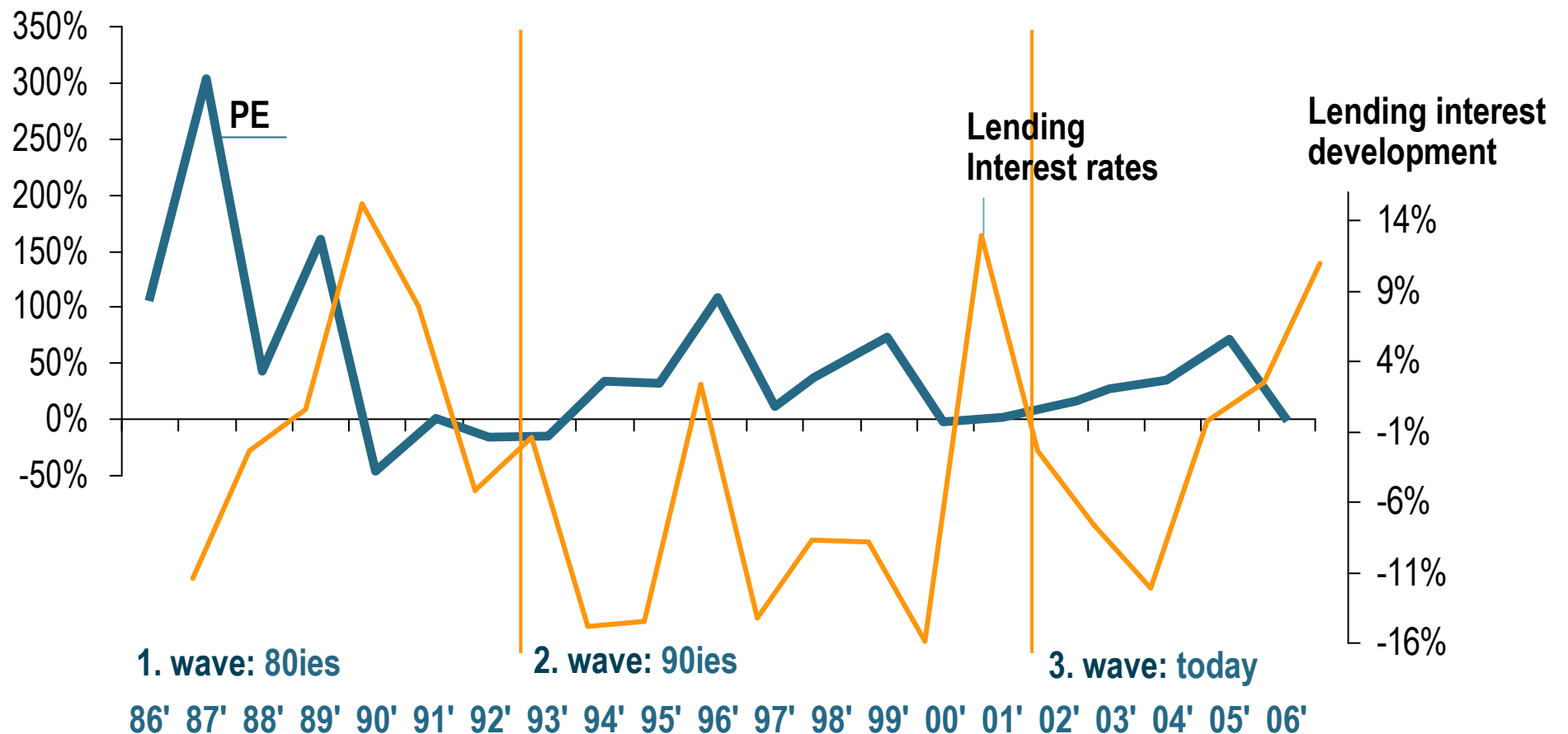


REMARKS

- > European economies are back on the growth track, but very lightly so – cyclical industries still bear high risks
- > With EBITDA multiples of over 6 and leverage of 30-35% a strong economy is very important for the investments to earn the returns
- > Highly leveraged companies hitting cyclical conditions have a high risk of defaulting – earnings of PE houses become volatile
- > Cost cutting and restructuring are key to secure returns especially in low-growth industries

... as low interest rates are crucial to leverage financing...

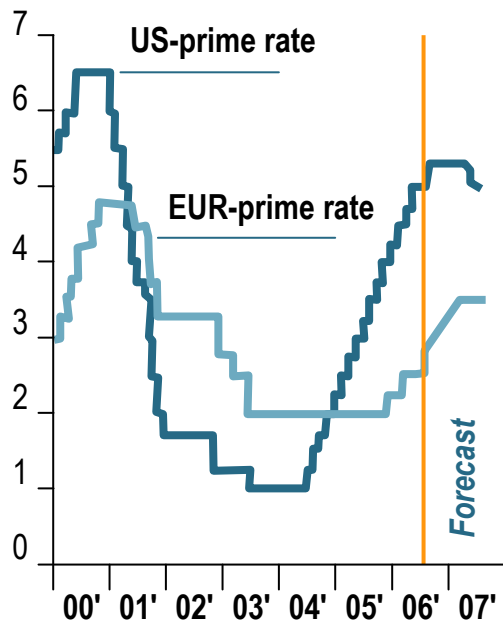
PE development



A rising interest rate has influence on the attitude of banks – Some PE houses have hedged this risk

Forecast data 2007 – Lending interest rates

Lending interest rates



Trend:



Influence:

