Private Equity: theory and practice

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What Does Private Equity Mean?

**Some definitions of private equity:**

- A fund established to invest specifically in unquoted securities rather than in publicly quoted securities or government bonds.

- Private equity consists of investors and funds that make investments directly into private companies or conduct buyouts of public companies that result in a delisting of public equity. Capital for private equity is raised from retail and institutional investors, and can be used to fund new technologies, expand working capital within an owned company, make acquisitions, or to strengthen a balance sheet.

- Note: The Jesuits: “The shock troops of the Pope.”
Concept of Private Equity and Venture Capital

• The terms “venture capital” and “private equity” are sometimes used interchangeably but they vary in principle in their investment philosophy.

• Venture capital investors usually invest in a company at an early stage whereas private equity investors invest as a part of growth capital.

• Venture capital have invested particularly in technology companies. Silicon Valley and the internet boom were driven by venture capital.

• Private equity investors usually do not invest into ideas or at an early stage; They require a significant and proven history of the company, i.e. 3-10 years of operations.

• Venture capital investors may invest as a seed capital in an idea or into 1-3 year old companies for them to grow.

• Private equity capital is primarily used for growth. These investors usually stay 2-7 years in a company and then exit.

• The expectations of private equity investors for rate of return range anywhere between 18 – 30 % per annum; especially in emerging markets like Turkey.
The Private Equity Business Model

Private Equity Firm ("General Partner")

Investors ("Limited Partners")
(public pension funds, corporate pension funds, insurance companies, high net-worth individuals, family offices, endowments, foundations, fund-of-funds, sovereign wealth funds, etc.)

Fund/Investment Management
Ownership of the Fund

Private Equity Fund (Limited Partnership)

The Fund’s ownership of the portfolio investments

Investment
Investment
Investment
The Biggest Private Equity Deals of All Time

- **$38.9 billion** - Equity Office Properties Trust (USA based Real Estate Firm) – In 2007, acquired by Blackstone. A fierce bidding war drove up the price by $3 billion.

- **$32.7 billion** - Hospital Corp. of America ((HCA) is the largest private operator of health care facilities in the world) - In 2006, acquired by Bain, KKR and Merrill Lynch. The buyers, including the Frist family, paid only $5.5 billion in equity. The rest was debt.

- **$31.1 billion** - RJR Nabisco (an American conglomerate formed in 1985 by the merger of Nabisco Brands and R.J. Reynolds Tobacco Company) - In 1989, acquired by KKR. It was, at that time and for over 17 years, the largest leveraged buyout in history.

- **$27.4 billion** - Harrah’s Entertainment (Harrah’s Entertainment, Inc. is the world's largest provider of branded casino entertainment through operating subsidiaries. - In 2006, acquired by Apollo and Texas Pacific Group (TPG). $90-per-share offer was a huge 35% premium over the casino's closing stock price.

- **$25.7 billion** - Clear Channel Communications (Owns and operates more than 1200 radio stations in the United States) - In 2006, acquired by Bain and Thomas H. Lee

- **$21.6 billion** - Kinder Morgan (Energy company operating a large network of natural gas and refined petroleum products pipelines.) - In 2006, acquired by Carlyle, Riverstone and Goldman Sachs. Goldman did the deal and earned fees from the buyers and seller.

Source: Fortune magazine
According to a 2011 ranking created by industry magazine Private Equity International, the 10 largest private equity firms in the world are:

1. Texas Pacific Group **
2. Goldman Sachs Capital Partners **
3. The Carlyle Group **
4. Kohlberg Kravis Roberts **
5. The Blackstone Group
6. Apollo Management
7. Bain Capital (BC Partners) **
8. CVC Capital Partners **
9. First Reserve Corporation
10. Hellman & Friedman

** : already have at least one investment in Turkey
Private Equity in Turkey

Global PE Firms with Turkish Offices
Abraaj Capital
Ackermans van Haaren
ADM Capital
Ashmore Private Equity
Carlyle Group
Eurasia Capital
HSBC Principal Investments
Global Investment House
Kerten Capital
Mediterra
Mid Europa Partners
NBK Capital
NBGI
PineBridge Investment
Private Equity in Turkey

