

Natural Bedfellows?

Private Equity and Retailing Today

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Agenda

- **My background**
- **What is private equity?**
 - **How does it work?**
 - **Where does value come from?**
 - **Is private equity dead?**
- **What does private equity look for in companies?**
 - **Especially in retailers?**
 - **What does private equity look at in portfolio companies?**
 - **Are there any lessons for other companies?**

My background

- **Public company CFO**
- **Public company non-executive director**
- **Adviser on retail to private equity**
- **Chairman of private equity-backed portfolio company**

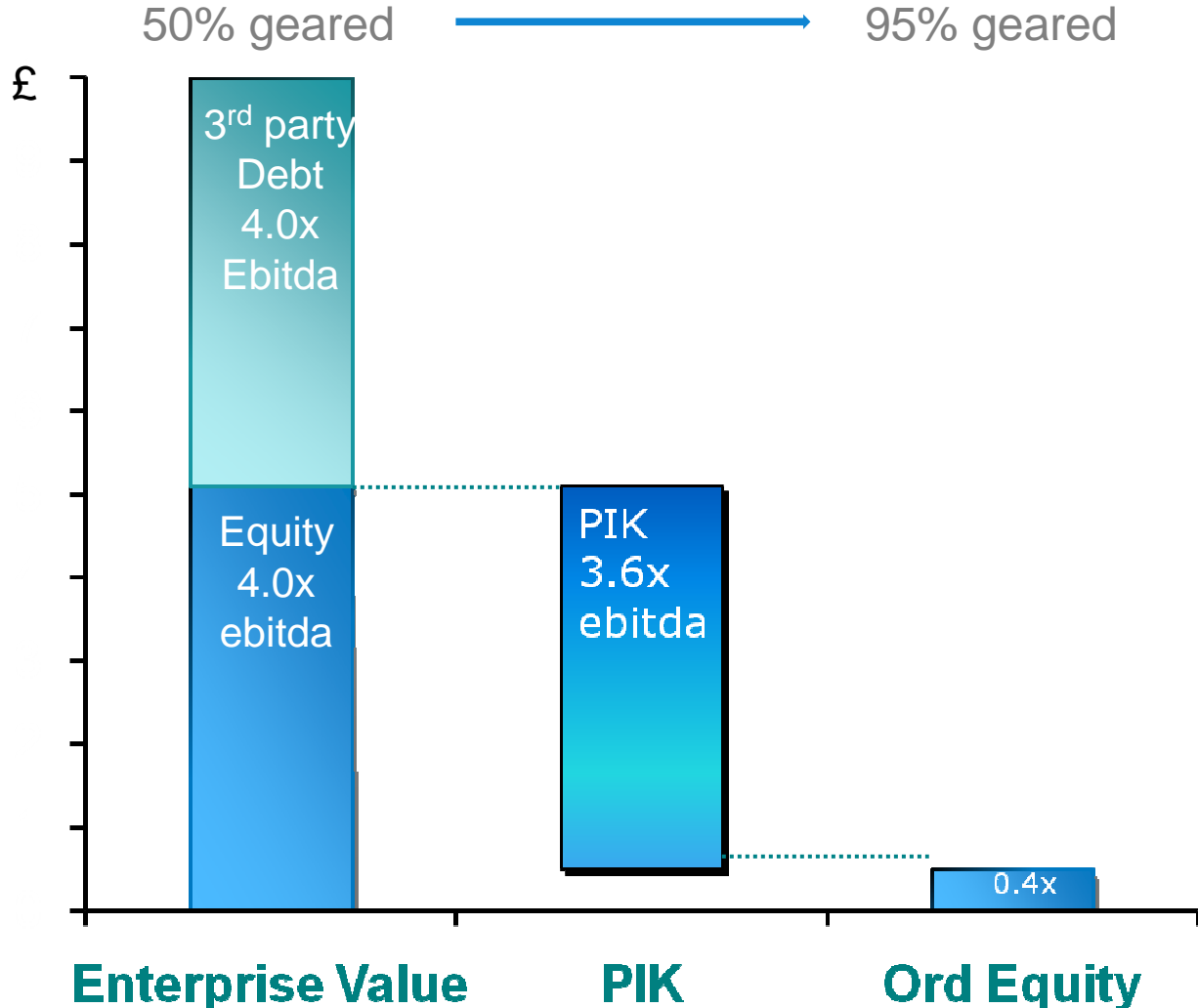
What is private equity?

