

INDUSTRI KAPITAL

# IK NEWS

:ISSUE NO 5 OCTOBER 2002



# :PERFORMANCE IMPROVEMENT – KEY TO SUCCESS

Private equity success hinges on 'active ownership' not 'asset stripping'

IT IS A POPULAR misconception – even among those who really should know better – that success for private equity firms comes from simply buying companies cheaply, running them for cash and then swiftly selling them on for a much higher price.

The reality, of course, is different. IK's success and that of the private equity industry as a whole, hinges on 'active ownership'. This means taking a close interest in our portfolio companies, having direct strategic input and working with management over a period of years to achieve performance improvements and value creation.

We are often involved with designing and implementing a restructuring or identifying and conducting acquisitions or divestments. We are there as a sounding board for management and will basically 'look outside the box' for anything which might help an investee company grow.

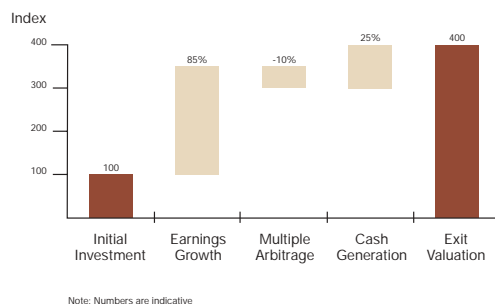
**"Although the stock market is a good home for companies in a stable, growing situation, it is probably not an ideal place to conduct an extensive restructuring of a business."**

Ours is a practical, supportive role which typically places a medium-term, three to five-year time horizon on an investment. It can take time to make things happen in a business, so a 'quick in/quick out' approach is clearly not for us.

Let's also explode the 'buy cheap/sell high' myth. Performance improvement may be our key to success, but it certainly does not come cheap. We try to be as smart as we can when buying companies, but we deal with professionals, and any turnaround potential of a company will almost certainly have been factored into the sale price.

And our risk is not just that the 'potential' is real and can be unlocked. We must also ensure that any performance improvements we facilitate are enduring. Further down the line the companies or financial buyers to which we exit will scrutinise everything. They will not pay good money for a business whose growth curve is about to collapse.

Occasionally, one finds a group of businesses bound together only by the fact that they have the same owner. With no natural reason for them to be together, it is logical to sell



**SUCCESSFUL EXAMPLE:** Value creation in Noviant through performance improvement.

them on to companies with which they have synergies. But in an efficient market, straightforward break-ups are rare and difficult to perform with any real profitability without taking huge risks. Core businesses usually need to be fundamentally improved before being sold on.

When it comes to performance improvements, private equity houses have the great advantage of operating in the private domain. With no market analysts or shareholders eagerly awaiting our next set of figures we can take short-term pain for longer-term gains – riding out a downturn in profits while a restructuring is being completed, for example. Being private also enables us to optimise financing structures to take full advantage of leverage and to be as flexible and innovative as possible.

No less important are the 'people' issues in a business, since these can also impact heavily on corporate performance. Motivation is crucial, hence the managers of private equity-backed companies usually have performance-related financial incentives. It also has to be far more satisfying for managers to be working in partnership with enthusiastic and interested backers who really understand and care deeply about the business rather than be used as a cash-cow in a large group.

Also, although the stock market is a good home for companies in a stable, growing

situation, it is probably not an ideal place to conduct an extensive restructuring of the business under the day-to-day scrutiny of analysts and journalists, whose job it is to communicate with a disparate group of shareholders. At such a critical phase we believe the management needs to focus on getting it done and worry less about how it all looks from the outside!

We regard performance improvement as a fundamental part of our stewardship of the companies in which we invest, and do all that we can to provide the optimum environment within which those companies can flourish.

This means that for many companies, and particularly those going through periods of significant change and growth, being an integral and material part of a private equity portfolio is the best place to be.

So, forget aggressive Barbarians at the Gate-style strategies. Applying a medium-term perspective, taking a hands-on interest, making structural changes away from the spotlight, and being prepared to make substantial follow-on investments in terms of both time and money is what true private equity investing is all about.



