

PreView



WEIL, GOTSHAL & MANGES

Private Equity Views | **AUTUMN 2008**

COLLER OF MONEY

“I reasoned that since everyone hates private equity, why not buy what everyone wants to sell?”

- Regional analysis: CEE and the consumer boom
- The changing face of charity funding
- How buy and build produced a TV star



“One of my directors told me in 2000 that I should sell – I ignored him, of course”

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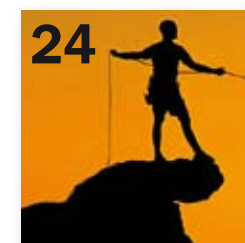
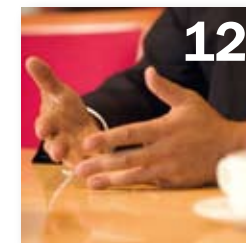
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EDITORIAL

Amid the current market hiatus, the casual observer might forgive a private equity professional for seeking retirement, taking a sabbatical, or extending the second summer break in a row. In reality, it is a better time now to be investing and advising than for a number of years.

Boom-time deal-making skills could be somewhat mechanical. For investors, life consisted of sanitised auction processes, where much of the due diligence was presented in advance, and the challenge was to make a bet on a management team you may have met just once. The sugar rush of winning a deal was at least partly pyrrhic, given the silent knowledge that, with the same information, you offered more than any other investor in a cash-rich world.

Post-credit crunch, deal flow has become much more proprietary. Investing is once again about rolling up sleeves and ferreting out deals – a situation to be relished by the tenacious and the ambitious. Meanwhile portfolio managers have moved from backroom boys who ensure nothing gets in the way of relentless multiple expansion, to front-line players confronted with the absolute necessity to create value.

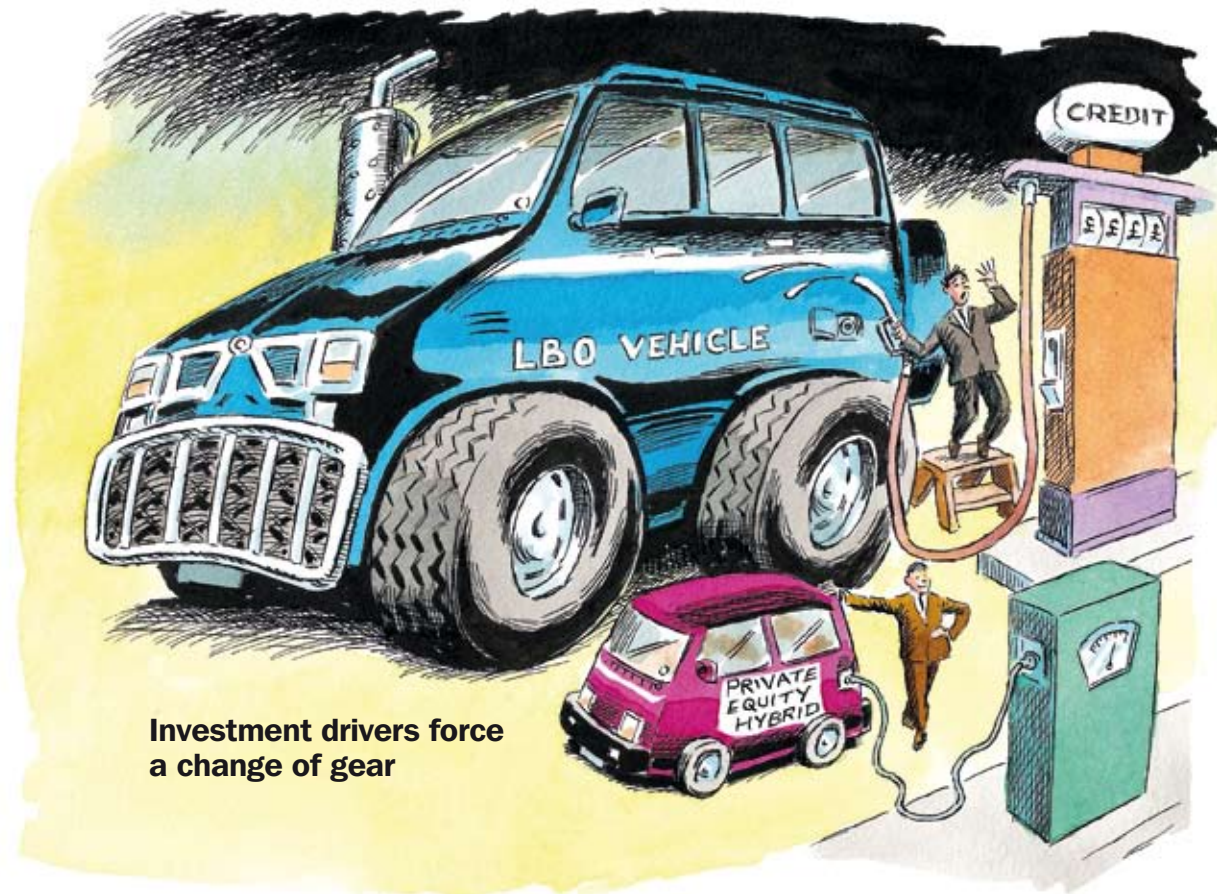
For advisers, bankers and lawyers, boom-time skills involved managing different competing branches and then moving fast to get one over the line. Now those formulaic processes have been replaced by an urgent need for thoughtful structuring and advice.

But while the heat is out of the market, bargains are unlikely to be as plentiful as in other downturns. Making money will not be easy, and not everyone will survive. High-level insight and perspective count now more than ever.

It is against this backdrop that Weil, Gotshal & Manges presents the launch edition of *PreView*. In this and subsequent issues we will provide private equity views and thought leadership from the most respected international investors and business people. I trust their insight will prove useful as we enter a new era of company acquisition and ownership.

Ross Butler, Editor

PRIVATE EQUITY NEWS



Investment drivers force a change of gear

PRIVATE EQUITY DOUBLES PUBLIC MARKET VALUE CREATION

Private equity-backed businesses sold in 2007 increased enterprise value at twice the rate of public market equivalents, according to a study by professional services firm Ernst & Young.

