



## Private Equity Trend Report 2008

Germany - still the golden opportunity for international investors?

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Editorial support: Dagmar Schadbach, PricewaterhouseCoopers AG Wirtschaftsprüfungsgesellschaft

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## A Executive summary

The second half of 2007 and the start of 2008 have seen challenging times for international private equity funds. As a consequence of the credit crunch, global deal activity has slowed down, and many big-ticket deals have had to be withdrawn or postponed. Despite the problems in the financing market, private equity activity in the lower to middle market in Germany managed to maintain its momentum in the second half of 2007, and after a slow start to 2008 we expect this trend to continue during the rest of the year. The key driver continues to be the volume of deals in the sub-€250 million segment, representing mainly buy-outs of owner-managed businesses or exits by existing investors.

In the light of a changing market environment and increasing competition from other investors, PricewaterhouseCoopers (PwC) has conducted a trend survey among 127 top management representatives of international private equity funds with a view to identifying: trends in relation to Germany as a business and investment location, international investment trends and flows of capital, and strategies to create value and achieve high returns.

The key findings of the survey are:

### German trends

- Our survey responses indicate that Germany could see a substantial net inflow of private equity capital over the next five years: 46% of funds interviewed stated that they already invested in Germany, but as many as 62% have plans to make investments in Germany between 2008 and 2013.
- 10% of all respondents plan to open a new office in Germany over the next five years in addition to the 2% which opened an office there in 2007.
- In terms of the overall environment for private equity, German competitiveness compared with other countries appears to be declining: 36% of respondents considered it to be very poor or quite poor. In last year's survey, only 23% of respondents believed this to be the case.

### International trends

- Western Europe will remain an important destination for private equity investments in future, and the proportion of respondents who currently invest in this region and intend to do so over the next five years remains unchanged (87%).
- Compared to our 2007 survey, respondents sent out stronger signals that Central and Eastern Europe (CEE) as well as Asia will increasingly be the "hot spots" for private equity funds over the next five years, with significant increases in investment coverage anticipated from 35% now to 44% in future in CEE and from 13% to 20% in Asia.

### Value creation and returns

- Germany leads the list of countries expected to offer the highest potential for value creation and high returns in future (named by 13% of participants), followed by the UK (11%), Poland (8%), the USA (8%) and France (7%).
- Favoured strategies for creating value within portfolio companies were organic growth (mentioned by 71% of participants), use of industry sector know-how (58%) and operational improvement/restructuring (50%).

### Conclusions

- Germany is viewed by a majority of international investors as a country rich in opportunity. However, the country's inherent attractiveness as an economy continues to be marred by its unfavourable environment for private equity relative to other countries. Indeed, participants appear to believe this has deteriorated further since last year.
- The major challenge for investors in future will be to generate the same high levels of return enjoyed in the recent past. In our view, this can only be achieved by more active portfolio management using value creation levers such as operational improvement and restructuring. A number of funds are already focused on this - others will surely follow.



## B Trends for German private equity investment

### German investment trends

Will Germany remain an attractive destination for private equity funds in future? According to our survey participants, the answer is a resounding yes.

At the time of the survey in December 2007, 46% of those interviewed stated that they already invested in Germany. When asked whether they had plans to make investments in Germany over the next five years, a total of 62% of all survey participants answered in the affirmative – a clear sign of the commitment that international private equity funds have towards Germany as a location for future investment.

A closer look at the responses reveals that only 5% of those currently investing in Germany do not wish to continue investing there in future. On the other hand, over a third of survey participants who do not currently invest in Germany (equivalent to 20% of all respondents) stated their intention to do so over the next five years, indicating a strong net inflow of capital into Germany in future.

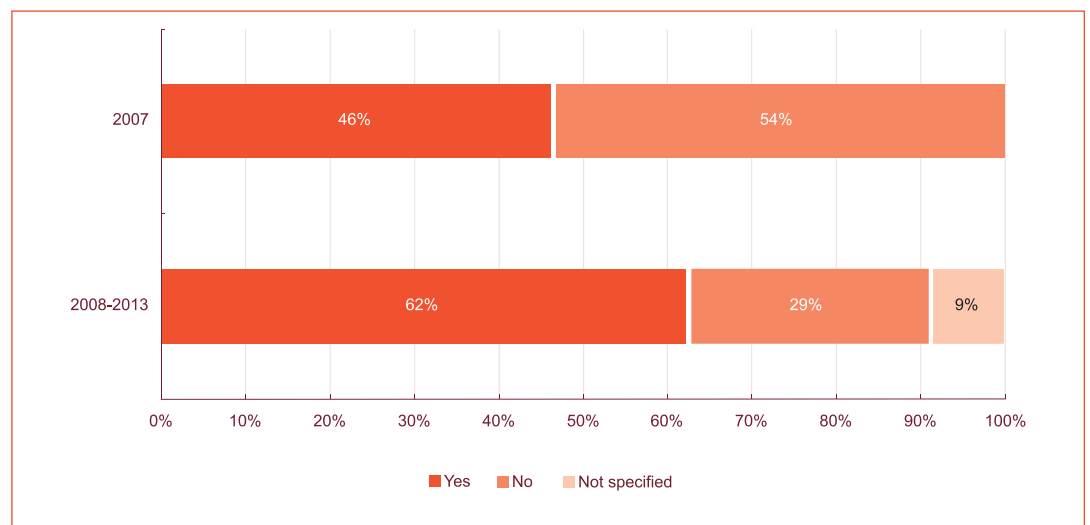


Fig. 1 Survey participants investing in Germany



# 2%

of those surveyed opened a new office in Germany in 2007

# 10%

of those surveyed plan to open a new office in Germany over the next five years

# 66%

of those who plan to keep investing in Germany in future intend to increase the assets they allocate to Germany.