*Gustav Öhman, Director of Industri Kapital*



**GROWTH POTENTIAL:** Potential for growth in Germany after years of cultivating the market.

# :GERMANY – WAKE-UP CALL FOR EUROPE’S SLEEPING GIANT

The Gardena buyout in Germany strengthened mid-cap opportunities

GERMANY CAN BE a perplexing market for private equity investors. It is the largest economy in Europe, has an industrial base ripe for corporate restructuring and a *Mittelstand* where smaller, family-owned companies are often facing succession problems. Yet despite the best efforts of Europe’s leading private equity houses, only a fraction of this unquoted equity investment potential has so far been unlocked.

Among those private equity houses is Industri Kapital which has had a presence in Germany since 1997 when it opened a dedicated office in Hamburg. This early commitment is now beginning to pay off, with some successful deal completions including the recent buyout of the gardening equipment company Gardena.

“Gardena illustrates the importance of having an office ‘on the ground’ in Germany,” says Detlef Dinsel, Director of IK’s German team. Even for controlled auction sales, Dinsel points out that data rooms and management presentations will often be conducted in the local language. “There is also the need to have a clear regulatory and cultural perspective, which can best be gained through in-depth local knowledge,” Dinsel explains.

A local office is also seen as being the only way to access proprietary deal flow effectively in Germany. “Without locally situated people keyed into the daily flow of information and the

local business network, the deals will not happen. You have to be as close to the market as possible, otherwise you are at a natural disadvantage. This is particularly so for mid-market deals,” Dinsel continues.

IK now has a seven strong team based in Hamburg. Under Dinsel the team comprises Deputy Director Peter Welge, Associate Director Dirk Tetzlaff and Associates Anders Petersson and Caspar von Meibom, supported by Assistants Dörte Billerbeck and Kerstin Huettinger.

## Raising private equity awareness

The buyout of Gardena – a well-known and highly regarded company throughout Europe – is an important step forward, not just for IK’s own standing in the market but also in terms of raising awareness of the private equity concept among prospective corporate divestors and MBO teams generally.

Gardena is based in Ulm in Germany, has annual sales in excess of €390 million and employs some 2,900 people worldwide. Its controlling family shareholders, the Kress and Kastner families, began looking for a suitable co-investor in September 2001. There was a great deal of interest in the company, with IK finally up against four other financial buyers and a trade buyer to secure 100 per cent of the common shares in the company (representing

approximately 88 per cent of the share capital) in March this year.

In May, IK launched a mandatory offer for Gardena’s publicly-listed preference shares. Having received acceptances that represent slightly more than 99 per cent, IK went for a final squeeze-out of the remaining minority shares this summer and anticipates achieving 100 per cent ownership in October.

“I think our bid for Gardena was successful because we had the clearest strategy for the company going forward. We were able to make the best investment case and were close to the management team,” says Dirk Tetzlaff.

IK also presented a firm, clear and consistent route by which it would deliver on the deal. “The vendors could be confident that we had a secure financing structure in place, that the sale and purchase agreement would stick and that we would not try and chip away at the price,” Dinsel continues.

IK plans to add value and support post-acquisition with a three-strand approach designed to strengthen Gardena’s position as the European leader in the gardening equipment sector.

“We see great potential for the business to grow organically and through selected investments. We are particularly keen to further expand the company outside Germany, and have further

identified product areas with scope for growth through acquisition," Dinsel explains.

"We will also further rationalise the company's operations, and focus on the most value-added parts with the aim of raising the company's EBIT level from its current level of approximately six per cent," he says.

IK anticipates holding the company for three to five years before returning it to the stockmarket via an IPO or, if the IPO route remains too uncertain, through a trade sale.

#### Sourcing add-on acquisitions

As well as primary deals, IK has also found Germany to be a particularly good source of add-on acquisitions for its existing portfolio companies. To this end, two years ago IK assisted VSM Group in acquiring Pfaff Household

Sewing Machines and Nobia in acquiring the kitchen designer and manufacturer Poggenpohl.

