Leveraged Buyouts in the U.K. and Continental Europe: Retrospect and Prospect

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JEL codes: G34, G32.
Keywords: Public-to-private, going-private, LBO, MBO, IBO, Management buy-ins, Management buyouts, Leveraged buyouts.

The opinions in the paper are those of the authors and not necessarily those of their employers.

LEVERAGED BUYOUTS IN THE U.K. AND CONTINENTAL EUROPE: RETROSPECT AND PROSPECT

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Buyout markets in the U.K. and Continental Europe have developed substantially over the past 25 years. The European market appears to be entering its third period of significant growth, following those of[the waves of buyouts during] the latter halves of the 1980s and 1990s. In recent years, successive records have been set in terms of both individual deal size and the total market value of transactions in a given year. In 1997, for example, the U.K. market broke the £10 billion barrier for the first time. Only three years later, in 2000, more than £20 billion worth of deals were completed. The first European deal larger than £3 billion, the buyout of MEPC by Leconport, was completed in 2000. And 2005 saw the closing of the 20,000th transaction in the combined UK-European buyout market since the late 1970s, when the first recognizably "modern" LBOs appeared in the U.S. and U.K.

With a few notable exceptions such as France and the Netherlands, buyout markets in Continental Europe did not materialize in earnest until around 1996. As can be seen in Panel A of Table 1, the growth in the number of buyout deals in the U.K. and Continental Europe from 1996 through 2005 has been steady if unspectacular (with the weak European stock markets of 2000-2004 appearing to have dampened activity). Although the U.K. has by far the most active of these markets, there has also been considerable buyout activity in France, Germany, Italy, Spain, and the Netherlands. Panel B shows a more striking evolution in terms of value: During the past 10 years (1996-2005), the combined value of all buyouts in Europe rose more than fivefold and broke through the Euro 100 billion mark in 2005.

[Insert Table 1 about here]

In the U.K. at least, the buyout market has become a significant part of the takeover market, accounting for half of all acquisitions by value in 2005, as compared to less than 20% two decades earlier. U.K. buyouts have also consistently produced the highest rates of return for investors among all the various sectors of the overall private equity (PE) market, which includes early-stage and later-stage venture capital (VC) as well as buyouts. But for all its successes in the past 10 years, the U.K. buyout market in particular now faces a number of formidable challenges—notably, finding new deals at attractive prices while competing with new market entrants, devising lower-cost ways to fund deals, and effecting timely exits capable of producing targeted rates of return.

In this article, we provide a backward look at market developments for buyouts in the U.K. and Continental Europe and then close by considering the prospects for such markets. Because the U.K. is the most developed buyout market in Europe, we start with an overview of the research on all major aspects and stages of the buyout lifecycle, including fund-raising, deal sourcing, deal structuring, offer premiums, exit mechanisms, and returns. Then, after noting the salient features of the largest buyout markets in Continental Europe, we conclude with a brief discussion of the challenges confronting the buyout market as a whole.

2.0 The U.K. Buyout Market

The development of the U.K. buyout market into its present state can be viewed as taking place in five distinct phases.[1] Although there have been buyout-like deals stretching back to the 19th century, the first phase of the modern buyout market in the U.K. began in the early 1980s (see Figure 1), roughly the same time as the U.S. market got its start. During the deep recession in the U.K. in 1979-82, many of the

[1] M. Wright, B. Chiplin, K. Robbie and M. Albrighton (2000), "The Development of an Organizational Innovation: Management Buyouts in the U.K. 1980-1997," *Business History*, 42, 137-184.

first deals involved failed companies or firms restructuring to avoid failure. The relaxing in 1981 of the prohibition on companies providing financial assistance, that is security for debt, to purchase their own shares reduced the barriers faced by lenders in obtaining security for the funds they advanced. And the introduction of a secondary tier stock market in 1980 (the Unlisted Securities Market) opened up possibilities for realizing exit gains from smaller buyouts.

[Insert Figure 1 about here]

The second phase in the development of the U.K. buyout market comprised the rapid market growth from the mid-1980s to the end of the decade. The buyouts transacted during this period were increasingly the result of corporate refocusing strategies, and a first peak in the value of deals was reached in 1989. Such transactions, which generally included the existing management and were thus dubbed "management buyouts," or MBOs, offered an alternative disposal route to a trade sale to a third party. Buyouts, such MBOs, were especially attractive in cases where the selling company wanted a speedy low-profile sale or when there were few external bidders for the business.

In addition to the many MBOs, the late 1980s saw large numbers of "management buy-ins" (MBIs), transactions in which private equity firms (or, in some cases, institutional investors) brought in their own management teams to run the purchased businesses. The advent of specialist private equity and mezzanine funds, along with entry by U.S. banks starting in the mid-1980s, helped fund the development of MBIs as well as MBOs.

The third phase of U.K. buyout development, which began with the recession of the early 1990s, involved the restructuring of many of the largest transactions of the previous phase along with a return to the smaller buyouts that characterized the first half of the '80s. As in the U.S., both the number and value of U.K. MBIs fell sharply as it became clear that many of the highly leveraged deals completed during the late ’80s—often premised on major asset sales or “unbundling of assets”—were having problems servicing their debt. The recession exacerbated these problems and made turnarounds longer and more difficult. Many foreign banks abandoned the buyout market, and those banks that remained active tightened their terms and covenants. Both private equity and debt providers were heavily involved in restructuring the problem cases in their portfolios, and some of the latter disbanded their lending teams that specialized in buyout type transactions.

The end of the recession in 1994 saw the emergence of a fourth phase of U.K. buyout activity—one that saw rapid growth in total transaction value, which reached a new peak in 2000. At the same time, though, a focus by private equity investors on larger transactions kept the total number of buyouts to drop from exceeding their “local peak” of 709 reached in 1997 until six years later in 2003. Along with a modest contraction in the number of deals in 1998 and 1999, the years after 2000 saw a sharp plunge in the total value of new deals in the wake of the collapse of the dot.com boom and its repercussions.

But a major resurgence in the value of the U.K. buyout market began in 2004, the start of the current phase five. In 2005, there were a record-high 49 buyouts with purchase prices in excess of £100 million, and the total value of deals also set a new record of £24.2 billion. A preliminary look at statistics in the first half of 2006 suggests a slow start to the year, raising questions about challenges to the market to which we return below. (For a more detailed overview of the major events in the evolution of the U.K. buyout market over the past 20 years, see Table 2.)

[Insert Table 2 about here]

2.1 Raising Funds

Fund-raising in the U.K. has evolved significantly over time and recently jumped to a record high of £18.6 billion ($24 billion) in 2005. During the period 2000-2003, the total amount raised by buyout funds in both the U.K. and Continental Europe exceeded the amount invested in each year. But, as can be seen in Table 3, this trend was reversed in 2004, when the amounts invested exceeded funds raised by a considerable margin.

[Insert Table 3 about here]

In the U.K., the trend among buyout firms has been to raise fewer, larger funds, each with more capital than the last. While persuaded of the attractions of private equity as an asset class, institutional investors in the U.K. (pension funds, mutual funds, and insurance companies) have indicated that they are likely to reduce their investments in all types of private equity in the future. At the same time, they also say that their investments specifically in buyouts will grow in importance as a percentage of their total commitment to private equity. By contrast, evidence from Continental Europe indicates an intent by institutional investors to increase their commitments to investment in all forms of private equity, including buyouts.

In addition to the funds raised and invested within Europe, in recent years U.S. private equity firms have become much more prominent investors in European buyout markets. The investment in U.K. firms by U.S. private equity funds increased from £1.6 billion in 1999 to £5.3 billion in 2005 (Figure 2). Among the explanations offered for such international expansion by U.S. PE firms are the increased competitiveness of the U.S. buyout market and hence declining returns on U.S. deals; the reduced appetite of institutional investors for early-stage funds since the end of the dot.com era; and greater opportunities for restructuring in the U.K. and, especially, Continental Europe.

[Insert Figure 2 about here]

The hedge funds that have recently emerged in the U.K. are now providing an additional source of investment funds in the buyout market. In the last year or so, hedge fund returns have not been as high as those of buyout funds and, presumably as a result, last year more new money went into private equity than into hedge funds. Hedge fund managers are now pushing into less liquid markets, such as taking controlling positions in mid-cap stocks, which is the traditional territory of private equity firms. Increased competition for traditional private equity players has also come from new entrants such as government-sponsored operators like Dubai International, family offices, and wealthy entrepreneurs. In the first quarter of 2006, such relatively new investor groups] led 33% of all transactions over £100 million, as compared to only 8% of these larger deals during the whole of 2005, and none at all in 2001.

2.2 Sourcing Deals

There are a number of common sources of management buyouts. As can be seen in Figure 3, the main source of U.K. buyouts have been divestments of divisions or subsidiaries by listed U.K. companies. Such divestment-induced buyouts were especially prevalent in the late 1980s, when large U.K. conglomerates were frequently selling off non-core activities. This phenomenon was less in evidence in the second half of the 1990s, when buyouts were equally likely to come from sales of family-owned and other private companies.

[Insert Figure 3 about here]

Another important source of U.K. buyouts were the State sector privatizations that gathered pace during the second half of the 1980s, leading to a sharp increase in *management-employee* buyouts [not broken out in Figure 3]. In such cases, the specific skills of the incumbent management and employees were presumably believed to be key to the value of the business.

Box inset: **A Privatization Success Story.** Inmarsat, the U.K. mobile satellite communications company, came into being as an intergovernmental organization

(IGO) in 1979 to provide global safety and other communications for the maritime community. Starting with a customer base of 900 ships in the early 1980s, it then grew rapidly to offer similar services to other users on land and in the air, until in 1999 it became the first IGO to be transformed into a private company.

Apax and Permira bought the company in December 2003 for £921 million. Their strategy was to continue to develop the company into the world's leading mobile satellite communications company by continuing with plans to launch the Inmarsat-4 satellites and the next generation of high speed data and voice services--the Broadband Global Area Network (BGAN) service. The company was successfully floated on the London Stock Exchange in June 2005 for a market capitalisation of £1120 million. Inmarsat now supports links for phone, fax, and data communications to more than 287,000 ship, vehicle, aircraft and other mobile users and its BGAN service is now accessible across 85% of the world's landmass and to 98% of the population.