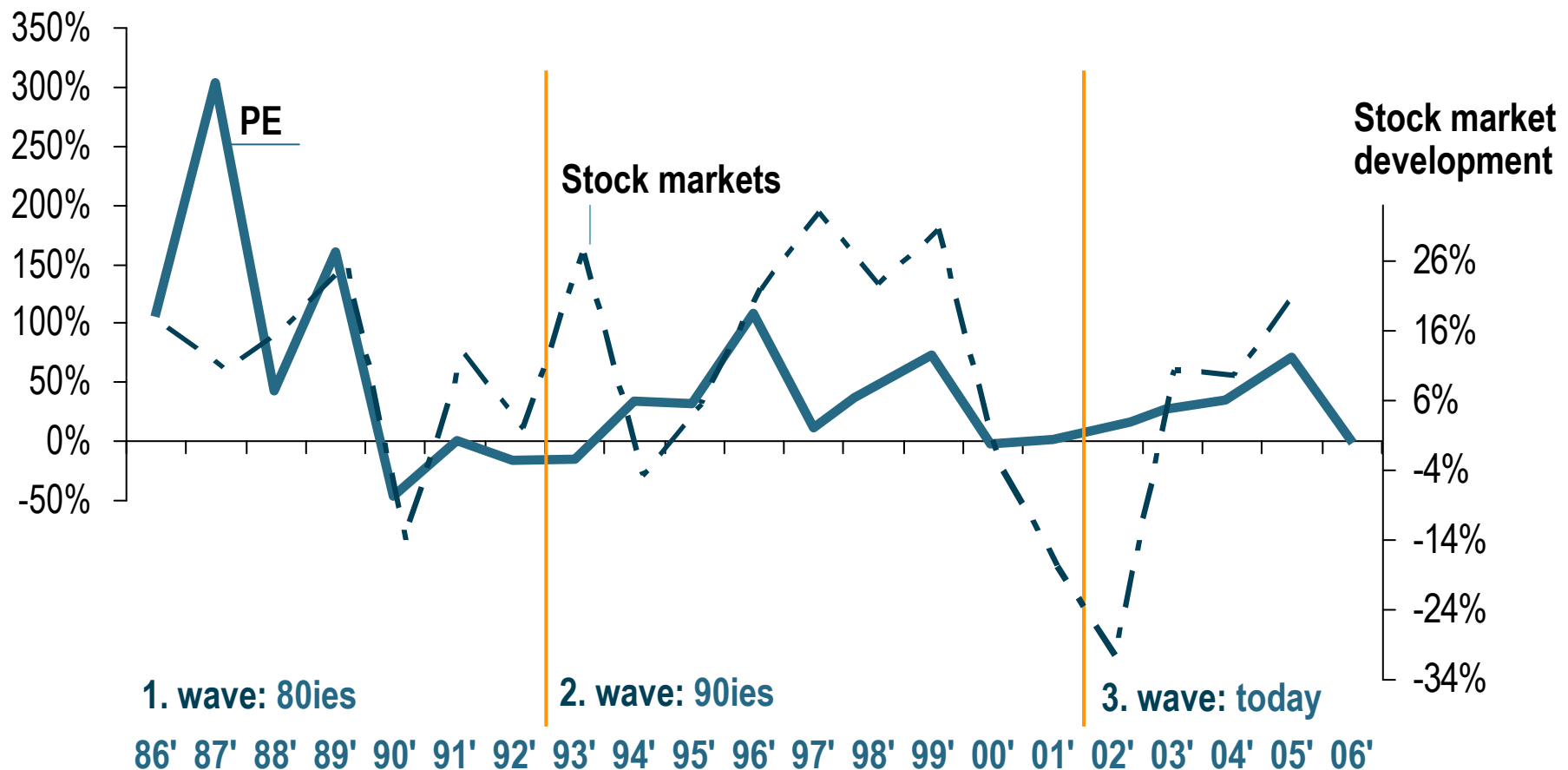


REMARKS

- > Interest rates will most likely rise further, which has a strong impact on the policy of PE houses, if these have not hedged their interest rates (most have)
- > Increasing interest rates could lead to over-leveraged companies and defaulting credits
- > Banks could freeze their easy credit policies and thus break the PE system, which depends on free access to high leverage
- > Investments will have to gain higher returns to serve the credit lines; restructuring becomes more important

... and healthy stock markets provide exit options for PE investments

PE development

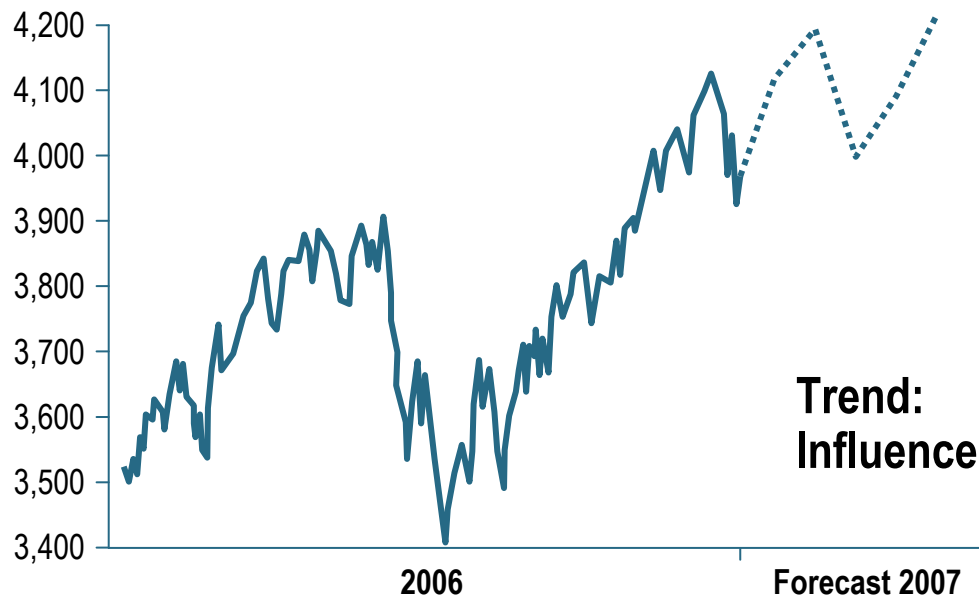


European stock market not likely to boom in 2007 – only little growth expected

Forecast data 2007 – Stock market

Stock market development (Example Eurostoxx)

Eurostoxx finale coutation [index]
Course until Oct 2006



REMARKS

- > The European stock market is not likely to relax next year, very little growth is expected
- > Many investments of PE houses are ready to go public – an efficient exit channel would be important, but is not given in Europe
- > Most investments today therefore go to secondary private equity investors to avoid the need to go public
- > Restructuring of the investment to be able to get a good price on the secondary market is increasingly important

OUTLOOK: A potentially more difficult PE environment lies ahead

OUTLOOK

- > Highly leveraged companies hitting cyclical conditions have a high risk of defaulting – earnings of PE houses become volatile. **GDP growth** is expected to **remain stable** in the EU, but cannot offset cyclical industries
- > **Interest rates** are **predicted to rise**. Banks could in reaction tighten their easy credit policy
- > The **Eurostoxx index** is **not expected to increase** significantly – stock market as exit channel appears difficult



PE winners and losers will distinguish: active portfolio management and restructuring will differentiate successful investments

When conditions are getting harder – where does the profit comes from?

ACQUISITION

1.

Purchase price

Low purchase price (e.g. purchase value/ EBITDA) in relation to fair value; high leverage

HOLDING PERIOD

2.

