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Q&A

German LPs share their views on the eurozone crisis and the impact of impending regulation

Data commentary

Statistics from *unquote” data* reveal a faltering market

State of the union

The sovereign debt crisis is taking its toll on even Europe’s most robust economy.

GERMANY REPORT

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Q&As

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Europe's last man standing

German funds thrive on the country's strong and nurtured Mittelstand, as well as its comparative economic strength, but like other European funds hit by the sovereign debt crisis, they too are facing sceptical investors. Anneken Tappe reports

THE FINANCIAL services industry has been a challenging field since the meltdown of 2008/09. The sovereign debt crisis has severely restricted any organic recovery. Greece has ceased to be the sole centre of attention, with Italy and particularly Spain looking increasingly on the edge. Economically much bigger, financially more complex and verging on political crises as well, the two southern European countries pose major problems for policymakers in Germany.

The lead creditor of both the ESM (European Stability Mechanism) and the EFSF (European Financial Stability Facility), Germany is entangled in Europe's every move, while trying to keep its own budget under control and grow its own economy out of the downturn.

LPs have traditionally looked at exits and returns when evaluating a fund manager, but both those are weighed down by the recession. This makes the case for maintaining a private equity allocation all the more difficult.

"The euro crisis is a chance for great returns: due to the excess liquidity now floating around the markets, I would not be surprised if we see a new all-time high for the DAX in the coming 12 months and this could also drive private equity and venture capital performance," argues Rainer Strohmenger, general partner at Wellington Partners, which held a first close for the firm's fourth life sciences fund on €70m in September.

Nevertheless, new regulation restricts the capital distribution of institutional investors more than ever before. Paired with potentially risk averse executive boards, this changes the role institutions are playing in private equity fundraising.

Many GPs are looking towards other players in their investor base. Some corporates partner with VCs to source innovation and nurture entrepreneurship. Governments all over Europe draft initiatives to support SMEs and jump-start poorly performing domestic markets. Family offices are changing their approach to private equity as well. Direct and co-investments have become more popular and private equity funds have to fill the gap that the capital squeeze on institutions has created.

However, fears about institutional investors' future commitments may be exaggerated. Private equity has historically been a very cyclical business that swings from boom to bust time and time again, with investors following behind. Evaluation of funds on historical grounds is likely to fail to adjust for cyclicality, manifesting the effect: after a period of positive economic growth and good returns, commitments will rise, while they are likely to be lower directly after a low-growth phase.

A business based on trust

The effect of increasing economic uncertainty and scepticism of investors translates to more difficult fundraising conditions for GPs. In the recent *unquote"* fundraising survey, many GPs admitted that existing investor relations are the backbone of their funds, more so than ever before.

Investors have to be picky about their allocations in times like these, when capital is scarce and regulation is about to bite. Institutional investors are constrained in their risk tolerance and face higher capital requirements through new legislation like Solvency II and Basel III. Among others, these factors have led to some LPs disappearing from the

"The euro crisis is a chance for great returns: due to the excess liquidity now floating around, I would not be surprised if we see a new all-time high for the DAX in the coming 12 months"

Rainer Strohmenger, Wellington Partners

market, either to sit back and observe developments or to focus on core allocations elsewhere.

Past performance has always played an important role in the highly cyclical private equity industry. However, LPs are increasingly saying that the leading manager's talent, experience and trustworthiness are just as important. The industry is going back to its roots of private equity being a business of trust and relations. After years of a herd-mentality among institutional investors, this changes the way funds are raised quite substantially and mostly means more work for the GPs' investor relations teams. After all, European funds remain a hard sell – even in Germany.

Those LPs still in the market are demanding stricter due diligence before committing capital, even those who have a previous relationship with the fund manager are no longer guaranteed to invest. The days of quick sells due to a blue-chip cornerstone investor are long gone.

In Europe, Germany certainly comes out on top in terms of economic strength and growth prospects, making it a more attractive investment among its Western European neighbours. But despite efforts over many years, the German private equity industry is far from being as mature as one might expect given the country's highly developed economy. The United Kingdom, historically Europe's most active private equity market, has a much smaller economy than Germany, but with a more developed financial infrastructure.

Germany and the macroeconomy

Being an export-driven economy distributes Germany's trade dependencies across the world, as opposed to just its European neighbours. Recent efforts to strengthen trade relations with China have shown just how much the country is looking beyond its home continent to achieve growth. But this effort led to a disproportionate exposure to the global economy which, despite its lack of monetary meltdowns, is barely registering any sign of vitality. China, for one, is facing a rapid slowdown of GDP growth, while tensions between the People's Republic and Japan demonstrate other risks present in the region.

But despite its global exposure, Germany is undeniably an integral part of the sluggish European economy, which continues to be depressed by its on-going sovereign debt crisis. The attention has shifted from Ireland and Portugal, to Greece, and is now focused on the big economies of Spain and Italy. The highly politicised debate between country leaders to resolve the situation has become an immense exercise in buying time and hoping for organic growth to resurface. Yet, a direct comparison between EU member states shows that Germany clearly comes out on top in terms of economic strength and debt management.