German competitiveness

The competitiveness of Germany as a location for private equity investors appears to be declining compared with other countries. When asked to assess German competitiveness in relation to private equity investment compared with other countries, 36% of the interviewees considered it to be quite poor or very poor compared with 23% in last year's survey. The proportion of participants who considered it to be quite good or very good declined correspondingly from 32% in 2007 to only 22% in this year's survey.

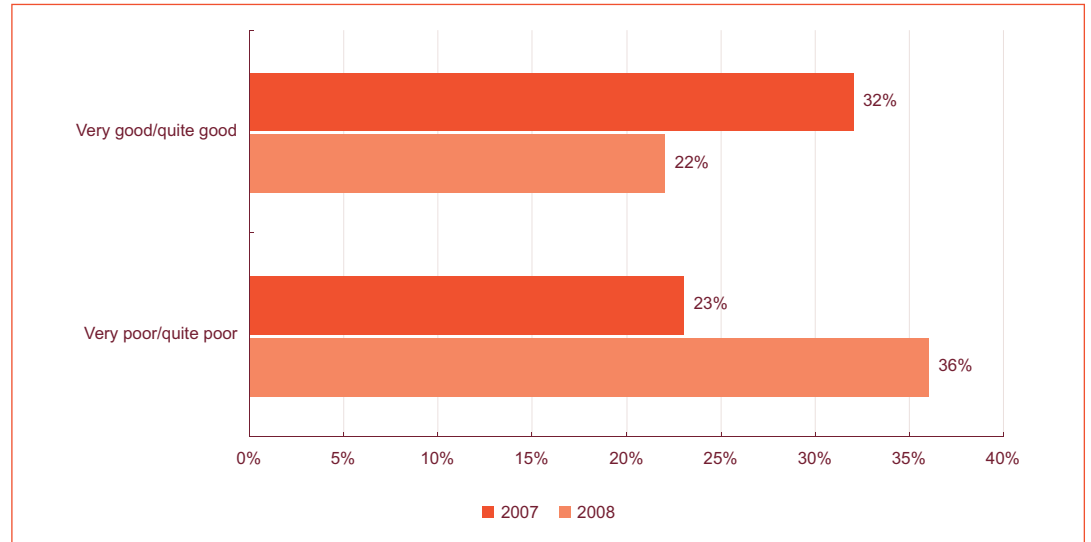


Fig. 2 German competitiveness in relation to private equity investment compared with other countries



Almost half of respondents (46%) also believed that competition between investors for attractive target companies within Germany had increased. Only 7% thought that it had decreased.

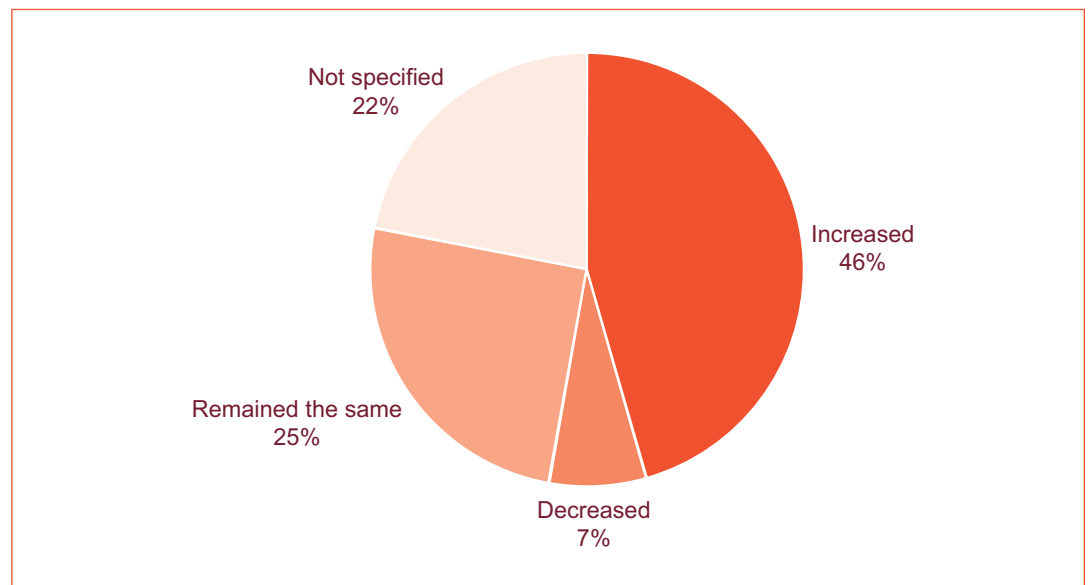


Fig. 3 Competition for targets in Germany

Germany currently ranks third in Europe based on private equity investment, behind the UK and France<sup>1</sup>. Respondents were divided over whether Germany's position in Europe would improve or remain stable compared with other countries. In last year's survey, the interviewees were more positive, with a majority of them stating that the position would improve (56%). However, only 7% expect Germany's position to deteriorate in future, compared to 12% last year.

