

RBS PRIVATE EQUITY CONFERENCE 2010

More than 200 private equity stakeholders attended the 2010 RBS Private Equity Conference, where the focus was on how private equity could best position itself to create value in what is still an uncertain economic environment.

The two key panels of the day addressed where the best opportunities would emerge for private equity investors targeting investments in sectors underpinned by public spending, and how private equity firms could deliver maximum value for their investors when exiting portfolio companies.

>PANEL 1: Delivering value from uncertainty

THE FIRST PANEL OF THE CONFERENCE, chaired by Ernst & Young partner Graham Beal, explored the state of the education, defence and healthcare sectors. Private equity has been active in these sectors in the past, but will need to adapt its investment strategies as public spending cuts are made and the government budgets for education, defence and healthcare are changed.

Key announcements

Beal identified some key events that private equity investors would need to watch closely in order to understand the changes that spending cuts and new government policy would bring.

"The emergency Budget will provide the first pointers to where opportunities will emerge. Then investors will need to understand the Comprehensive Spending Review as this will show where the axe will fall, and what government is going to stop doing," Beal said.

Education

In the 2008/2009 financial year, education accounted for 5.6 per cent of the UK's GDP and 13 per cent of total government spending, said Mark Jeynes (pictured, right),



a London partner at advisory firm The Parthenon Group, who addressed the conference on trends and investment opportunities in education.

Jeynes said that under the Labour government, education spending had grown by five per cent per annum during the last decade, a level that is unlikely to be sustained as the government tightens the purse strings.

But, although spending on education will retract, previous experience suggests that the sector will be pruned less aggressively than others. "If you look back at recessions and downturns during the last 20 years, education and healthcare have done better relative to other sectors," Jeynes said.

According to Jeynes, education spending has been cut by around four per cent in real terms during past recessions, though he did warn that this time around, the spending cuts could be larger.

But even if the spending cuts are to exceed the four per cent level of previous recessions, there will still be opportunities for private equity investors to find value from investments in education. "There is likely to be a consolidation of vocational skills provision, and a role could emerge for private

>THE LINE-UP

PANEL 1

- **GRAHAM BEAL**, Ernst & Young
- **LEONID SHAPIRO**, Candesic
- **MARK JEYNES**, The Parthenon Group
- **SEBASTIAN CHAMBERS**, CIL

PANEL 2

- **BOB COWDELL**, RBS Hoare Govett Corporate Broking
- **JEREMY FURNISS**, Livingstone Partners
- **KEN MAYNARD**, Cabot Financial Group
- **MICHAEL MOWLEM**, LGV Capital

operators of academy schools and for-profit higher education institutions," Jeynes said.

Private equity investors should also consider opportunities associated with consolidating small providers of vocational skills training, as the Skills Funding Agency has indicated that it will only offer contracts to providers of a certain size.

However, investments supporting the Train to Gain programme, a priority programme for the Labour government where the budget has increased significantly in the last four years, could prove less attractive, as this is an area where the current government is likely to pull back support.

Defence

The spending cuts facing the military come at a time when the UK is involved in a war and preparing to undertake a Strategic Defence Review - two factors that make it very difficult to predict where cuts will be made.

Sebastian Chambers (pictured, above right), managing director of commercial due diligence adviser CIL, told delegates that cuts were more likely to fall on the Ministry of Defence (MoD) than the actual front line of the RAF, the Navy and the Army. "I think the civil service understands the need to cut public spending more than people think," he said. "There is going to be a lot of scrutiny of poor decision-making and spending, and heads are going to roll."

The potential job cuts within the MoD are



something that all investors targeting businesses with military exposure should consider closely. "There is a risk that the people that a company has been selling to in the past may no longer be there," Chambers said.

Large capital expenditure projects, however, should be more resilient to cuts as they have long life cycles, in some cases up to 70 years. "These projects are very expensive to cancel. There is an amazing amount of support for the 'mend and make do' approach," Chambers said.

The main investment opportunities will centre on equipment procurement and efficiency savings. "Outsourcing is a big driver. There are clear areas where private sector involvement can cut costs and provide quality. There is also likely to be an emphasis on investment in troop protection and surveillance," Chambers said.

Healthcare

Healthcare spending under the last government doubled, but although investment increased, productivity and value did not always follow suit. "Much of the spending on healthcare went into higher wages and more levels of management and administration," said Leonid Shapiro, the managing partner of consultancy firm Candesic, who outlined healthcare trends on the panel.

But, although government spending has risen significantly since 1997, it is an area that the new government said would be ring-fenced from cuts.