"Deals such as these enable us to add greater value to our current investment portfolio, streamline and focus the investment story and improve the exit opportunities," says Peter Welge.

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Poggenpohl helped Nobia gain sufficient critical mass to enable it to float on the Stockholm Exchange in June this year. Pfaff, meanwhile, has gone from a clear turnaround situation to, after just two years, contributing a

significant part of VSM's current operating profits.

IK has a distinguished track record in the European private equity market with its 45 acquisitions and 19 exits to date. Although some of the portfolio companies have encountered problems and gone through restructurings, it is highly unusual for investments to go wrong. Last year, however, i-center, the German electrical wholesale business backed by IK in 1998, went into receivership.

A number of valuable lessons have been learned from the situation, as Dinsel explains.

"Turnarounds in cyclical industries with no top line stability are very difficult. We have also seen how tricky it can be to carve out distribution chains where the vendor is a significant supplier. Captive distribution channels can only be successful with the clear support of the key supplier, for example through a significant minority shareholder position," he says.

Dinsel believes that it is also important to tackle any restructuring that needs to be done at the outset – and certainly within the first year.

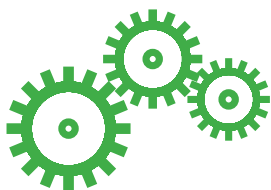
"Management changes made at a later stage complicate matters," he says. "We are now also wary of companies with too many dimensions requiring restructuring. In i-center there were management, cultural and logistical problems and it simply became too complicated," he says.

Germany's private equity market is taking longer to develop than many originally anticipated, but deals such as Gardena all help to move the market forward. If this momentum continues and more of corporate Germany plugs into the private equity option, then soon the market will begin to light up. ◀



**IK'S GERMAN TEAM:** From left Anders Petersson, Caspar von Meibom, Dirk Tetzlaff, Peter Welge, Detlef Dinsel and Dörte Billerbeck. Kerstin Huettinger was absent during the photo session.

## :GERMANY – A TOP-HEAVY MARKET AS MEGA-DEALS LEAD THE WAY



Private equity activity in Germany increased significantly year-on-year until 2001 when the economic downturn put a slight halt on the market. Even so, according to figures from Thomson Securities Data, Germany was second only to France in terms of deal volumes in mainland Europe.

The market in 2001 was dominated by a clutch of mega-deals. These included Henkel's €2.5 billion sale of its Dutch speciality chemicals business Cognis, the \$2.5 billion sale by Aventis of the industrial gases company Messer Griesheim, and Cinven's \$842 million acquisition of Klöckner Pentaplast.

The growth in the overall value of deals in Germany last year relied almost entirely on these large transactions. The Mittelstand, meanwhile, has been much quieter. However, encouraged by the Gardena transaction earlier this year players like IK are confident that the middle market will soon become a more vibrant source of MBO opportunities.

"Our philosophy is to get ready and be prepared for the upsurge," says Detlef Dinsel.

"We firmly believe that Germany is an interesting and strong private equity arena with the potential to become the most important target market in Europe," he says.

Given the size of its economy and the pressure which is mounting on large corporate entities to increase shareholder value and focus on core competencies, logic suggests that there are many deals waiting to be done. However, following an influx of UK and US participants in recent years, the market is also very competitive with a high density of private equity houses. "Fortunately we are targeting the mid-cap sector which is slightly less

crowded," says Peter Welge.

Dinsel believes that deal flow has been fairly slow in the mid-market over the last two years because although corporate restructuring has been widely discussed, as of yet relatively few German companies have actually put their strategic plans into action.

"Few medium-sized German companies are currently undertaking drastic reforms and many still have a strong appetite for the IPO route," says Dirk Tetzlaff. IK has also found that stiff acquisition competition can come from outside the financial community. "Germany has such a big domestic market that companies for sale will usually also trigger high interest from trade buyers," says Detlef Dinsel.