**Local PE Firms**
Access Turkey
Actera
Esas Holding
Fiba Capital
Gözde Finansal Hizmetler
iLab Ventures
İş Girişim Sermayesi
Kobi Girişim Sermayesi Yatırım Ortaklığı
Standard Unlu Private Equity
Turkven
Verusa Private Equity
Private equity deal volume in Turkey

![Bar chart showing total deal value, total PE deal value, and PE deals as % of total from 2006 to 2010.](chart.png)
Private Equity in Turkey

- Private equity activity was limited up until recent years. Despite alternative sources of capital and funding have always been limited for private sector investments in Turkey, private equity did not make substantial headway until around 2006.

- Investments were funded primarily by a small amount of capital put in by the owner and through short-term bank loans provided by Turkish banks. Capital was accumulated mostly in the hands of big or mid-size family conglomerates and groups.

- The history of private equity needs can be analyzed in periods with distinct features:
  - **Period 1**: The first period, before 1999, may be called the “nomadic investment period”
  - **Period 2**: The second period was between 1999 and 2000 where we see the “first wave” of private equity efforts happening in numbers;
  - **Period 3**: The third period between 2001 and 2005 may be regarded as the long take-off period;
  - **Period 4**: The fourth period is 2006 to 2008 and can be fairly presented as the “period when potential is finally being realized”.
  - **Period 5**: the crisis period from mid-2008 to around the end of 2009. A worldwide problem.
  - **Period 6**: the recovery.
## Private Equity in Turkey