Policy considerations and sustainable national budgets aside, the eurozone crisis is creating the most uncomfortable environment for investors. Current scepticism is not the kind that can be helped by in-depth country analysis or knowledge of national culture, which are often sources of concern for investors in emerging markets. In Europe, the problem at hand is the lack of a crystal ball forecasting the direction of the crisis. Many investors have removed entire countries from their investment map and are increasingly sceptical towards committing capital in those that are still on it. ■

With debt scarcely available and cash-rich corporates looking to diversify through acquisitions, Germany's buyout market has suffered a heavy blow these last few years, but it is still well-placed to take advantage of opportunities. John Bakie reports

Strong economy belies faltering buyout market

GERMANY, EUROPE'S powerhouse economy, has been remarkably resilient in the face of southern European problems. The largest economy in Europe and a major world manufacturer and exporter is so successful, it is today seen as a lifeline for heavily indebted nations such as Greece and Spain. Indeed, it has played no small part in holding the eurozone together for over a year of troubles, but these problems are starting to take their toll.

"Challenging conditions means we can still arrange financing due to our long-standing bank relationships"

André Mangin, Deutsche Beteiligungs AG

For the private equity industry, this means shrinking debt availability and a drying up of deal opportunities. The eurozone's biggest economies, Germany and France, have both seen private equity activity tumble in 2012 after several years of growth in the wake of the financial crisis of 2008/09.

The first three quarters of this year have clocked up just 26 buyouts in Germany (*see chart, right*), compared to 76 in 2011 and 55 in 2010 (full-year figures). At the current rate of investment activity, there is a real threat that German buyout volumes could fall below the 2009 trough.

Values are down too, with €4.25bn transacted in the first nine months of this year compared to €6.98bn across the whole of last year. EQT's acquisition of BSN Medical accounted for more than a third of this year's value.

The figures paint a grim picture; perhaps surprising, considering Germany's general economic strength and wealth of mid-market businesses, which one might assume would translate into a resilient private equity market.

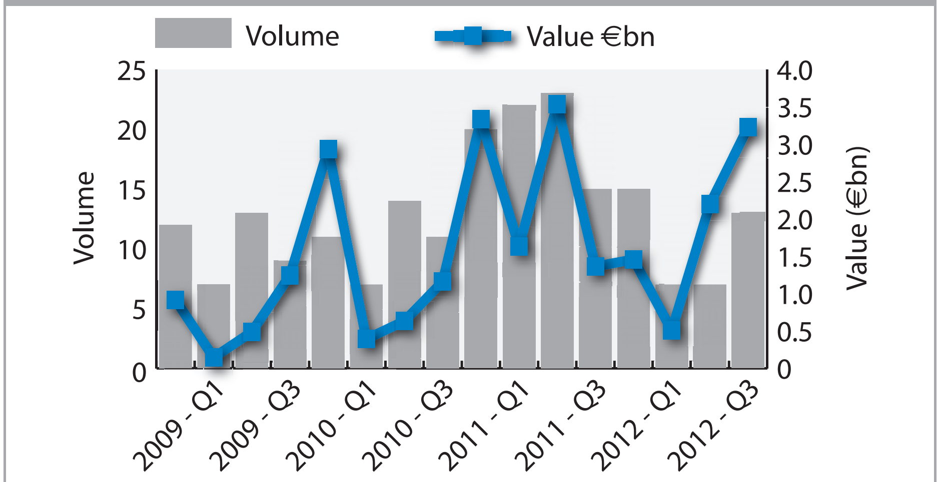
"There are two major factors affecting the German buyout market right now," says Dr Hanno Schmidt-Gothan, managing director of Perusa Partners. "Firstly we've got a lack of financing, which we're seeing elsewhere in Europe because of all the problems banks have been having. However, in Germany we've also got inflated prices to deal with."

The relative strength of the German economy has meant that businesses are still very profitable, and vendors have high price expectations when selling their businesses. Combined with a lack of finance availability, many buyout investors are finding it difficult, if not impossible, to secure deals at a price that makes sense from an investment perspective.

Preiswert

High pricing is not unusual at present. For the last few years, GPs across Europe have complained that, while the economic

Volume and value of German buyouts



Source: *unquote" data*

situation has been dire, many vendors have refused to cut their prices and EBITDA multiples have remained stubbornly high. This trend, while showing some signs of abating recently according to research by Argos Soditic, is also being driven by the growing presence of corporates in the deal room.

Having hoarded cash for the past few years, many corporates are now cash-rich and seeking out acquisition opportunities to help them grow, as their existing markets are often stagnant. As corporates come to dominate auctions, private equity bidders are squeezed out. "We are seeing far fewer financial investors in the deal room these days," says Schmidt-Gothan.

