MEET THE ROUNDTABLE

THOMAS FETZER
Managing director and head of DACH investment banking
BAIRD
Fetzer is responsible for overseeing Baird's Europe investment banking activities in Germany, Austria and Switzerland. Prior to joining Baird, Fetzer was European head of industrials investment banking at Jefferies. His previous career included being managing director in the global industrials group at UBS and principal at Greenhill & Co in Germany.

HAJO KRÖSCHE
Director
EQT PARTNERS
Krösche joined EQT Partners in January 2013, prior to which he spent more than two years in London working for Bain Capital in their global private equity team, working across several industries before focusing on TMT and German investments.

DR CHRISTIAN HOLLENBERG
Founder
PERUSA
Hollenberg founded Perusa in 2007 and has more than 20 years of investment experience. Previously a co-founder of Munich-based Orlando Management, he has experience in turnaround and recapitalisation management, as well as investment banking.

JOHANNES WENDT
Investment director
ALLIANZ CAPITAL PARTNERS
As an investment director, Wendt's chief focus lies on co-investments and relationships with European fund managers. Before Wendt joined ACP in 2011, he was head of fund investment at Golding Capital Partners. Prior to that he was part of the European private equity team at Bain Capital.

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Bavarians integrate

With Germany's dealmaking environment stuck in the doldrums, a panel of industry experts tells Isobel Markham that it no longer makes sense to view the country as a standalone market

Four industry experts gathered in the office of Allianz Capital Partners off the broad, imposing Ludwigstrasse in central Munich for *Private Equity International*'s Germany roundtable. On one point, they are in total agreement: the greatest challenge for practitioners in the German private equity market is dealflow.

Or, as Thomas Fetzer, managing director and head of DACH investment banking at Baird, puts it: "There are not enough businesses for sale in Germany relative to the size of the economy."

Johannes Wendt, investment director at Allianz Capital Partners, adds that the country has "a long history of underwhelming in terms of dealflow", while Christian Hollenberg, co-founder and managing director at Perusa, observes that the overall size of the private equity market relative to the size of the German economy is "astonishingly small".

"That's a structural issue, and we need to live with what we have," says Hollenberg. "There's good business to be had [in Germany], but don't expect fast growth. I don't see that."

Alongside the oft-noted social stigma associated with selling a family business, EQT Partners director Hajo Krösche observes that many business owners just don't see the benefit of selling.

"A lot of German Mittelstand companies are still deep in family hands," he says. "One can assume that many families like to keep it that way, especially as they do not necessarily have an alternative use for the capital. It can be rather challenging to find attractive alternative investment opportunities, so therefore the families decide to keep the business private."

Fetzer agrees that prolonged low interest rates, which are likely to remain for many years, are only compounding this problem. "If you have a good business that is paying you dividends, why would you »

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>
> **Christian Hollenberg**

» sell if you need to reinvest the proceeds in a near zero percent interest rate environment?"

The response from local funds such as Perusa has been to cast the net wider.

"We've stopped marketing ourselves as a purely German fund," Hollenberg says. "Just looking at Germany and just typical industrial businesses, that's not been a good strategy for the last five years, even more, and it certainly won't be for the next five years."

In a country where exports of goods and services accounted for 45.7 percent of GDP from 2011-15, according to the World Bank, it is no longer possible to "sell to your investors that you're exclusively Germany exposed", says Hollenberg.

"If you buy a halfway reasonably-sized German business it will probably have so much in export that its fate is determined in South America, in the US, somewhere else in the world, but certainly not somewhere in Baden-Württemberg. That's just yesterday's concept."

Consequently, Hollenberg says his firm is "paying less and less attention" to whether target companies are based in Germany or not. "We like German exposure a lot, we like German technology, German processes and engineering, but the purely German market focus I think is becoming very difficult to maintain."

Fetzer agrees that those wishing to succeed in Germany should not think of the market in isolation.

"For potential new private owners, and for M&A advisors, it is important to be able to provide an international perspective. Even if you reach down in the size bands to very small companies and investment opportunities, many of these companies have an international dimension to them already. They're probably exporting globally, they might be sourcing in China, and when they think of a new owner they also think about what that new owner might bring, so being able to provide an international perspective is important. Just being local with capital and not much else is unlikely to be very appealing for a seller."