<table>
<thead>
<tr>
<th>#</th>
<th>Acquirer</th>
<th>Origin</th>
<th>Target</th>
<th>Sector</th>
<th>Stake Acquired (%)</th>
<th>Date</th>
<th>Deal Value (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>BC Partners; DeA Capital; Turkven</td>
<td>UK</td>
<td>Migros Türk</td>
<td>Retail</td>
<td>97.9%</td>
<td>Oct-08</td>
<td>3.100,0</td>
</tr>
<tr>
<td>2</td>
<td>Alfa Group</td>
<td>Russia</td>
<td>Turkcell</td>
<td>Telecommunications</td>
<td>13.2%</td>
<td>Dec-05</td>
<td>1.590,0</td>
</tr>
<tr>
<td>3</td>
<td>Kohlberg Kravis Roberts (KKR)</td>
<td>USA</td>
<td>UN Ro-Ro</td>
<td>Logistics &amp; Transport</td>
<td>97.6%</td>
<td>Oct-07</td>
<td>1.251,6</td>
</tr>
<tr>
<td>4</td>
<td>Texas Pacific Group</td>
<td>USA</td>
<td>Mey İçtik</td>
<td>Food &amp; Beverage</td>
<td>90.0%</td>
<td>Apr-06</td>
<td>810,0</td>
</tr>
<tr>
<td>5</td>
<td>Abraaj Capital</td>
<td>UAE</td>
<td>Acıbadem Sağlık Hizmetleri</td>
<td>Healthcare</td>
<td>53.8%</td>
<td>Jan-08</td>
<td>586,7</td>
</tr>
<tr>
<td>6</td>
<td>Bizim Toptan; Gozde Finansal Hiz.</td>
<td>Turkey</td>
<td>Sok Marketler</td>
<td>Retail</td>
<td>99.6%</td>
<td>Jun-11</td>
<td>380,0</td>
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<td>7</td>
<td>Lusail International Media</td>
<td>Qatar</td>
<td>Turkuaz Radyo Televizyon</td>
<td>Media</td>
<td>25.0%</td>
<td>Jul-08</td>
<td>270,0</td>
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<td>8</td>
<td>Providence Equity Partners Inc</td>
<td>USA</td>
<td>Digitürk</td>
<td>Media</td>
<td>47.0%</td>
<td>Jan-06</td>
<td>250,0</td>
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<tr>
<td>9</td>
<td>CVCI ve Partners in Life Sciences</td>
<td>USA</td>
<td>Biofarma İlaç</td>
<td>Pharmaceuticals</td>
<td>100.0%</td>
<td>Dec-06</td>
<td>240,0</td>
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<tr>
<td>10</td>
<td>Goldman Sachs</td>
<td>USA</td>
<td>TAV Yatırım Holding</td>
<td>Infrastructure</td>
<td>N/D</td>
<td>Dec-06</td>
<td>225,0</td>
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<td>11</td>
<td>Abraaj Capital Limited</td>
<td>UAE</td>
<td>Acıbadem Sağlık Hizmetleri</td>
<td>Healthcare</td>
<td>21.7%</td>
<td>Aug-07</td>
<td>162,5</td>
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<td>SU Private Equity, Turkven</td>
<td>Turkey</td>
<td>Natura Gida</td>
<td>Food &amp; Beverage</td>
<td>25.0%</td>
<td>Apr-11</td>
<td>150,0</td>
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<tr>
<td>13</td>
<td>CVCI</td>
<td>UK</td>
<td>Beymen Mağazacılık</td>
<td>Retail</td>
<td>50.0%</td>
<td>May-07</td>
<td>142,6</td>
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<tr>
<td>14</td>
<td>ADM; PGGM N.V.; IFC</td>
<td>H.K., Neth., US</td>
<td>Universal Hospitals Group</td>
<td>Healthcare</td>
<td>26.0%</td>
<td>May-11</td>
<td>140,0</td>
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<tr>
<td>15</td>
<td>Esas Holding</td>
<td>Turkey</td>
<td>Mars Entertainment Group</td>
<td>Entertainment</td>
<td>30.0%</td>
<td>Nov-10</td>
<td>130,0</td>
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<td>16</td>
<td>Argus Capital Partners &amp; Qatar F.I.B.</td>
<td>Qatar</td>
<td>Memorial Health Group</td>
<td>Healthcare</td>
<td>40.0%</td>
<td>Aug-10</td>
<td>120,0</td>
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<td>17</td>
<td>Turkven</td>
<td>Turkey</td>
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<td>Education</td>
<td>N/D</td>
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<td>18</td>
<td>Bosphorus (Krea &amp; Merrill Lynch)</td>
<td>USA-Turkey</td>
<td>Neo Shopping Center</td>
<td>Real Estate</td>
<td>100.0%</td>
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<td>94,0</td>
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<td>19</td>
<td>Union Investment</td>
<td>Germany</td>
<td>Forum Mersin</td>
<td>Shopping Center</td>
<td>35.0%</td>
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<td>20</td>
<td>Bancroft Private Equity LLP</td>
<td>UK</td>
<td>Standard Profil Otomotiv</td>
<td>Automotive &amp; Parts</td>
<td>100.0%</td>
<td>Sep-06</td>
<td>90,0</td>
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<tr>
<td>21</td>
<td>Babcock &amp; Brown</td>
<td>Australia</td>
<td>TAV Yatırım Holding</td>
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<td>N/D</td>
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<td>22</td>
<td>Odien Asset Management</td>
<td>USA</td>
<td>İhlas Madencilik</td>
<td>Mining</td>
<td>18.0%</td>
<td>Jul-08</td>
<td>90,0</td>
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<td>23</td>
<td>Deutsche Bank</td>
<td>Germany</td>
<td>Doğan Gazetecilik</td>
<td>Media</td>
<td>22.0%</td>
<td>Jul-07</td>
<td>88,0</td>
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<tr>
<td>24</td>
<td>One Equity Partners &amp; Rhea Inv.</td>
<td>USA, Turkey</td>
<td>Nortel Networks Netash</td>
<td>Telecommunications</td>
<td>53.1%</td>
<td>Oct-10</td>
<td>83,7</td>
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<td>25</td>
<td>Asya Katılım Bankası</td>
<td>Turkey</td>
<td>A101 Supermarkets</td>
<td>Retail</td>
<td>25.0%</td>
<td>Jul-08</td>
<td>83,6</td>
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<tr>
<td>26</td>
<td>Esas Holding</td>
<td>Turkey</td>
<td>AFM Uluslararası Film</td>
<td>Entertainment</td>
<td>88.01%</td>
<td>Jul-10</td>
<td>82,4</td>
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<td>27</td>
<td>Actera</td>
<td>Turkey</td>
<td>Mey İçtik</td>
<td>Food &amp; Beverage</td>
<td>10.0%</td>
<td>Jan-07</td>
<td>81,0</td>
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<tr>
<td>28</td>
<td>Venice European Investment Capital</td>
<td>Italy</td>
<td>Global Liman</td>
<td>Infrastructure</td>
<td>22.1%</td>
<td>Jul-11</td>
<td>77,4</td>
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<td>29</td>
<td>HSBC Principal Investments</td>
<td>UK</td>
<td>Havaş</td>
<td>Services</td>
<td>28.3%</td>
<td>Oct-09</td>
<td>76,1</td>
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<td>30</td>
<td>Global Investment House</td>
<td>Kuwait</td>
<td>TAV Yatırım Holding</td>
<td>Infrastructure</td>
<td>5.0%</td>
<td>Aug-06</td>
<td>75,0</td>
</tr>
</tbody>
</table>
Private Equity in Turkey

