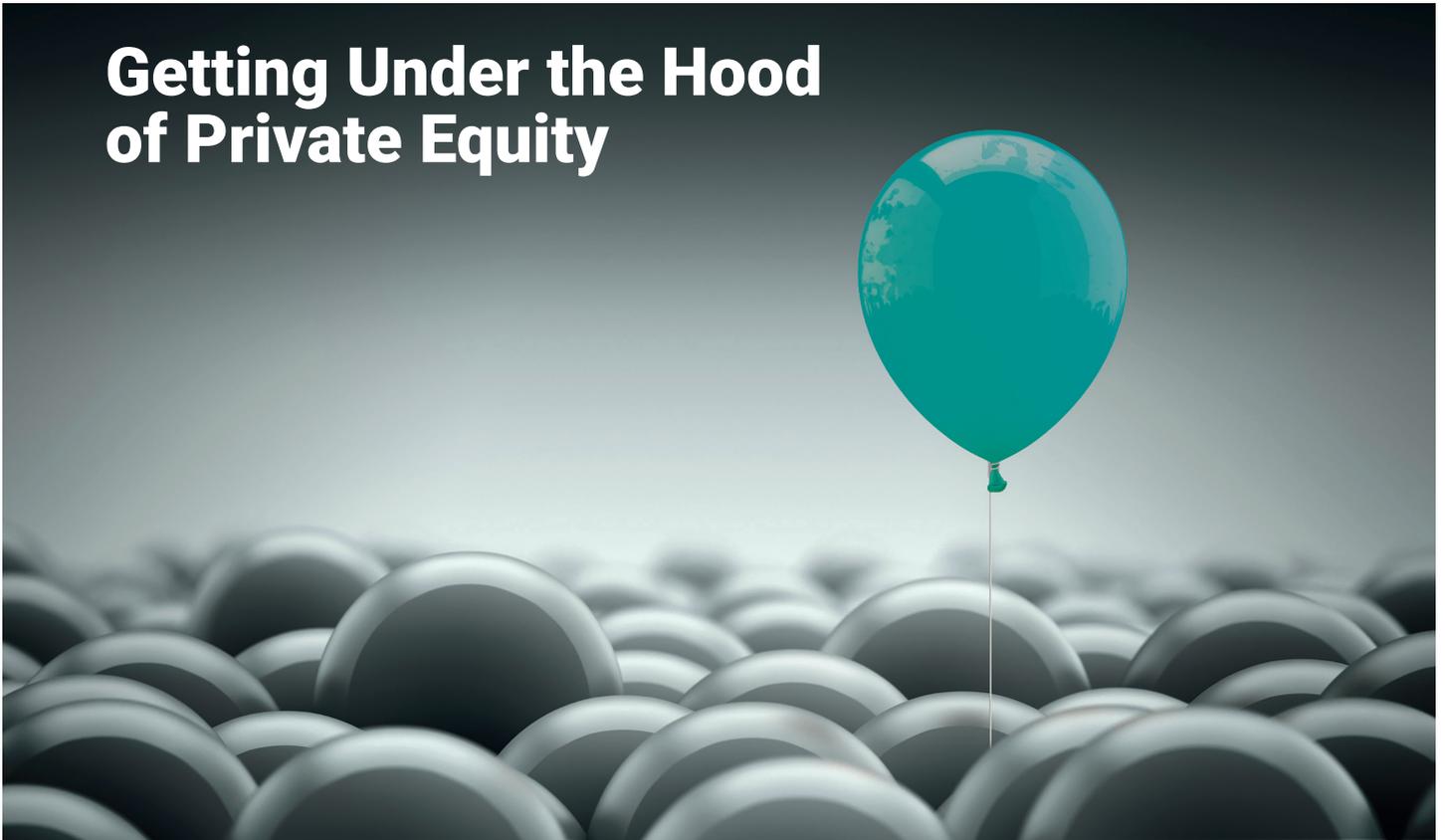


Getting Under the Hood of Private Equity



In this special feature on Private Equity, Key Capital, IMAP's partner firm in Ireland, takes a deep dive into the world of private capital and why it is often misconstrued by business owners when they are considering a liquidity event. In addition to looking at the macro picture for Private Equity in Europe and Ireland, Key Capital shares details of its recent Private Equity focused event for business leaders held in Belfast, as well as some key insider views with an interview with **David Menton, Founder and Managing Partner of Synova Capital**.

CHALLENGING TIMES IN EUROPE, YET PRIVATE EQUITY CONTINUES TO OUTPERFORM AS AN ASSET CLASS

After a series of record-breaking years in European deal making, 2018 saw a softening both in Private Equity ("PE") deal volumes and values across Europe, with total PE transactions falling to 3,208 from 2017's record level of 3,680.