The global study of the 100 largest private equity exits globally found that companies owned by private equity grew in enterprise value by an average of 24% a year. Meanwhile, both Ebitda and productivity grew 33% faster than public market equivalents.

"As in previous years, 2007 exits revealed superior value creation in the businesses owned by PE firms around the world compared to public market benchmarks", says Simon Perry, Global Head of

Private Equity at Ernst & Young (pictured). "And our study counters the continuing myth that cheap debt and cost-cutting are the principal drivers of PE success."

The fastest growing businesses were in the technology and telecoms sectors, while the best performing buyouts by size were between \$500m and \$1bn.

When comparing different parts of the private equity market, the study found that Germany provided the richest pickings for private equity investors for the second year in a row, with a 29% annual growth rate, dwarfing the public markets average of 9%. Meanwhile UK buyouts suffered from their exposure to the worst performing acquisition type – the public-to-private –

which yielded a 17% enterprise value growth, compared with 32% for private-to-private deals. Northern Europe was the poorest performing region, suffering a small average loss on companies sold in 2007.

Buy-and-build investment strategies, which accounted for 16% of all buyout deals, enjoyed the highest growth rates. However, organic revenue growth accounted for 52% of total value creation, up from 44% in 2006.



Illustration by Steve Fricker

MID-MARKET EYES P2PS AS CREDIT CRUNCH WORSENS

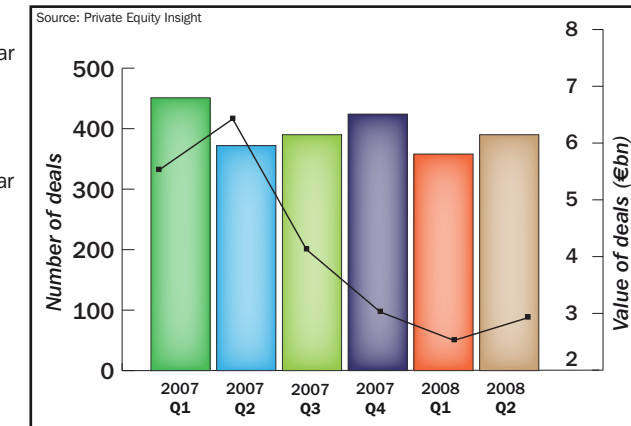
Deal activity in the UK's mid-market has hit a four-year low as the effects of bank lending constraints begin to pinch. The value of deals during the first half of the year dropped to £3bn compared with £7bn in the first half of 2007, according to the Centre for Management Buyout Research.

The mid-market was believed to be more resilient to the credit crunch than

the larger deals market, which suffered falling activity throughout 2007. But from the start of this year, the lack of available credit for buyouts began to filter down to those operating in the £100m to £500m "mid-market" transaction bracket. The total size of the UK buyout market in the first half of the year was £11bn, its lowest since 2004.

With a misalignment of price expectations deterring private vendors, many mid-market investors are pinning their hopes on the take-private market as plummeting share prices offset the complexity of de-listing stocks.

The top four deals completed in the first half of 2008 were all public-to-privates: the £2bn acquisition of Emap; the £1.3bn acquisition of Biffa; the £900m purchase of Abbot Group and the £500m take-private of Northgate



Information Solutions. With equity market valuations continuing to suffer, investors believe there may be bargains to be had. Private equity speculation has surrounded targets such as buy-to-let business Paragon, which has suffered a 90% valuation slide, and former FTSE100 pubs group Punch, which has seen its share price drop around 80% since its peak last summer.

In separate research, Candover's quarterly Barometer (see graph) showed a remarkable second quarter increase in the value of growth capital deals, rising 238% to record-breaking €6bn worth of investments – albeit largely driven by two big investments, in Evonik Industries and Weather Investments. The number of deals also rose 17% on the previous quarter, albeit from a low base compared with historical norms.

LION CAPITAL LEADS THE PACK IN SUMMER DEAL RUN

Fears of a quiet summer were shrugged off in July when Weil Gotshal's London office was instructed on no fewer than five private equity deals in the space of two weeks.

Consumer sector specialist Lion Capital made three acquisitions during July, with the buyout of Russian Alcohol Group, which followed Lion's earlier acquisition of Nidan Soki, the first-ever foreign sponsor leveraged acquisition in Russia.

Lion then agreed to acquire Advang Holding, owner of frozen snack brands in the Benelux. And finally the firm acquired the FoodVest Group, one of the largest frozen food makers in Europe, in a secondary buyout from CapVest, for around £1.1bn.

In the same period, Weil advised Fidelity Equity Partners on the buyout of Rights Digital Limited, a UK-based photographic business, as well as advising long-standing client Advent International on its acquisition of Craegmoor Limited Group, the UK-based healthcare business.



WEIL GOTSHAL HIRES PETER KING AS NEW CORPORATE PARTNER

Peter King (pictured) has joined Weil, Gotshal & Manges as a corporate partner in the firm's London office.

King, who has worked on such high profile deals as Delta Two's attempted takeover of Sainsbury's, was head of mergers & acquisitions at rival firm Shearman & Sterling in London, where he was responsible for the development and implementation of London M&A and equity capital markets strategy.

Other major deals he has worked on to date include the acquisition of Borsa Italiana by the London Stock Exchange and the rights issue by Paragon earlier this year.

King joined Shearman in 2003 from Linklaters, where he trained and became a partner in 1990.

"Weil Gotshal has a very attractive platform for the strategic growth of M&A across Europe, the US and Asia. To play a significant role in this growth is a unique opportunity that I simply couldn't turn down," said King.

Mike Francies, managing partner of Weil's London office, said "Peter is one of a small number of English M&A lawyers who is very highly regarded across the market by bankers and corporates alike."

THE LONG GAME

Those involved in the private equity industry are no strangers to making hard decisions. Now, says **Mark Soundy**, managing partners employ those skills uncomfortably close to home.



In the latest economic malaise, the famous private equity win-win, namely that downturns present good buying opportunities, has not so far applied. The problem isn't just the much-reported lack of debt. There remains a rift between sell- and buy-side price expectations, and the fact that private equity firms are often on both sides of a deal has not so far reconciled the dislocation.

