ACCESS CAPITAL PARTNERS

PRIVATE ASSETS IN EUROPE

2017 GENERAL PARTNERS MEETING

SUMMARY OF MARKET VIEWS

On 8 December 2017, Access Capital Partners (Access) held its 17th Annual General Partners Meeting and gathered 59 of its small to mid-market buy-out General Partners (GPs) and 11 of its private debt GPs to exchange views on the current state of the market.

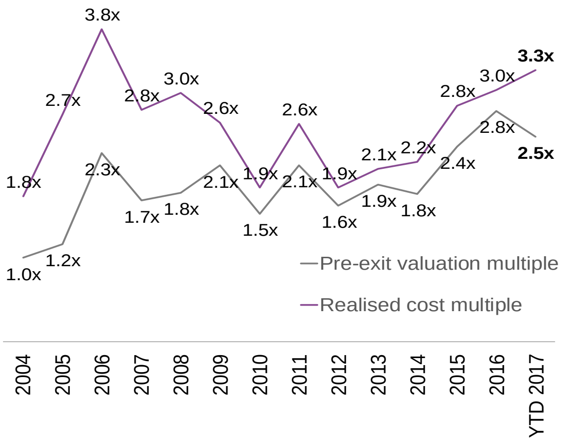
BUY-OUT SESSION

While GPs agreed that their key concern was the historically high level of valuations for buy-out investments, the discussion covered downside protection measures that can be taken from the start of the investment process, the implementation of growth strategies, as well as appropriate actions when business performance deviates from the investment case.

APPROACHING THE PEAK?

Fundraising in the buy-out market is on track to reach all-time highs, with $74 billion raised in Europe in 2016 and a probable continuation of that trend in 2017. The resulting capital overhang coupled with abundant liquidity has generated strong competition amongst buyers and fueled high pricing levels. As a result, it has been a good year for exits, with 2017 exits expected to surpass 2016 both in value and in volume and cost multiples across Access' buy-out portfolio reaching an average of 3.3x in 2017. It is clearly a seller's market, with 64% of GPs in Access' portfolio reporting returns exceeding expectations in 2017 and spreads between latest book values before exit and actual exit values increasing and getting close to the level of spreads observed pre-2008.

CARRYING VALUES vs GROSS EXIT MULTIPLES ACROSS ACCESS' BUY-OUT FUNDS OF FUNDS



Source: Access Capital Partners

Whilst overall sentiment on the sell-side is positive, buy-side confidence has somewhat decreased since 2016. Participants concurred that the market seemed to be getting over-heated and that current pricing levels were generally not justified. There was no clear answer regarding the question of whether we are indeed approaching a peak and when the cycle will reverse, however participants agreed that they had to remain highly disciplined in their investment process in an uncertain environment.

"The key is not so much knowing if and when the cycle will reverse, but investing in the right company at the right price"

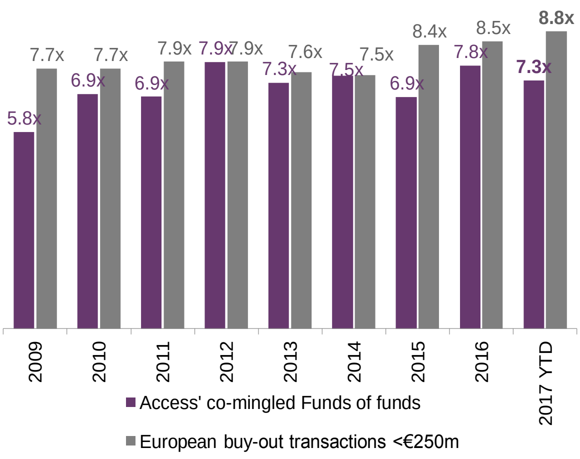
MAINTAINING PRICE DISCIPLINE

The GPs in Access' portfolio are therefore cautious on the buy-side, citing pricing as one of the main reasons for not completing deals, followed by the GP's own selectivity on deal fundamentals. Despite the necessity to deploy capital, pricing across Access' portfolio has stayed well below market levels for the comparable market segment.

To deploy in a competitive environment, participants highlighted the importance of proprietary sourcing to access differentiated deal flow, which can be achieved through pro-active and creative origination efforts, systematic industry research, networking and spending time on building relationships, particularly in the case of complex situations, where confidentiality is key.

"There are situations where you do not have to pay the highest price"

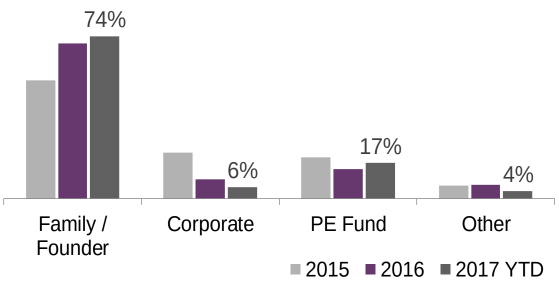
EV / EBITDA MULTIPLE AT ENTRY



Source: Access Capital Partners / S&P, Unquote, Epsilon

Some GPs noted that they only participated in competitive auctions if they had a clear angle on the target sector or company and that they were increasingly looking at complex or niche transactions to avoid wide auction processes. In addition, targeting primary deals (i.e. where the vendor is a family / founder or a corporate as opposed to a private equity firm) can be a good strategy. Participants stated that 80% of the deals they targeted in 2017 were primary deals.