However, high price expectations are starting to fade, according to André Mangin, managing partner at Deutsche Beteiligungs AG: "What we've seen in the automotive industry is a lowering of price expectations as export markets in southern Europe have declined, and Asia is not providing as much growth as might have been expected. High prices have been a feature of the first half of this year but should become less of an issue," he says.

Don't bank on it

Tough leverage conditions have been a feature of the buyout market since the financial crisis erupted in 2008, and continue to weigh on the German market. Adding to a general aversion to risk among banks, new regulations such as Basel III are likely to further limit the ability of banks to lend and will curtail any recovery in the buyout market.

Furthermore, there is a growing threat of national regulation on the banking sector. In September, former federal finance minister Peer Steinbrück called for a ban on bank lending to private equity funds, raising concerns from the BVK.

However, despite difficult financing conditions, today GPs may have more options available to them than in the past. Alternative non-bank lenders are becoming increasingly common in the market.

"We're seeing more of these kinds of lenders, and it's something we're watching carefully, but at the moment it's an expensive way of financing deals. I think in the future we will see these players gain ground," says Mangin.

While these kinds of lenders might provide more options, there remain concerns about their suitability. "We get a lot of calls from people offering alternative forms of financing, but when you sit down with them, it often turns out to not really be economically viable," Schmidt-Gothan explains.

Mangin is also concerned providers might not fully appreciate how to do business in Germany. "Some are trying to enter the market without understanding the dos and don'ts of German business."

Heading for the exit

The picture appears gloomy, but there are reasons for optimism. The increased presence of corporate buyers is providing good exit opportunities for funds that, in many cases, have been sitting on portfolio companies for some time.

"We expect the market to remain stable and the economy will continue to be difficult, but we don't mind those scenarios," explains Mangin. "Challenging conditions means we can still arrange financing due to our long-standing bank relationships."

Schmidt-Gothan agrees that the market offers a lot of opportunities. "There are potential deals on the horizon and we're seeing good dealflow. Lots of companies in Germany offer the potential to be built into pan-European leaders in their fields. Also, when you sit down and talk to vendors, you can arrange flexibility in financing that is needed to get deals done."

German buyout activity is expected to remain subdued for the remainder of 2012 and will almost certainly come in below 2011 levels. However, challenging times create opportunities and private equity funds should be well placed to take advantage of these. ■

Berlin: Europe's fastest growing tech hub

As adventure-hungry young people flock to the capital and technology fuses with Berlin's creative community, a thriving entrepreneurial culture has formed and is growing at a rapid pace. So what comes next? Carmen Reichman reports

FOR MANY, the Berlin start-up scene was a ticking time bomb. Home to people from all parts of the world, the German capital offers an array of different languages and a lively party scene. Armed with the teachings of Eric Ries and Fred Wilson, young Berliners have stormed the market helped by incubators such as Samwer Brothers' Rocket Internet. These young entrepreneurs are ready to challenge the German status quo that has earned the nation a reputation of being too scared to take risks. They benefit from a dense and supportive ecosystem, a good geographical placement within Europe and low overheads due to the city's vast amount of real estate, including old factory buildings.

Berlin's venture scene can be traced back 10 years to the dotcom bubble, which saw many new entrepreneurs setting up for the first time. The current boom in Berlin venture, however, started only about five years ago, with the last two years in particular seeing an acceleration of international interest in the city. Berlin has become particularly strong in creative technological development such as consumer oriented tech, e-commerce and mobile, with eight out of 10 start-ups falling into these sectors, as estimated by Christian Thaler-Wolski, investment manager at Wellington Partners.

"In the past three years there has been a number of promising companies emerging, but the real big bang is still to happen"

Christian Thaler-Wolski, Wellington Partners

"It's all coming together in Berlin", says Thaler-Wolski. "The city now has enough well-known angel investors and companies that are funded by well-known international venture firms to build up a reputation for itself. I think a few years ago, big US start-ups went straight to London for their European base, whereas now they either head to Berlin directly or they look to Berlin as the next step after London." Start-ups that have internationalised out of Berlin include Airbnb, Etsy, Fab.com and Citydeal, which was bought up by Groupon.

Berlin is home to a number of angel syndicates and small funds operating in the €5-10m under-management range. However there are also large international venture capital funds that invest in the city, including Sunstone Capital, Index Ventures, Wellington Partners and Union Square Ventures, which invested in SoundCloud. The capital also features venture capital-like organisations that specialise in helping young businesses off the ground between the seed and series-A rounds. Alexander Kölpin, co-founder of

German Startups Group, explains: "While we know that you need a series A or B to grow a company internationally, we believe that you can start a business with a relatively small amount of capital nowadays. Young businesses are increasingly looking for smaller amounts of money and to give away smaller stakes. We are here to bridge that gap."