Investment performance

Implementation of measures ensuring and enhancing profitable growth (cost reduction/ sales up, working capital reduction, liquidity enhancement)

EXIT

3.

Selling price

Selection of the right moment and exit channel to realize highest value



Investor has to manage three critical steps in order to meet the high performance requirements

Value creation in the acquisition phase is limited – time of ‘lucky buys’ is over ...

Current SITUATION



- > Number of Private Equity firms as well as funds volumes have increased despite sufficient investment opportunities
- > Sellers tend to employ experienced investment banks in the process increasing the level of professional pricing/valuation
- > Auctions are used to realize highest offers

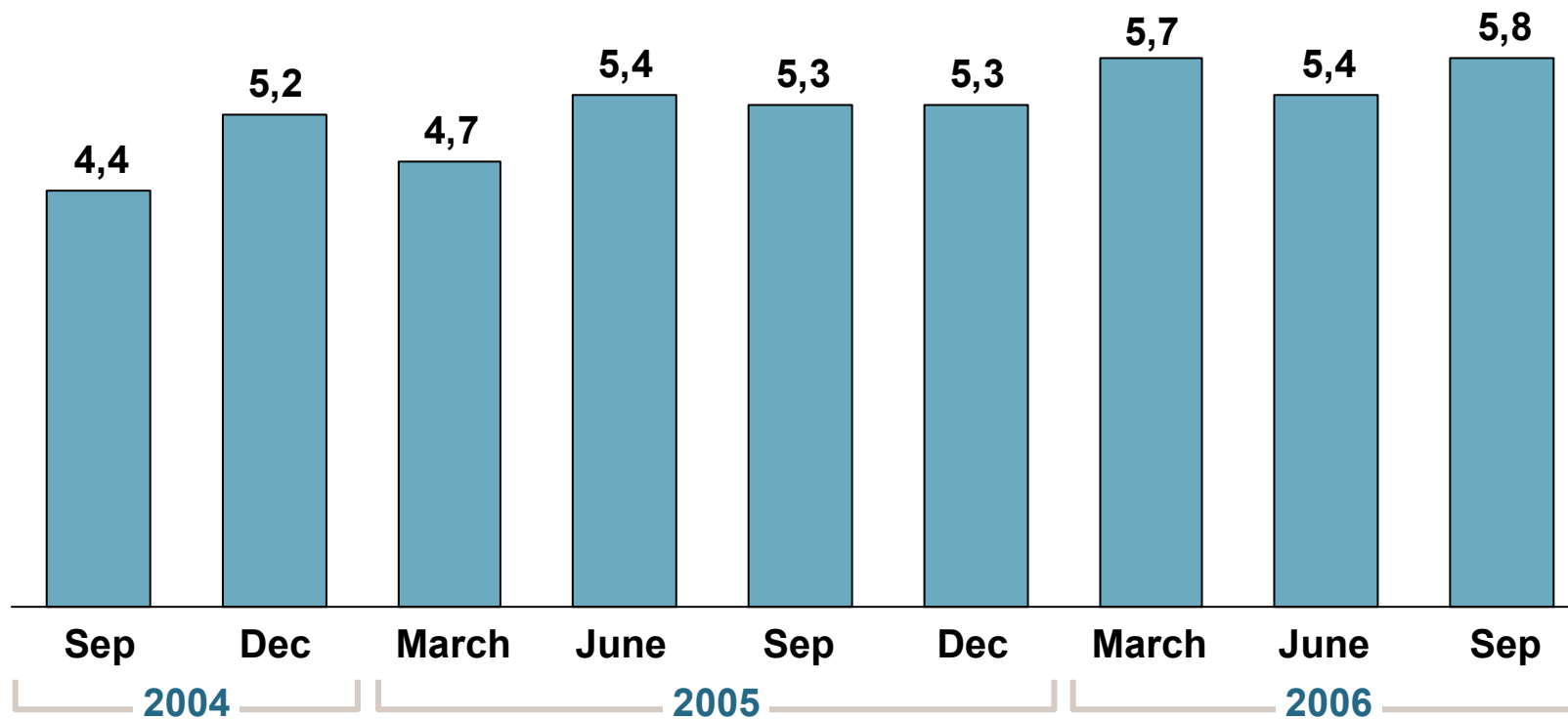
IMPLICATIONS for purchase price



- > Selling process of companies through auctions results in a winners curse
- > Small chance of realizing value especially as sellers will also value possible restructuring opportunities
- > Therefore value creation in the acquisition phase is aligned with low probability

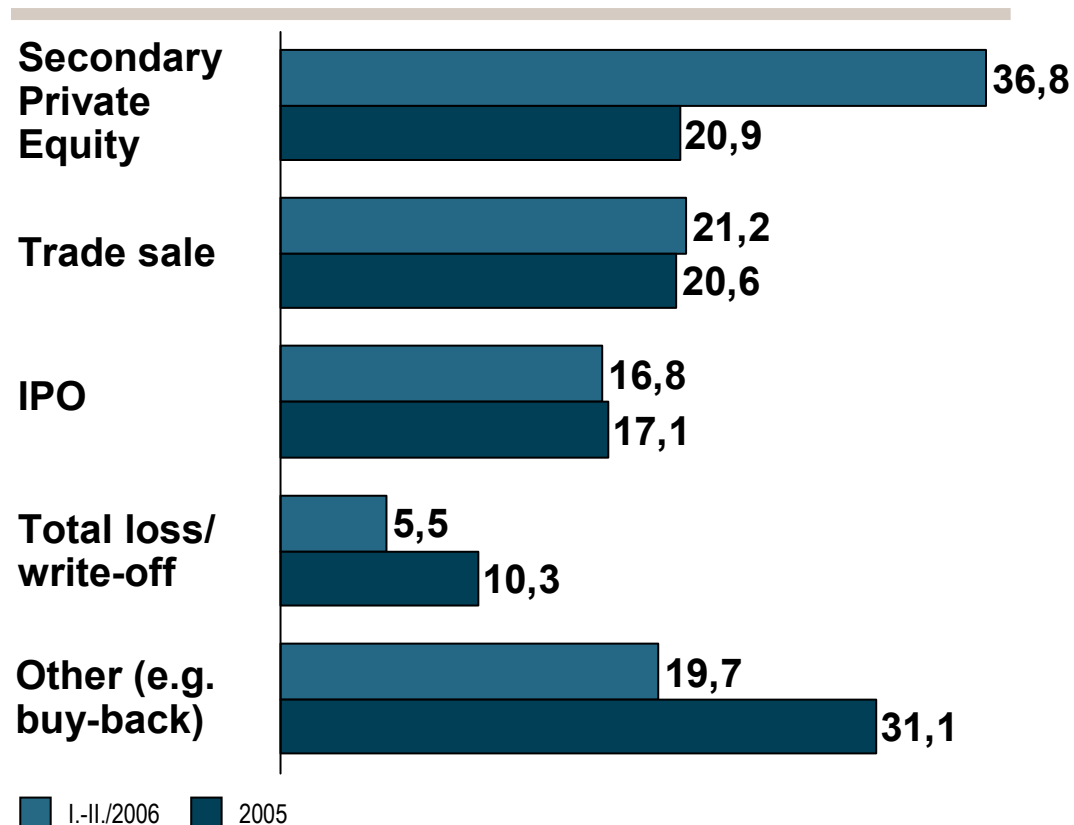
... as EBITDA multiples nearing levels last seen in the 90s