As already noted, the late '80s also saw a wave of management buy-ins, in which PE firms sought to match experienced entrepreneurial outside managers with underperforming businesses in cases where poor internal management made a management buyout or a trade sale infeasible. The first buyouts of U.K. listed companies, known as public-to- private transactions (PTPs), also took place during the second half of the '80s, in some cases in response to hostile bids. And in 1989, a U.K. PE firm actually made a hostile bid for a listed public company (and won!)— the first of its kind in U.K. history.

Then, during the recession of the early 1990s, buyout acquirers benefited from a steady deal flow at a time when reductions in corporate profits led to divestments and limited the ability of established groups to make further acquisitions.

In the second half of the 1990s, the pressure to maximize shareholder returns in corporate divestiture programs meant that the incumbent managers of subsidiaries were no longer seen as the preferred bidder, especially in larger transactions. This period saw the rise of *investor-driven* buyout acquisitions of subsidiaries, notably the so-called institutional buyout (IBO).[2] Additionally, as mentioned earlier, publicly listed family firms (as well as those in private hands) were a main source of buyout investments,

[2] A related development was the growth of leveraged build-ups (LBUs), an initial buyout type transaction to which further companies are added through a process of acquisition.

reflecting the need of founding owners for successors and wealth diversification, as well as a greater effort by intermediaries and financiers to target these kinds of companies, given the increasing difficulties with divestment cases.

Since the late 1990s, the major changes in the relative prominence of different deal types have been the growth in importance of both secondary buyouts and public-to-private buyouts (PTPs), and the shift of attention to larger deals caused by the severe challenges in exiting smaller deals. Although private equity providers had previously been reluctant to purchase companies from each other, the pressure for existing PE firms to obtain an exit due to the limited life of their funds helped them overcome their reluctance. Much of the impetus for private equity providers to buy portfolio companies from other financial investors has come from the difficulties in finding attractive deals from other sources as corporate restructuring programs passed their peak and auctions pushed up prices. In fact, over a third of the total U.K. market value of buyouts is now accounted for by secondary buyouts. There were 91 such buyouts in 2005, as compared to just 29 in 1995.

PTPs have developed over the life cycle of the market's growth, starting somewhat later than general activity in 1985 and showing a marked resurgence during the second half of the 1990s. Due to the high costs and risks associated with such deals, the first PTPs were relatively small and invariably involved incumbent management. But, as the process became better understood and those initial deals were successfully completed, there was a growing tendency towards larger and investor-led or institutional buyouts (IBOs) of larger public companies.

This suggests that the opportunities to restructure listed corporations by taking them private may be greater than once thought. Both in terms of volumes and values, PTPs have been far more important in recent years than in the top deal years of the 1980s, reaching a peak in 1999-2000, and then easing before recovering in value terms in 2005 (Figure 4). The Continental European trend has been similar.

[Insert figure 4 near here]

2.3 The Financial Structure of Buyouts

In contrast to the U.S. experience, where buyouts represented a continuously large fraction of total private equity investing throughout the 1980s, U.K. buyouts during the ’80s started small and became increasingly important relative to the overall private equity market.[3] One major contributor to the rise of the U.K. market was the significant entry by U.S. banks into the U.K. market, which boosted the provision of senior debt and mezzanine finance. At the same time, a number of new specialist funds for investment in buyouts were launched in the U.K.. Although domestic U.K. lenders were initially reluctant to become involved in transactions where asset sell-offs were necessary to repay debt, such an approach, after successful applications by U.S. buyers, gradually became an accepted feature of the larger end of the U.K. market.

As deal size increased from the mid-1990s, so did financial innovation. Most important for the development of the larger end of the buyout market was the emergence, in March 1997, of a European subordinated high yield debt market that was willing to fund buyouts. The initial demand for larger amounts of financing in larger U.K. buyouts could not be met with traditional senior debt or privately placed mezzanine. As a consequence, larger U.K. buyouts before 1997 resorted to the U.S. high yield bond market. But, from 1997 onwards, U.K. financial institutions became at first willing and then eager to invest in high-yield, non-amortizing senior debt instruments.[4] Such instruments enabled buyout financiers to operate with highly leveraged capital structures but without creating foreign exchange risks. The securitization of such leveraged loans, already popular in the U.S. buyout market, also

[3] Accounting for more than half of U.K. PE investments since 1987.

[4] As a reaction to the ruling environment of low nominal yields and the dampening of volatility in traditional asset classes

gained momentum in the U.K. and Continental Europe during this period.

The proportion of debt in U.K. buyouts has varied considerably over the past 20 years. While the percentage of debt in buyout deals peaked in the late 1980s in the U.K. and sharply declined in the early 1990s, the recent decline in interest rates has been associated with a relative increase in leverage ratios. In the average deal transacted in 2005, debt represented 51% of the purchase price (Figure 5).

[Insert figure 5 near here]

The number of equity, mezzanine, and debt providers that participate in any one buyout has also changed over time. In the early years (1985-89), when the market was immature, broad syndication was more common. The top ten buyouts during this period were funded by, on average, ten equity providers, eleven debt providers, and two mezzanine providers. These high numbers reflected the desire to spread the risks of the relatively smaller, less experienced fund providers that comprised the market at the time. But, as the U.K. buyout market has matured, the number of providers involved in buyouts has fallen. For example, in the ten largest buyouts over the period 2001-2005, there were, on average, three equity providers, four debt providers, and one mezzanine provider. But even so, as the deals keep getting larger, so does the number of equity providers that make up the consortia.

2.4 Buyout Bids and Probable Sources of Value Added

To gain control of a buyout target, investors usually pay a premium over its going-concern market value. While this premium cannot generally be observed for private companies, studies of PTP transactions have shown large abnormal gains for the selling shareholders when an LBO is announced.[5] The premium is traditionally calculated as the difference between the last price traded before the delisting and the pre-announcement price of the firm. Usually, the pre-announcement price is taken

[5] Michael C. Jensen, "The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems," *Journal of Finance* 48 (1993), 831-880.

some weeks (or months) prior to the first announcement in order to control for market "anticipation," which may drive prices upwards following insider trading or trading on rumors.

As reported in Table 4, a reasonable estimate of the average premiums paid to selling shareholders in LBOs is around 45%. Our recent study of U.K. PTPs during the period 1997-2003 found an average premium of 41% (with the pre-announcement price measured one month prior to the announcement). The share price reaction on the day of the PTP announcements was a positive 30%.[6]

[Insert Table 4 about here]

How can the private equity buyers in such deals feel comfortable offering 30-40% premiums, especially when their own investors are looking for returns on the order of 15-25% per annum? A number of arguments have been offered to explain such large anticipated gains.[7] While there are some similarities between U.S. and U.K. sources of value creation in LBOs, there are also some important differences.

Consistent with most studies of U.S. LBOs, studies of pre-transaction shareholders in the U.K. PTPs suggest that part of the value created by taking *public companies* private may be attributable to the market's undervaluation of the firm. Especially since the 1990s, according to statements by CEOs of firms going private and in terms of a deterioration in a PTP firm's share price relative to comparable firms that remain public, an important driver of U.K. PTP deals appears to be the incumbent management's belief that the market has incorrectly valued the company's prospects.[8] Another argument is that going private enables management to realize

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[6] L. Renneboog, T. Simons, and M. Wright, "Leveraged Public to Private Transactions in the UK," Working paper ECGI and Tilburg University, 2005.

[7] For an overview see L. Renneboog and T. Simons (2005), Public to private transactions: Motives, trends, theories and empirical literature on LBOs, MBOs, MBIs and IBOs, Discussion paper CentER, Tilburg University.

[8] C. Weir, D. Laing, and M. Wright (2005a), 'Incentive effects, monitoring mechanisms and the threat from the market for corporate control: an analysis of the factors affecting public to private transactions

perceived opportunities that could not be exploited while being listed.

The potential for increased *incentive alignment* in the private firm also seems to be an important source of value creation in PTPs and, presumably, in buyouts and private equity of all kinds. The operating managers in such companies typically are given or asked to purchase, significant grants of stock or options. And the fact that the private firm's board of directors is made up of its largest investors suggests a much more vigorous and effective monitoring process. Lending additional support to this argument, U.K. studies of U.K. PTPs also suggest that firms with outside blockholders, reap *smaller* benefits from going private. This is consistent with the idea that in firms monitored by this type of outside shareholder, there is less scope for operating performance improvements following the PTP transaction.[9]

In contrast to studies of U.S. LBOs, studies of U.K. PTPs suggest that the *reduction of the corporate tax bill* potentially accomplished by high leverage is not a significant motive to take a listed company private. Nor do U.K. deals appear designed to manage a corporate *free cash flow problem*—a conclusion reached by most studies of U.S. buyouts as well. But there is some evidence that the *costs of maintaining a listing* could be motivating some companies to go private. What's more, since the *indirect* costs of a listing—in the form, say, of management time spent on investor relations--are almost certainly much higher than the direct costs, it may be worth focusing more attention on this motive.

Our study shows that, in a sample of 182 U.K. PTPs over the period 1997-2003, only five firms were in financial distress before the transaction and required concessions from their banks for the continuation of their operations. In three of these

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in the UK', *Journal of Business Finance and Accounting*, 32, 909-944; Weir, C., D. Laing and M. Wright (2005b), 'Undervaluation, private information, agency costs and the decision to go private', *Applied Financial Economics*, 15, 947-961.