Start-ups from scratch

Unlike London's early-stage scene, Berlin's has grown organically and not profited from government-backed initiatives. The city has an investment bank, IBB, that offers loans and makes a few investments, but the amounts they work with are not really relevant, says Thaler-Wolski: "If they ten-folded their resources I'd be impressed, but that would also create market distortion".

What Berlin profits from is a special dynamic, says Stefan Glaenzer, founding partner at Passion Capital: "Berlin is probably the quickest growing digital hub. It still lags behind London but it's got a very good dynamic. I've been involved in the German start-up scene since 1997 and it has never been as vibrant and active as it is now. What's really changed is the Anglo-Saxon interest coming from the UK and the US to invest in German start-ups."

For some, what is still missing in Berlin is a mega-exit to really drum up interest and provide a role model that young entrepreneurs can aspire to. The city enjoyed a few big exits 10 years ago and in 2010 it saw Brands4Friends, a company operated by Private Sale, sold to eBay for $200m. But a grand exit in the leagues of Skype is what Berlin still needs, says Thaler-Wolski: "In the past three years there has been a number of promising companies emerging including Gameduell, Wooga and SoundCloud, but the real big bang is still to happen. And that's what everyone is waiting for." ■

Q&A: SEB

SEB global head of acquisition finance Simon Wakefield and acquisition finance executive Stuart Hewer talk to Greg Gille about recent financing trends in the German market

Greg Gille: What is the current situation regarding leverage availability and pricing for LBOs in Germany?
Stuart Hewer: Recent deals have shown that leverage remains available for almost all sizes of deal. Many domestic and international senior lenders remain open for business, both for club and for underwritten deals. We have also seen the return of mezzanine tranches, and the new inter-creditor precedents set in the BSN and Aenova deals are bound to open the way for further mezzanine opportunities in 2013.

Apart from that, structures haven't changed much. Club deals still see a broad 50/50 split of the A and B tranches, and deals structured for the fund market are naturally slanted more towards the B loan.

Pricing has generally trended up since 2011, although club deals tend to be more tightly priced given the absence of market risk. Typical pricing for a club deal hovers around 4.5%, with underwritten deals usually being priced some 50bp wider than this, although recent transactions such as BSN and Bartec have seen reverse flexes reflecting the strong bid from funds.

GG: Which assets are more likely to whet the appetite of senior lenders in the current environment?
SH: It's the same old story: good deals are easier to do than bad deals. In times of macro-uncertainty lenders look for borrowers who are active in stable underlying markets with cost flexibility and with good cash conversion. A review of a company's performance through 2008 to 2010 gives lenders a good chance to kick the tyres on this.

Secondary deals (or tertiary, quaternary, quinary, etc) with a strong track record are always viewed positively by the market. Assuming a robust financial structure, their familiarity makes the lending decision easier and gives price support in the secondary market.

There are arguably fewer lenders looking at the smaller deals (sub-€20m EBITDA) because of the sometimes thin economics, but here too there are rich pickings for those willing to roll their sleeves up and do their homework.

GG: What is the current syndication appetite for LBO loans? Has that changed the way that you approach deals compared to last year?
Simon Wakefield: The banks active in the LBO space have, with some obvious exceptions, come through the post-Lehman period largely unscathed. Default levels have been better than feared and the combination of robust structures and attractive pricing still offers good risk-adjusted returns in this space, even with Basel III "best guesses" priced in. If you add the fund bid into the mix – largely CLOs still in their reinvestment periods – then market appetite is strong.

At SEB, we see ourselves as being in a good position to move up a gear in our underwriting activities. Being anchored in one of Europe's more robust economies and having one of the best capital ratios among our peers gives us an advantage.

Having said all that, the eurozone concerns we

"Our advice to GPs is to speak to the lending banks as early as possible. This helps everyone to find the best way to avoid insolvency"
Stuart Hewer, SEB

all had this time last year have hardly gone away, and with weaker economic indicators in Germany and in China, we will all be keeping an eye on default rates. Any further softening of sentiment will have an inevitable effect on market risk.

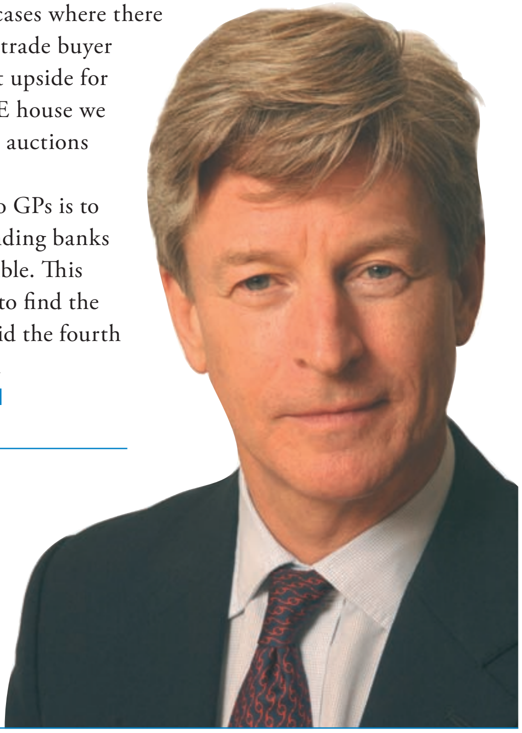
GG: Many European GPs have been busy getting refinancings underway in the first half of 2012. Is it an issue that is particularly prevalent for German PE-backed businesses? What would be your advice to GPs currently looking to refinance their portfolio companies?

