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"China and Brazil offer good growth opportunities to European companies present in the region."

OLIVER SCHUMANN
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Oliver Schumann shared his insights with Global M&A Network on how the sovereign debt crisis has impacted deals and valuations, trends for cross-border buyout opportunities, their decision to establish local presence in the Brazilian and the Japanese markets, the appropriate level of incentives for the management team of the portfolio company to generate value, along with his observations on investing in the European retail, consumer and industrial sectors.

Q. What is the state of private equity deal activity in Europe today?

Mr. Schumann: We have taken a positive view about the market environment. Transactions have taken some time to come through, but lower entry valuations and the economic recovery have led to a better risk and return balance. Generally, if private equity firms can take the large amount of capital available to create strong market positions, we should see good transactions coming through. Overall, I think the private equity industry is stronger now than it was a year ago.

Q. How has the European sovereign debt crisis affected deals and valuations?

Mr. Schumann: Recently, the sovereign debt crisis has brought the fragility of the economy back into focus, but I have not seen a material impact on the region yet. My main concern at the moment is that in some transactions valuations have already increased to a level where an investment is not attractive to us. Obviously it depends very much on the industry and growth prospects, but if in doubt, we prefer to be conservative.

Q. What are the underlying deal trends for cross-border buyouts in the coming year by European based firms?

Mr. Schumann: A number of companies that we see, although headquartered in Europe, have impressive growth opportunities elsewhere as well, especially in emerging markets. For example, China and Brazil offer good growth opportunities to European companies present in the region. However, entering these markets is not easy without local knowledge and established relationships. We invest in companies that already have those relationships. Another trend we are seeing is the opportunity to consolidate markets post-crisis, leading to attractive buy-and-build opportunities in Europe.

Q. Capital Dynamics has established offices in Brazil and Japan in the past year. What led to making this decision and have you invested in these markets?

Mr. Schumann: We opened our Brazil office in July 2010 because we saw the long-term potential that the Latin American market holds. Brazil is undergoing a real change – between 2000 and 2008, 34.9 million Brazilians moved into the middle- and highest-earning segments of the population. Now, for the first time, many of these people are sending their children to private schools, and buying new cars and even first homes, leading to many attractive investment opportunities. In addition, Brazil will host the 2014 FIFA World Cup and the 2016 Olympic Games, and is expected to attract about USD 75 billion in direct investments. Something we are also keeping our eye on is the pre-salt reservoir, which has the potential to place Brazil in the top 10 oil producers in the world.

Q. Has the tragedy in Japan impacted your operations and what is your future investment strategy?

Mr. Schumann: In the initial aftermath of the Japanese disaster, our first concern was for our colleagues in our Tokyo office. Luckily they were all OK. We remained in close contact with them and our day-to-day operations were not greatly affected. However, some portfolio companies with exposure to Japan have been impacted, but to varying degrees. But, all things considered, Japan has managed to recover from this tragedy extremely quickly and, during day-to-day business, there is little sign of the disaster having had a long-term impact.

Q. In your experience, which of the sectors has witnessed high levels of buyout activity?

Mr. Schumann: We've seen an increasing number of investments in the retail and consumer sectors recently, particularly in those countries that were hardest hit by the crisis, for example in the UK and Spain, but we are not convinced about the growth prospects there. In Germany, we have noticed several attractive industrial opportunities post-crisis, with the combination of the right lead investor, reasonable entry prices and solid growth prospects. Business services companies should find a good market environment for outsourcing and we expect to see opportunities there as well. Generally, the question is how to create value in these transactions and whether the recovery is sustainable.

Q. How does your team source investment opportunities?

Mr. Schumann: Because of our global office structure, we can identify interesting regions in all parts of the world and are able to benefit from a wide funnel of deal flow. I couldn't say that there is one source which is more effective than another, but we specialize in co-investments so we source many of our opportunities through our network of fund relationships. In a typical year it leads to 100+ deal opportunities.

Q. In this rapidly changing economic environment, what elements of due diligence is vital for private equity buyers such as yourself?

Mr. Schumann: Our approach has always been comprehensive and thorough, and commercial, financial and legal & tax due diligence are pretty standard. Depending on the company, sometimes technical or operational due diligence is carried out as well. We also pay close attention to ensure that the leverage level is acceptable, particularly in cyclical industries. We always invest as part of a consortium, so we have to make sure we invest with the right lead investor. As a global private equity house, we usually have known the lead investor for a long time and know their areas of expertise well. Another important element of due diligence is to make sure that the management team's incentive structure is aligned with the investor group to ensure everybody works in the same direction.

Q. How does your team create value post buyout?

Mr. Schumann: Key elements of a transaction are the company's competitive advantage, its market growth trends and expansion opportunities. In some cases, the cost basis can be adjusted or the flexibility of the cost structure can be increased. For example, through operational efficiencies.

Q. What is your specific style of working with the management of your portfolio companies towards creating value?

Mr. Schumann: The management team that defines and executes the business plan is a key element of every deal. The key relationship is between the lead investor and the senior management. However, Capital Dynamics is often represented on the board as a co-investor.

In general, investors may not have the same deep sector understanding as the senior management, so all parties have to agree on clearly defined and realistic targets, as well as timelines, up front. The incentive system is usually tied to these targets so you create a system which aligns the interests of the investors and senior management.

Q. How long do you typically hold on to your investments and how do you plan your investment exit?

Mr. Schumann: We typically look to hold companies for around four-to-five years and we will have considered all possible exit options even before investing. Generally, we look for investments with multiple exit options, such as a trade sale to a strategic or financial buyer, or through an IPO.

Exiting through an IPO is highly dependent on circumstances – the company has to be large enough to create interest and the general capital market environment has to be supportive of an IPO. If we had the choice, we would generally prefer a trade sale, because you mostly sell at once. By contrast, in an IPO you often have a staged exit over a longer period of time, and depend on the share price performance post IPO, which is less predictable.

However, in the last few years, the team has had great success with two IPOs for investments made prior to joining Capital Dynamics, which created stellar returns for investors, particularly TGE Marine, a company in the energy sector, which went public in May of 2008.

Q. How in your experience, if at all can private equity investors drive growth in Europe or other markets?

Mr. Schumann: The times have changed – the days when good returns could be achieved through leverage alone have gone. The most successful private equity houses improve the operations of their investments and have teams with the expertise to do that.

To attain growth you need to identify the right growth trends in your industry and focus on those regions where you can achieve a competitive advantage. If you can't build it, you might have an opportunity to buy into it. To get all of that done, with a reasonable amount of capital and in the timeframe of a private equity fund, you need to have a business plan in place before investing and a strong management team to execute the business plan. Obviously this is not a static process, but rather a dynamic process that may need adjustment from time to time.

Q. What differentiates Capital Dynamics' buyout team from other global firms?

Mr. Schumann: Capital Dynamics enjoys access to a large number of potential investments through its wide, global network. The team has a tremendous amount of experience, having directly invested in 51 transactions since 1994, prior to and during our time at Capital Dynamics, and has had great success in sectors such as energy and power, consumer, healthcare and general industry. We have closed transactions in over 16 countries, illustrating our ability to identify and capitalize on regional, as well as industry, trends.

Q. On a personal note, what book are you currently reading?

Mr. Schumann: At a recent conference, I picked up a copy of *The Intelligent Investor* by Benjamin Graham. The original publication was in 1949. If you consider how much the world has changed since then, it is amazing how applicable his principles still are in today's world.