The underlying problem is that a lack of visibility has led to great uncertainty with regards to performance projections and company valuations. A business may be ahead of plan this year, but what kind of environment it may be operating within next year is anyone's guess.

Some point to public company acquisitions as an obvious investment opportunity. But while stock market valuations may have tanked, extreme volatility means that the process of putting together an offer – never easy in the best of markets – has a much greater element of uncertainty. Company directors are quite reasonably questioning whether a valuation that is a fraction of last summer's highs can really be meaningful. Meanwhile, for buyout investors who face the prospect of much larger equity cheques and much more expensive debt financing, last summer's earnings multiplication no longer adds up. To make things tougher, the chances of sealing a bargain are remote, given the weight of capital targeted at the market.

One of private equity's great attributes is its locked up capital that insulates it from having to put money to work in the near term. But as the liquidity crisis continues, pressures – whether perceived or actual – will start to build, both in and outside of investment firms, as the orderly cycle of investment, divestment and fundraising is disrupted. The longer the virtual paralysis of the larger buyout market prevails, the more precarious private equity's position looks.

Most private equity executives – and indeed their advisers – get up in the morning to do deals.

The current situation will be a test of everyone's resolve, but the first to get itchy feet may well be the bright young investment professionals who face a deal-vacant CV unless they make a jump into a more liquid industry, or to a rival firm offering the chance of faster promotion.

Meanwhile, protracted deal and fund cycles will push out remuneration from carried interest and co-investment, further increasing partner tension.

There will also be the temptation to tinker. With less deal activity to keep them busy, executives may start poking around their existing portfolio. Portfolio company management teams face the prospect of greater scrutiny and, as the downturn kicks in, private equity owners will be increasingly inclined to use their most powerful muscle: the trigger finger. Even if management stays in place, increased meddling could undermine the relatively gentlemanly relationship that has prevailed this side of the Atlantic between owner and manager. Already, the practice of seconding junior deal-doers into investee companies has begun to test relationships.

dangers, just as failing to adapt to a situation carries risks.

We're in a world where major banks are on life support, recession is looming, and fresh elections in the US, the UK and the European Parliament and the prospect of a return to the Cold War days all add to the uncertainty. It would be reckless to base a business model on a return to a benevolent environment any time soon.

What cheer can be taken from this dark situation? The long-term health of the market is sure to benefit, as the lazy money that survived on multiple arbitrage and leverage is found out. The more extreme fee structures are also unlikely to survive a prolonged period of poor performance.

What kind of environment a business might be operating within next year is anyone's guess

Managing partners shouldn't feel too much pressure from long-standing LPs to invest, but a slowing of the investment pace could disrupt a firm's place in the fundraising cycle. If the market does suddenly 'get going' it could push numerous firms on the narrow runway for institutional capital at once.

Of course, there is an alternative: to invent different types of transactions that may work in the prevailing market, such as the growing trend for so-called "enterprise finance". But shifting away from tried and tested strategies has clear

But if that doesn't have you reaching for the champagne, consider this. Every good sociologist knows that happiness and a sense of self-worth are derived from relative success. Over the coming years there will be nowhere for the weak to hide. If you have confidence in your application of the private equity model, and the patience to focus on the long game, this could be the opportunity of a lifetime.

Mark Soundy is a partner in Weil Gotshal's international private equity team, based in London.

Illustration by Sam Kerr

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Drifting towards danger?

Economic uncertainty and restricted leverage means larger buyout groups have a stark choice: to hang tight with their capital or be creative in putting it to work. **By Vince Heaney**

During an economic slowdown, having plenty of money and not much to spend it on ought to be a comfortable position. But the private equity industry is faced with a difficult choice. Fundraising remains buoyant but credit is tight, and is simply not available in the quantities required to finance the type of mega-buyouts witnessed in the past few years. With big leveraged buyouts being thinner on the ground, private equity firms must choose whether to stick closely to their existing strategies or look at new ways to put money to work.

Recent industry data put this dilemma into context. According to Dealogic, the overall number of financial sponsor buyouts has fallen by 19 per cent in the first half of 2008 compared with the same period last year, but in value terms the decline was a far starker 76 per cent.

Meanwhile, the number of buyouts of more than \$1bn has fallen to 31 in the first half of 2008, down from 92 in the first half of 2007. The pace of fundraising, on the other hand, shows no sign of abating. According to Private Equity Intelligence, \$162bn was raised in the second quarter of 2008 – the second highest quarterly total ever achieved.

With investors' growing appetite for the asset class underpinning the need for private equity managers to deploy capital, there are understandably concerns about strategy drift. According to a survey released in June by Collier Capital, three-quarters of institutional investors in private equity are worried that fund managers will stray into strategies or geographies where they lack expertise.

"They [investors] know the dispersion of returns between more and less able GPs rises in tougher times, so that worrying about GP strategy drift and focusing more resources

on their strongest managers are very sensible responses to today's climate," says Jeremy Collier, CIO of Collier Capital.

Give it back

But it is not only investors who are uncomfortable with strategy drift. Guy Hands, chief executive of Terra Firma, has been particularly vocal on the subject. In his quarterly letter to investors in May, Hands described some of the moves towards new products and geographical areas as knee-jerk reactions to the market, which use capital entrusted to one strategy to pursue another.

"If a firm wants to undertake new investment strategies, it should hand back the committed, but undrawn, capital to LPs and ask for their re-commitment," was Hands' controversial recommendation. LP investors carry out due diligence based on a private equity firm's existing track record, and may be unhappy for that capital to be invested in new sectors or countries.

'Sticking to your knitting' also builds long-term credibility with investors, which is an advantage for an asset class with an investment horizon of several years. "It comes down to [backing] very good, experienced managers who haven't panicked, become overleveraged or chased deals," says Ilona Brom, a managing director with Wilshire Private Markets, the fund of funds private equity investment business unit of Wilshire Associates Incorporated.