Leverage Ratios (Total debt/EBITDA, in europ. LBOs) von Standard & Poors [...]



Also, generating value through exit is rather limited within current channel options

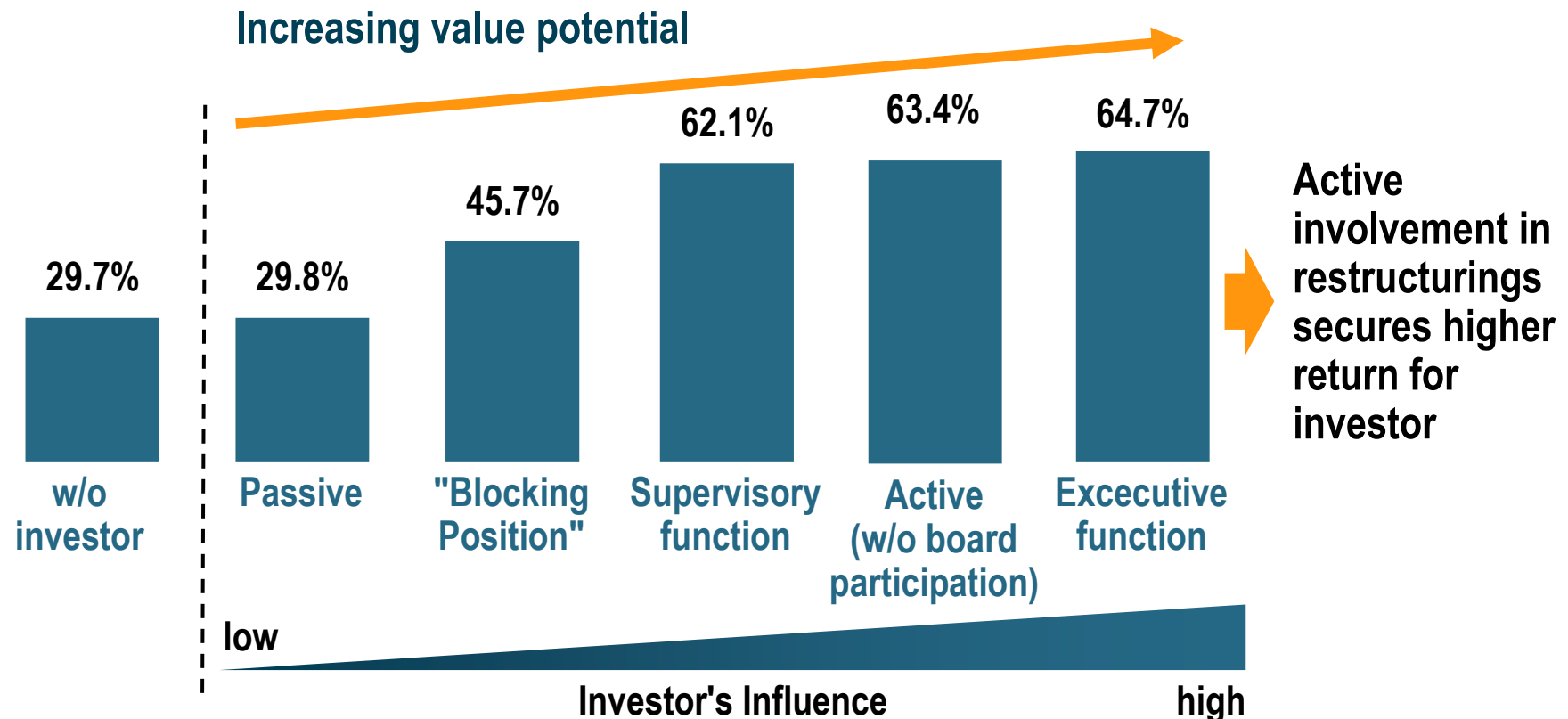
EXIT CHANNEL [%]



- > **IPO** in current market conditions difficult (potential private shareholder still disappointed since burst of the bubble in 2000), although interesting in terms of return
- > **Sale to secondary PE investor** as main exit channel, but getting harder as EBITDA multiples are reaching its limits and no optimization is left
- > **Trade sale** to strategic investor as very important exit channel but not given for granted

Thus largest potential for value creation within the holding period – requiring active PE investors

ROI-Improvement¹⁾ in 2 years for US restructurings [%-points]



1) Operative Result / Total Assets

B.

A call for active PE
performance
improvement!



Within the holding period, value levers of Private Equity funds are on a par with managers of conglomerates

Sources of value creation in holding period

VALUE CREATION WITHIN PARTICIPATION

1

- > Increase of competitive position
- > Increase of financial performance
- > Financial restructuring

Restructuring
the 'whole'

VALUE CREATION WITHIN PORTFOLIO

2

- > Execution of buy and build strategies
- > Use of synergies within portfolio (market and cost wise)
- > Build-up of shared services for portfolio (e.g. purchasing, HR, IT)