[9] Evidence also shows that[, after they go private,?] PTPs have higher concentrations of insider ownership, on average, and tend to separate the functions of CEO and Chair of the board more often (as suggested by the Combined Code). Weir et al. ibid.

five cases, the banks had actually announced that they were terminating their investments, thus forcing these firms to seek a new life-line. Since the bidders in these transactions have to supply the company with additional funds and assume a high risk of failure, they usually pay a discount to the going-concern market value.[10]

PTPs are costly to undertake and the risk that a bid will fail is significant. In the U.K., private equity bidders for listed companies may use irrevocable commitments, legally binding promises by shareholders to sell to the buyout bidder, both to ensure the success of a PTP proposal and to discourage a bidding contest that would potentially reduce their returns from the investment.[11] Irrevocable commitments are widely used in U.K. PTPs: 23.40% of a sample of 155 PTPs completed in the period 1998-2003 gained up to 20% irrevocables, and some 60% achieved at least 50% support from shareholders prior to the bid announcement.[12] Private equity firms use their expertise to obtain higher irrevocable commitments to the deal from significant shareholders in order to [persuade the target firm to?] accept the bidder's bid before the offer is made public. This approach is especially relevant when the incumbent management holds significant stakes and existing institutional shareholders are locked in to holding shares in the company. As already suggested,

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[10] For example, starting in 1995 Industrial Control Services underwent a major restructuring and a new management team consolidated the firm's technological position after 1997. Nevertheless, the financial position continued to deteriorate as the firm was too small to function in a market dominated by large competitors. The management could not rely on the continuing support of the banks over the long term and was not able to do another equity issue. Therefore, the board asked some investment banks to seek an interested party to acquire the firm or some parts. The board decided to support the offer from Alchemy Partners in order to assure short-term solvency. They took the firm private in an IBO at an 85% discount on the last quoted share price before the announcement of the offer, at 1 pence.

[11] Irrevocable commitments involve legally binding promises given by existing shareholders to agree to sell their shares to the bidder before the bid is announced. In the UK, the City Code on Takeovers and Mergers includes both rules concerning the conduct of management buyouts of listed corporations and restrictions relating to irrevocable commitments in terms of the number of shareholders that can be approached to obtain irrevocable commitments, the prohibition of favorable treatment for those offering irrevocable commitments without Takeover Panel consent, and the disclosure of irrevocable commitments. Irrevocable commitments are thus part of the public bid process. While they may not formally be given until just before a bid is announced, obtaining them involves private actions by the bidder prior to the bid being announced.

[12] Wright, M., C. Weir and A. Burrows (2006), 'Irrevocable Commitments and Going Private', *European Financial Management*, forthcoming

the announcement of irrevocable commitments may make other potential bidders less likely to enter the contest with an alternative bid since the commitment ensures that, without any higher alternative bid, the agreement to sell the share becomes binding, although a higher bid can still undo the commitment if it is a so-called ‘soft’ irrevocable. Research on irrevocable commitments suggests that investors proposing a PTP are more likely to gain the backing of other shareholders the greater the bid premium and the more reputable the private equity backer as indicated by the extent of their PTP activity.[13]

2.5 Exit Mechanisms and Returns from Buyout Investments

Studies of the longevity of buyouts suggests that private equity firms are under significant pressure to achieve their target returns and hence work towards a timely exit.[14] As a consequence, besides more intense monitoring of their portfolio companies, PE firms are also likely to use exit-related equity-ratchets on management's equity stakes. As can be seen in Figure 6, the most common type of exit has varied somewhat over the life of the U.K. buyout market. Sales to corporate buyers, or “trade sales” as they are typically called, have generally been the most common form of exit in the U.K., accounting for about a third of all exits during the recessionary period 1990-1994 (when receivership was an even more common end) and for close to 50% during the latter half of the ’90s.

[Box inset]The Case of Bols: Creating Value through Trade Sales. Bols, founded in Amsterdam in 1575, had become the Bols Royal Distilleries division of Dutch food group Royal Bols Wessanen NV by the time it was sold to CVC Capital Partners Ltd. in 1998 for €185 million. That move marked the end of a five-year effort to combine Wessanen foods with Bols drinks. Under the CVC umbrella, Bols bought the Metaxa and Asbach brands in 1999 from Diageo PLC, the world's biggest liquor company, which at the time was slimming its huge portfolio to focus on a core group of nine global brands. France's second largest liquor and wine company, Remy Cointreau S.A., wanting to participate in industry consolidation, agreed to buy Bols

[13] ibid.

[14] Wright M, K. Robbie, S. Thompson and K. Starkey (1994), 'Longevity and the life cycle of MBOs', *Strategic Management Journal*, 15, 215-227.

Royal Distilleries for €510 million in August 2000 just two years after the buy-out.

For the largest, most successful buyout portfolio companies, however, the most popular choice is likely to be an Initial public offering (IPO). This was the choice in roughly a third of the exits in the second half of the 1980s. But since then, the percentage of exits through IPOs has fallen sharply, from about 10% in the 1990s to 5% during the last five years.

The total value of exits reached a record of £18 billion in 2004 and remained high at £15 billion in 2005. This is more than twice the total value of exits that took place a decade earlier.

[Insert Figure 6 near here]

Secondary buyouts—sales of portfolio firms from one PE firm to another—have gained in importance since their start in the early 1990s, and they now account for almost a third of all exits. A number of factors have contributed to financial investors' decisions to sell their portfolio firms to other PE firms. Chief among them are (1) difficulties in exiting buyouts through IPOs; (2) the reduced acquisition appetite of corporations (especially for smaller deals), which appear increasingly intent on achieving greater focus; and (3) the need for private equity firms to exit from deals when their funds are nearing the ends of their contractual lives. The record levels of U.K. exit values in 2004 and 2005 were driven largely by major exits through secondary buyouts.

An increasing number of buyouts have had several subsequent private equity owners (sometimes referred to as "tertiary" or "quaternary" buyouts). At the end of 2005, a total of 41 companies had gone through at least three buyouts. Such companies tend to be mid-sized cash generators in mature sectors that can be easily releveraged.

[Box inset]The Case of Sirona Dental Systems: A Tertiary Buyout. Sirona Dental Systems, headquartered in Bensheim, Germany, manufactures dental equipment for clinics and dental laboratories worldwide and has been the subject of three buyouts. The first took place in 1997, when the company was bought by Permira from Siemens for €460 million. In 2003, EQT Partners bought the company from Permira for €418 million. Finally, in 2005, the company was sold as a secondary buyout to Madison Dearborn Partners for €800 million, with debt provided by JP Morgan. Sirona had performed well with EQT and a strong European business plan had been implemented. With Madison Dearborn at the helm, they aim to focus on the U.S. market and further develop their global strategy.

Performance of IPOs. Studies show that IPOs of U.K. buyouts result in positive and highly significant first day returns to IPO buyers. MBOs that are (at least) partly controlled by private equity firms are more underpriced than MBOs without private equity investors.[15] However, there is no difference in the long-run, post-IPO performance of either type of MBO.

Venture-backed MBOs in the U.K. tend to go public at an earlier stage than their non-venture backed counterparts. PTP MBOs in the U.K. that are backed by more reputable private equity firms tend to exit through IPO earlier and to perform better than those backed by less prestigious private equity firms.[16]

Returns. Private equity returns have been declining in recent years, which is not surprising considering the negative trend in the stock market over the period 2000-2004, the higher competition for deals, and the prevalence of auctions. But even so, the fund-level data published by national venture capital associations and the European Venture Capital Association (EVCA) consistently show that the internal rates of return (IRRs) on buyout funds outperform both the two other main categories of private equity funds: early-stage and all-stage venture capital funds.

A study (involving one of the current writers) using firm-level data on 321 exited buyouts in the U.K. during the period 1995-2004 reports that the average buyout company earned an IRR of 22.2% on its total Enterprise Value (debt plus

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[15] Jelic, R., B. Saadouni and M. Wright (2005), 'Performance of private to public MBOs: the role of venture capital', *Journal of Business Finance and Accounting*, 32, 643-682.

[16] Ibid.

equity) and that its average equity IRR was 70.5%.[17] IPO exits, as expected, outperformed trade sales and secondary buyouts. Larger buyouts--those with an initial transaction value above £100 million--had greater returns than medium-sized or smaller buyouts. The study further provides evidence that the monitoring and incentive effects associated with larger managerial equity stakes are a major contributor to the increases in enterprise value. (But, interestingly enough, this effect reverses when management controls the *majority* of the equity, a phenomenon limited to very small buyouts that fall below the target size range of most financial sponsors.) In the average U.K. buyout, the study also finds that leverage and interest coverage are also positively related to the rates of return value increases.

Refinancings and Partial Sales. In recent years, with the traditional forms of exit proving somewhat difficult, refinancings and partial sales have become a popular way for private equity houses to cash out part of their investment while at the same time keeping control of their portfolio company. There are two common methods of exiting through refinancing. First, the private equity house can refinance a business they own by having it borrow more and then paying themselves special dividends from the borrowings. Alternatively, the PE firm can sell some of its property assets to a third party (for example, to an insurance company), lease back the property, and transfer the proceeds from the sale to the PE firm in the form of a dividend. In 2005, the total refinancings accounted for almost a third of the total value realized in the U.K., as compared to a little over a tenth in 1997 (see Table 5).

A partial sale of the portfolio company provides another means of realizing part of the initial investment without losing control. These sales made up just under a third of the total value realized in the U.K. in 2001, when the value of the FTSE 100 fell sharply, but have since become less popular and now account for less than 10% of

[17] Nikoskelainen, E., and Wright, M., "The Impact of Corporate Governance Mechanisms on Value Increase in Leveraged Buyouts" CMBOR Occasional Paper (2006).

the total.

[Box inset]**A German Case of Partial Sale**. The Moeller Group, headquartered in Bonn, is one of Germany's largest and longest-established privately owned industrial and buildings electronic component producers. After the company suffered a downturn in performance in 2000-2002, it was bought in 2003 for €49 million by Advent International, which aimed to use the buyout structure to create a platform for successful growth and enhanced competitiveness. The existing management team were joined by two new board members from Advent and a restructuring plan was implemented. Advent turned an underperforming business into a profitable one in about two years and partially exited their investment by selling a 75% stake to Doughty Hanson in 2005, in a secondary buy-out, for €1.1 billion.