"Often, drift is a media construct rather than something investors are sensitive about"

Chasing deals regardless of the stage of the economic cycle potentially poses a bigger threat to returns than strategy drift. Deal activity and valuations were high in 2006 and 2007. If a private equity group has invested most of a five- to seven-year fund in those years, the resulting vintage concentration may drag down returns, given the uncertain outlook for exit multiples.

GPs must also consider the impact of strategy drift on their own management teams. Some large buyout groups have moved back down the market capitalisation scale and are competing on smaller deals. Not only is it more difficult to generate financial out-performance from a large pool of capital by investing it in small amounts, but star deal-makers who signed up to close billion-dollar deals may become disaffected by working on a succession of \$100m transactions.

Evolution not drift

Hands' view is at one end of the spectrum, and even he is prepared to admit that investment strategies have to evolve and that it is difficult for private equity firms to do nothing for very long before feeling the pressure to invest. This need to adapt to meet changing market circumstances shifts the argument from whether a private equity firm should deviate from its strategy to what actually constitutes 'strategy drift'.

"Often, the notion of strategy drift is a media construct rather than something investors are sensitive about," says a senior executive at one UK-based private equity group. "There is never an equilibrium state because we invest over the cycle, and the cycle is never quite the same. Private equity is in a constant state of evolution."

Evolving the strategy is a point of differentiation for private equity groups. "If you want to be the private equity firm of choice, you have to differentiate yourself, both in the eyes of investors and in the eyes of managers running companies who are looking to change their business," says Patrick Dunne, group communications director at 3i. As part of that objective, 3i decided that it needed to operate on a worldwide basis and has been developing its international business for the past 25 years.

"But where it used to be that being international was a big point of differentiation, a lot of companies are now following that strategy," he says. "As the industry matures, the bar is raised and what used to be a point of differentiation is now a given."



Successful evolution involves striking the right balance between delivering the returns investors expect while deploying ever-larger amounts of capital. "The biggest theme concerning strategy drift from our perspective [as an LP] is geographical expansion in the context of ever-increasing fund sizes," says Dr Stefan Hepp, chief executive and founder of SCM, a provider of management and consulting services for alternative investments. "Increasingly, to justify the size of the funds they are raising, private equity firms have to be able to defend investing a proportion of their capital outside the domestic market. This started with private equity groups migrating from the UK to Europe, US firms expanding into the European market and now to Asia. But do these private equity firms have the

local knowledge and competitive edge in the deals they are competing for?"

But from a GP's perspective, rather than suffering from a lack of expertise, private equity's entry into new markets offers the chance to utilise existing skills more widely. "The basic principles of doing a private equity deal in the UK are the same in Asia. Private equity can bring a level of expertise to those markets that wasn't there before," says Buchan Scott, partner at Duke Street Capital. "Of course there are caveats. The risk is that you are playing on someone else's pitch, so you need to work with people with local knowledge of those markets."

For many private equity firms, widening their geographical scope mirrors the overseas expansion of existing portfolio companies and, if

Dr Hepp agrees: "It's a fair-weather strategy only. If a portfolio company runs into trouble, there is a conflict if the same private equity firm is negotiating on the debt and the equity." And there is recognition among some GPs that debt trading does not sit comfortably within a

vendors in falling equity markets, with both sides tending to hold back because they believe the situation from their own perspective will improve. This reluctance, combined with the fact that it currently takes longer to assemble financing packages, reduces deal volumes, which can, in

Chasing deals regardless of the stage of the economic cycle potentially poses a bigger threat to returns than strategy drift

private equity structure. "We ran a successful CDO operation and then sold it to a large insurer with a big capital base that didn't have the same potential conflicts of interest," says Scott. "The business is much happier where it is now." But having the flexibility to invest in both distressed debt and equity can present opportunities not available to firms with a more rigid approach.

Take a closer look

Investments – that appear on the surface to be clear examples of strategy drift – may, on closer inspection, be aligned with private equity's core investment values. Alongside minority stakes, private equity sponsors will often also secure board seats, an agreed strategy with the controlling shareholders and other protections such as against dilution.

"Savvy investors come up with ideas that superficially look like drift," says Brom. "But as long as there is the private equity element of having sufficient control to be able to create value, then it's an acceptable strategy."

Conversely, deal structures that superficially look similar to past transactions can be based on different investment criteria as market conditions change. Public-to-private deals predicated on financial arbitrage, for example, are now more difficult to execute given tighter credit conditions, but there may be a resurgence of P2Ps driven by the undervaluation of listed assets.

This raises the related question of the mismatch in expectations between buyers and

turn, increase the temptation for private equity buyers to drift from their core strategy.

Strategy drift does exist, but it is not as prevalent as might be expected when a sensible degree of latitude is permitted in defining strategy. Investors have legitimate concerns about the potential negative impact of drift on returns, but they are also displaying a growing appetite for change.

Appetite for change

According to Private Equity Intelligence, while second-quarter aggregate fundraising was at near record levels, not all strategies fared equally well. Buyout funds raised less capital compared with the first quarter, but investors poured more money into distressed debt and infrastructure funds. "Investor appetite for these funds is strong and we have seen both fund types grow from being niche sectors in the industry to being major components of the private equity asset class," says Tim Friedman of PEI.

Private equity is constantly evolving. If that process is managed gradually, while adhering to private equity's core investment principles of investing with sufficient control to effect change, LP investors' interests can be aligned with those of GPs.

Vince Heaney is a freelance journalist and former deputy editor of the Financial Times Lex column. Before becoming a writer, Vince spent 16 years as a proprietary trader in the banking and hedge fund industries.



FIRST AMONG SECONDARIES

The father of the European secondaries market talks about ICI, disruptive artwork and the growing private equity discount.

Few can claim to have founded a part of the private equity market. How did you manage to create the first dedicated European secondaries vehicle?

I didn't intend to. When I left ICI Pension Plan to start my own business – it was 18 years ago, in November 1990 – I wanted to do co-investments. I set out to raise the first European fund of funds, called European Capital Unquoted Investments. Our main sponsor and placement agent was Barings, who said they would raise ECU 150m in six weeks. But a month into the fundraising, the first Gulf War began. Six months later, everyone hated private equity and the economic environment was similar to today's.