Germany is an exciting market at a relatively early stage of maturity. Although deal flow levels to sustain so much active interest from unquoted equity investors are slow to emerge, those players prepared to take a long-term approach and really work at generating deals will find their efforts well-rewarded in the future.



**NEW CONTRACT:** Enermet Group, a leading supplier of metering systems, has landed a contract with energy giant Vattenfall.

**CORE FOCUS AND IMPORTANT NEW CONTRACT FOR ENERMET**

Enermet Group Oy has sold its heat meter business to Kamstrup A/S of Denmark. Enermet's Managing Director Markku Talonen explained the rationale behind the sale: "The focus of our core business is electricity metering and relating systems and services, and our heat meter business, accounting for just six per cent of sales, deserved a more appropriate owner in order to develop the business in the best possible way," he said.

In August, Vattenfall Verkko Oy and Enermet Oy announced the signing of an important contract for the management of the energy metering data of Vattenfall's customers. The electricity of Vattenfall's 30,000 household customers will be read automatically by an Enermet system.

Enermet Group is one of the

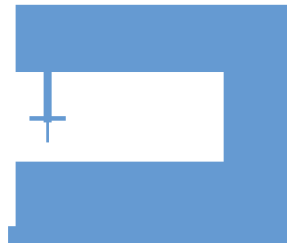
leading suppliers of energy metering systems and devices in Europe. Enermet's sales in 2001 amounted to €83 million and the company employs approximately 400 people.

**ADDEK ACQUIRES BUSINESSES FROM WALTER BAU**

Addtek International Oy Ab has signed a contract with the German construction company Walter Bau AG regarding the acquisition of its railway sleeper and special concrete pipe business in Germany, as well as its precast concrete business in the Czech Republic. The annual turnover of the businesses is approximately €80 million.

The acquisition strengthens Addtek's position as the leading producer of concrete elements in Europe. With the addition of the Walter Bau's railway sleeper factories, Addtek will produce railway sleepers in seven

countries. Addtek reported a turnover of €531 million in 2001 and has approximately 4,200 employees.



**NEW NAME FOR VIKING SEWING MACHINES**

Viking Sewing Machines has changed its name to VSM Group. As before, the company's marketing resources will be concentrated on the two brands – Husqvarna Viking and Pfaff. VSM Group is the leading manufacturer of domestic sewing machines, as well as software and accessories

for sewing and embroidery. The company has 1,750 employees worldwide.

**INTRUM JUSTITIA AND CRÉDIT AGRICOLE INDOSUEZ IN JOINT VENTURE**

Intrum Justitia Group and Crédit Agricole Indosuez have entered into a joint venture for purchasing written-off consumer debt portfolios in the Nordic countries.

This market was chosen as the first market for debt purchases due to the well-developed legislation, collection practice and servicing capacity offered by Intrum Justitia.

Intrum Justitia, one of Europe's leading receivables management services groups, was listed on the Stockholm Exchange in June this year. The Group has revenues of over SEK 2.3 billion and has approximately 2,600 employees in 21 European countries.

**MANAGEMENT CHANGES**

The Board of Directors of MacGREGOR Group has appointed Hans Pettersson President and Chief Executive Officer of the company effective from 27 August. Hans Pettersson joined MacGREGOR in 2001 as the General Manager of the Cranes Division.

Pertti Nupponen has been appointed Chief Financial Officer of Addtek International Oy Ab.

Bertil Persson, Chief Financial Officer of Intrum Justitia AB, has been appointed Deputy CEO and acting CEO of the company following the resignation of Peter Sjunnesson.

During an interim period, Bo Ingemarson, Chairman of the Board, assumes the role of working Chairman. The process of recruiting a new CEO has been initiated.