- As a promising emerging market, Turkey provides good investment opportunities for private equity primarily because of its investor friendly liberalization, deregulation, and privatization policies, fast growing business environment, and scarcity of capital. However, figures show that the industry has not grown to expectations.
Challenges in Turkey

• Finding the right deal: existing shareholders want new capital, real growth potential
• Valuation
• Scarcity of capital in domestic market
• Lack of interested international VC funds for start-ups
• Limited deal flow while there are many companies looking for funding, uninformed market about VC, insufficient managerial resources
• Limited exit opportunities – Volatile capital markets, limited M&A activity, most family-owned companies are too small for a meaningful exit in terms of IPO.
Leveraged Buyout, LBO or Buyout refers to a strategy of making equity investments as part of a transaction in which a company, business unit or business assets is acquired from the current shareholders typically with the use of financial leverage. The companies involved in these transactions are typically mature and generate operating cash flows.

Requires a financial sponsor agreeing to an acquisition without itself committing all the capital required for the acquisition. To do this, the financial sponsor will raise acquisition debt which ultimately looks to the cash flows of the acquisition target to make interest and principal payments.

The amount of debt used to finance a transaction varies according:
- the financial condition and history of the acquisition target
- market conditions
- the willingness of lenders to extend credit
- the interest costs and the ability of the company to cover those costs
- Historically the debt portion of a LBO will range from 60%-90% of the purchase price
Types of Private Equity

**Growth Capital**

Equity investments, most often minority investments, in relatively mature companies that are looking for capital to expand or restructure operations, enter new markets or finance a major acquisition without a change of control of the business.

These companies are likely to be more mature than venture capital funded companies, able to generate revenue and operating profits but unable to generate sufficient cash to fund major expansions, acquisitions or other investments.

Growth capital can also be used to effect a restructuring of a company’s balance sheet, particularly to reduce the amount of leverage (or debt) the company has on its balance sheet.
Distressed or Special Situations is a broad category referring to investments in equity or debt securities of financially stressed companies. The "distressed" category encompasses two broad sub-strategies including:

“Distressed-to-Control” or "Loan-to-Own" strategies where the investor acquires debt securities in the hopes of emerging from a corporate restructuring in control of the company’s equity.

"Special Situations" or "Turnaround" strategies where an investor will provide debt and equity investments, often "rescue financing" to companies undergoing operational or financial challenges.
Types of Private Equity

Mezzanine Capital

Mezzanine capital refers to a subordinated debt or preferred equity instrument that represents a claim on a company’s assets which is senior only to that of the common shares.

Mezzanine capital is often a more expensive financing source for a company than secured debt or senior debt. The higher cost of capital associated with mezzanine financings is the result of its location as an unsecured, subordinated (or junior) obligation in a company’s capital structure.