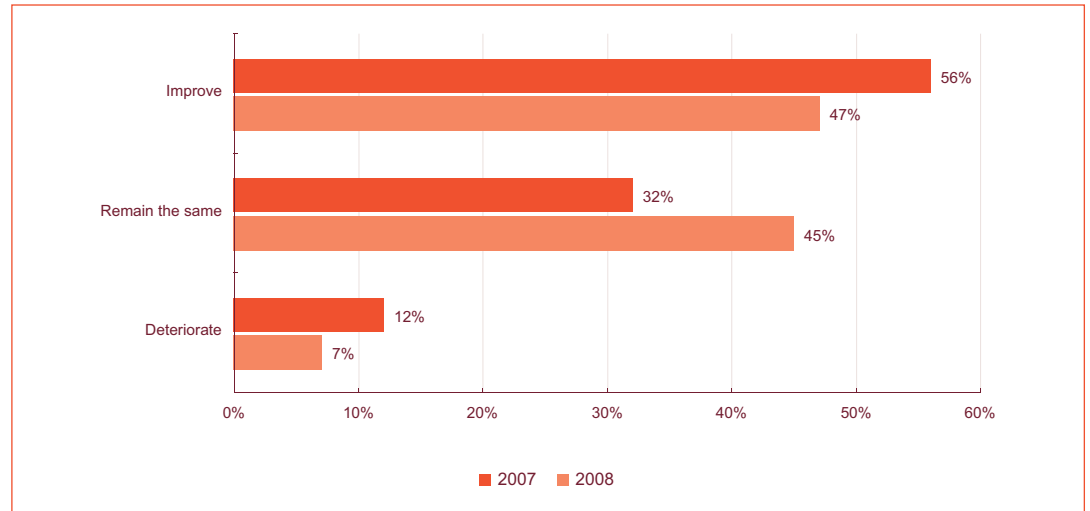


Fig. 4 Germany's future position in an international ranking for private equity investments



#### PwC comments

As part of their investment strategies, international funds often look at regions as a whole rather than at specific countries. Nonetheless, the upward trend for investments in Germany and the respondents' plans to open new offices there is clear. At the same time, the trend stands in marked contrast to the interviewees' perception of the country's competitiveness – a warning sign that there is room for improvement in the country's regulatory environment for private equity.



## C International investment trends

The latest available data from the European Private Equity and Venture Capital Association (EVCA) in October 2007 showed that private equity investments in Central and Eastern Europe increased “dramatically” in 2006, amounting to a record level of €1.67 billion. Fundraising for Central and Eastern Europe has seen a steady increase since 2003. In 2006, the total amount of €2.25 billion was raised for the CEE region – an increase of 75% over 2005. The largest part of the capital raised stems from Western Europe and North America<sup>2</sup>.

According to the Asian Venture Capital Journal (AVCJ), investments in the Asia Pacific region amounted to approximately €58 billion in 2007, a 33% increase on 2006 and a “clear sign” that Asia was less affected by the credit crunch than the more developed markets. Funds raised in Asia during 2007 amounted to €35 billion, up 23% compared with 2006<sup>3</sup>.

### Regional investment focus

The growing inflow of capital into CEE countries and Asia is also reflected in the responses by the survey participants: A total of 87% stated that they invested in Western Europe at the time of the survey and that they planned to continue investing there in future. What is noticeable is that participants expect CEE countries to gain in popularity among the private equity funds – with a likely increase in investment coverage from 35% of funds currently to 44% by 2013. Likewise, Asia will become more attractive for investors, whereas fewer funds expect to invest in the USA by 2013 compared to today.

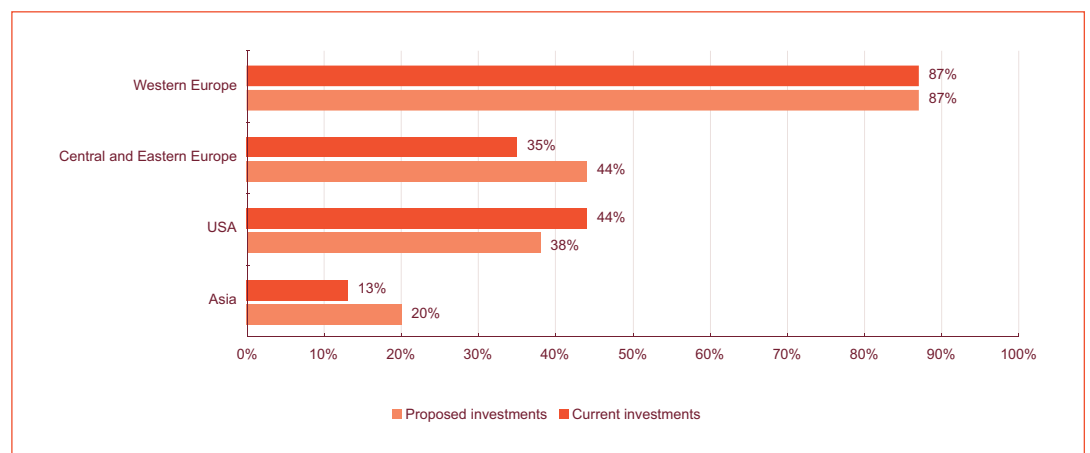


Fig. 5 Regions where the respondents currently invest and plan to invest in future