TYPE OF SELLERS IN DEALS TARGETED BY GPs



Source : GP responses to Access' 2017 questionnaire

CONTINGENCY PLANNING

There was a general consensus that buying companies at reasonable multiples, with limited leverage, flexible cost bases and low cyclicality would provide some level of protection in a potential downturn, although holding periods would likely increase. However, participants also agreed that contingency plans needed to be discussed with management teams upfront in order to incorporate potential macro-economic risks in the investment decision and to be able to adapt the business plans to different scenarios. This may not always be possible in a competitive auction but should be diligenced as much as possible.

Access' GPs in the UK have already factored in Brexit-related risks in their portfolio management and due diligence. Although the UK remains the most active market for European buy-outs, managers highlighted the need to focus on the less cyclical businesses going forwards and to invest more resources in risk management, for example by rigorously monitoring the portfolio's exposure to Brexit-related risks or by hiring operational change consultants.

For some German GPs, avoiding concentration on level 2 automotive suppliers is one of the examples given of downside protection measures that can be taken in portfolio construction.

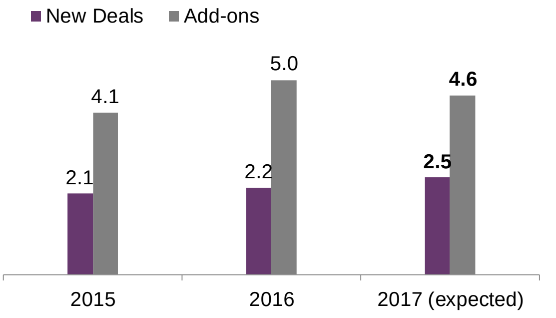
"We need to focus on building growth but need to push target companies to prepare for the worst"

STAYING FOCUSED ON GROWTH

Although there is uncertainty in the market and although managers can prepare for and partially mitigate the impact of a potential downturn by maintaining price discipline and contingency planning, all participants agreed that the focus should be on growing portfolio companies.

In a context of relatively limited organic growth, GPs have increasingly been engaging in buy-and-build strategies, which are a good way to deploy capital into smaller companies, at reasonable valuations and typically on a proprietary basis.

NUMBER OF DEALS AND ADD-ONS COMPLETED OR EXPECTED TO BE COMPLETED BY GPs



Source : GP responses to Access' 2017 questionnaire

A portfolio company can be used as a platform to consolidate a segmented market and, if executed correctly, to dilute the entry price, promote revenue and cost synergies, create value and enhance the exit multiple.

"The implementation of a buy-and-build strategy not only allows for pricing arbitrage from doing smaller acquisitions, but also creates the deals by capturing the attention of entrepreneurs"

The potential for add-on acquisitions and the capacity of the management team to integrate new companies therefore needs to be an important part of due diligence. In addition, implementing a successful buy-and-build strategy requires a significant resource investment from the GPs as the add-on targets are usually "under the radar" and their size often sub-optimal.

Elements of success also include a cultural dimension as bolt-on companies are generally easier to integrate in the existing processes if they are situated in the same country or region.

"We need to have an educational role towards the company management. Training managers is crucial if they have never made acquisitions previously"

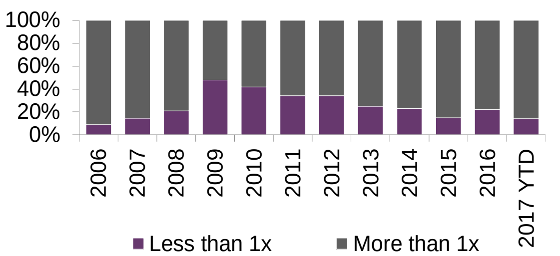
Despite these complexities and given the attractions of buy-and-build strategies in a competitive and expensive market, GPs generally expect to increase their capital deployment into add-on acquisitions in 2018. Private debt managers are also increasingly financing these types of transactions, along with traditional buy-outs.

"Buy & build is a good way to get more capital to work with a management team you already know"

WHEN DEALS DO NOT MEET EXPECTATIONS

Despite GPs' best efforts to implement growth strategies and contingency plans in their portfolios, and although the proportion of underperforming deals has significantly decreased since 2009, challenging situations appear to remain inevitable.

DEAL PERFORMANCE ACROSS EXIT YEARS



Source: Access Capital Partners

Whilst participants listed macro-economic conditions as the main factor for underperformance, in hindsight a number of GPs also admitted to due diligence mistakes, for example wrongly assessing business models and a company's position within an industry, misjudging a business' capacity to generate growth, and making assumptions based on third-party analyses.

"Due diligence mistakes often come from assuming rather than assessing. Some things are taken for granted but should be questioned".

HOW TO DEAL WITH UNDERPERFORMING DEALS

As underperforming deals usually represent a significant psychological burden on the investment team who not only have to own up to their mistakes but also have to face the potential social impacts of underperformance (e.g. job cuts in the target company), it can be a difficult decision to let go of such investments.

