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Financial News: Private-equity IPOs outperforming others --- Stock performances show sponsored deals weathering woes well

By **Oliver Smiddy**
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One of the biggest casualties of the economic downturn has been the initial public offering, for years the exit route of choice for private-equity firms. Returning a company to the public markets allowed buyout firms to retain an equity interest in the business, if desired, and also provided a public seal of approval for a job well done in building a company.

Yet since the start of last year, there have been just two European IPOs of $50 million or more that were backed by private-equity firms, a sign of how unattractive the public markets have become as an exit route. Buyout firms either have refrained from selling assets because of lower valuations or turned to alternative exit routes opportunistically or when forced by circumstance. The buyers of such assets have generally been companies or other private-equity firms.

There were 221 sales to companies last year, according to data provider Dealogic, making it the most popular exit route for private-equity firms. Secondary buyouts followed with 102 and equity capital markets (IPOs of all sizes or partial sales of companies on the public markets) saw just 11 cases.

Of the 45 European sponsor-backed IPOs completed since the start of 2007, there were seven health-care companies in the top half of the list in performance terms, more than any other sector.

The best-performing IPO in terms of share-price performance was for an energy-focused company, while the second-best IPO was a health-care business.

Firms once owned by private equity appear to outperform the wider IPO market, according to the data, which will add weight to the buyout industry's claims that the work it puts into a company under its ownership continues to pay dividends in later life.

The research, based on figures from data provider Dealogic, showed that in Europe, companies floated by private-equity firms from 2003 to 2008 performed better than others listed in that period. There have been no IPOs this year.

Sponsor-backed IPOs showed an average share-price change from list price to the price on April 23 this year of minus-20%. For nonsponsor-backed IPOs the figure was minus-37%. This contrasted with the findings last year, which showed private-equity-backed IPOs in Europe underperformed other IPOs launched over the past six years. Last year's research showed sponsor-backed IPOs launched since 2002 delivered an average aftermarket performance of 23% until mid-April, compared with an average of 28% for IPOs not backed by financial sponsors.

At first sight, the performance appears counterintuitive. Market participants and those operating in and around the private-equity industry accept that private-equity-owned businesses are more highly geared than their peers. Last year, Christian Hess, European head of UBS's financial-sponsors group, said: "Companies brought to market by private-equity firms probably have slightly higher leverage compared with their sector peers, and 'leverage' is seemingly a bad word at the moment."

If "leverage" was a bad word then, it is a worse one now. The expectation would be that formerly private-equity-backed public businesses would perform worse in the downturn because of the higher level of debt on their balance sheets. Yet the data show sponsor-backed IPOs have in fact fared better.

However, learning to live with higher leverage may have benefited the companies in the downturn. Mervyn Metcalf, a managing director at boutique advisory firm Global Leisure Partners who worked on a number of sponsor-backed IPOs during his time at Merrill Lynch, said: "Private-equity-owned companies are generally more used to cash-flow management and operating with leverage on their balance sheets. This can be a strength in this market."

"A private-equity-backed company that floats compared to, say, a family-owned business, has probably spent more time focusing on the investment story and building a long-term business model for the next investor," he said.

John Cole, a partner at financial-services group Ernst & Young, said: "There has long been the suspicion that once a company has left private-equity hands and returned to market, it is wrung out. But that is an extreme view."

"Investors will buy into the IPO if you can make a case for regular cash flow and distributions to shareholders, or if you can demonstrate its potential for further growth to drive capital appreciation," he said.

He added: "Private equity does provide a level of discipline to companies, and that benefit certainly has not become invalid in this market. A clear, sharp focus in terms of a business's goals isn't to be sneered at. Management teams that have worked under private-equity ownership have benefited from the experience."

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Buyout-backed IPOs beat the market

Oliver Smiddy
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Companies floated by private equity firms outperform businesses that have gone public from other sources, overturning the figures from the same time last year, according to an annual survey by Financial News.

Companies listed in Europe by private equity firms for more than $50m (€38m) since 2003 have suffered a less severe decline in their share price than others listed in the same period, with a -20.2% change compared with -36.9% for other listings, the research found.

The findings contrast with last year's survey, which showed sponsor-backed initial public offerings launched since 2002 delivered an average aftermarket performance of 23%, compared with an average of 27.6% for other initial public offerings.

Mervyn Metcalf, a managing director at boutique advisory firm Global Leisure Partners who worked on sponsor-backed IPOs during his time at Merrill Lynch, said: "Private equity-owned companies are generally more used to cashflow management and operating with leverage on their balance sheets. This can be a strength in this market.

This year's research found that while most companies had suffered in the economic downturn, sectors such as healthcare and energy had withstood the downturn better than others.

Of the 45 European sponsor-backed IPOs completed since the start of 2007, there were seven healthcare companies in the top half of the list ranked by performance, more than any other sector.

The second-best performing IPO by share price performance was an Italian healthcare business, Diasorin, while the best-performing was oil and gas services group Wellstream Holdings.

However, there have been no private equity-backed IPOs so far this year and only two last year, meaning that for many of the companies examined, private equity firms have had little or no input in their operations for several years.

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