Restructuring
for synergies

VALUE CREATION BY PRIVATE EQUITY

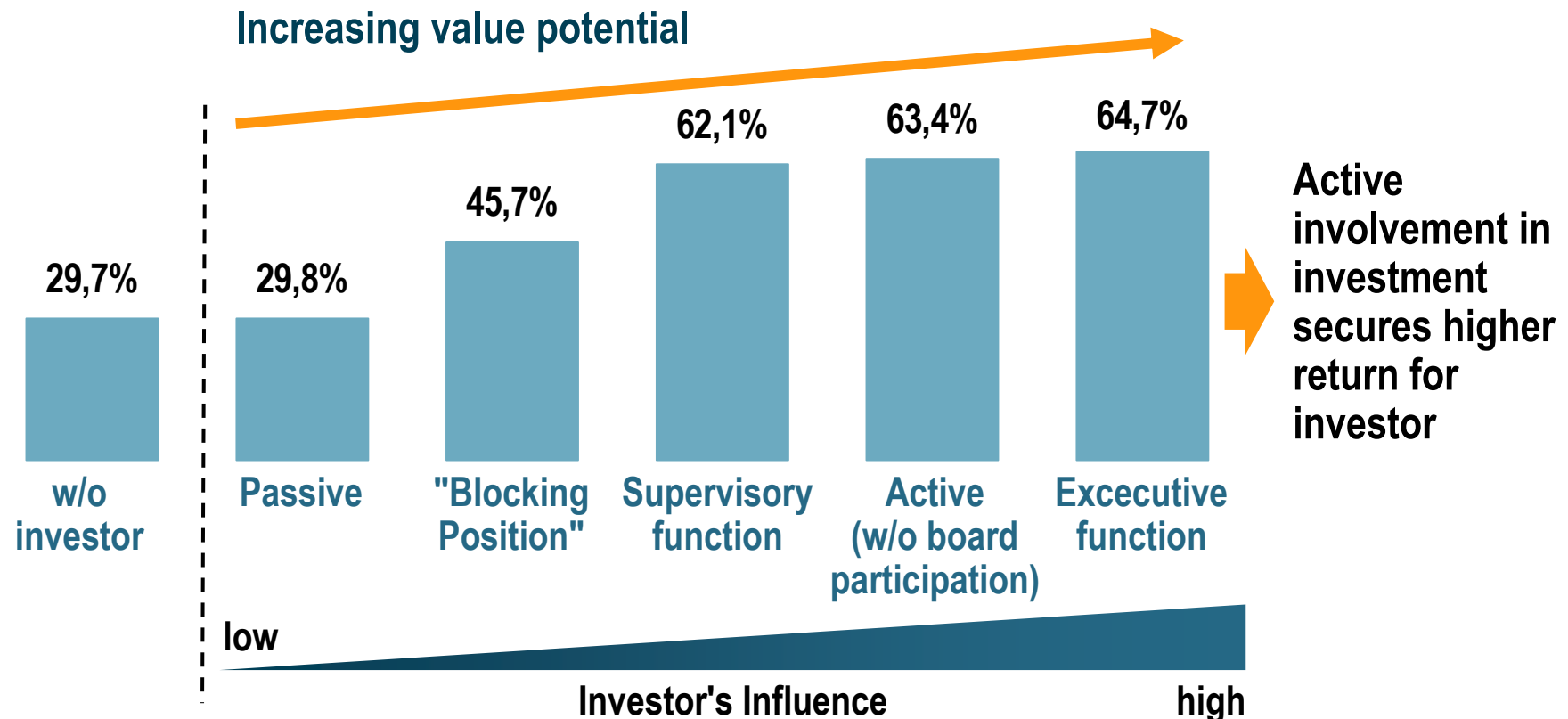
3

- > Strict measure management
- > Performance-oriented management compensation
- > Performance management and controlling

Restructuring of/with
management systems

Thus an active involvement (in the restructuring) will increase the value potential of a Private Equity fund

ROI-Improvement¹⁾ in 2 years for US restructurings [%-points]