The industry is currently facing several headwinds in Europe. Global political

and economic uncertainty, particularly surrounding Brexit and the future of the UK, which is Europe's largest deal market for PE investment, undoubtedly contributed to the reduction in the number of PE deals announced in the region (988 PE deals in the UK in 2018, a decline of 10% from 2017¹). However, the rest of Europe may in fact be a beneficiary of Brexit from a PE investment perspective, as investment teams will likely need to look further afield to other European

markets in order to identify attractive investment prospects.

Despite this challenging environment, PE continues to be the best performing asset class globally. The returns track record of the industry, combined with the current low interest rate environment has meant that European PE fundraising has been at record levels. The €66 billion of capital raised by private equity funds in 2018 was the second highest amount

1. Source: Pitchbook

2. According to Preqin, global PE committed undrawn funds (dry powder) stood at c. USD1.2 billion in July 2018

EUROPEAN DEAL ACTIVITY 2008-2018



Source: Pitchbook.

post-financial crisis¹. Record-breaking levels of dry powder available to PE firms² and the development of strong corporate balance sheets owing to several years of buoyant economic growth have resulted in significant competition for quality assets in Europe. Unsurprisingly, valuation multiples in Europe reached an all-time high in 2018.

THE OUTLOOK FOR PE IN EUROPE

While the current environment of high valuations, economic and political uncertainty in Europe and intense competition for assets means PE firms need to work harder and more creatively to source quality deals at sensible valuations, the best firms have a track record of generating returns in adverse situations. The levels of capital that have been raised by funds and the resulting pressure on these funds to put money to work, means that PE will continue to be a key driver of M&A activity in Europe in 2019 and beyond.

PE GETS A Foothold IN IRISH MID-MARKET M&A

Private Equity is a relatively new phenomenon in certain smaller markets in Europe, Ireland being a prime example. Prior to the recent financial crisis, there was no indigenous PE industry in Ireland and any PE activity that took place, involved major international funds acquiring very large Irish corporates. Following the financial crisis, a government-backed initiative established a cohort of Irish PE funds, encompassing both international funds such as Carlyle and MML, as well as new domestic players. These funds were established to target Ireland's mid-market, the backbone of the Irish economy, which housed a large number of high-quality businesses and management teams that had much more limited capital options available to them at that stage.

Private Equity's prevalence and importance in the Irish M&A market

continues to increase. This is particularly true for mid-market³ activity, the lifeblood of the Irish M&A market (mid-market M&A transactions represented 93% of 2018 deal volume in Ireland). In 2018 there were 34 deals in Ireland that involved PE, up from 13 deals in 2012⁴. However, given the relatively short timeframe in which PE has been a feature of the Irish M&A landscape, there are still significant misconceptions about what PE brings to the table, not only in terms of deal structures and flexibility, but also the value it can bring to a boardroom.



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3. The mid-market includes transactions with deal values up to €250 million

4. Source: William Fry 2018 M&A Review

Key Capital Displaces the Myths of Private Equity with Business Leaders in Ireland

In April 2019, Key Capital hosted its most recent event in a series entitled “Getting Under the Hood of Private Equity.” Held in Belfast and attended by 25 Irish CEOs and business owners, the event was designed to demonstrate how PE can be an attractive form of capital for businesses.

A previous issue of Creating Value explored the theme “Who’s afraid of Private Equity?” and looked to educate readers on some of the reasons that PE can be the right investor for businesses in the German market, when PE firms are often considered to be the “bad guys.”

The Irish corporate community can also be subject to some of the same misconceptions, with many business owners believing PE firms to be aggressive financial investors whose sole aim is to leverage a business to its capacity, cut costs and to use clever financial engineering to generate profits. It was with those misconceptions in mind

that Key Capital, IMAP’s Partner in Ireland, hosted a series of events entitled “Getting Under the Hood of Private Equity” with a view to demystifying PE as a source of capital for a select audience of business leaders.

The most recent event, held in Belfast in April 2019, saw Key Capital, together with David Menton, Managing Partner and Co-founder of Synova Capital, address a gathering of 25 Irish CEOs and business owners about how PE firms really think and operate and what bringing PE on board could mean for the businesses attending, ‘warts and all’. Together, Key Capital and Synova illustrated how PE

can offer an attractive alternative to a traditional exit route, allowing business owners to benefit from what is arguably a financially and psychologically superior form of capital.

Jonathan Dalton, Head of Key Capital’s corporate finance team, recalls, “the theme that appeared to resonate most with guests was the opportunity a private equity transaction affords private business owners to de-risk financially and re-risk strategically; the proverbial ‘have your cake and eat it’”. The guests were also very interested in the alignment of interests a PE structure can provide, from management to co-investors to LPs to GPs.



The theme that appeared to resonate most with our guests was the opportunity a private equity transaction affords private business owners to de-risk financially and re-risk strategically...the proverbial have your cake and eat it



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KEY TAKEAWAYS FOR ATTENDING BUSINESS LEADERS

1.