### Allocation of fund volume

An in-depth look at the distribution of the respondents’ international fund volume now and over the next five years reveals that they plan to allocate slightly fewer assets to Western Europe and the USA. On the other hand, they plan to invest a larger proportion of their total global fund volume in the CEE region and Asia.

<sup>2</sup> EVCA, Central and Eastern Europe Statistics 2006, October 2007.

<sup>3</sup> AVCJ press release on 18 January 2008 “Asian private equity assets top US\$190bn, US\$50bn funds raised”, [www.avcj.com](http://www.avcj.com).

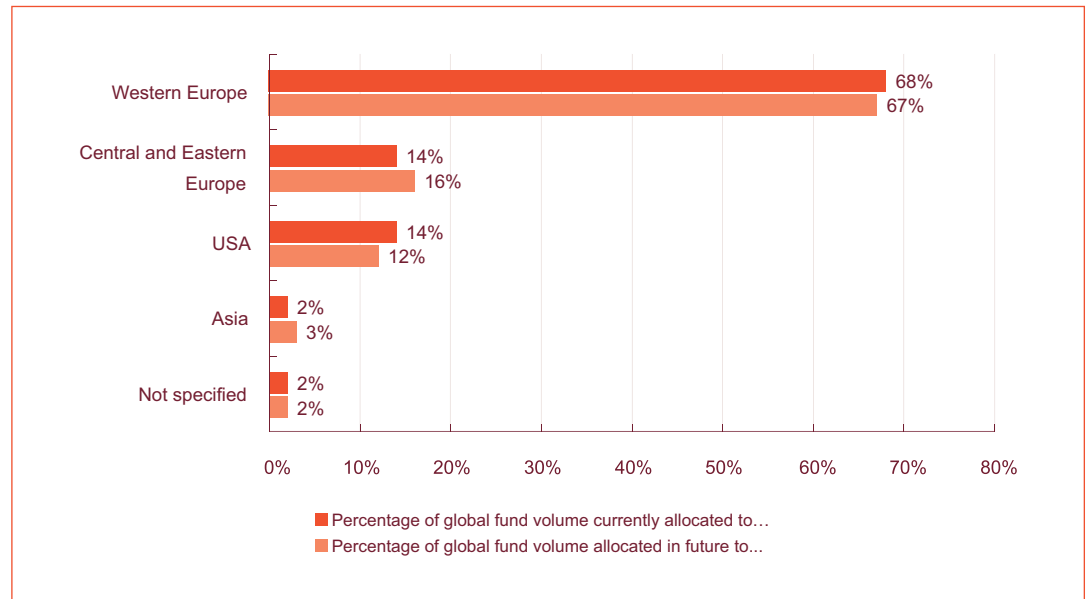


Fig. 6 Allocation of global fund volume

**PwC comments**

The trends towards newer investment markets in CEE and Asia noted in our 2007 study have been further corroborated by this year's survey. However, it is equally clear that most funds continue to see good investment opportunities in the more mature markets, particularly Western Europe.

**Opening of new offices**

A total of 27% of respondents confirmed that they had opened new offices internationally in 2007. The USA, the UK and Romania were the most popular countries. When asked whether they had plans to open a new office over the next five years, 48% of the interviewees responded in the affirmative. The favourite location is Germany, followed by the USA and the UK.