So I came up with a change of strategy. My starting point was: forget anything else – what will get me into business? I reasoned that since everyone hates private equity, why not buy what everyone wants to sell? So I changed European Capital Unquoted Investments to ECUI Secondaries. I had a track record, since I had been the very first person in Europe to buy secondaries. And, incidentally, when I left ICI, I became the first person ever to leave a pension plan and become a GP.

You clearly had a strong belief in the potential of the private equity market at the time?

In those days, you didn't have to wait for dead men's shoes. At ICI, I asked my CIO if I could explore two areas. One was derivatives and the other private equity. I bought call options on Hanson, BATS and Glaxo; I got the market completely right, but I lost £30,000 because they were all dollar stocks and in 1988 they didn't move. That's when I discovered I prefer real assets. Of course, what hedge funds do, once you put aside all the complicated jargon, is make bets on the market – and you can lose your stake.

Photography by Kerbe.co.uk

So secondaries were merely expedient for you at the time?

I didn't want to do secondaries. I really did not want to: nobody has to be nice to you; you are not a primary investor; and you are not providing new capital.

So you don't have to be well liked?

When it started, people regarded me as a leech on a leech's back. Early on in 1993, one GP got extremely angry with me at an EVCA conference for daring to speak to his investors about a secondary sale. His starting-point was: Why would anyone want to sell a position in my fund? That was very symptomatic of the ego and mentality of GPs in those years.

Secondaries obviously provide private equity investors with liquidity, but publicly quoted private equity vehicles also offer easy liquidity. How do these liquidity mechanisms compare?

A private equity fund is different from any other investment vehicle because it's self-liquidating from the day you raise it. There are three basic financial structures through which people invest: the company, the mutual fund and the limited partnership. Private equity does not fit well with a mutual fund model (or with unit trusts or hedge funds, which are variants of it) because you can't mark-to-market properly in private equity. We saw investment trusts going into private equity in the early 1990s and coming unstuck. Those private equity investment trusts that have been successful are based on their management company's fee income. As a vehicle for holding private equity assets, the mutual or hedge fund structure is just not appropriate. Neither are the public markets. We recently bought Prelude Investment Trust, a group founded by Bob Hook, who has done a brilliant job in pioneering venture investments over the past 20 years. But an investment trust is not a suitable vehicle for venture capital investment, which requires a much longer-term view.

Fact file

Jeremy Collier
CIO, Collier Capital

Education

Studied at Carmel College.
Master's degree in Philosophy from the University of Sussex.
Bachelor's degree from Manchester University School of Management.
Diplôme Cours de Civilisation at the Sorbonne.

Early career

Head of Research at Fidelity International.
Sector fund manager at ICI Pension Plan.

Market innovator

Launched the first European secondaries fund in 1994 and the first global in 1998.

Milestone investments

The purchase of Lucent's Bell Labs corporate venture portfolio is often credited with kick-starting the 'Directs' segment of the secondary market.
Major acquisitions from Shell's US pension fund, the Royal Bank of Scotland/NatWest, and Abbey bank were, in their times, the largest secondaries investments ever made.

Current fund

In April 2007, Collier Capital closed its fifth fund at \$4.8bn. With commitments from 195 leading institutional investors, Collier International Partners V is the world's largest private equity fund of its kind.

“When it started, people regarded me as a leech on a leech's back”



Stretching himself: Collier at home in his Pilates gym

Being an investor in private equity is about continuously and proactively confirming your investment choices. If you no longer want to invest through a certain GP, or in a certain geography or type of private equity, you just don't re-invest in a GP's next fund – your existing investments with the GP will liquidate over time.

The secondaries market was kicked off by growing macro-economic turmoil in the early 1990s. Can you draw comparisons with today's market?

Let's get one thing straight. The secondaries market started off because there was a big enough primary market. Secondary markets are a natural consequence of any large pool of capital – look at mortgages and insurance, for example. Private equity secondaries started for the same reason.

Presumably it helped that there were distressed sellers in those days, though?

It's true that when I started out the market was mainly motivated sellers, but there never have been many distressed sellers. We have never spent our time talking to bankrupt or near-bankrupt institutions, and it would make little difference if we did – even liquidators want to

get the best price. So what is a motivated seller? Our purchase of Abbey National's private equity interests, prior to its acquisition by Santander, is a good example. Abbey was motivated to sell, but there's no way it wasn't going to chase the highest price possible. Of course, confidence of closure, understanding of the assets, and the ability to transact quickly all came into play. Abbey benefited because it got the highest price available at the time, and a complete solution. Abbey shareholders made real money because the analyst community saw the private equity portfolio as an iceberg that was difficult to value. Because Abbey managed to dispose of it cleanly and at a good price, the bank's share price rose and Santander paid more for the business.

The challenges of the market must be greater now than in those early days?

No, they aren't. I can't tell you how difficult it was when I first started. It took four years to raise my first fund. All the investors in Europe asked why I wanted to buy other people's rubbish. It was a very good question, and it took me a while to be able to explain it well: that what we wanted to do was buy good quality assets from people that wanted to sell. As far as the competitive landscape

goes, the hurdles may have changed, but in many senses things have become easier: secondaries are totally accepted today, the market is growing dramatically, and the players in the market haven't grown as fast as the market itself.

What has happened to your returns?

If anything they have got better as our volume of investment has increased. That's because we know more about what we are doing. For example, putting in bridge financing helps the return for your investor. In our first fund we drew down too much capital because we issued a capital call every time we made an investment – and we made a lot of small investments. But investors don't want 200 draw-downs. By putting in bridge financing we have decreased the admin burden on our investors and made an additional couple of percent IRR. Our returns have got slightly better over time, despite competition, because we are constantly learning our trade. With experience, we have also bought fewer dogs!

What's happening to pricing today?

It's tough to generalise because prices vary so much across GPs and assets, but 18 months ago it was not unusual to see portfolios go at a 10%

to 20% premium to NAV. Today, premiums have vanished – everyone knows there is going to be earnings multiple contraction. Now, discounts of 10% to NAV are common. By segment, we've seen venture portfolios at 30% to 40% discounts, and buyout funds at 10% to 15%, and, as we approach September, the buyout discount is getting closer to 20%. Our 30 June accounts show that the mark to market, which some people predicted would be the death of secondaries, has resulted in '05 to '07 vintage buyout funds marking their assets down. So, in a sense, selling at a 10% discount is a great sale, because Ebit multiple contraction and the consequences of the credit crunch are slowly eating into corporate profits.