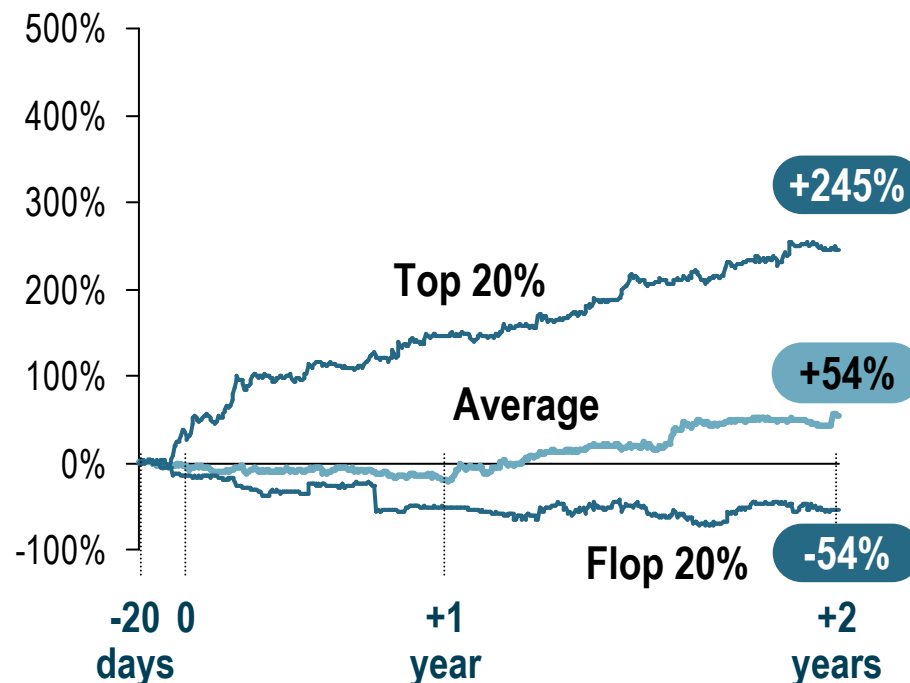


1) Operative Result / Total Assets

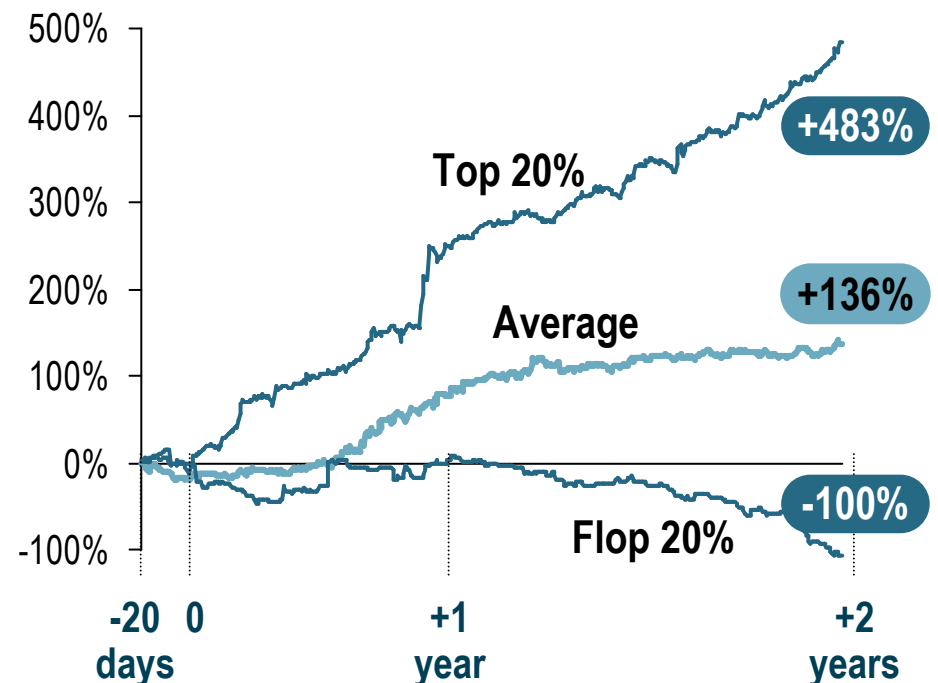
The beneficial impact on value creation of a comprehensive restructuring is proven

Development of cumulative abnormal return in comparison to CDAX

MINOR DOWNSIZING FOCUS ON COSTS



SUBSTANTIAL DOWNSIZING FOCUS ON COST AND GROWTH



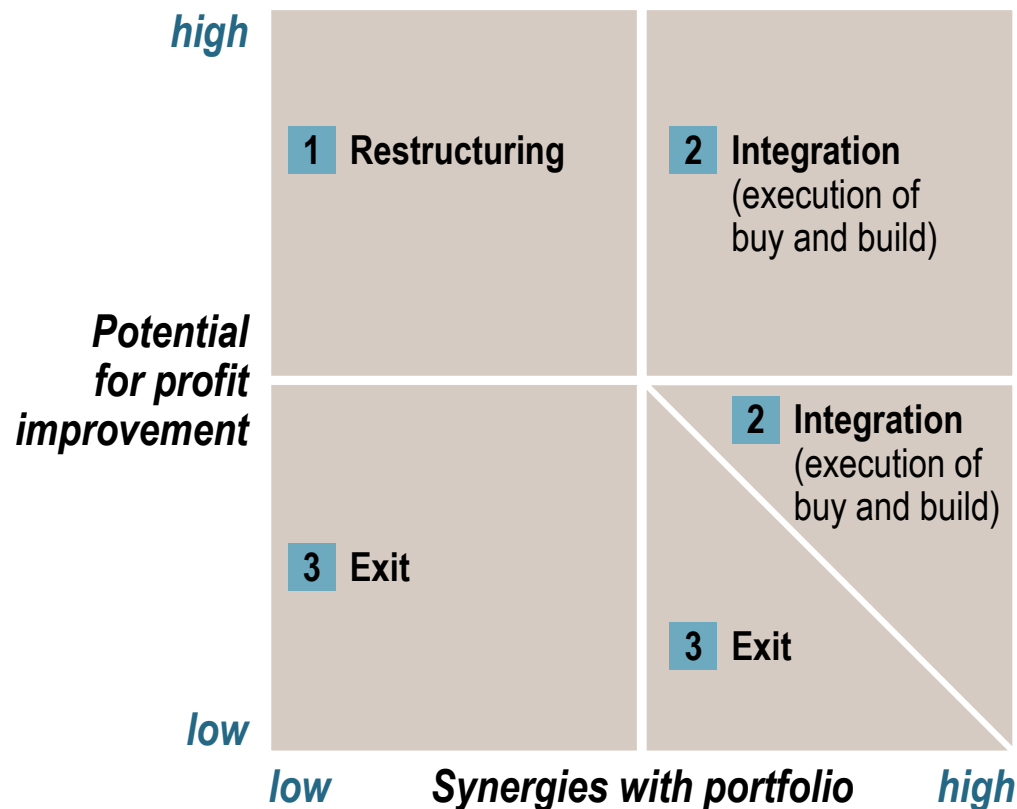
Within a restructuring the following set of tasks have to be fulfilled

Restructuring Process

1. Determination of **IMPROVEMENT TARGET** of the company (Targeting)
2. Identification of **AREAS OF POTENZIAL** (Evaluation)
3. Determination of **NEED FOR ACTION** (Prioritizing)
4. Identification of **CONCRETE AND DETAILED MEASURES** (Content, Time, Responsibility) of all areas of potential (Detailing)
5. Subsumption of all measures into a **CONCEPT** incl. integrated business plan (Coordination/Implementation)

The fund management has to ensure that the value of each participation is maximized

Scope of Portfolio Management



1 RESTRUCTURING

- > Implement measures for profit improvement

2 INTEGRATION

- > Execution of buy and build strategy
- > Realize synergies between portfolio companies
 - Sales (exploitation of customers)
 - Cost (shared services, centralized purchasing etc.)
- > PE fund management must take the lead for implementation and realization of potential

3 EXIT

- > Prepare exit of company
 - IPO
 - Trade sale
 - etc.

In a buy-and-build strategy independent companies - offering parts of the industry value chain - are combined

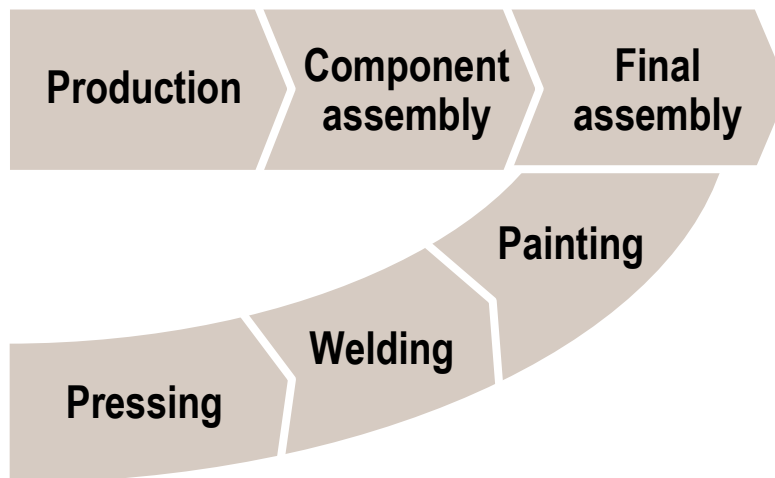
Basic buy-and-build strategies – Example automotive industry

BUY-AND-BUILD STRATEGY

STRATEGY I: Combine production and assembly know how, e.g. IWKA

STRATEGY II: Become biggest player in assembly, e.g. Maxcor

CUSTOMER VALUE CREATION



CRITERIA FOR SUCCESSFUL BUY-AND-BUILD STRATEGIES

- > Customer demands
 - Does the customer demand turn-key solutions?
 - Is the customer himself the expert in managing the value chain?
- > Economies of scale
 - Does size matter?
 - Does the customer accept decreased competition?
- > Economies of scope
 - Is there an increased knowledge transfer along the value chain?
 - Is there access to different customer groups?