Shapiro warned, however, that healthcare would still be required to tighten its belt and offer more efficiency. "We could see a freeze on wages, re-negotiations of general practitioner contracts and a merger of some Primary Care Trusts, which could cut staff costs by up to 15 per cent," he said.

An ageing population also means that although healthcare spending will not be reduced, there will be a greater demand for care, so there will be less to go around. "By ring-fencing demand and at the same time demanding more efficiency, the government are betting that there could be an extra £20bn of demand coming into the market during the coming years," Shapiro added.

In order to absorb this demand, there could be moves to perform fewer procedures, and keep people out of hospital by providing more in-home care. Tighter procurement will also be a feature.

Shapiro said this focus on efficiency and value for money would inform the investment strategies of private equity firms targeting the healthcare sector: "New business models and consolidation plays are going to be the key strategies for investors rather than multiple arbitrage and financial re-engineering."

>PANEL 2: Exit options: driving value to successful exits

PRIVATE EQUITY FIRMS

struggled to secure decent exits in 2009, when receivership accounted for more than a fifth of private equity exits, according to the Centre for Management Buy-out Research (CMBOR).

Panelists at the 2010 RBS Private Equity Conference were adamant, however, that the first quarter of 2010 had shown that it was still very good at delivering value on exit.

First-quarter boost

"The proportion of buyout exits that ended in receivership last year was not significantly higher than previous years, and many firms have continued to perform well," said LGV Capital managing director Michael Mowlem.

CMBOR numbers show that in the first quarter of 2010, exit volumes increased by 39 per cent to 41 deals, up from 31 in the final quarter of 2009. A continuation in current exit levels would see a rise in the number of exits for 2010 to an estimated 172, up from 109 in 2009.

Jeremy Furniss, a partner at corporate finance advisory firm Livingstone Partners, was buoyed by this activity: "Good companies have been sold at good multiples," he said, adding that less stellar companies would be difficult to shift.

One exit route that did not meet expectations was the IPO market. Most exits in the first quarter came from trade sales and secondary deals to other private equity firms. In 2009 there was only one private equity-backed IPO, while in 2010, a number of IPOs of high-profile private equity businesses were put on ice.

Bob Cowdell, managing director of RBS Hoare Govett Corporate Broking, said that although there had not been as many private equity IPOs as GPs had hoped, this did not mean that the public markets were shut.

"The question is not whether the public markets are open or not. The right kinds of businesses will attract interest," Cowdell said.

Private-equity backed businesses that had not gone ex-growth and were not carrying too much debt would be attractive to stock market investors, Cowdell added.

Exit planning

But even if a company boasted these credentials, exits still need careful management to maximise value, said Ken Maynard, chief executive of consumer debt purchaser Cabot Financial Group.

"Running an exit process in 2006 and 2007

was relatively straightforward, but now an exit has to be very closely managed," Maynard said.

Management teams and private equity firms that want to maximise value on exit need to make sure a business is sold at the right time in the economic cycle and in the business's evolution, Maynard said. Vendors also need to prove that their business has a growth story, and is in a sector that is expected to be strong.

Furniss added that it was still possible to run a competitive process between rival bidders, even though deal activity was still weak compared to previous years. "If you do the work, you can find competing bidders for a good business. The key is to build the relationship between the management team, the private equity firm and the potential buyer. In the past it has too often been the adviser's role to drive these parties apart in order to create competitive tension," he said.

Mowlem added that sellers needed to be "more thoughtful" about information: "You need to provide intelligence rather than just dumping information. Advisers can add a lot of value here. They help businesses to get their houses in order."

Managing management

Another crucial part of steering a business to a successful exit is to ensure that the management team and private equity owner are both happy to exit at the same time. This is an area that can bring tension if one party wants to hold on for longer.

Maynard said that at the very beginning, the management team and private equity firm need to set a plan for the business. "Setting out clear goals is very important. Once those goals are achieved it creates a clear point where the business is ready for new owners to take it forward, and the private equity firm is ready for an exit," Maynard said.

Cowdell added that the type of exit route also required discussion, especially if the private equity owner was considering an IPO. "The regulatory, investor and market demands on a listed business's management team are very different from those of a private business," he said.

For more information about the conference, or to discuss any aspect of the private equity market, please contact Mark Clark or Malcolm Hassan at The Royal Bank of Scotland:

MARK CLARK (Senior Director - Financial Institutions UK) Tel: +44 207 672 1990

Email: mark.clark@rbs.co.uk

MALCOLM HASSAN (Senior Director -

Financial Sponsors UK) Tel: +44 207 672 1193

Email: malcolm.hassan@rbs.co.uk