SH: The "maturity wall" is as relevant to Germany as to anywhere else, given the number of deals that were structured between 2005 and 2007. We think that there are four generic end-games.

The bond market offers sponsors and borrowers the opportunity to lock in attractive pricing and more flexible covenants. However, bonds are not for everyone and sometimes either the debt is too small or the reporting requirements or the non-call periods go against the interests of the borrower or the sponsor. In these cases an "amend to extend" strategy can be appropriate, particularly for businesses with a good track record, although this is more of a short-term solution.

The third option is to sell the business, but the main inhibitor here is the price expectation of the selling GP. In cases where there is no cash-rich trade buyer and insufficient upside for an incoming PE house we have seen some auctions being pulled.

Our advice to GPs is to speak to the lending banks as early as possible. This helps everyone to find the best way to avoid the fourth scenario, which is insolvency. ■



"Being anchored in one of Europe's more robust economies and having one of the best capital ratios among our peers gives us an advantage"

Simon Wakefield, SEB

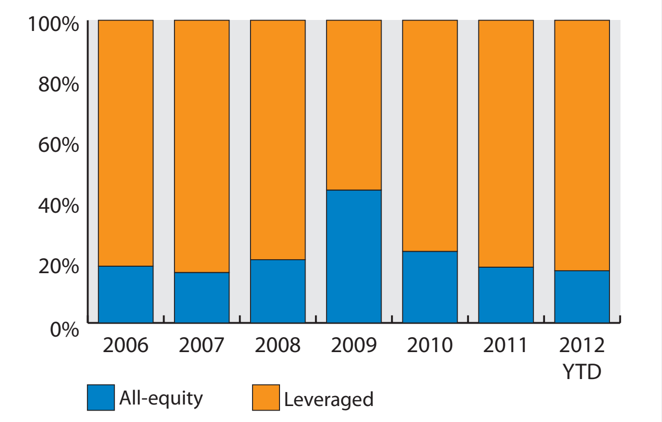
All-equity buyouts on the wane

GERMAN BUYOUT activity might still be struggling to recover following the financial crisis (*see page 4*), but as SEB's Stuart Hewer points out, leverage remains broadly available – as a matter of fact, the proportion of all-equity transactions has been slowly but steadily declining since 2009, according to *unquote" data*.

That year unsurprisingly marked an exceptionally high point, with nearly 45% of all German buyouts being completed without a debt element: of the paltry 41 transactions done in 2009, 18 were all-equity deals.

The proportion of unleveraged buyouts then kept declining as overall activity progressively picked up the pace. Although dealflow in the first nine months of 2012 remains lacklustre – with 29 deals completed so far against 76 for the whole of 2011 – the proportion of all-equity buyouts is back to 2007 levels at around 17%, against 18.5% last year.

Proportion of all-equity to leveraged buyouts in Germany



Source: *unquote" data*

Christian Böhler, principal at Akina Partners, anticipates good returns in the future from technically-specialised niche funds committed to a buy-and-build strategy

Q&A: Christian Böhler

Christian Böhler, Akina Partners

How does Germany compare to other markets you're investing in?
Within Europe, Germany is the largest and most solid economy. But compared to other markets, the UK or France for example, it is still relatively underserved in terms of private equity, so there could still be a catch-up effect as it becomes more and more accepted.

Given that 70-80% of deals are in traditional German manufacturing, engineering and renewable energy, private equity activity mirrors the strengths of the economy. But as such, it is dependent on the overall global economy, which makes them quite volatile investments. But looking at historic performance, Germany is a strong midfield player in the overall European landscape.

What has changed in your fund manager selection process?
Due diligence is more intense and takes longer. We want managers to really understand the sectors they are investing in, not just as investors but as real specialists. It is important to ask if what they have done in the past reflects what they will do in the future. People change strategies and shift from growth financing to buyout or larger deals, and raise funds for bigger deals – we want to consider what impact fund size will have on the strategy.

What are you looking for in T&Cs nowadays?
If a fund is heavily oversubscribed, the negotiation power remains with the GP. But given that nowadays only about 5% of GPs fundraising find themselves exceeding their targets, LPs have a much stronger position for negotiation.

We look at a few things; firstly, corporate governance rights, which are implemented more strongly, but with typically lower thresholds. And then we consider transparency reporting, which is even more important. We want reporting within three or four weeks, not months.