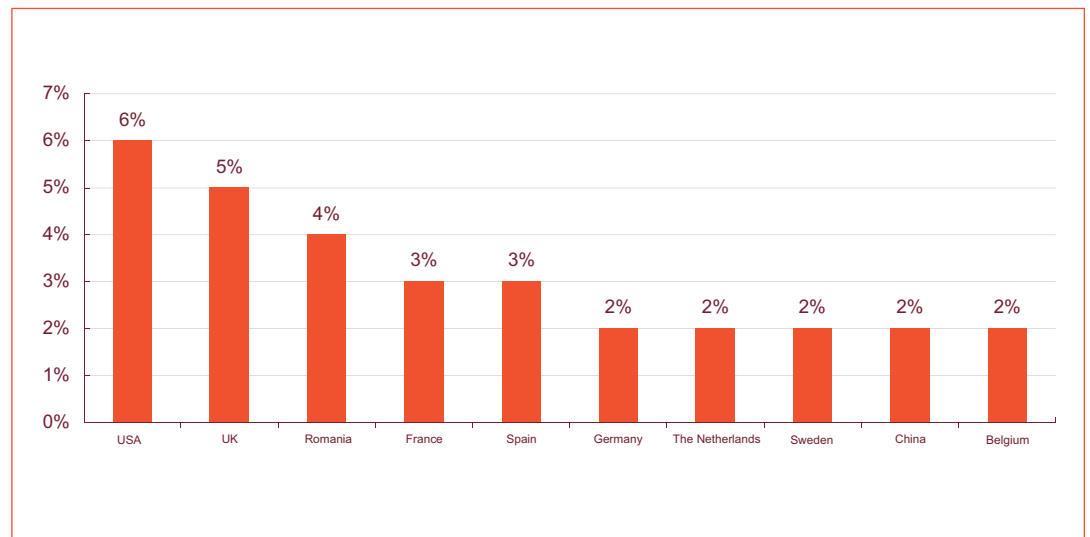


Fig. 7 New offices opened in 2007

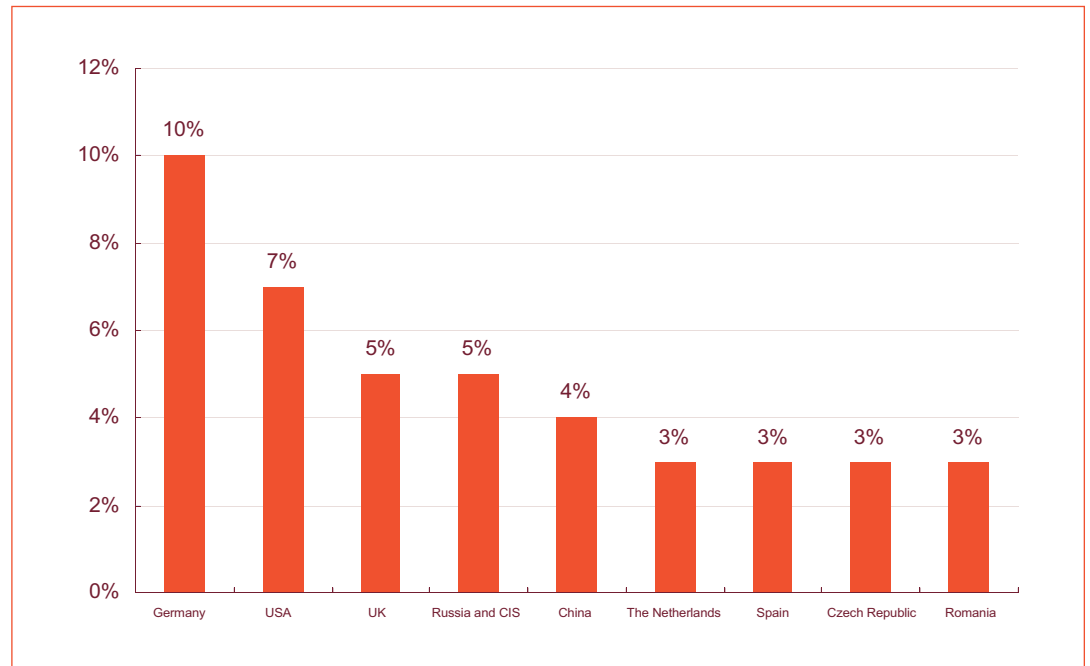


Fig. 8 New offices to be opened over the next five years

#### PwC comments

In the USA, New York was a popular location for opening a new office in 2007. In Western Europe, a number of funds opened an office in London, Munich, Frankfurt or Madrid last year. Hong Kong, New Delhi and Tokyo were popular locations for many funds to launch their business in Asia, and the CEE region saw new offices opened in Warsaw, Prague and Bucharest, among other cities.

In both Western Europe and Central and Eastern Europe, office locations often serve as a “hub” from which several countries can be covered. Germany, for example, is seen as a hub for the other German-speaking countries and potentially as a stepping-stone towards the CEE region.



## D Value creation and returns

Creating value and achieving high returns in an increasingly competitive global environment remain the key objectives of most funds.

When asked to list the top three countries in which they had achieved the highest average returns on companies exited in the last two years, the UK, the USA and France were mentioned most often, followed by Germany and Sweden.

