

## **Capital Creation 2008** **15<sup>th</sup> – 17<sup>th</sup> September, Le Meridien, Monte Carlo**

That old adage that someone's loss is someone else's gain sprung to mind when interviewing delegates at last week's 8<sup>th</sup> Annual Capital Creation conference in Monte Carlo. While the mood was unsurprisingly sombre than previous years, there were those that were keen to point out the opportunities that have already been won or lie ahead.

The global economy is heading into uncharted territory with hitherto unseen levels of government intervention since the Gold Standard crisis of the late 1920s. Some areas of financial services have reached breaking point and consequently this has permeated through to the buyout market where some transactions have been put on hold indefinitely. Lenders are pulling back the purse strings and with it too the firepower of the private equity [PE] community.

Activa Capital's Michael Diehl is one of many that believe conditions will get worse next year. The funding crisis has made it difficult for PE firms with equity to invest to finance transactions. One of the problems Diehl pointed out was that price expectations among vendors were still high and will need to be aligned with market conditions over the next few quarters.

Meanwhile those sitting on investments have yet to realise losses and "like the venture capital funds in 2000 [after the dot com bubble burst]", he says, it will take a while for this to work its way through.

Still, while recent events have left some feeling less than sanguine about the future, others still remain upbeat, so it depends on whether your view of the world is of a "glass half empty or a glass half full," Diehl added. With that in mind, there are two schools of thought beginning to emerge, with one suggesting that PE firms should exit now before conditions worsen and the other, urging to ride out the storm until value is restored, he said.

Jon Moulton, a partner at Alchemy Partners, is clearly in the first school. He warned industry professionals in his speech at the Capital Creation conference to "don't try to keep a corpse warm", and urged PE firms that have loss making assets to act quickly in disposing them before they become a larger problem.

Meanwhile, one obvious downside to the current conditions is that larger private equity firms are now moving into what was traditionally mid market buyout territory, given the fewer liquidity problems at this level, Diehl opined. Karsten Langer, a partner from Riverside Europe Partners, agreed noting that deals at the smaller end of the spectrum will be easier to do. "The funds that do smaller deals will suffer less". Riverside is a fund that typically puts in EUR 12m- EUR 20m of equity on deals up to EUR 100m

The lending environment is the biggest determinant and while banks are still open for business, many are no longer operating from one deal to the next but are instead focused on retaining key relationships, Langer said. More lending will be done by the commercial banks, as opposed to the investment banks, he added.

But it is not all doom and gloom on the financing front. Adrian Lurie, an investment director from Indigo Capital has also noticed that the banks have a significantly lesser appetite to underwrite mezzanine finance and have been approaching independent firms such as Indigo to do so. The last twelve months have been the busiest that Indigo has experienced and over that period it has invested over EUR 200m and has some EUR 340 million left to invest from its current fifth fund. A lot of firms are now approaching Indigo directly to assess the availability of mezzanine funding before considering a deal.

Indigo's investment strategy focuses on strong defensive characteristics, eschewing property and other more cyclical businesses.

Both Lurie and Langer believe that a number of quality assets could come available over the next few months as parent companies seek to sell off assets to fund debt. As these companies need liquidity, these sales will be quick and fast providing buyers with opportunity to buy quality assets at good value.

Real estate and financials are the sectors that will be hit particularly hard, and where many opportunities will quickly available, Langer predicted.

The current climate will separate the wheat from the chaff, Langer finally said. Those funds that do not perform well over the next few years will simply not be able to raise funds in future.

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