Another point is fund size. We have become extremely restrictive; we give a cap on the fund size we will invest in, and if it is too large we won't invest.

If we act as a cornerstone investor, or one of a very small group with a large ticket that comes in at a first close, we would consider negotiation of a reward, which could be a discount on the management fee or special co-investment rights. We have always asked for those sorts of things historically if we found ourselves in the right sort of negotiation position - nothing has changed there. But those sorts of situations are arising more frequently as fundraising gets harder.

"From a generalist financial engineering fund, I expect a bad performance going forward as bank leverage isn't there anymore"

What expectations do you have for returns in the current vintage compared to earlier vintages?
Current vintages should outperform 2006-2007. But looking further back, 2001-2003 after the tech bubble are excellent vintages. Is that going to be repeated? I don't think so, as the environment now is sluggish. From a generalist financial engineering fund, I expect a bad performance going forward as bank leverage isn't there anymore. So I expect good performances from dedicated niche funds with a certain industrial edge, where the fund strategy could be buy-and-build and it could have a technology specialisation. ■

Q&A: Sven Berthold

Sven Berthold, senior investment manager at WEGA support GmbH, is pleased to have greater clout at the negotiation table as an LP and says robust returns in the region have retained the market's attraction

How does Germany compare to other markets you're investing in?
Germany is one of the few European countries investors seem to focus on these days. From a macroeconomic point of view, it has done pretty well – and the Mittelstand in particular has proven to be very competitive globally. Investors clearly find this attractive.

From an investor point of view, it has not been easy to reap this potential in full though. The often anticipated generational handover never took place on a scale offering private equity funds elevated levels of dealflow and a certain degree of scepticism towards the private equity model remains within the entrepreneurial community. As a result, we haven't experienced the same euphoria for private equity that took place in some other European markets.

And yet local GPs have managed to establish themselves over the last 10 years or so and returns have been very robust. There is much more of an institutional GP base to invest in nowadays.

What has changed in your fund manager selection process?
Overall, not that much. We have tended to focus on local groups that have more of a sectoral expertise – this you would expect to come with stronger industry networks and potentially a certain edge when it comes to sourcing deals and assessing specific deal risks. But these remain tougher to find in Europe.

Robustness of the track record is important. Deal pricing and investment-pacing discipline, next to clear visibility of operational performance improvements since an investment was made, are metrics we closely review in our due diligence process. I'd say they are more important than just the pure valuation of portfolio companies.

What are you looking for in T&Cs nowadays?
As relatively small investors, our negotiation power had been limited in most cases in the past. With the new momentum in T&C negotiations we have become more vocal about our term preferences. In times where new standards can be set, it is important to show that change is actually supported by a broad LP base. Otherwise change might be short lived. Today we do pay more attention to non-fault divorce clauses and also to how management fees come down at the extension time. High GP contributions and a LP-friendly attitude have also been two important factors for us.

Early-bird discounts and co-investment opportunities might be popular at the moment, but these incentives can eventually create a misalignment of interest between investors, which is not desirable.


Sven Berthold, WEGA support GmbH

"I'd be happy if my GPs prove me wrong on the positive side of the return spectrum"

What expectations do you have for returns in the current vintage?
As investors we all aspire to achieve high returns. But given all the global uncertainties, low interest rates, and reduced return expectations in general, my best guesstimate would be that if you had a global programme with a mix of sub-strategies you would be looking at a range of high single-digit to lower double-digit returns. I am sure there will always be a specific strategy or manager who can do better, but for the PE universe as a whole, that's where I'd put my number. I'd be happy if my GPs prove me wrong on the positive side of the return spectrum. ■

Q&A: Katharina Lichtner

Capital Dynamics managing director Katharina Lichtner still holds hope for a torrent of generational handovers in the Mittelstand, as elderly business owners seek retirement

Katharina Lichtner, Capital Dynamics

How does Germany compare to other markets you're investing in?
Germany has huge potential. Not only is the country doing well economically compared to Europe, but the much-awaited wave of successions is still on the cards. Post-war founders of businesses are at retirement age, but they haven't sold yet, so the issue of Mittelstand succession remains on the horizon and is materialising at last since many simply cannot postpone it any longer.

The current generation of owners remains hesitant about PE – the locust debate has really hampered the industry. That said, the next generation of owners that will inherit these businesses often has a different mindset, because many have moved on to their own careers and are less emotionally attached to the business. The potential will therefore come to fruition in the next five years. It has to. The new economic backdrop makes it very hard and the elderly owners have to sort out estates, so selling a business is increasingly becoming an attractive option nowadays.

What has changed in your fund manager selection process?
Our emphasis has changed; three things have gained importance. Firstly, the ability of fund managers to raise debt for deals, and their experience with more complex issuance. Secondly, we are looking at succession issues and alignment of those individuals actually doing the heavy lifting – are they sufficiently participating in the carry? Finally, we are spending more time on understanding how the manager has generated value, and whether they can do this going forward. We match their ability to generate value with what we believe works in each market – and this is different in each market.