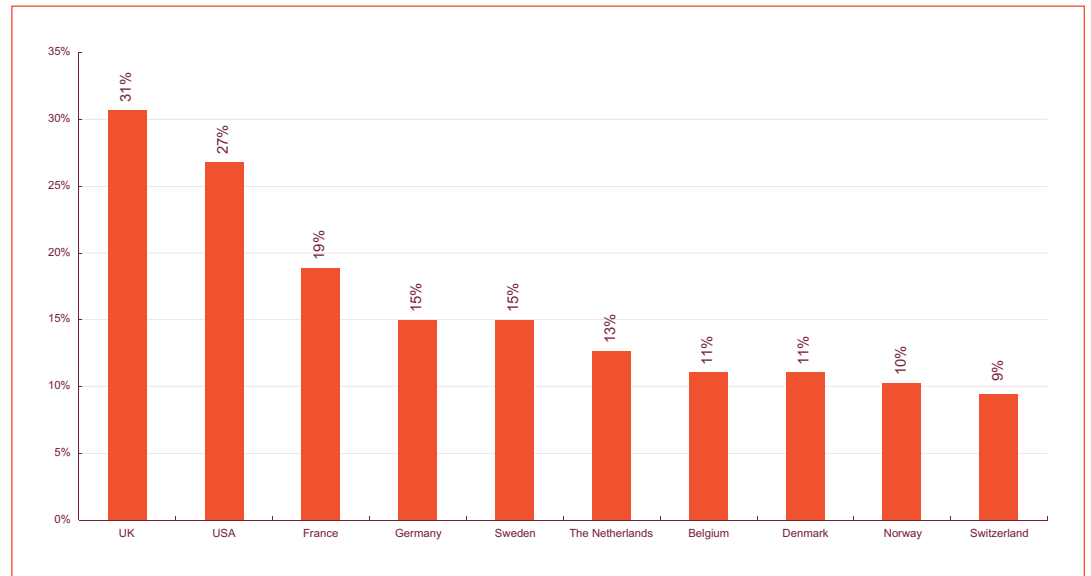


Fig. 9 Countries where the respondents achieved the highest average returns

A look into the future shows that the highest number of participants expect Germany to offer the most potential for value creation over the next few years, followed by the UK, USA and Poland.

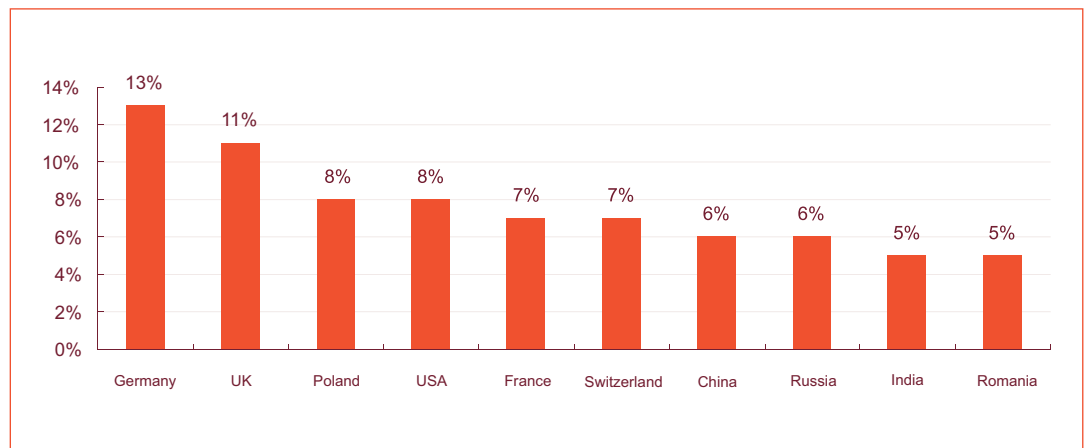


Fig. 10 Countries with the highest potential for value creation over the next five years

### PwC comments

The future potential for value creation outlined in this survey is a strong indicator that investors believe that high returns will continue to be achievable in the more mature markets across Western Europe and the USA. At the same time, the results provide further evidence of a shift in focus to CEE countries as new “hot spots” for private equity, such as Poland and Romania, as well as dynamic Asian countries like China, Russia and India.

### Value creation strategies

When asked about their strategies to create and increase value in the portfolio companies they have invested in since 2005, the respondents mentioned organic growth most often (71%), followed by in-depth industry sector know-how (58%) and operational improvements or restructuring (50%). Add-on acquisitions represented another popular option for value creation, together with investment in innovation and product development as well as increased financial discipline and transparency.

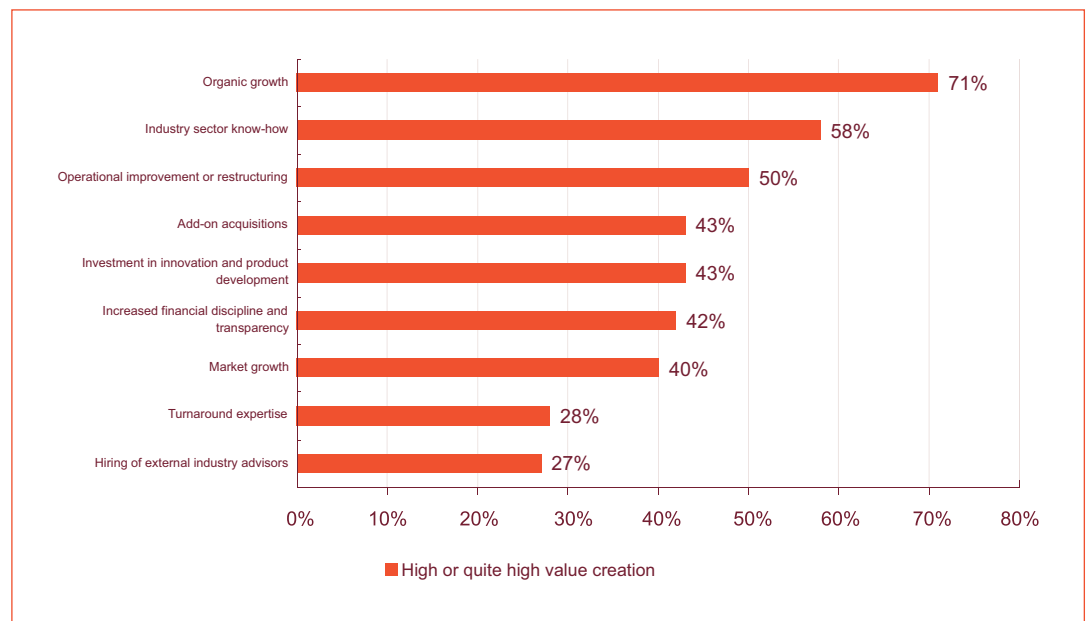


Fig. 11 Factors contributing to value creation in portfolio companies

### PwC comments

Given the tighter financing conditions, private equity funds will need to work harder in future to create value from portfolio companies and hence to achieve the high returns of the recent past. We see active hands-on ownership as the key factor to secure future returns, particularly following a secondary buy-out. A number of funds have recognized this necessity and have begun devoting increased resource to more active portfolio management. We believe that this trend will continue.