➔ Tasks for portfolio manager:

1. Find the right strategy
2. Combine the necessary companies **and** realize synergy potential

The implementation of a value management system generally consists of three steps

Implementation of Value Management

DERIVATION OF VALUE BASED MANAGEMENT CONCEPT

- > Screening and benchmarking of existing participation portfolio
- > **Identification of value potential and definition of targets** (participation and portfolio level)
- > Derivation of **value based management concept**

ANCHORING OF VALUE MANAGEMENT AT PRIVATE EQUITY

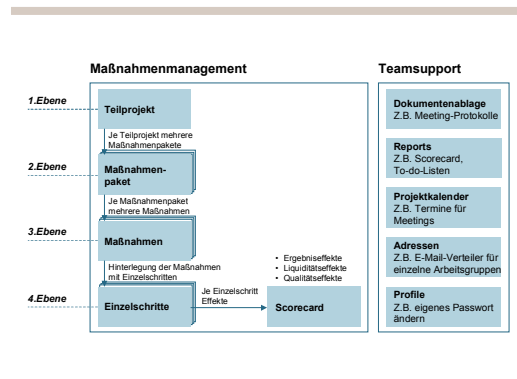
- > **Optimize portfolio decisions**
- > **Define main value drivers and value components**
- > Implement **value orientated steering processes** (incl. periodical valuations)

ANCHORING OF VALUE MANAGEMENT IN PARTICIPATION

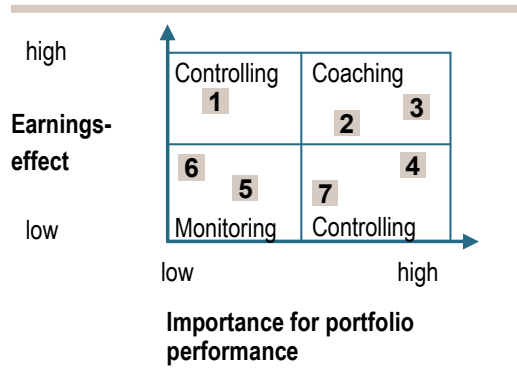
- > **Derivation of restructuring potential, value drivers and KPIs** for participations
- > Setting of **value based targets** for participation management
- > **Derivation of measures** to increase value
- > **Align reporting processes**
- > **Control implementation**