Do you see an increase in private equity write-offs around the corner?

The writing is on the wall for some stagflation. People say you can't predict the future, but it's obvious. When food, commodity and energy prices are going up massively, and asset prices in the UK and Europe are falling, you are going to see stagflation. So far at least, the US economy has been surprisingly resilient, partly because the weak dollar has helped manufacturing – US exports have grown 20% in the recent past.

Might that help the performance of US buyout funds?

That would be too much to read into it, because most of their underlying companies are not export-led. According to our Global Private Equity Barometer, around half of investors think the US is going to be hardest hit by the downturn. But there are good opportunities for private equity too, of course – in India for instance, there is a real hunger for growth and a need for the infrastructure to support it. There have been five secondaries in India in the last two years, and we have done four of them, including the first and the largest.

You are the largest European venture capital investor in the world. Is it a rich man's hobby or a serious business?

Very serious – venture works well if you can buy it seven to ten years down the road. The problem with European venture is very simple: you can't build a company in four years – and that's the myth it has often been sold on. No business is built in three or four years. Weil Gotshal didn't take three or four years to build. Our own

company started in 1990. It took us four years to raise our first fund; then in 1998 we raised £200m – the first ever global secondaries fund; and in 2000 we raised a £500m fund. One of my directors told me in 2000 that I should sell: 'Cash in, it's a great company.' I ignored him, of course. I feel strongly that we are an 18-year-old start-up. We are still putting our infrastructure in place. We've grown to 130 people, but five years ago we had only 30 – and that was after 13 years of learning what this is all about. And we still only ever have one fund in its investment phase.

Direct secondary portfolio sales are the latest innovation in your market. What's your view on directs?

In fact, we invented direct secondary deals when we bought Rothschild Asset Management's US venture portfolio in 1996. And the NatWest bank assets we bought in 2000 were largely directs –



IN FIRST PLACE: Collier's track record

- 1990 Business formed
- 1994 First European secondaries fund
- 1996 First investment in a direct secondaries portfolio
- 1998 First global secondaries fund
- 1998 Largest secondaries investment of its time – Shell US Pension Trust portfolio
- 2000 Largest secondaries investment of its time – NatWest/Royal Bank of Scotland
- 2001 First major investment in a US corporate venture portfolio – Lucent's Bell Labs
- 2002 Largest secondaries fund of its time – CIP IV
- 2003 First major investment in a European corporate venture portfolio – British Telecom
- 2004 Largest unsyndicated secondaries investment of its time – Abbey National
- 2005 First secondaries investment in an SBA business – Capitol Health
- 2006 First Indian secondaries transaction – ICICI
- 2007 Largest-ever secondaries fund – CIP V
- 2007 Largest-ever secondaries investment in corporate venture – Shell Technology Ventures
- 2008 First direct secondaries investment in China

there were 292 companies, of which 248 were on the bank's balance sheet. But our acquisition of Lucent's Bell Labs was the deal that really kick-started the direct secondaries market. After that, many new players rushed in.

There aren't many modern private equity firms that are named after the founder

What about Kohlberg Kravis Roberts & Co (KKR) and Clayton Dubilier & Rice? One interesting thing, though, is that there aren't any major private equity firms that have survived with more than two equal partners. KKR quickly became a two-man business. If you have four equal partners, how much do you want to give away to cut other people in? I own 100% of Collier Capital.

What are your hobbies?

I am writing a book on how inventors lived and died. And I've started a collection of posters commemorating innovation and disruptive technologies. I have the first ever movie poster – for a film made by the Lumière Brothers in 1895. It's one of only six remaining copies in the world. And I have a poster depicting an early post-war use of nuclear power: an advert for General Dynamics which shows a nuclear submarine coming out of a nautilus shell. It has the slogan "Atomic energy in pursuit of peace." When I'm not making investments, busy collecting posters, or spending time with my family, I do something really stretching – in our Pilates gym.

The original *super-indie*

From being a germ of an idea five years ago to becoming the UK's largest independent TV production group, All3Media demonstrates how a successful buy and build strategy can turbocharge a company's growth. **By Vicky Meek**

It sounds like the latest Hollywood blockbuster and that's because the rise of the original 'super-indie' has been pretty dramatic.

From a standing start five years ago, film and TV production and distribution group All3Media has grown into one of the UK's most successful operations in the sector, with a portfolio of 15 companies across Europe and the US and revenues above £100m a year. More than that, it created the super-indie model that has become an established part of its industry.

The story began in 2003, when three senior executives from ITV, Steve Morrison, Jules Burns and David Liddiment, teamed up with Bridgepoint to acquire Chrysalis TV for £45m through a management buy-in. The trio had been working in different parts of ITV and its predecessor company Granada since the mid-1970s and decided to set up a business together.

"There had just been some changes to the UK regulations surrounding the relationship between broadcasters and producers," says Burns, All3Media's chief operating officer. "The reforms allowed production companies to retain

the copyright and international rights on the programmes they made."

The three decided there was a business opportunity to be had in putting together a portfolio of diverse TV production companies under one umbrella.

But they weren't alone. Several private equity firms had realised that the market might now produce opportunities for growth investment.

"Before the changes, private equity wasn't interested in the sector," says Burns. "There wasn't much to invest in and the business was considered high risk because of the large people element. But the reforms changed their attitude because it meant there were assets to acquire in the form of intellectual property. The people element was still a factor, but it was now mitigated by the IP."

Before encountering the All3Media team, Bridgepoint had been searching for the right business to acquire. "Media is one of our core sectors," explains the firm's Jason McGibbon. "We had identified the way in which regulatory change would impact the TV production area and so it became a target sub-sector for

us. We could see it was going to be a great consolidation opportunity and so we met with most of the top 15 players. The problem was, there weren't many businesses with sufficient scale – a critical factor for an initial acquisition in a buy and build strategy."