[Insert Table 5 about here]

Financial distress represents, of course, a forced exit. Over the last 20 years, there have been 12,267 U.K. buyouts, of which 1,431, or about 12%, have so far entered protection from creditors.[18] The high leverage in LBOs means, of course, that financial default will occur sooner, and with greater frequency, than in firms with lower gearing. And for this reason, we would expect significantly higher recovery rates for creditors. In U.K. buyouts that defaulted, secured creditors recovered on average about 60% of their investment. And, as happened in the U.S., many of these companies were eventually restructured and sold as going concerns.[19]

3.0 Buyouts in Continental Europe

Despite the growth in U.K. and Continental European markets noted earlier, the maturity of the different buyout markets varies markedly. One common indicator of the relative maturity of buyout market is the ratio of the value of buyout transactions to a country's GDP. As can be seen in Figure 7, the U.K. and the

[18] In the U.K. system, this process is known as receivership. The receivership rates varies according to vintage year, peaking at 21% for buyouts completed in the boom years of 1988-1990 which subsequently encountered problems in the recession of the early 1990s (see CMBOR, Management Buyouts Quarterly Review, Autumn 2005 Table A39 p.73). The failure rate of buyouts completed during the first half of the 1990s was approximately 12% by Sept. 2005.

[19] D. Citron, M. Wright, R. Ball and F. Rippington, "Secured Creditor Recovery Rates from Management Buyouts in Distress," *European Financial Management* 9 (2003), 141-162. Approximately a fifth were sold as outright going concerns.

Netherlands have the largest buyout markets as a proportion (about 1.5%) of their GDP, while the French and German markets appear to be about half that size. Spain and Italy have relatively undeveloped buyout markets, representing only about 0.5% of GDP.

[Insert Figure 7 about here]

Table 6 compares the factors influencing the development of private equity-backed buyouts in four different markets that are representative of the different stages of maturity observed in European private equity markets. As mentioned above, the U.K. represents the most mature market, with France closely following. Germany represents the less developed, though large, European PE economies, and CEE is representative of the largely undeveloped, emerging markets.

[Insert Table 6 about here]

As summarized in Panels A of Table 6, there are important differences among countries in terms of the supply of buyout opportunities. For example, in the U.K. most opportunities have come from the restructuring of diversified groups, with going private transactions becoming more important only in recent years. In France, by contrast, the marked growth in buyouts has been driven mainly by succession and portfolio reorganization issues in the large number of family controlled listed and unlisted companies. But even so, divestments by French corporations, in response to growing competitive pressures and an increasing focus on corporate governance and shareholder value, have recently become a major part of the French private equity market.

[**Box Inset**]**Profiting from Divestment**. In March 2002, CDC Equity Capital acquired Européenne de Stationnement, France's second largest car park operator, as part of a €100m ($88.4m) buyout from Groupe Fabricom, a construction subsidiary of French water utility Suez Lyonnais des Eaux. Européenne de Stationnement was sold to CDC along with Cabinet Villa, the second largest residential property management company in Paris, with a real estate portfolio valued at roughly €20m. Xavier Thoumieux, a partner at CDC Equity Capital responsible for the deal, planned to sell the real estate portfolio and develop Cabinet Villa before selling it on to another financial sponsor or strategic partner. Both Européenne de Staionnement and Cabinet Villa generate strong cash flow and yield attractive contracts. In France, the markets for both car park operators and property management have yet to be consolidated and provide good buyout opportunities for financial buyers.

By contrast, in countries like Germany, Spain, and Italy, the reluctance of founders of small and medium-sized firms to sell to private equity firms—or to cede control at all—has restricted market growth. As a result, divestments and secondary deals have been the most important sources of buyouts in these countries. In CEE, the transition from communism has been the main source of opportunities as many state-owned firms were privatized, though these volumes have steadily declined in recent years. The overall Continental European market for PTP transactions is still small, in part because these countries have far fewer listed companies in the first place. Culture may also play a role in this, with managers in some countries apparently expressing such pride in their listings to even consider going private.

Panel B of Table 6 attempts to summarize aspects of the “demand” side of the buyout market, particularly cross-country differences in attitudes to entrepreneurial risk and the willingness of managements to undertake buyouts. The most notable finding here is that U.K. managers appear much more inclined to take risks than managers in Continental European countries. The most important exception to this generalization is France, where the recent growth in buyouts seems to have been fueled in part by a more entrepreneurial culture. In contrast, the willingness of German managers to undertake buyouts has traditionally been low, but this appears to be changing as a high number of corporate restructurings reduces the security of managerial tenure.

The “infrastructure” for doing buyout deals also differs significantly across countries. As can be seen in Panel C, the U.K. has more developed private equity and debt markets, better intermediary networks, and more favorable legal and taxation frameworks. Nevertheless, changes are underway in the other countries to improve their institutional and regulatory infrastructure. The French private equity industry grew rapidly from the mid-1980s, with law firms playing a particularly important role in the diffusion of the buyout concept. The infrastructure to complete German deals was for a long time less than favourable--few intermediaries, an underdeveloped private equity market, and high rates of taxation. Many of these restrictions did not begin to ease until the mid-1990s, when, for example, the country's punitive capital gains tax regime relating to share disposals began to be relaxed.

Finally, we considered cross-country differences in exit routes and their importance to private equity firms in realizing the value of their buyout investments. As summarized in Panel D of Figure 6, there are notable differences among countries in the extent to which stock markets facilitate IPOs of buyout companies. One must begin by recognizing that even highly developed stock markets provide limited exit opportunities to all but larger, fastest-growing businesses. At the same time, as many corporations complete their restructuring and markets become more concentrated and global, the corporate M&A market provides less scope for the trade sale as an exit route, especially for smaller deals. As a result, secondary buyouts and buy-in transactions have become a popular exit route for PE buyout investments in the U.K. market; and they are likely to become increasingly important in other markets as they mature, particularly as companies seek exits when both the stock and M&A markets are weak. In France, although the development of the Second Marché and the Nouveau Marché enlarged the possibility for the realization of value in buyout investments, partial sales have provided a frequent exit route for investors.

Box inset: **The Case of Autobahn Tank & Rest**. The secondary buyout of Autobahn Tank & Rest by Terra Firma for €1.1 billion was announced in 2004. For more than 50 years, Autobahn Tank & Rest has operated a network of filling stations, and service and catering sites throughout Germany. The company had performed well under Allianz Capital Partners and Apax Partners, which funded the €961 million first buyout in 1998, and planned to realize their investment through an IPO on the Frankfurt stock exchange. But since the IPO would only have given shareholders a

40% exit, the selling PE firms chose the secondary buyout by Terra Firma, which provided a 100% exit.

4.0 Prospects and Challenges

In this section, we present the challenges and prospects now facing the European private equity sector. We focus on the most pressing issues at the moment, including challenges in fund-raising, deal sourcing, structuring, bidding, and exit.

4.1 Fund-raising: What are the implications of the current fund overhang?

Private equity fund-raising has reached record levels in the last five years, but the investment of funds has not kept pace. As a result, Europe is currently endowed with a fund overhang estimated at roughly $40 billion;[20] and the general sentiment, shared by practitioners and academics alike, is that too much capital is chasing too few deals. With rising entry multiples, and many new entrants in the private equity industry in the last few years, this suggests the need for rationalization of the playing field and some consolidation of the industry.

4.2 Deal-sourcing: How will private equity firms source their deals in the future?

Data on buyouts of subsidiaries and parent-to-parent sales suggest that divestment activity by U.K. corporations has passed its peak. However, as corporations continue to make acquisitions, opportunities for divestment buyouts are likely to remain--for example, in cases where post-acquisition integration issues are not adequately addressed, or senior managers fail to provide compelling incentivizes for the management of the new subsidiaries or divisions. And there still seems to be ample potential for restructuring larger corporations in Continental Europe.

In the U.K. as well as Continental Europe, there also continue to be large numbers of family-owned firms, many with aging founders and little active succession

[20] See e.g., Pricewaterhouse Coopers Global Private Equity 2004 for funds raised and invested between 1998 and 2003

planning.[21] A central issue in such firms is the founder's expectation of future involvement with the business, which can play a major role in the negotiation of the deal, especially the price at which they are willing to sell. Owners of private businesses in the U.K. seem in general to be more willing both to sell and to cut their ties with their firms than their counterparts in Continental Europe.

The entry of hedge funds into the Continental European buyout market poses a competitive challenge to private equity firms in terms of deal sourcing. The expectation is that hedge funds' investments may trigger restructuring and focus on cost reduction over the relatively shorter term. To the extent this turns out to be correct, it raises doubt about hedge funds' ability to build the longer-run "growth" value of the LBOs they invest in. Questions are also being raised about how hedge funds will behave when one of their LBO companies becomes financially distressed. Will they walk away or focus mainly on generating fees (at the expense of total value) when participating in recapitalizations? The presence of hedge funds thus also has implications for the approach adopted by existing debt providers in the market.

Our expectation is that different types of hedge funds will emerge with different mandates and a focus on different types of buyouts. Securitization likely will become more prevalent, and its impact on the future buyout market could be far-reaching in terms of the size of deals that will be possible.

4.3 Deal structuring: What further innovations can PE firms make in buyout structuring and financing?

The majority of hedge funds active in the leveraged buyout (LBO) market have focused so far on providing subordinated debt, such as second-lien and mezzanine debt, and payment-in-kind securities (PIKs). Thus, they may represent more serious competition for providers of mezzanine and junior debt than the private

[21] Over a fifth of respondents to a recent CMBOR survey of buyouts of family firms have not done any succession planning.

equity funds themselves. The emergence of alternative private equity providers at the top end of the market may bring more innovative and more flexible players with a lower cost of capital, but it remains to be seen whether they have the skills to generate the gains achieved by private equity firms.

The resurgence of club deals has enabled syndicates of private equity firms to bid for very large buyouts that would otherwise be too risky to fund on their own. In addition to this risk-spreading rationale, they may also bring together the diverse specialist skills required to restructure and regenerate a particular deal.[22] However, club deals pose a number of potential problems.[23] Limited partners seeking to diversify their investments in private equity may be concerned when the different funds in which they invest are part of the same syndicate to complete a particular deal. Despite the presence of "drag along," "come along," and "tag along" provisions, coordination may be problematical when restructuring is required. Where these syndicates involve partners who are highly experienced players in the market, the potential for tensions when egos clash about strategy and restructuring seems clear.