- **An unfortunate name!**
- **Limited partners are institutional investors**
- **General partners are private equity managers**

- **Different to plc investors;**
 - **Illiquid investment**
 - **Long-term interest**
 - **Activist shareholders**
 - **Determine the board**

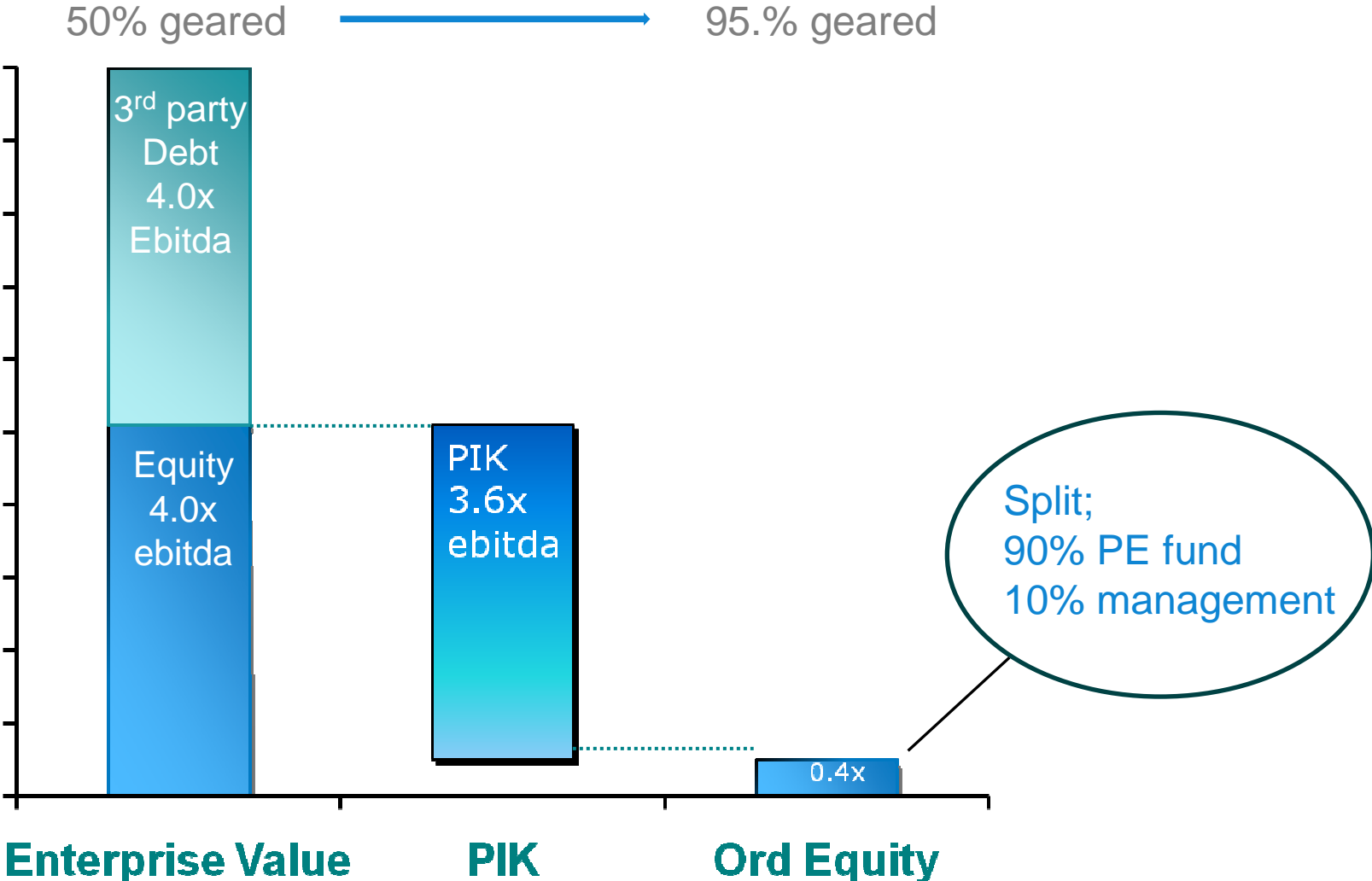


Leverage works wonders...



PIK is debt on which interest is only paid when it matures or is repaid

Management gets a piece of the action



Private Equity economics: A simple illustration - selling

- **Improve ebitda from £10 to £15m over 3 years**

- **Sell company at 9.0x ebitda** **£135m**

- **Repay bank loans** **£40m**
- **Repay PIK (+15% pa interest)** **£54.8m**
- **Sell Ordinary equity** **£40.2m**
 - **Split 90% PE funds** **£36.2m**
 - **Management** **£ 4.0m**