Enter Morrison, Liddiment and Burns. "As with any private equity deal, management is key to success," says McGibbon. "These three had experience in production and broadcasting spanning nearly 30 years. They had the right balance of skills, they were well known enough in the industry to create ripples and they had a very interesting target company in Chrysalis."

Not that it was easy. "Chrysalis TV was a disparate business with no central management," he adds. "But it had great potential because of its stable revenues and recurring profits."

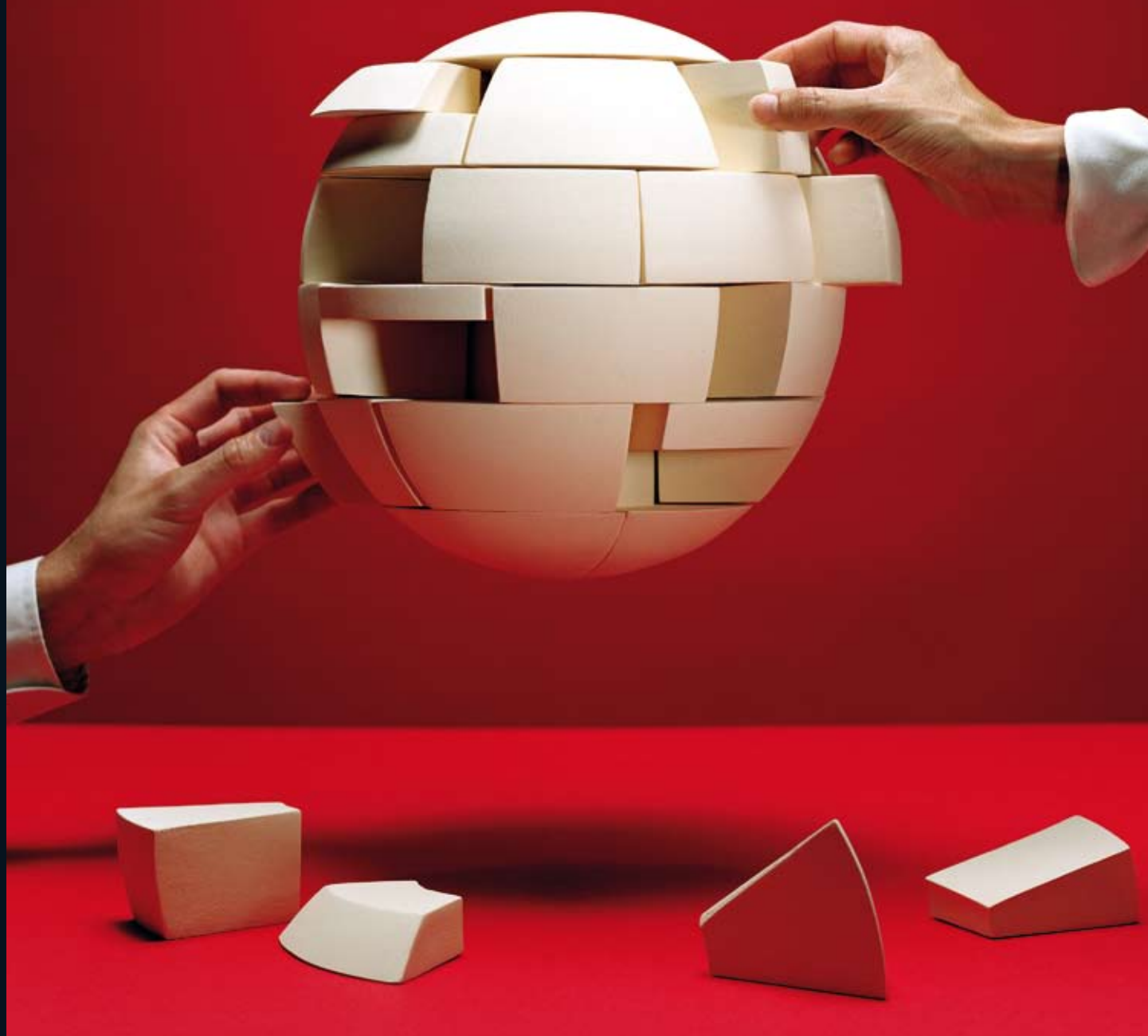
The deal went ahead and All3Media was born, with six production companies bought from Chrysalis. Within a year, the company had made its second acquisition, Lion TV, which specialised in factual, history and entertainment programmes and had operations in the US. Six months later, Company Pictures, a specialist in primetime TV drama and feature films, joined the fold. By mid-2006, when Bridgepoint sold All3Media for

"The reforms changed their attitude because it meant there were assets to acquire"

Illustration by Gary Bates

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The right foundations

Buy and build has become more popular with private equity firms in recent years in their quest for value creation, and it seems to be paying off. But it's not necessarily an easy strategy. Buying several businesses in quick succession can carry as much potential for value destruction as creation if not executed properly. So what are the vital ingredients?

The management team will have to be capable of identifying the right targets, negotiating, acquiring and integrating them to varying degrees, while also managing and growing the platform business.

"You have to have an outstanding team," says Bridgepoint's Jason McGibbon. "With All3Media, the three of them had a rare combination of administrative, financial and creative talent. Their ability to run a professional business while still understanding and managing creative people was far more important in delivering deals than we ever imagined at the outset."

The next step is the right business – many buy and builds start out as management buy-ins. "A lot of buy and builds fail because they don't generate momentum from the first deal," says McGibbon. "So you have to have critical mass, and predictable and stable revenues in your first deal so that it can support the weight of the central overhead you have to build before making large numbers of acquisitions."

And lastly, the process is smoothed by having the right advisers, who understand what you are trying to achieve and who will be with you over the long term. A team of advisers to work on all the transactions allows a management team to build trust, so that transactions can move faster and overheads can be kept to a minimum.

£320m to Permira, Mersey TV and talent agency Artists Rights Group had also been signed up.

Friendly assimilation

The company was growing fast. One of the crucial elements enabling this rapid expansion was the model All3Media chose. In the past, broadcasters had generally made hostile acquisitions and sought to integrate them wholly into the business. The problem with this approach was that the buyers often ended up losing the talent they wanted to acquire in the first place.