Other factors that help create value as mentioned by the respondents:

“Management competence”

“Entrepreneurial expertise”

“Change in strategy”

“Hands-on involvement”

“Financial leverage”

In view of the increasing influence of other types of global investors, such as hedge funds, sovereign wealth funds and specialist infrastructure investors, together with the recent return of strategic buyers, PwC asked the respondents how challenging they thought these competitors were in bids for attractive target companies. Despite the changing competitive picture, other private equity funds are still perceived as providing the biggest challenge to winning a deal, followed by strategic investors in a distant second place. Infrastructure funds, hedge funds and sovereign wealth funds were only seen as valid competitors by a small minority of survey participants.

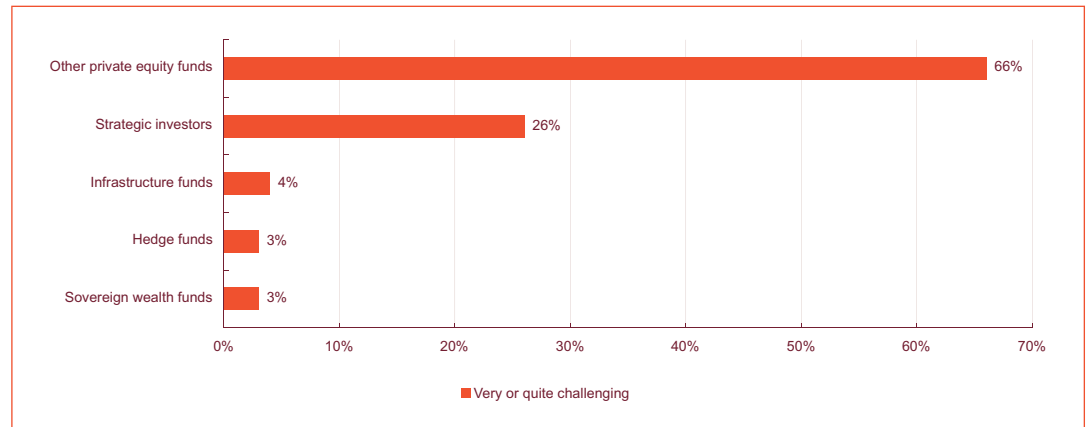


Fig. 12 Global competition by type of investor

#### PwC comments

The above results show that the influence of newer types of investors is starting to be felt by some market participants, but is not yet a significant factor in terms of individual acquisitions of companies. We believe, however, that competition will increase in 2008 and in future, in particular from strategic investors re-entering the market and from other types of investors such as providers of integrated finance solutions.

## E Methodology

### Structure of the survey participants

In December 2007 PricewaterhouseCoopers' International Survey Unit interviewed 127 top management representatives of international private equity funds. The criteria that qualified a fund as "international" was an investment focus that went beyond the fund's country of origin, for example, having portfolio companies in at least two countries outside of the fund's home country.

The overall sample included 410 international private equity funds, most of which were based in Continental Europe and the UK. 31% of these funds actually participated in the survey.

Respondents headquartered in Continental Europe make up the vast majority of the survey participants (70%). 23% of participants were from the UK, 6% from the US and 1% from other regions. Representatives from 17 different Continental European countries (including CEE) participated in the survey.