A SELLER'S MARKET

The lack of quality assets for sale has inevitably led to too much capital chasing too few opportunities, leaving the power in the hands of the sellers.

"It's a seller's market," Fetzer says. "It's been a seller's market for some time, in Germany it will remain a seller's market. This supply-demand imbalance translates into entry valuations which private equity buyers must view as high by historical standards, raising the bar for value creation."

Wendt agrees that "if you have a good asset to sell, you will have many buyers looking at it".

On the sell side, it's creating dilemmas as well as opportunities.

"Maybe we're selling some of our portfolio a bit too early at this point," Hollenberg says. "In some cases we may still have more ideas of what we could do with it even though we're selling it, but the problem is: if I can increase the earnings by 25 percent but the market multiples go down by the same percentage then there isn't much gain for our LPs, so we are doing it now rather than squeeze more improvement from it."

Krösche does not consider any particular part of the market to be more competitive than another.

"EQT has been successful in finding opportunities across different size bands – the different EQT funds cover a wide range of investment tickets, from early stage to large buy-outs. And in various sectors," he says.

"The market in itself is very competitive and the multiples are high across segments, and I think this is regardless of size bracket."

However, the participants agree that very stable assets with EBITDA of more than €10 million are hotly contested.

"On high quality assets, which may have been owned by more than one private equity firm, the competition is really fierce. Even pension funds or other fund structures with a longer term investment horizon are part of the competition resulting in even higher prices," Krösche says.

"We are looking for investment opportunities where EQT's skills, track record, network and sector competence is key for the company in question, where there is an 'EQT angle' for growth and transformation. Focus lies more on proprietary situations and on a pipeline that we have built up now for several years."

Hollenberg identifies the very large transactions, the operationally-intensive smaller companies and growth investments as the market segments in which it's possible to make good money in Germany.

"The mid segment where you don't see a lot of growth – but it's sizeable enough to attract the whole PE industry – that to me sounds very expensive. I think people will still make good returns from it, but at high entry multiples, and maybe the returns will be capped in the end because there is so much competition."

To access those much-desired proprietary situations, building up a strong personal network – and hiring strategically to enhance that network – is essential.

Krösche says: "EQT has a 'local with locals' approach and has many eyes and ears in the German market. This is our way of securing an early position for EQT in the processes, often even before an investment memorandum is sent out. If we receive such memorandum without having heard about the situation before, it is probably an opportunity we tend to decline to pursue anyway."

Krösche notes there has been more interest from some US-based funds, who are looking to return to the German market after having been less active during and in the aftermath of the financial crisis.

"I believe it will be harder for them to compete with players who have been in the market for a long time with local established teams," he says, adding that to be successful in Germany a "truly long-term perspective" is needed.

"I believe a three-to-five-year perspective is not good enough if you want to build a strong private equity business in the German market."

Private equity firms across Europe have faced stiff competition from strategic buyers in the last 24 months, and Germany has been no different. Fetzer has observed that as an active seller of medium-sized businesses, Baird's ratio of businesses going to private equity buyers and strategic buyers is "probably 50-50". "In the »

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Thomas Fetzer

» sectors we serve, for instance industrials and healthcare, strategic buyers are very active," says Fetzer. "They're obviously looking at the same low growth world. At the same time their balance sheets, on average, are very strong [and] the appetite to grow inorganically is very strong."

In recent years the German market has also seen interest from new entrants.

"Looking at the buyer participation in our sell side processes, I would also note Asian buyers, Chinese in particular, in Germany, which has been a very topical theme in the recent past [and] which we see as likely to continue," Fetzer continues. "Buyers from Asia have become very meaningful competitors to the private equity firms investing in the region."

Hollenberg observes that another big competitor in today's environment is "the 'no-deal' option".

"Because interest rates are very low, if people manage to get any kind of slight upturn in an ailing business, [then they] refinance the whole thing on low interest rates," he says.