**:CALENDAR**

**3 DECEMBER 2002**

Annual Investor Meeting, Stockholm  
Advisory Committee Meeting, Stockholm

**DURING DECEMBER 2002**

Annual Update

**BY END OF DECEMBER 2002**

30 September 2002 reports, including  
Valuations distributed to Investors

**DURING MARCH 2003**

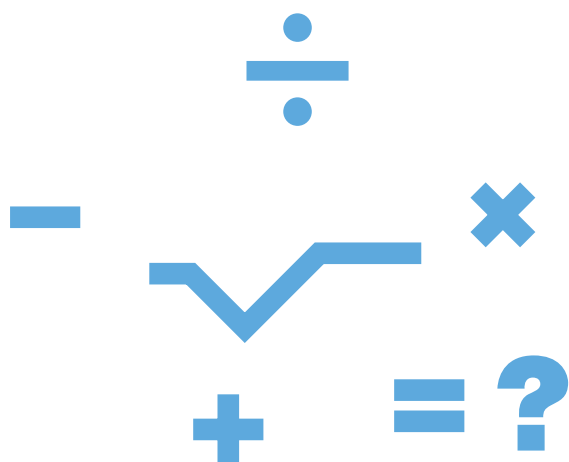
Next IK News

**13 MAY 2003**

US Investor Meeting, New York

**27 MAY 2003**

Investor Meeting, London  
Advisory Committee Meeting, London



**:TRANSPARENCY, INTEGRITY, ACCOUNTABILITY**

IK News talks to Bob Barnden, Partner at Öhrlings PricewaterhouseCoopers in Stockholm, about the climate for auditing and due diligence in the wake of the Enron and Worldcom scandals

**Q: What has been the impact of the recent US corporate scandals on accounting in Europe?**

A: The US irregularities have broken public trust in the accounting world. Everyone is now scrutinising any figures they are given to look at much more closely.

**Q: Why were Enron and Worldcom able to conceal their**

**true financial shape for so long?**

A: Because US accounting has become so complex and so detailed, and has evolved into what is essentially now a 'cook book' system. Companies may well be following the rules but, at the same time, no one is looking at what is actually being prepared. Under the present system, accounts can be both complete and accurate yet be neither meaningful nor understandable.

**Q: How can the situation be improved?**

A: Above all, the need is for far greater transparency. Management should be using the accounts to present the clearest picture

possible of the financial strength of a company. The current system unfortunately promotes 'disparity'. It allows management to superficially play by the rules and yet use those rules to engage in financial engineering – taking things above or below the line or off balance sheet altogether, as it suits them.

I also think there is a requirement for greater integrity among management. Some are apt to forget that they are in a position of trust. Instead of running the company for shareholders they may be looking first towards their own financial gains.

**Q: Are lack of independence and conflicts of interest a problem?**

A: Management must realise that they are accountable not just to themselves but also to an independent Board of Directors and to the shareholders and other stakeholders in the company. Here, the move towards creating boards which are more independent is a welcome step. Auditors must also recognise the potential for conflicts of interest and divided loyalties. Setting up audit committees in Europe is a good move. This will give auditors a forum to speak to the Board of Directors, independently of management.

**Q: Does the accounting regime need revising?**

A: Accounting standards and principles need to be streamlined and simplified and, in the

process, become less open to interpretation. It would also make sense, as capital becomes more global and deals increasingly cross borders, for a uniform set of global standards to be agreed. In marrying international, US GAAP, and European accounting standards a more level, transparent and, ultimately, less corruptible business environment would emerge.

**Q: What does IK need to watch out for in the current climate?**

A: IK should take extra care with due diligence and, particularly when investing overseas, not necessarily take the accounts of a target company at 'face value'.

On the other side of the coin, IK must ensure that its own accounts, and those of its portfolio companies, are as clear and consistent as possible, following the spirit, as well as the letter, of the appropriate accounting rules.



Bob Barnden, Partner at Öhrlings PricewaterhouseCoopers in Stockholm.

**:PERSONNEL**

**Ulrika Lindqvist**  
Swedish. Assistant, Swedish team. Based in Stockholm.

**Francesca Zavatteri**  
Italian. Assistant, French/Italian/Spanish team. Based in London.

**Josep Turro Bassols**  
Spanish and American. Associate, French/Italian/Spanish team. Based in London.

**Krister Holmberg**  
Swedish. Corporate Counsel/Legal Control. Based in Stockholm.

**:WEBLINKS**

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