Mezzanine financings, which are usually private placements, are often used by smaller companies and may involve greater overall leverage levels than issuers in the High Yield market; as such, they involve additional risk. In compensation for the increased risk, mezzanine debt holders require a higher return for their investment than secured or other more senior lenders.
The private equity secondary market (also often called private equity secondaries or secondaries) refers to the buying and selling of pre-existing investor commitments to private equity and other alternative investment funds. Secondary transactions can be generally split into two basic categories:

**Sale of Limited Partnership Interests:** The most common secondary transaction, this category includes the sale of an investor's interest in a private equity fund or portfolio of interests in various funds through the transfer of the investor's limited partnership interest in the fund.

**Sale of Direct Interests:** Secondary Directs or Synthetic secondaries, this category refers to the sale of portfolios of direct investments in operating companies, rather than limited partnership interests in investment funds. These portfolios historically have originated from either corporate development programs or large financial institutions.
Types of Private Equity

Venture Capital

Subcategory of private equity that refers to equity investments made, typically in less mature companies, for the launch, early development, or expansion of a business. Venture investment is most often found in the application of new technology, new marketing concepts and new products that have yet to be proven.

Entrepreneurs often develop products and ideas that require substantial capital during the formative stages of their companies’ life cycles. Many entrepreneurs do not have sufficient funds to finance projects themselves, and they must therefore seek outside financing.

Venture capital is most suitable for businesses with large up-front capital requirements which cannot be financed by cheaper alternatives such as debt.
Exit Strategies

**Trade Sale**

A trade sale of privately held company equity is the most popular type of exit strategy and refers to the sale of company shares to industrial investors. The trade sale is agreed in private.

**Management Team Repurchase**

The repurchase of a company by its management “is becoming more and more successful as an exit strategy if the company can guarantee regular cash flows and can mobilize sufficient loans”... Until 2008!

**Investor Sale**

One investor may sell his equity stake to another when the company has reached the envisioned development or the current development no longer corresponds to the investment criteria of the fund.

**IPO (initial public offering)**

An IPO aims to make the company more dynamic over the long term and to profit from the growth possibilities offered by a stock market. Thus the share placed on the market must be large to ensure liquidity.

**Liquidation**

This is obviously the least favorable option and occurs when the efforts of the head of the company and the investors to save the company have not succeeded.
BANGLADESH:
Bangladesh is vitally located as a bridge between the emerging markets of South Asia and fastest growing markets of South East Asia and ASEAN countries. A significant array of reforms, deregulation and liberalization have been carried out over the recent years in policies relating to virtually every sector of the economy including financial reforms with the aim of globalization.

The country has a policy of private sector led, liberal economic approach; export oriented.

PHILIPPINES:
Regional Investment Promotion Centres:
Why Do Business in the Philippines?
The answer is simple - quality manpower resources, strategic business location, liberalized and business friendly economy, hospitable lifestyle and unlimited business opportunities.
It's not just Turkey that's trying to attract investment...
It’s not just Turkey that’s trying to attract investment . . . .

JORDAN:
The Jordanian government has focused on reforms and investment policy aimed at:
Liberalization of trade, investment procedures, and elimination of trade barriers
Encouragement of foreign investment
Encouragement of private sector investment
Privatization of previously-owned governmental projects

ALBANIA:
Albanian Foreign Investment Promotion Agency
Why invest in Albania?
• A liberal regime for foreign investment, which guarantees equal treatment of foreign and local investors.
• Free Trade Agreements with regional countries
• A strategic geographic position
• Access to the EU market
• Numerous sectors in privatization and concession (telecommunication, water-supply, oil and gas)
• Low labor cost with great availability of a skilled and productive work force
Real Private Equity Cases - some famous recent disasters


• Terra Firma acquisition of EMI in 2007: US$ 1 bn of equity, US$ 2.6 bn of debt. EMI’s revenues have fallen through recession and the shift in music buying habits. Terra Firms is now in serious dispute with the main lender Citibank, about possible write-offs of part of its loans.

• BC Partners acquisition of Foxtons Real Estate Agents in 2007: a smaller investment, the purchase price was £360 m but only about £50 m of this was equity from BC Partners. Spectacularly bad timing as the UK real estate market went into severe recession soon after, with a 50-70% drop in transaction volumes.