The emergence of second-lien bonds and loans, typically with fewer covenants than first-lien debt but sharing of collateral with senior debt providers, introduces the possibility of longer maturities and more attractive interest rates. But such debt instruments may have the disadvantages of limiting future finance options by creating conflicts of interest between first- and second lien providers. In Europe, second-lien loans in buyouts are typically mezzanine debt.[24]

4.4 Buyout bid: Will bidding conditions for private equity firms change?

Given the greater prevalence of auctions, record levels of fund-raising, and

[22] For example, a generalist private equity firm may link with a second firm with specialist technology skills.
[23] Wright, M. and A. Lockett (2003), 'The structure and management of alliances: syndication in venture capital investments', *Journal of Management Studies*, 40, 2073-2104.
[24] Issues remain to be resolved about the duration of the enforcement of standstill agreements and the extent of waiver of adequate protection rights by second-lien providers.

difficulties in identifying attractive new deals, it seems unlikely that PE firms will be able to acquire control of target companies at lower bid premiums than those observed to date. This fact, combined with the current high market valuations and entry multiples, as well as the institutionalized pressure on PE firms to invest, raises the important question as to how buyout financiers will be able to generate sufficiently high returns to satisfy their investors three to ten years from now.

Since facing limits on the further use of leverage as a value-creation mechanism is now common as well as pressure to generate high exit returns over the short to medium term, PE firms will have to make their buyout operations even more efficient. As a consequence, private equity firms will increasingly have to distinguish themselves through their operating capabilities and, perhaps, industry specialization.

4.5 Exit: What further challenges does the advent of the secondary buyout pose?

The recent record growth in secondary buyouts may help management to remain independent while enabling private equity firms to obtain at least a partial exit. For the incoming investors, even though management has a proven track record, a major question needs to be answered: will managers be buyers or sellers in the deal? This raises a further number of issues. First, when the management team is seeking to increase their equity stake, there may be a corresponding reduction in control by the private equity firm. This may be problematical if it means that management are able to embark on risky growth strategies with little monitoring. When managements are able to realize significant gains, motivating them to perform in the subsequent deal may also be difficult.

A final, unresolved issue about secondary buyouts concerns the possibility that limited partners will be asked by private equity firms to invest again in the same deal through a subsequent fund, and presumably at a higher price than the first time around. While exit from the first buyout allows the realization of capital gains, limited partners may take some convincing that further significant capital gains will be forthcoming.

5. Conclusions

In the past two decades, European buyout markets have continuously adapted to changing conditions, including challenges relating to deal sourcing, the entry of new players, and the generation of returns. Competition for larger buyouts has forced prices higher, but with record amounts of capital raised in 2005, it seems that large deal flow will continue to grow over the coming years. With strong buying power at the disposal of specialized venture capital, private equity firms, and hedge funds, and with the growth of club buyouts, it may only be a matter of time before we see very large firms (even FTSE 100 companies) being taken private.

With the higher profile of the private equity asset class enabling buyout funds to attract the best managers to run the target companies, banks have been more willing to gear up deals and even refinance them after a short period of time. Although this strategy involves significant risks--and growing concerns about the near-term performance of European economies and trends in interest rates are beginning to raise questions about the degree of leverage in buyout deals--there is also potential for commensurately higher returns.

The U.K. market has become quite mature and has one of the highest proportions of buyout values to GDP. If this remains at around 1.5 to 2%, as it has over the last several years, then the buyout market should grow at least in line with the U.K. economy. Elsewhere in Europe, pressures on larger corporations to restructure likely will lead to increased deal activity, notably divestments. The growing number of large secondary buyouts provides valuable liquidity for the buyout market at a time when exits have become difficult. Trade sale opportunities appear to be growing once again and stock markets have become more encouraging, which should help allay building concerns of institutional investors about the recycling of capital seen in recent years.

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Table 1: Number and value of buyouts/buy-ins in Continental Europe (CE) and U.K. 1996-2005

Panel A: Number of Buyouts/Buy-ins

Country Name	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Austria	1	2	2	1	2	1	4	0	1	0
Belgium	2	3	4	5	5	4	2	1	5	8
Denmark	3	2	3	3	5	2	2	1	2	6
Finland	1	3	6	3	2	3	4	5	5	6
France	26	25	48	64	38	19	25	35	22	63
Germany	17	21	22	18	15	21	8	11	17	22
Ireland	1	3	4	2	3	5	4	5	4	2
Italy	15	10	13	24	10	6	15	12	17	19
Netherlands	14	13	20	18	15	7	9	8	9	14
Norway	2	0	0	0	2	2	2	3	4	5
Portugal	4	2	3	3	3	0	1	1	0	2
Spain	3	8	20	11	10	12	11	11	9	22
Sweden	5	6	8	7	4	2	6	6	5	13
Switzerland	11	7	5	7	4	1	2	1	4	0
Total (CE)	**105**	**105**	**158**	**166**	**118**	**85**	**95**	**100**	**104**	**182**
UK	646	709	691	656	618	642	637	711	701	685
Total (inc UK)	**751**	**814**	**849**	**822**	**736**	**727**	**732**	**811**	**805**	**867**

Source: CMBOR/Barclays Private Equity/Deloitte

Table 1: Number and value of buyouts/buy-ins in Continental Europe (CE) and U.K. 1996-2005

Panel B: Value of Buyouts/Buy-ins (€m)

Country Name	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Austria	72	128	95	680	734	47	154	303	88	28
Belgium	147	414	820	2,595	337	1,744	517	1,448	2,266	4,057
Denmark	411	263	267	2,173	1,313	500	1,391	848	260	7,060
Finland	724	440	560	1,085	675	1,047	480	1,039	977	2,044
France	2,189	5,275	6,198	8,387	6,503	6,387	15,557	8,772	11,489	20,714
Germany	1,704	3,538	5,265	4,629	15,084	7,229	8,143	11,908	17,915	11,727
Ireland	116	119	244	1,475	259	5,021	4,930	747	970	770
Italy	1,146	3,121	673	2,756	2,555	1,002	3,428	7,773	3,013	17,512
Netherlands	1,001	1,059	3,528	2,906	1,856	4,433	1,870	4,958	7,612	10,256
Norway	315	180	22	225	1,004	1,370	142	308	455	426
Portugal	158	64	83	206	83	2	26	54	8	76
Spain	227	374	859	1,715	941	1,528	2,069	934	2,274	9,391
Sweden	700	1375	928	2,926	3,169	3,005	1,116	2,226	1,701	4,702
Switzerland	1,316	2,426	1,347	1,013	1,772	715	2,766	864	1,570	563
Total (CE)	**10,226**	**18,776**	**20,889**	**32,771**	**36,285**	**34,030**	**42,589**	**42,182**	**50,598**	**89,326**
UK	12,555	17,114	23,273	26,864	38,349	31,343	24,844	23,570	30,144	35,406
Total (inc UK)	**22,781**	**35,890**	**44,162**	**59,635**	**74,634**	**65,373**	**67,433**	**65,752**	**80,742**	**124,732**

Source: CMBOR/Barclays Private Equity/Deloitte

Table 2: Management Buyouts 1986-2006: Major Highlights

	UK	Continental Europe
1986	Emergence of bought deals and US banks; First going private buyouts involving recommended offers (Gomme, Raybeck). First over £250 million U.K. Buyout Fund.	CMBOR begins to record the deals across CE in earnest. There were 167 buyouts with a combined value of €1 billion. First PTP recorded in France and Sweden.
1987	Emergence of large buyouts and growth of going privates; Privatisation buyouts record market share (10.3) per cent) and deal volume (32) but receivership buyouts record low at 0.6 per cent; Strong growth in Western European market. 100th buyout flotation.	First investment in CE firms by US financiers (in France and Spain).
1988	First mezzanine debt fund; buy-ins exceed 100 deals and £1 billion value in a year for the first time; peak year for subsequent buy-in failure.	First PTP in Denmark and the Netherlands. Market value exceeds €5 billion for first time. Beginning of first market boom due to rapid growth in the number and types of financiers and major growth in management buy-ins.
1989	Emergence of hostile LBOs and unbundling; Record total deal value £7.5 billion. First £2 billion transaction (Isosceles). First 500 MBIs; Record MBO trade sales; almost £1 billion raised for U.K. buyout specific funds.	First investment in German buyout by US financier. First use of mezzanine by 3i (investment in Lignotock in Germany).
1990	Collapse of large highly leveraged deal market; resurgence of smaller buyouts and those from receivership; record total buyout/buy-in deals volume (597) and of buyouts (486). U.K. interest rates at their highest.	Deal numbers peak for the first time at 413. Europe-wide recession closes in.
1991	Buyouts from receivership record 19.3%of deals; record failures of buyouts/buy-ins at 124.	A relatively quiet year for the buyout market with deals numbers falling compared to previous years to 336 and value falling similarly to €5.5 billion.
1992	Buyouts and Buy-in account for record 57%of all takeovers and 35%of their value; Emergence of Eastern European Buyouts.	First PTP in Germany. Surge in buyouts in Germany due privatizations by Treuhandanstalt post reunification. Basel I implemented in G-10 countries (risk management in banking). First secondary buyout recorded by CMBOR.
1993	500th buyout recorded by CMBOR; Buyouts from receivership decline from earlier peak; Buyouts from U.K. parents reach record low of 39 per cent; 200th buyout flotation.	Second highest number of privatizations across Europe.