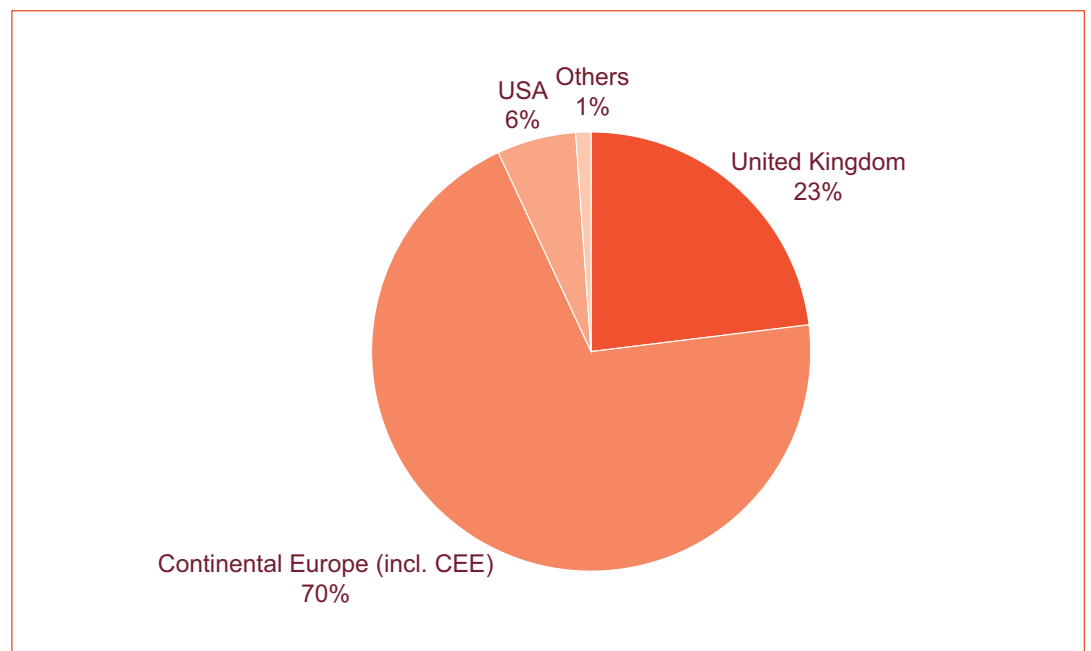


Fig. 13 Interviewees by headquarters

The majority of the participants (61%) have up to €500 million capital under management. Just under 40% manage funds of over €500 million.

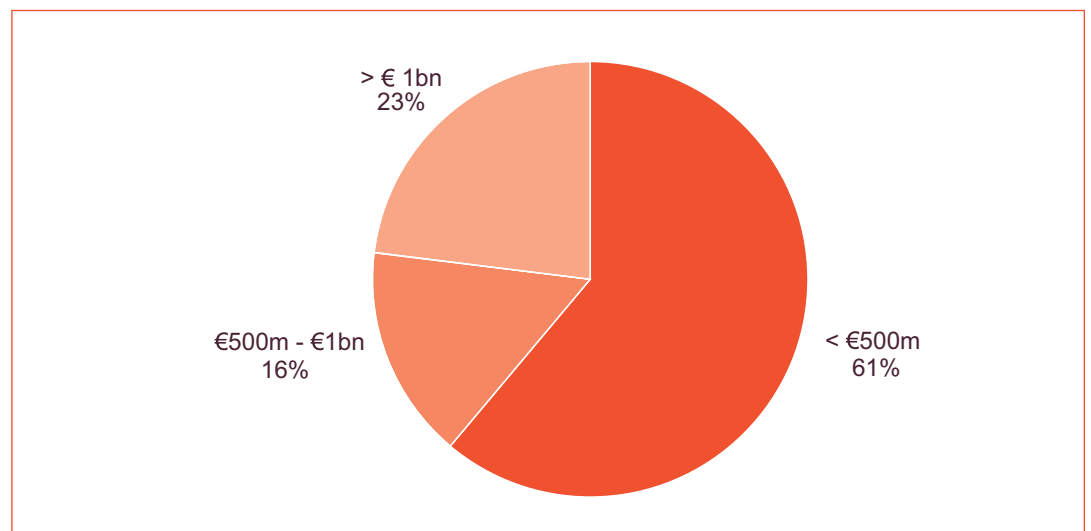


Fig. 14 Private equity funds by volume (capital under management)

## Contacts

### Transaction Services

Volker Strack  
Tel: +49 69 9585-1297  
E-mail: volker.strack@de.pwc.com

Richard Burton  
Tel: +49 69 9585-1251  
E-mail: richard.burton@de.pwc.com

### M&A Lead Advice

Werner Suhl  
Tel: +49 69 9585-5650  
E-mail: werner.suhl@de.pwc.com

Richard Miller  
Tel: +49 69 9585-5896  
E-mail: richard.miller@de.pwc.com

### M&A Tax

Dr. Frank Schmidt  
Tel: +49 69 9585-6711  
E-mail: frank.r.schmidt@de.pwc.com

Jürgen Scheidsteger  
Tel: +49 69 9585-5150  
E-mail: juergen.scheidsteger@de.pwc.com

### Valuation/Purchase Price Allocation

Martin Scholich  
Tel: +49 69 9585-5600  
E-mail: martin.scholich@de.pwc.com

Andreas Mackenstedt  
Tel: +49 69 9585-5704  
E-mail: andreas.mackenstedt@de.pwc.com

### Business Recovery/Restructuring

Dr. Derik Evertz  
Tel: +49 69 9585-5548  
E-mail: derik.evertz@de.pwc.com

Dr. Joachim Englert  
Tel: +49 69 9585 5767  
E-mail: joachim.englert@de.pwc.com

### Operational Due Diligence/Post Deal Services

Christian Knechtel  
Tel: +49 69 9585-3188  
E-mail: christian.knechtel@de.pwc.com

### Strategy/Commercial Due Diligence

Dr. Arno Wilfert  
Tel: +49 211 981-4893  
E-mail: arno.wilfert@de.pwc.com

### Audit Private Equity

Dr. Ulrich Störk  
Tel: +49 69 9585-1271  
E-mail: ulrich.stoerk@de.pwc.com

PricewaterhouseCoopers AG Wirtschaftsprüfungsgesellschaft  
Marie-Curie-Straße 24-28  
60439 Frankfurt am Main  
www.pwc.de