Shareholders and management teams should educate themselves early on. Meet with different PE firms to develop a first hand understanding of the options

2.

Identifying the right PE partner is critical: this is the firm you will have to work intimately with for a significant period of time

3.

PE uses sweet equity as a tool to align management interests with the shareholders. This represents a significant wealth creation opportunity for management

4.

The management team has a huge influence in determining the exit outcome in a PE deal and 60% of PE exits go to another PE investor allowing management to “go again”

5.

PE investors bring a lot more to the table than financial firepower; vision, relationships, access to new markets and industry expertise are ways they add value

Synova Capital – A Proven Track Record in Delivering Strong Returns to its Investors

During its "Getting Under the Hood of Private Equity" event in Belfast, Key Capital had the pleasure of sitting down with guest speaker David Menton from Synova Capital, to discuss some of the key trends currently impacting not only his firm, but the wider PE industry in Europe

Can you tell us a bit about Synova and your business model?

Synova is a growth investor specialising in partnering with founders and managers across the UK and Ireland who are committed to scaling their companies to the next level. Our sectors of focus are Financial Services, Technology and Healthcare. We have developed a heavily partnership-led model and specialise in building long-term relationships with shareholders, often prior to our investment, to ensure the alignment of our shared growth ambitions.

Are you seeing a change in attitude towards PE as a solution for entrepreneurs?

There is certainly more knowledge nowadays among entrepreneurs about the existence of PE, though the industry hasn't always highlighted clearly enough to the market the important role it plays in the wider economy. At Synova, we pride ourselves in developing trusted relationships with companies in our focus sectors and using our track record of successful partnerships to share with management teams what our approach has successfully delivered for similar sized businesses.

Synova operates in a rapidly changing environment and you have successfully navigated a global recession and now the impact of Brexit. What has been the key to this success?

We have always invested in smaller non-cyclical growth companies, typically operating in niche markets and with limited exposure to macro trends. Our narrow focus on services businesses with strong growth potential, providing B2B or technology enabled solutions (often in highly regulated markets) has continued to deliver strong returns to our investors.

You mentioned having an interest in investing in Irish businesses. What makes Ireland an attractive acquisition landscape?

We have always had a focus on investing across the UK & Ireland. Aside from Dublin being my hometown, we have consistently identified and engaged with companies across certain sub-sectors which for various reasons have proved successful in the Irish market, from Financial Services and FinTech, to Health and Pharma Outsourcing. Within these areas, and particularly the technology space, Ireland continues to benefit from a highly educated and well-trained workforce. For software companies, the availability of highly proficient developers remains a powerful pull factor.

What are your views on current market valuations – have we passed peak valuations?

Given the long-term performance of the asset class, the PE industry has benefited significantly from large inflows of capital, which in addition to other factors is driving higher valuations. We have to assume that over the medium term, as seen through previous cycles, there is a risk of GDP contraction; whether that impacts valuations or not is hard to judge.

You have invested in a lot of successful businesses over the firm's history. What are the top 3 key characteristics you seek in any potential acquisition?

The 3 most important factors for us are the robustness of the underlying earnings of a business, its ability to scale within its existing market or into adjacent markets and our ability to work alongside a talented management team who we believe have the potential to build a good business, into a great business.

What can businesses owners do in the years ahead of a transaction in order to increase the attractiveness of their business?

The key challenge for any team is to set themselves reasonably ambitious plans and prove their ability to deliver them in the run up to a transaction. Additionally, it serves them particularly well to be able to evidence a strong handle on the financial metrics and key KPI's within their business.

How does Synova add value to the companies they invest in?

We are extremely active in providing

operational advice and a strategic vision to our management teams and work tirelessly to help them drive operational efficiencies by investing heavily in their people and their processes. We also help them develop accelerated growth plans pre-investment. These can often include:

- Deeper penetration into existing markets and customers
- Focus on expansion into other verticals
- Analyse overseas sales strategy and potential for international growth
- Understand where strategic acquisitions can be accretive and drive accelerated growth

Finally, what are the common pitfalls you would advise business owners to avoid during the sales process?

The most important factor when undertaking a sales process is preparation; business owners cannot allow the sale to distract them from the day to day operations of their business.

Furthermore, I would advise all owners to consider the merits of engaging well credentialed experts to advise them on the various aspects of an M&A process. Seeking expert advice in the areas of corporate finance, legal and tax aspects of a transaction is critical and appointing M&A experts to manage the transaction process enables management to remain focused on the company's growth plans and to prove their ability to deliver on financial targets to all potential buyers.



DAVID MENTON

David co-founded Synova during 2007 having previously worked both within a

subsidiary of WPP plc and at a prominent European family office. He covers the Financial Services and FinTech sectors, working closely with management teams across the Synova portfolio to support their growth plans. David was recently featured in the prestigious Dow Jones – Financial News '40 under 40 rising stars in Private Equity'.