There was however a consensus amongst participants that problematic investments were usually very difficult to turnaround, even with specialised external advice, and that the time and resource spent on trying to turn them around was potentially best spent on sourcing and executing new deals, learning from past mistakes. GPs concurred that it was preferable to exit such investments, and that the current exit environment was particularly favourable to getting rid of "bad" assets.

"The best answer to a bad deal is doing a good deal next time round."

THE NEED FOR EVEN MORE STRINGENT DUE DILIGENCE

To avoid making due diligence mistakes, a response has been to focus on sourcing deals where the GP has full and unlimited access to management and historical financial data, although this may not always possible in the context of highly competitive auctions. Participants stressed the importance of establishing open and consistent communication with the target company and to have extensive discussions with the management team regarding strategy in order to set up a clear vision for the future. The emphasis should be on determining, prior to closing the investment, the business plan – including potential exit routes - and what the team in place is capable of.

Increased pressure to deploy in a competitive market may push the boundaries of GP expertise and drive demand for heightened and differentiated due diligence to optimise value and mitigate risk. This requires important resources but also finding the right balance between swift deal execution and a stringent due diligence process. For illustrative purposes, a UK-based fund manager shared its own three-step approach:

- Step 1 consists in carrying out workshops with the management team. Due diligence cannot progress to the next steps until these have been conducted
- Step 2 consists in scrutinizing the management team as well as the second and third layers to understand the existing team's capabilities - and any required changes - and to make sure that everyone is on the same page
- Step 3 determines which individuals within the company will be taking the lead in terms of executing the agreed business plan. Emphasis is also put on human resources, commercial and ESG issues.

"The first thing we want to do before closing a deal is to have extensive discussions about strategy, the exit horizon and how to get there."

Investing in companies requires in the first instance an assessment of the business model and in the second phase an assessment of the management and transversal teams. Hence the human factor can be crucial to an investment decision and to future performance. The outdated model based on a pure financial partnership has shown its limits to the extent that deal performance is highly dependent on extra-financial aspects, and on people.

CONCLUSION

General Partners all voiced concerns regarding the increasingly competitive market dynamics that have led to historically high valuation levels. Many GPs have therefore focused on exiting portfolio companies, thereby reducing their 2007-2009 legacy portfolios, and have remained patient on the buy-side. A consequence of this has been the high level of exit proceeds distributed to LPs, which have been outpacing capital calls for new investments over the past two years.

While acquiring companies at reasonable valuation levels is essential to delivering strong performance, GPs are also well aware of the possible negative consequences of waiting too long to invest and of a speedy deployment at the end of the predefined investment period. In such situations, correctly sizing the next fund - despite the current fundraising exuberance - is key for the years ahead.

Access' GPs concurred that favoring lower leverage strategies, maintaining pricing discipline at entry as well as avoiding disproportionate exposure to consumer related businesses, continue to be the most appropriate safeguards to withstand a potential downturn.

PRIVATE DEBT SESSION

STRONG DEAL ACTIVITY IN 2017

2017 has been a good year for private debt in Europe, with strong mid-market deal activity driven by an active buy-out market, in addition to refinancing deals and buy and build activity.

There has been a pick-up in activity in France and the UK, which are the leading markets for private debt in Europe, France remaining active in mezzanine and the UK being particularly strong on unitranche, given the depth of the domestic buy-out market and despite Brexit.

"The UK remains an attractive place to invest, with strong dealflow and limited competition from banks"

There has also been increased activity in Southern Europe, although this remains a relatively small market.

COMPETITION REMAINS STRONG…

As the fundraising environment has remained strong and banks continued to be very active all across Europe, competition amongst lenders has remained high and indeed increased, with a tendency for "covenant-light" deals and somewhat of an erosion of returns as warrants have been more difficult to secure. This is especially the case at the higher end of the market.

Amidst a competitive environment, Access GPs have sought to differentiate their offerings from those provided by banks by seeking to provide more-value add to management teams, with more creative and flexible terms and structures, as well as swift deal execution.

GPs have also sought to differentiate their offerings by strategy, and sponsorless and corporate mezzanine deals are becoming increasingly prevalent, presenting a number of attractions for GPs, including:

- less competition from banks, who are usually more comfortable lending to SMEs in the context of sponsored transactions;
- lower risk of an early refinancing event, as sponsorless deals are usually designed as long-term partnerships with the management teams.

"There is limited appetite from banks to provide capital to SMEs in the context of sponsorless deals"

…ALTHOUGH THE LOWER-END OF THE MARKET REMAINS UNDER-SERVED

Despite a heated market in which pricing and leverage levels have steadily risen, the GPs in Access' portfolio have managed to stay disciplined in securing appropriate returns, covenants and terms and to maintain conservative structuring across deals, with an average equity cushion of 48% across Access' private debt portfolio.

In addition, participants concurred that there was typically less pressure at the lower end of the market and that SMEs generally remained under-served, leaving numerous and attractive opportunities for small and mid-market debt lenders in Europe.