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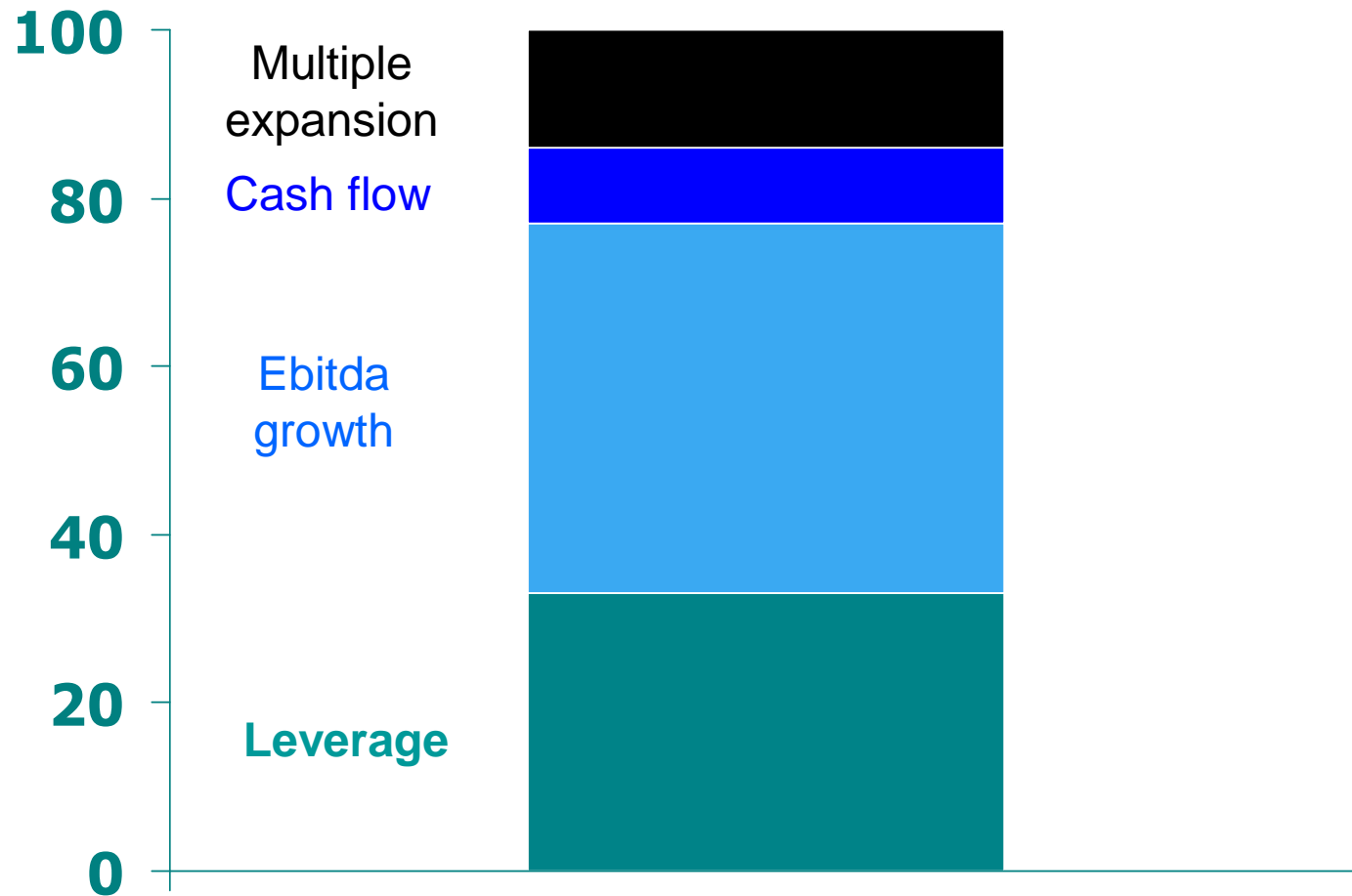
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Management **£ 4.0m**

- **PE funds earn £54.8m + £36.2m = £91m = 2.3x money**

- **Management earns £4.0m = 10x money**

Value comes largely from profit growth and higher leverage



But life's got more difficult

- **\$434bn to invest**
- **Debt coming back**
- **Exits are available:**
 - **\$232bn in 2010**
 - **154 IPO's**
 - **Rise of secondaries**
- **Returns still strong**
- **But:**
 - **debt levels lower than previously**
 - **Recession makes more cautious**
 - **Investors (LP) more cautious**
 - **Increased focus on performance improvement**

Private Equity looks for;

- **There's a deal to be done**
- **There's a value opportunity**
 - **Good cash flow**
 - **Performance improvement possible**
 - **Asset-backed (especially property)**
- **It's not too risky**
 - **Many suppliers and many customers**
 - **Easily comprehensible business model**
 - **Not too cyclical or volatile**

Personally I look for in a retailer...

- **Growing market**
- **Won't be damaged by hypermarkets**
- **Relatively immune from internet**
- **Performance improvement**

Private equity focuses on a 3 things after buying a company

- **Cash, cash & cash**
- **Performance improvement**
- **Long-term growth**

And they can be very interventionist to achieve these...

What lessons are there for other companies?

- **Complete all-pervading emphasis on cash**
- **How long term are you?**
- **Are acquisitions a crutch?**
- **Management pitfalls*;**
 - **Too much resource, poorly directed**
 - **Squeaking wheel gets the grease**
 - **One size fits all**
 - **Paralysis by analysis**

Natural bedfellows indeed

- **Private equity still here**
 - **But older & wiser**
 - **Equity rich but debt poor**
 - **Still long-term horizons**
- **Well matched to retail**
- **Suffers same problems as other companies**
 - **And similar solutions**