Track record is de-emphasised to some extent, because the world has changed. Its value as an indicator of being successful in the future has decreased.

What are you looking for in T&Cs nowadays?
The economics haven't really changed. The strong fund managers with a story that have fared well through the crisis are not really under pressure with their economics. Few are questioning the model in the mid-market funds. The fee pressure is mostly on the larger funds; for example, if there are transaction fees, they must be entirely credited against management fees. But this is the only area where there is pressure since it creates misalignment.

With the mid-market managers, the focus is more on the key-man clauses, which are crucial to an orderly succession. They must cover not only senior people but those actually doing the heavy lifting.

> *"[Track record's] value as an indicator of being successful in the future has decreased, because the world has changed"*

What expectations do you have for returns in the current vintage?
If a fund does okay, you have a guaranteed return of 8%. What other asset class offers that? Industry standard is to offer 20% but in reality we're looking for public market out-performance of 400bp to 600bp.

Now is actually a good time to invest as we expect better returns from investments made today than from those made between 2005-2008. Markets are down now and marginal deals are no longer happening. Historically, those 2-3 vintage years following an economic crisis have always shown very strong performance. ■

Allianz Capital Partners managing director Michael Lindauer believes a GP's current portfolio is the best indicator of a successful investor – and is willing to pay the fees for the best in the business

Q&A: Michael Lindauer

How does Germany compare to other markets you're investing in?
Germany has relatively less severe macroeconomic problems compared to other countries, which on the surface is a plus. However, this obviously has not remained a secret among investors and a lot of capital is being raised targeting a private equity market that is solid but has not been growing significantly over the last decade.

As such, Allianz does not consider Germany any different from other private equity markets we are interested in. After all, there are pros and cons, and the assessment of the specific fund opportunities on their own merits remains key.

What has changed in your fund manager selection process?
With fund manager teams changing with higher velocity, track records are losing their relevance more and more. Therefore, the current portfolio is the closest an investor can get in terms of considering future performance, so that is very important to us.

Against the background of changes in the private equity landscape and strategic preferences, we have also become more selective with regard to re-upping with fund managers. But overall, our selection process has not really changed over the past few years, we have always considered ourselves to be quite rigorous.

What are you looking for in T&Cs nowadays?
There are three important factors that we look for, two of which are often more important than the other. First, we like to see a fund size target appropriate to the perceived opportunity set – that obviously differs across segments and strategies. Then, we also like to see the highest possible commitment by the manager itself to ensure real alignment of interest. Finally, we do consider fees, but, if considered appropriate overall, this could be a less important factor.

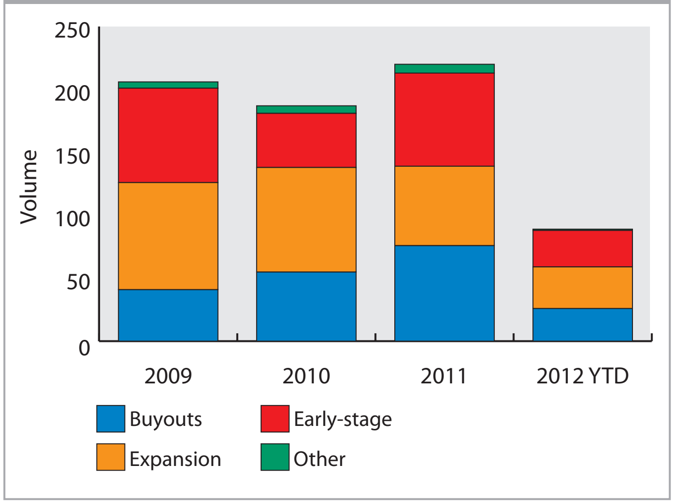
What expectations do you have for returns in the current vintage?
Over the past years, our expectations have remained the same, at a net return of around 15% on a fund. Our expectations for current vintages are in line with that. ■