1994	Emergence of Serial Buyout/Buy-in Entrepreneurs. All-time Privatisation buyouts exceed 200. First 1,000 MBIs; record buyout fund raising; Record flotations of buyouts/buy-ins at 48.	The number of buyouts from foreign parent divestments peaked for the first time at 74; those from privatizations fell from the year before but remained a significant source.
1995	Emergence of Investor Buyouts (IBOs); Buy-ins account for a record 36%of the buyout/ buy-in market; Buyouts of privately held/family businesses at record 40%of market; record trade sales of buyouts/buy-ins at 95; 10,000 buyouts recorded by CMBOR. The Alternative Investment Market (AIM) was introduced.	SWX (Switzerland), the world's first fully automated stock exchange, comes into operation.
1996	Total buyout market at £7.8 billion exceeds previous 1989 record. Buy-ins rise to a record 55%of total M&A. Rise of secondary buyouts and a new record for exits.	The end of a Europe-wide recession leads to the second market boom and the buyout market begins to take off again. Market value exceeds €10 billion for the first time.
1997	Another record year beats the £10 billion barrier. Exits down with flotations only two thirds of previous year. New trend of privately sourced deals exceed U.K. divestments. Continental buyout market receives increasing focus.	Neuer Markt launched in Germany for smaller companies. Geberit Beteiligungs was Switzerland's largest buyout (€1.3 billion). Deal numbers across CE exceed 500 for first time.
1998	Growth of IBOs and MBIs lead the third successive record market value year at £14.5 billion. PTPs responsible for 20%of value. Trade sales reach record high, but flotations continue to fall.	Tecnologistica (Italy) was the first tertiary buyout in CE. Deal value exceeds €20 billion for first time. The second highest number of buyouts from family firms is recorded. MBIs become a major feature of market.
1999	Buyouts over £100 million reach record numbers to boost value to another record £16.8 billion. PTPs account for a quarter of market value; deals under £5 million drop by a third. Exits slow, particularly flotations. Emergence of US fund interest.	Andritz largest buyout in Austria (€481 million)
2000	At £23.9 billion market is more than four times 1995 value, but depressed number of smaller and mid-market deals. Family/private deals lowest since 1986. PTPs smash previous record. Receivership show largest increase in exits. 15,000 buyouts recorded by CMBOR. First £3bn deal (MEPC/Leconport, £3.5 billion)	Dyno Nobel was Norway's biggest buyout (€680 million). Alfa Laval was Sweden's largest buyout (€1.6 billion). Euronext formed in September in order to take advantage of the harmonization of the European Union financial markets.
2001	Value falls 20% to £19.2 billion as	Eircom Ireland's largest buyout (€4.8

	mega deals disappear and PTPs slow. Big drop in trade sales emphasize exit difficulties but funds raised boom to an even higher amount.	billion). Cognis Holland's biggest buyout (€2.5 billion). Basel II deliberations begin. Kabel Deutschland CEs largest secondary (€2.1 billion).
2002	Further fall in volume, value down another 20%. Large deals and PTPs disappearing. Buyouts still account for nearly half of M&A activity. Trade sales continue to drop, but receiverships and secondary buyouts increasing.	Neuer Markt closes after losing 95% of its value in 2.5 years. Legrand was largest buyout in France (€5.1 billion). Telediffusion de France was largest privatisation (€2.4 billion). No. of buyouts from the high technology sectors at their highest.
2003	Buyout market stabilises: 6 percent increase in value; 8%increase in volume. PTPs highest for three years. Exits still flat but secondary buyouts almost equal to trade sales.	There were more buyouts originating from the business services sector than in any other year.
2004	Year ends strongly with second highest ever value of £20.1 billion. Mega deals bounce back with 47 above £100 million. Record exits largely due to secondary buyouts. Fund raising lowest since 1996. 20,000 buyouts recorded by CMBOR.	Record value of buyouts in Germany (€17.9 billion). Celanese was largest ever German buyout (€3.1 billion). CBR first German buyout over €1 billion. Deal value across CE exceeds €50 billion for first time.
2005	Another strong year with highest ever value at £24.2 billion. Buyouts over £100 million a record 49. Highest number of exits with secondary buyouts highest recorded. First buyout financed by Hedge Fund.	There were 694 buyouts with a combined value of €88.7 billion. Record number of buyouts in Germany (113). SBS Broadcasting Belgium's largest buyout (€2.1 billion). Wind Telecommunications was Italy's largest buyout (€12.1 billion). Amadeus was Spain's largest buyout (€4.3 billion). Sanitec was Finland's biggest deal (€1 billion). Frans Bonhomme and Eau Ecarlate (both France) were the first quaternary buyouts. Highest number of buyouts from family firms.
2006	Slow start, especially in deal value.	TDC of Denmark becomes largest ever buyout in the whole of Europe including the U.K. (€13 billion).

Source: CMBOR

Table 3: European Buyout Funds Raised and Invested (€m)

	2000	2001	2002	2003	2004
Funds Raised - CE (of which UK)	24,347 (12,265)	21,541 (14,286)	18,255 (12,323)	20,661 (13,732)	17,787 (7,975)
Funds Invested – CE (of which UK)	14,406 (6,871)	10,945 (3,863)	16,917 (7,519)	18,438 (9,446)	25,743 (15,128)

Source: EVCA. U.K. in parentheses

Table 4: Premiums paid above market price to take a firm private: US and U.K. studies compared

Study	**Sample period/ country**	**Type of Deal**	**Obs.**	**Premium**	**Event window**	**CAAR**
DeAngelo, DeAngelo and Rice (1984)	1973-80 US	ALL	72	**56.3%**	-1,0 days -10,10 days	**22.27%***** **28.05%*****
Lowenstein (1986)	1979-84 US	MBO	28	**56.0%**	N.A.	**N.A.**
Torabzadeh and Bertin (1987)	1982-85 US	ALL	48	**N.A.**	-1,0 months -1,1 months	**18.64%***** **20.57%*****
Lehn and Poulsen (1989)	1980-87 US	ALL	244	**36.1%**	-1,1 days -10,10 days	**16.30%***** **19.90%*****
Amihud (1989)	1983-86 US	MBO	15	**42.9%**	-20,0 days	**19.60%*****
Kaplan (1989a)	1980-85 US	MBO	76	**42.3%**	-40,60 days	**26.00%*****
Marais, Schipper and Smith (1989)	1974-85 US	ALL	80	**N.A.**	0,1 days -69,1 days	**13.00%***** **22.00%*****
Asquith and Wizman (1990)	1980-88 US	ALL	47	**37.9%**	N.A.	**N.A.**
Slovin, Sushka and Bendeck (1991)	1980-88 US	ALL	128	**N.A.**	-1,0 days -15,15 days	**17.35%***** **24.86%*****
Lee (1992)	1973-89 US	MBO	114	**N.A.**	-1,0 days -69, 0 days	**14.90%***** **22.40%*****
Frankfurter and Gunay (1992)	1979-84 US	MBO	110	**N.A.**	-50,50 days -1,0 days	**27.32%***** **17.24%*****
Travlos and Cornett (1993)	1975-83 US	ALL	56	**41.9%**	-1,0 days -10,10 days	**16.20%***** **19.24%*****
Lee, Rosenstein, Rangan and Davidson (1992)	1983-89 US	MBO	50	**N.A.**	-1,0 days -5,0 days	**17.84%***** **20.96%*****
Harlow and Howe (1993)	1980-89 US	ALL	121	**44.9%**	N.A.	**N.A.**
Easterwood, Singer, Seth and Lang (1994)	1978-88 US	MBO	184	**32.9%**	N.A.	**N.A.**
Van de Gucht and Moore (1998)	1980-92 US	ALL	187	**N.A.**	-1, 1 days -10,10 days	**15.60%***** **20.20%*****
Goh, Gombola, Liu and Chou (2002)	1980-96 US	ALL	323	**N.A.**	-20,1 days 0,1 days	**21.31%***** **12.68%*****
Weir, Laing and Wright (2003)	1998-	ALL	95	**44.9%**	N.A.	**N.A.**

	2000 UK					
Renneboog, Simons and Wright (2006)	1997-03 UK	ALL	177	**41.0%**	-1,0 days -5,5 days -40,40 days	**22.68%***** **25.53%***** **29.28%*****

Note: ***, **, * stand for statistical significant at the 1, 5 and 10% level, respectively. ALL = all going private deals. MBO = MBO deals only. Source: Renneboog and Simons (2005)

Table 5: Total Value Realised for U.K. Buyouts/Buy-ins

Year	Total Value Realised (£m)	Total Exit Value (Percent)	Total Refinance Value (%)	Total Partial Exit Value (%)
1997	6801	87%	12%	1%
1998	6283	70%	28%	2%
1999	8471	77%	12%	11%
2000	16736	59%	25%	16%
2001	18179	47%	23%	30%
2002	17587	62%	21%	17%
2003	13417	66%	19%	15%
2004	34258	53%	30%	17%
2005	40533	54%	31%	15%

Source: CMBOR/Barclays Private Equity/Deloitte

Table 6: Comparison of Factors Affecting MBO Market Development in Europe

Panel A: Supply of opportunities

	UK	France	Germany	CEE
Need to deal with family succession problems	Moderate need	High need	High need	Low need
Need to restructure diversified groups	Established patterns throughout period	Became established in 1990s	Becoming established from mid-1990s	Increasingly established in early 2000s
Need to privatise state-owned companies	Well established programme from 1980s; now complete	Less extensive than UK	Former GDR apart, relatively little	Bulk of privatizations completed
Scope for 'going-private' transactions	Large stock market; few initial deals now significant	Steady flow but often family control issues	Relatively small number of quoted companies	Many candidates; specific opportunities must grow
Development stage of M&A markets	Highly developed	Relatively active	Becoming active	Relatively active

Panel B: Demand for private equity

	UK	France	Germany	CEE
Attitude to entrepreneurial risk	Was very positive from early 1980s	Moderate	Traditionally low, changing slowly	Positive and growing
Willingness of managers to buy	High	Moderate	Starting to develop	High, but lacking financial means.