The implementation requires the application of well established management tools

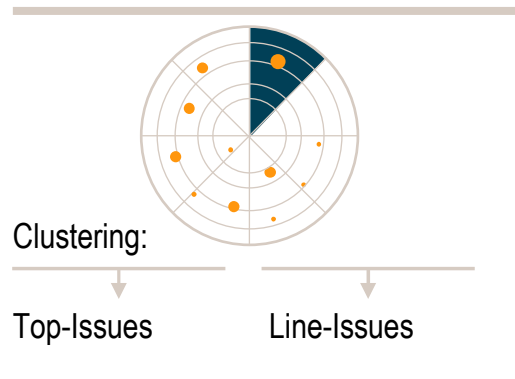
MEASURE MANAGEMENT



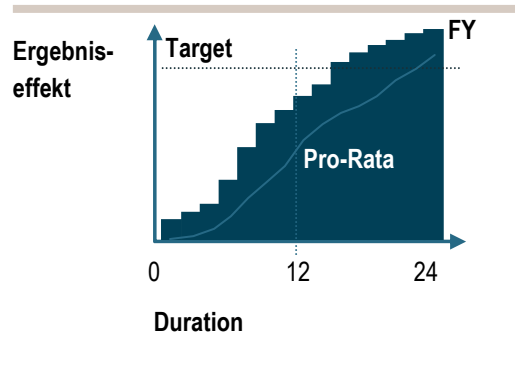
PRIORIZATION-MATRIX



ISSUE-RADAR



EFFECT MONITORING



MANAGEMENT TOOLS

Implementation of Value Management utilizes proven project management tools

> **Stringent Management**

- Detailed planning
- Definition of targets and measures

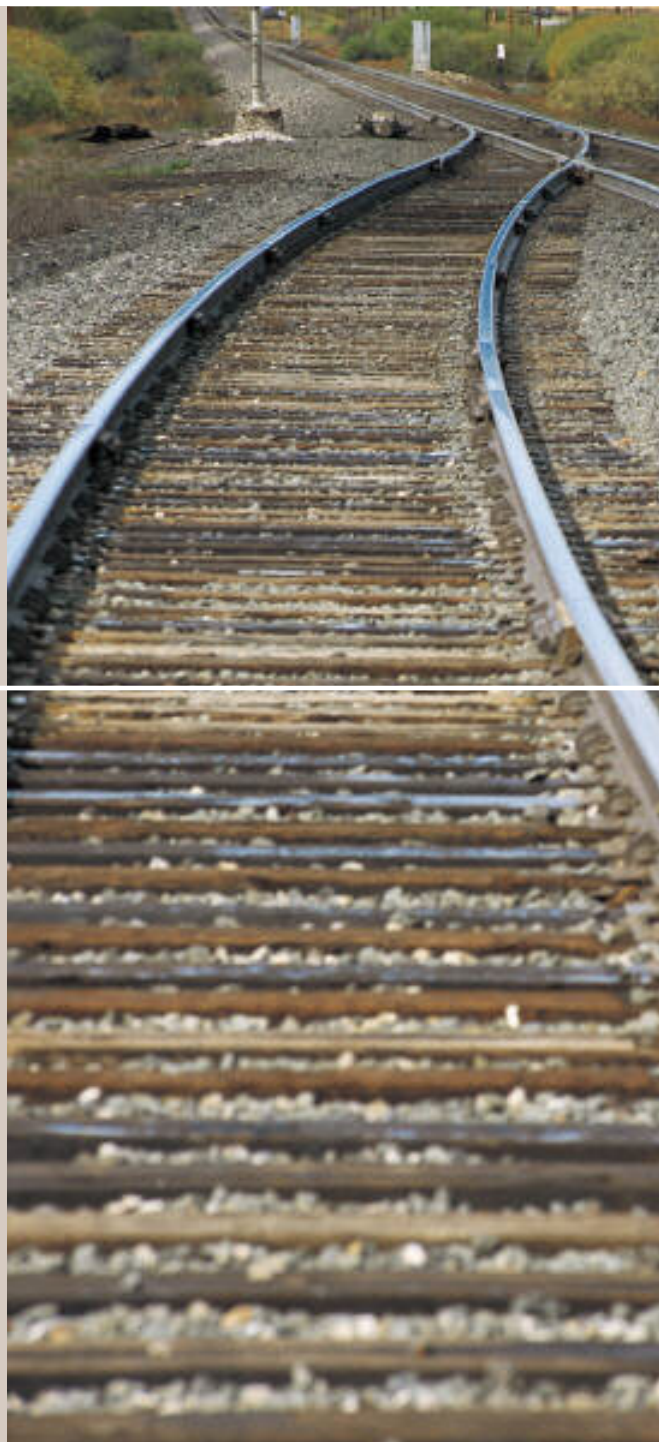
> **Coverage of all relevant issues**

> **Prioritizing of issues** for Coaching/Task-Force-Assignment

> **Controlling of implementation and effects** (incl. one-off effects)

C.

How Roland Berger
can support you



Roland Berger Strategy Consultants is uniquely positioned to support you

RB - VALUE PROPOSITION

1

OUR BASE:

STRONG UNDERSTANDING of EUROPEAN COMPANIES, MARKETS and CULTURES

2

OUR KNOW-HOW:

SEASONED INDUSTRY EXPERTS and international network

3

OUR EXPERIENCE:

Numerous **PROJECTS** related to **PRIVATE EQUITY TRANSACTIONS**

4

OUR APPROACH:

Integrated **STRATEGIC, OPERATIONAL** and **FINANCIAL VIEW** and "**HANDS-ON IMPLEMENTATION**"

... plus "**DOOR OPENER**" for your investments

OUR BASE: Strong understanding of European markets

Amsterdam | Bahrain | Barcelona | Beijing | Berlin | Brussels | Bucharest | Budapest | Detroit | Düsseldorf |
Frankfurt | Hamburg | Kiev | Lisbon | London | Madrid | Milan | Moscow | Munich | New York | Paris | Prague | Riga
| Rome | São Paulo | Shanghai | Stuttgart | Tokyo | Vienna | Warsaw | Zagreb | Zurich

>1,700 PROFESSIONALS

32 OFFICES IN 23 COUNTRIES

>EUR 550 m REVENUES

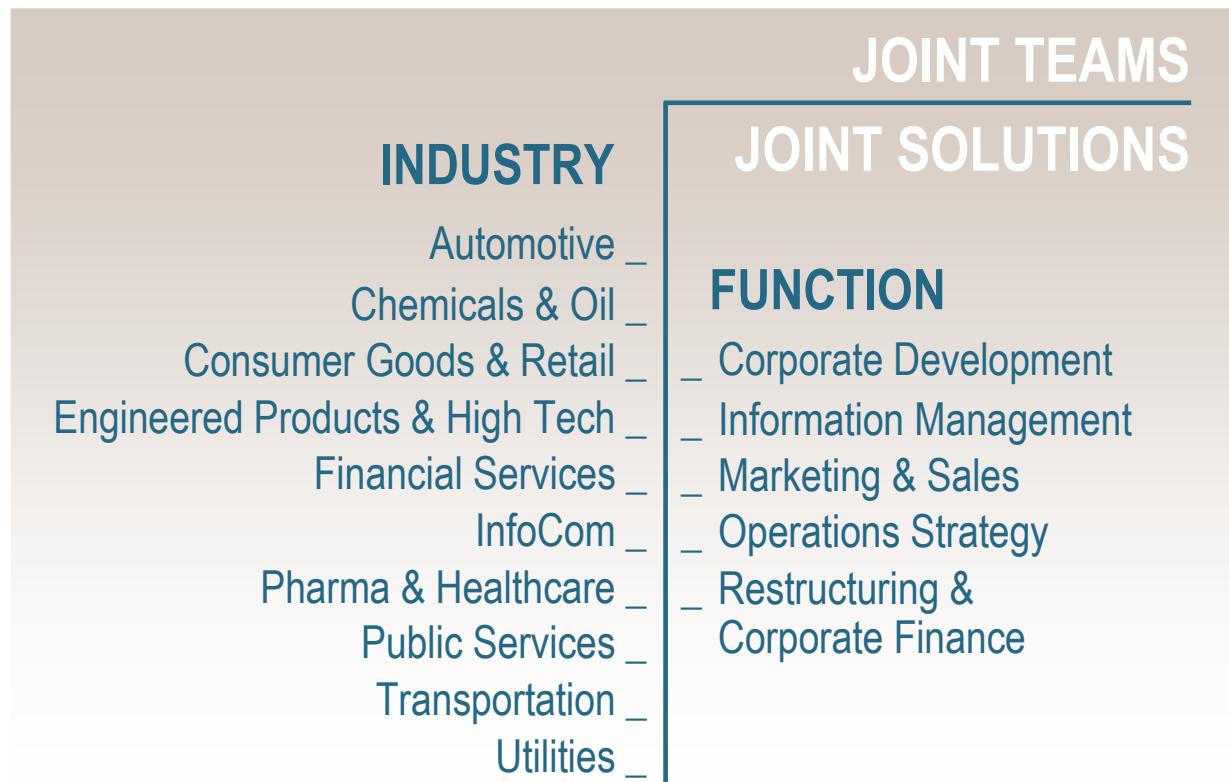
INDEPENDENT PARTNERSHIP

#5 globally

#3 in Europe

#2 in Germany

OUR KNOW-HOW: Seasoned industry experts combined with functional know-how



- **Thorough understanding of the industry and its major players**
- **Creative functional solutions and approaches**
- **Bridging industry know-how with functional expertise**

OUR EXPERIENCE: > 200 projects since 2002 related to private equity transactions for many clients (1)

Roland Berger Strategy Consultants has advised ... (Examples)

**For further information please contact:
joerg_horstmann@de.rolandberger.com**

OUR EXPERIENCE: > 200 projects since 2002 related to private equity transactions for many clients (2)

Roland Berger Strategy Consultants has advised ... (Examples)

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OUR APPROACH: Integrated strategic, operational and financial view plus 'hands-on implementation'