Michael Lindauer, Allianz Capital Partners

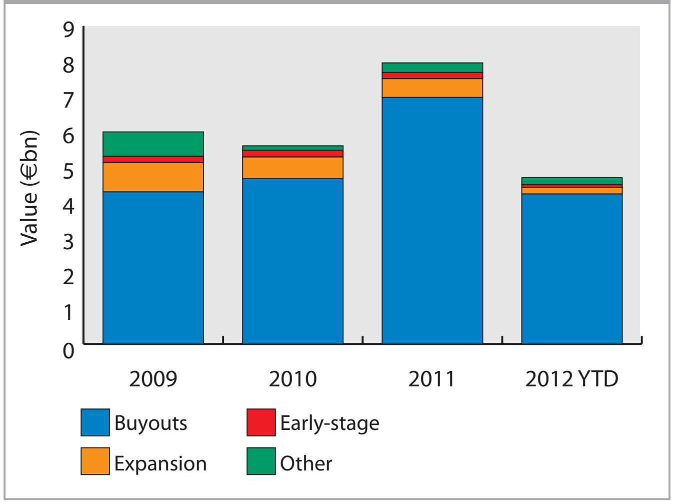
STATISTICAL COMMENTARY

By Pierre Le Saux

Volume of private equity deals in Germany by deal type



Value (€bn) of private equity deals in Germany by deal type



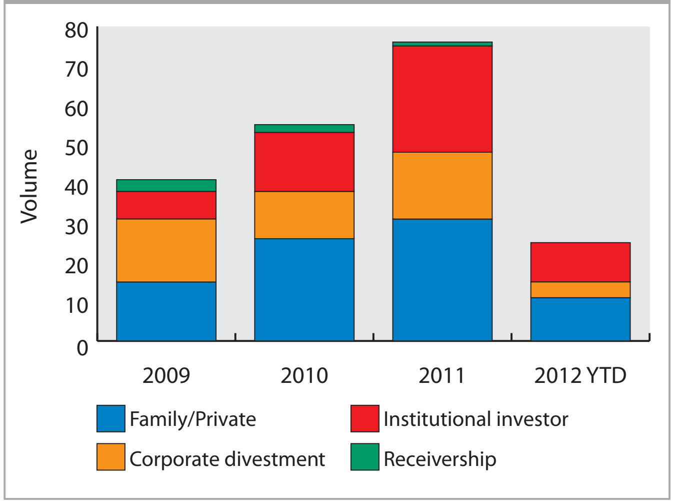
Source: *unquote" data*

Buyout values strong, though few and far between
Looking at the volume of private equity deals completed so far this year reveals a relatively sluggish state of affairs for the German market. However, digging a layer deeper and analysing deals by type reveals buyouts have been performing exceptionally well in value terms, already reaching the full-year figures for 2009 and nearly the levels seen in 2010. If the next four months of the year continue at a similar pace, Germany could prove to be a leader in European buyout markets once more.

Institutional backers selling off more assets than private owners
German activity for the first eight months of 2012 was down on the same period in 2011 and is likely to fall short by the end of year. This decline is particularly stark within corporate divestments: January through August of this year saw corporate disposals drop two thirds over the same period last year, when 12 deals were recorded.

Similarly, institutional investor and family/private vendors have both fallen by roughly 45%; the latter experiencing its worst performance since 2004. A comparison of activity during the first eight months of each year since 2009 also shows that while family/private vendors used to provide the majority of investments being made in Germany, institutional investors have for the first time in 2012 exceeded that amount with 12 deals being made against 11 for the family/private vendor.

Volume of buyouts in Germany by vendor type

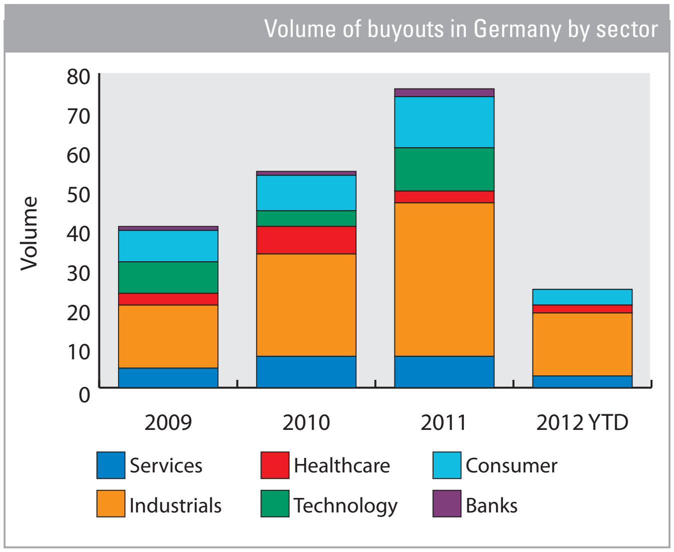


Source: *unquote" data*

EQT's buyout of BSN a hard act to follow

While 2011 will undoubtedly remain one of the strongest years for deals post-crisis, 2012 has seen a tempering of activity. Statistics from *unquote data"* reveal a 47% drop in industrial investments between the first eight months of 2012 versus 2011, though the sector continues to represent the largest portion of overall deal volume in Germany. The same cannot be said about the technology sector, where investments have disappeared altogether in the first eight months of this year. Deteriorating economic conditions across Europe are likely behind investor reluctance to back buyouts in the sector.

German firm BSN Medical made headlines after EQT Partners took control of the medical supplies manufacturer for €1.82bn, but Christmas came too early in Germany and only a couple of players were able to follow the Swedish giant with significant investments. Providence Equity Partners managed to acquire Germany-based Home Shopping Europe from AXA Private Equity for €524.46m. Meanwhile, Charterhouse snapped up industrial safety technology provider Bartec in an SBO from Capvis Equity Partners and Partners Group.



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