While private equity has battled with an unsavoury image problem in other markets, the experts gathered in Munich agree that in Germany the public is by and large indifferent to the industry.

"I think Germans are by choice and by design financial analphabets and anything that is related to financial issues they tend to look at with scepticism," says Hollenberg.

"Having said that, I think it has normalised so much and has become so commonplace over the last five years that a lot of the previous debates that we had a few years ago I think are no longer applicable today."

Fetzer agrees that private equity is "not a significant matter of public debate or interest".

NO GERMAN 'SIR RONALD'

The experts note that private equity is not personified in Germany; there are no individuals for the public or the media to latch onto, either positively or negatively.

"In the UK, Ronald Cohen, co-founder of Apax, who has been Sir Ronald now for some time, is a great example of an outstanding private equity professional who has received strong public recognition for his work," Fetzer says.

"In Germany there is not really an equivalent to Sir Ronald in the industry, there's no one on the horizon, and it is unclear what a process would be to get a German private equity figurehead this sort of public recognition and standing."

Despite its challenges, Germany is still a fundamentally good market that has shown good returns.

"We do find good, strong companies in Germany, so if you manage to get a hold of one of them, then you have a good asset," says Wendt.

Consequently, there is high demand from international investors for exposure to the German market, both through country-specific and pan-regional funds. Due to the size of the German private equity market over decades, most LPs tend to feel under-exposed and are looking to make additional commitments, Wendt says.

"[LPs] feel that generally it's a good economic environment, good macroeconomics around it, so they look for that exposure."

Hollenberg has observed a lot of interest from US investors, although their size often precludes commitments to local managers.

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"I think [LPs] are concerned that when you go into the big segment of the market there's a lot of capital there, there's a lot of competition there, [but] in the small segments some investors may not feel very much at home because they need larger ticket sizes."

There is also strong support from funds of funds who, Wendt notes, "really like to show a foot in the German market, which is almost a must-have".

The desire for increased exposure to Germany – and the desire to counterbalance fees – has resulted in a strong interest in co-investment and direct investment.

While Allianz does invest directly into infrastructure and renewable energy, it only approaches traditional private equity through funds and co-investments, a set-up which is unlikely to change, Wendt says.

As well as the consolidation issues that go along with an insurance company holding non-insurance company assets, Wendt says there has always been a "fear of reputational damage".

"No matter how big, any private equity deal is ultimately a small part of the portfolio and an even smaller part of the overall business. So the fear of having every Allianz representative being asked by his clients and prospects about what we're doing in that company and why it's having difficulties and dragging out closing the deal on the insurance was detrimental to the business and not worth the risk for the core business."

However, Wendt views co-investments as a way to both boost returns and to further develop Allianz's relationships with its GPs.

"You get to know the GP even better if you don't only taste the cooking but you're in the kitchen joining in with the cooking," he says.

However, as with most LPs, Allianz tends to shy away from co-investing in portfolio companies that require more of a transformational approach.

"Our appetite is on the 'low-risk, we can understand the business' side," Wendt says. "Whereas if you have this ugly duckling and tell us it's going to be a swan, you have some ambitious plan for it, we like to have that in the fund [but] we're probably simply not fast enough to follow that logic and understand it within the timeframe that's available."

While all agreed that co-investment as an industry trend is likely to stay, the strong fundraising environment – resulting in ever-larger funds – could curb it slightly.

"It may tail off a little bit just by virtue of the funds having more capital," Wendt says.

Hollenberg adds: "There's enough money in the funds already and you're paying large fees for it, so having a co-investment would make me wonder, as an LP, why is it that this specific deal is subject to a co-investment whereas the rest of the portfolio was not. There may be legitimate reasons, but it may be a situation that needs analysing."

With the German market an intensely competitive place as it is, the panel of experts agree that there is little room for new firms, especially general-purpose mid-market houses without compelling differentiating factors.

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"If you're just another guy, the market has a couple of guys in it already, and nobody's welcoming the new guy," Wendt says. "You need some approach, you need to bring something to the table. And it's a competitive market, so think carefully."

Hollenberg adds: "I'd say very clearly unless you have something very specific in terms of investment themes, strategy or target search, don't do it." ■