Panel C: Infrastructure to complete deals

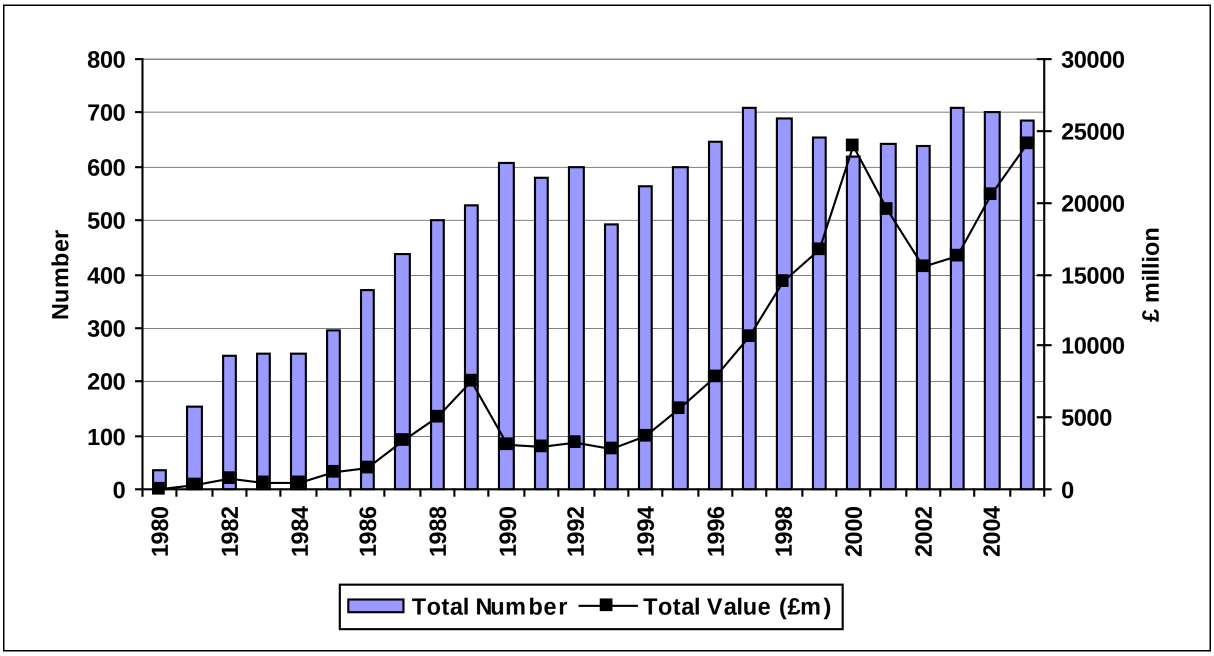
	UK	France	Germany	CEE
Private Equity and Venture Capital market	Grew rapidly from early 1980s	Grew from late 1980s but many small players	Traditionally small & not MBO orientated	Small but developing.
Supply of debt	High	High	Tradition of high leverage	Low but growing
Intermediaries network	Highly developed	Moderately developed	Fragmented	Highly developed
Favourability of legal framework	Favourable	Favourable	Moderately favourable	Favourable
Favourability of taxation regime	Favourable	Favourable	Reforms in progress	Moving to favourable with EU reforms

Table 6 continued
Panel D: Realization of Gains

	UK	**France**	**Germany**	**CEE**
Stock markets	Receptive to private equity cos. From mid-1980s; now more difficult	Development of 2nd market	New issues sparse; secondary tier market closed	Growing domestic capital pool and appetite
Trade sales	Highly active	Becoming more active especially for partial sales	M&A market developing	Highly active
Secondary Buyouts/restructuring	Increasing interest	Favoured route	Possible route	Possible exit route

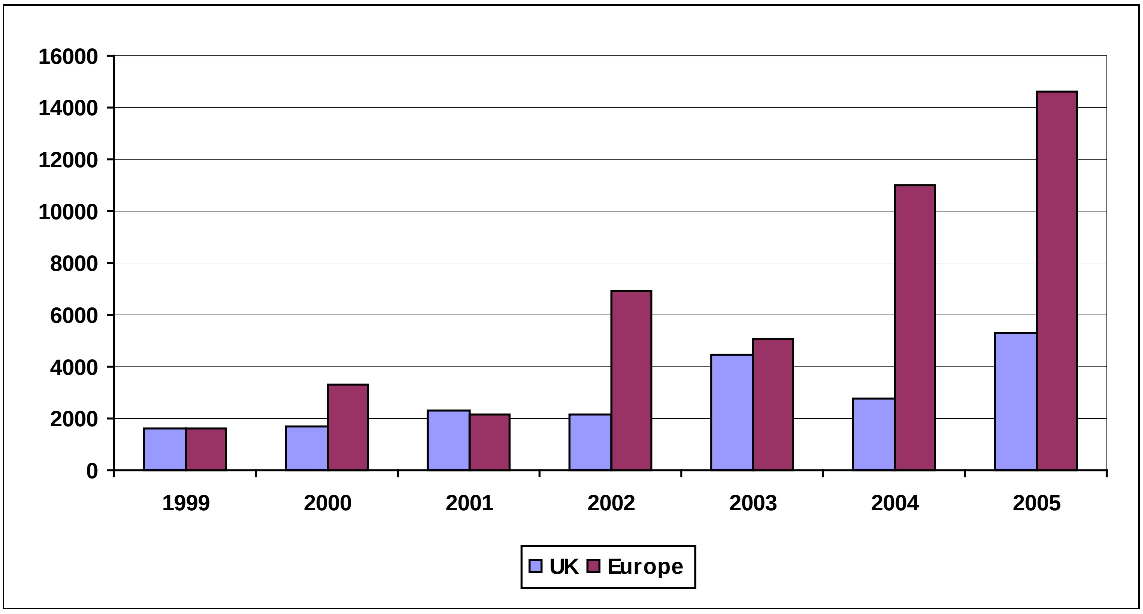
Source: CMBOR

Fig. 1: U.K. Buyouts/Buy-ins, 1980 - 2005



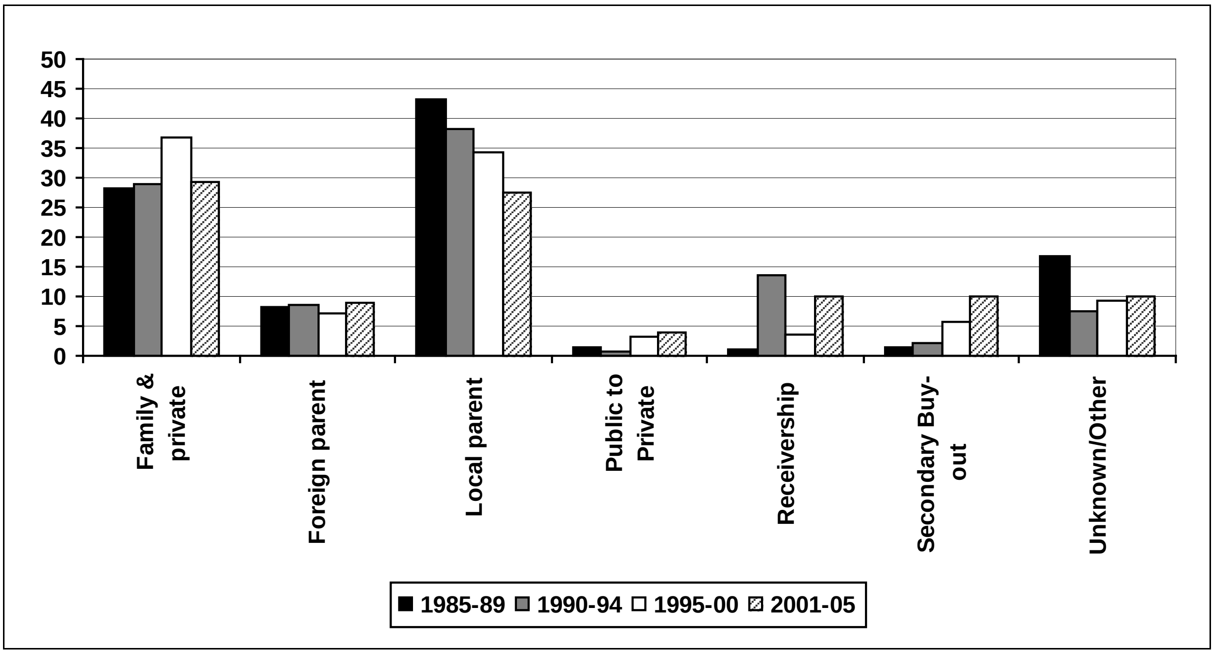
Source: CMBOR/Barclays Private Equity/Deloitte

Fig. 2: US-Based Buyout Funds Raised, 1999 – 2005 (£billion)



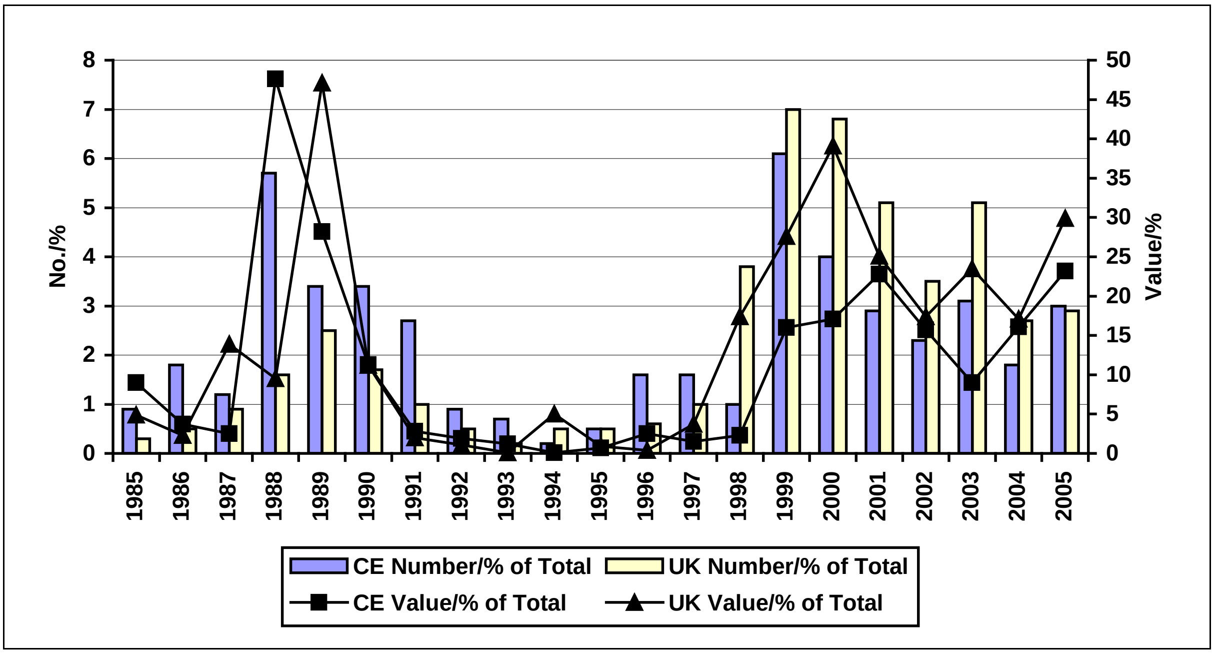
Source: CMBOR/Barclays Private Equity/Deloitte

Fig. 3: Sources of U.K. Management Buyouts/Buy-ins (Volume %)



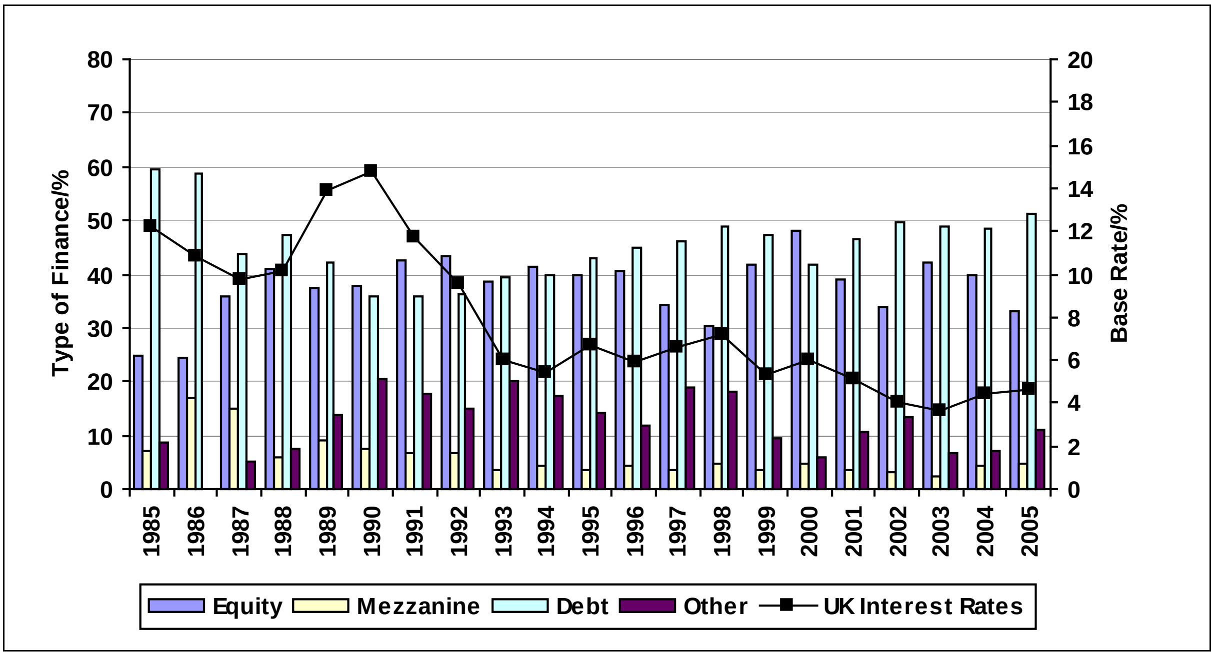
Source: CMBOR/Barclays Private Equity/Deloitte

Fig 4: PTP Numbers and Values as Share of Total Market



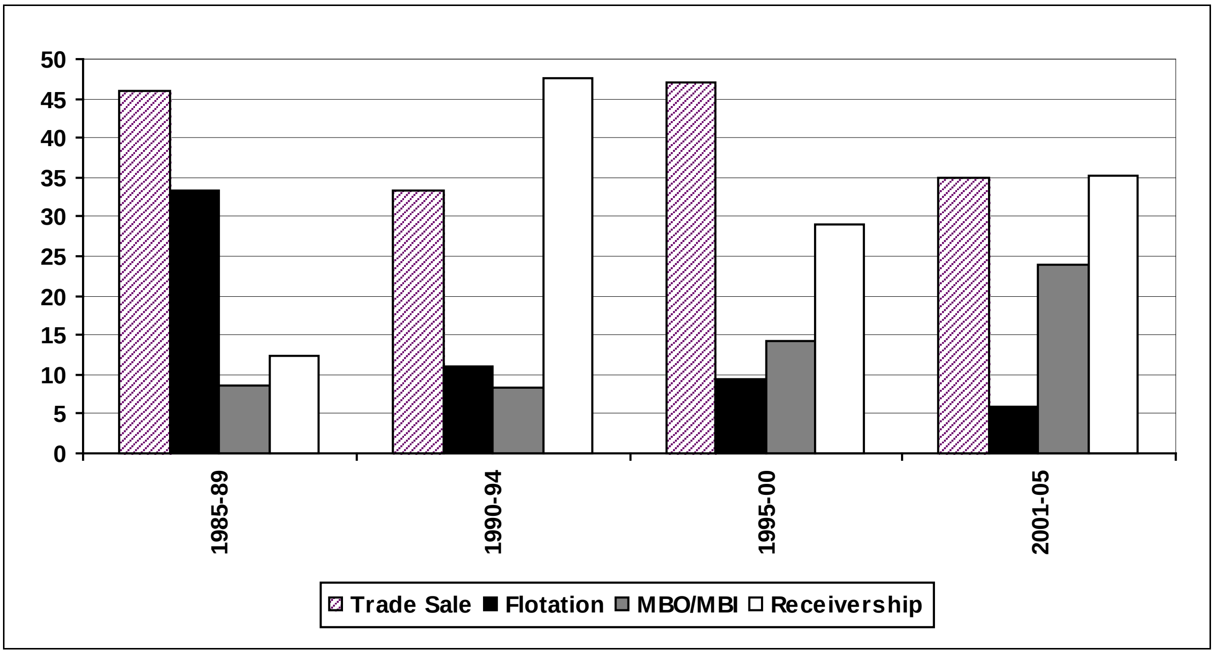
Source: CMBOR/Barclays Private Equity/Deloitte

Fig. 5: Average Deal Structures and U.K. Interest Rates



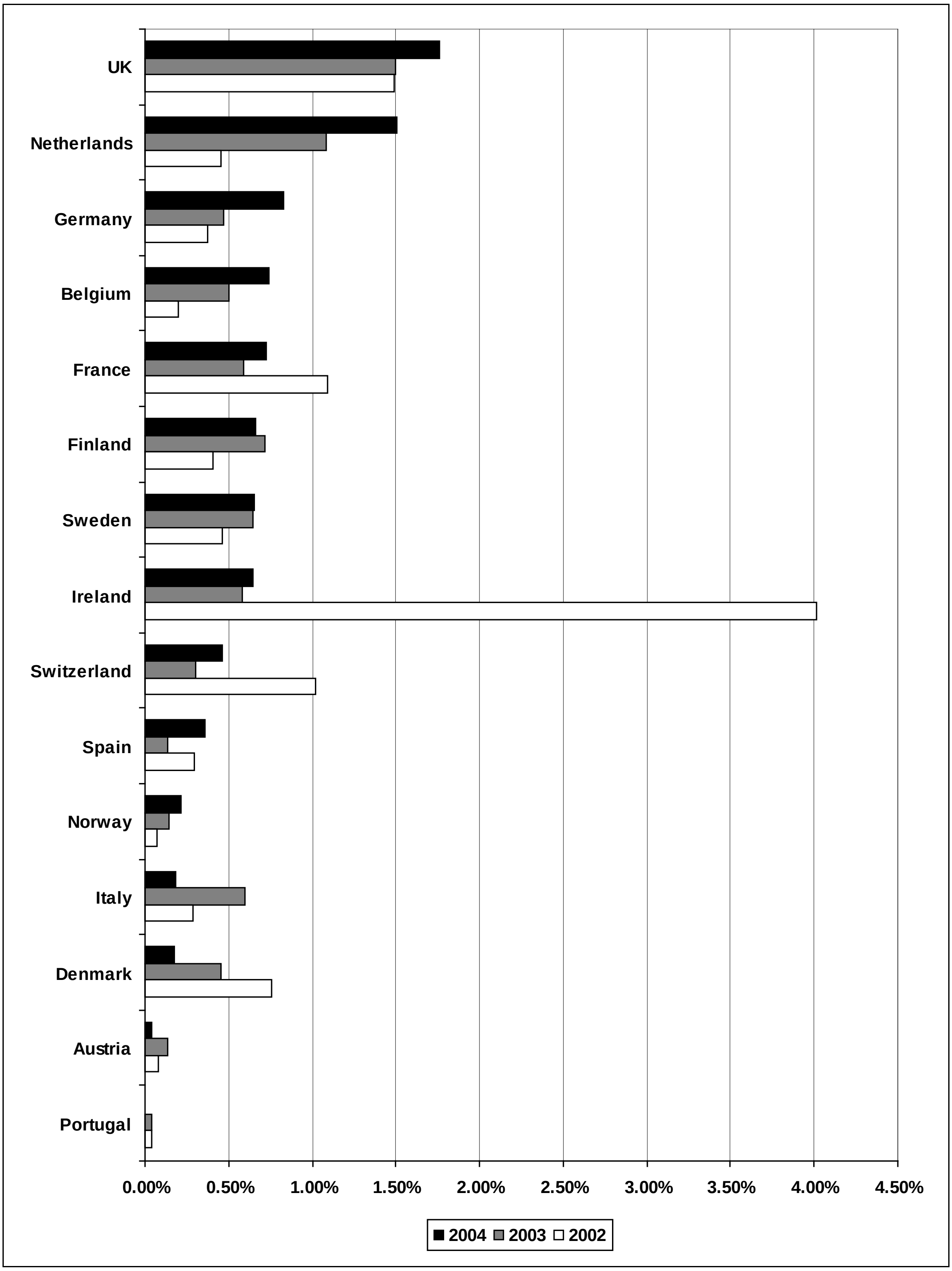
Source: CMBOR/Barclays Private Equity/Deloitte

Fig. 6: Exits of U.K. Buyouts and Buy-ins (%)



Source: CMBOR/Barclays Private Equity/Deloitte

Fig. 7: Buyouts as a Percentage of GDP



Source: CMBOR/Barclays Private Equity/Deloitte and OECD Statistics