Instead, All3Media decided to keep each of the companies running separately while bringing together the processes and commercial side of the business. "They have integrated the back office and effectively taken on the work that the creative people in production companies generally

don't like doing, such as finance, treasury, IT and procurement," says McGibbon. "They also pitch to broadcasters on behalf of their companies, bringing a consistency of approach. This brings benefits of scale, but it also appeals to the management teams of these businesses."

US expansion will be one of the key planks of All3Media's strategy in the future

"It brings a great advantage to the companies we buy," adds Burns, who as COO was closely involved in the structuring of the acquisitions. "It allows owners to sell without losing control of their business as they continue to run it. These are people who thrive in independent entities – they are not interested in working in large organisations. One of the key elements in our success has been in retaining creative talent."

But employing this approach was a steep learning curve for the trio, one that the company's advisers and private equity backers helped them climb. "It is a different M&A process from the one I had known before. We had to learn the art of consensual M&A – persuading management that it is a good idea to be part of All3Media. I can understand that when they see all the documentation and the conditions they feel they are going to be shackled, but it's our job to manage people through this. It's quite a long-winded process – it can take nine to 12 months or longer – but it gets results," says Burns.

International expansion

With new backers on board in 2006 and opportunities in the UK dwindling – as many of the best companies had already been acquired by All3Media or its emerging competitors – the group entered a new phase: international expansion.

All3Media now has interests in Germany, the Netherlands, New Zealand and the US, which are acquiring businesses themselves. For example,

its German company is in the process of taking private its rival, MME Moviement.

This expansion has presented fresh challenges, and again All3Media's latest private equity backer has been on hand to help negotiate the potential pitfalls. The German take-private, for example, has so far lasted 18 months and it could be another two years until it's finalised.

All3Media's US acquisition was also complex because of the different tax laws. "You really have to have good advisers at all times, but particularly when you're buying overseas," says Burns. "Buying any of our businesses takes a long time because it's as much about building trust and winning people's hearts and minds as it is about the financials. Buying internationally just adds another dimension to that."

US expansion will be one of the key planks of All3Media's strategy in the future. Some of the group's existing companies already had US operations, but its purchase of Zoo Productions is the start of its ambitions to follow a similar strategy in the US. "We will get to the point where we will create All3Media America and have to have management on the ground," says Burns. "No one else is yet consolidating production companies in the US, so we want to be doing that."

There is a new strand to All3Media's growth plans: the company is backing start-up businesses as a means of capturing talent in the industry. The first is Studio Lambert, set up by Stephen Lambert, the man behind TV programmes such as *Faking It*, *The Secret Millionaire* and *Wife Swap*. And there is another in the offing.

All3Media has come a long way in just five years, so what about the next five? There may be structural limits to the number of companies it can develop or absorb under its current structure – although there are no sign of stresses as yet.

But if the company has proved anything, it is that when dedicated managers join forces with committed shareholders, they are capable of reshaping an entire industry. Stay tuned.

Vicky Meek is a freelance business journalist specialising in M&A.





Złote Tarasy shopping centre in Warsaw: retail sales in Poland are growing by 15 to 20 per cent a month

Old and new: Prague's retail landscape



BEST OF BOTH WORLDS

The phenomenal rise in consumer spending across Central and Eastern Europe has fuelled the potential for private equity. **By Clare Nuttall**

The pot of money available for private equity investment in Central and Eastern Europe (CEE) has grown enormously during the past year. Not only have all the big local players raised substantial new funds, but many Western European and international buyout houses have also begun to target the region. The increase in interest is hardly surprising since it now offers a developed business environment combined with emerging market returns.

But the flavour of the next round of investments will be quite different from previous private equity forays – into areas such as manufacturing, infrastructure and telecoms. As disposable incomes have risen steadily, private equity firms are gearing up to capitalise on the consumer boom.

The evidence is palpable. In major cities from Zagreb to Tallinn to Moscow, high-rise buildings are emerging from thousands of construction sites, retail outlets selling everything from cars to cosmetics are throwing open their doors, and

billboards advertising credit cards and mortgages loom above the busy shopping streets.

“Private equity follows the money and, as consumers are spending the money at present, there’s a lot of activity in this sector,” says Jacek Siwicki, president of Enterprise Investors, a Polish private equity firm. With retail sales in Poland growing by 15 to 20% a month, he says, “it’s no wonder private equity firms are active in the retail and consumer products businesses.”

But the emergence of a powerful consumer class spells opportunity beyond retail. Emerging

areas such as construction, healthcare and financial services are arguably even more exciting for private equity buyers.

“Anyone who can get into the pocket of the regional consumer is going to make a lot of money, but it’s not always obvious how,” says Craig Butcher, senior partner at Mid Europa Partners. “Firms need to identify the right opportunities among rapidly growing companies.”

Aside from the healthcare sector (see p.22), construction services and construction materials, companies are also benefiting as people demand modern housing to replace the obsolete Soviet-style apartment blocks, and a DIY craze has swept across the region. Financial services, too, have attracted investments. “The more consumer spending goes up, the more demand for a financial services industry grows,” says Armando d’Amico, managing partner of placement agent Acanthus. “Probably the sector will see above-average growth because it is under-represented in this region.”

This is not to say that consumer-related sectors are the only ones attractive to private equity. Certain manufacturing companies taking advantage of the relatively low costs in the region and its proximity to Western European markets have also seen success.

“You have to look for businesses that benefit from their location,” says Butcher. “In the mid-1990s, electronics companies went to Eastern Europe but many have now relocated to China. However, manufacturers of automobiles and other bulky products need to be closer to their markets.” As do factories catering to the ever-more flighty European fashion industry, where the eight-week boat ride from China is no longer fast enough to respond effectively to demand.

Downturn – what downturn?

The great advantage of the consumer sector is that it is based on solid macroeconomic trends within the region. While many markets are sinking into recession, growth forecasts for CEE remain strong, meaning this is likely to continue for several years to come. “There are more and more private companies in sectors that didn’t exist ten years ago. On the back of domestic demand, they have now grown to a scale where they are of interest to people like us,” says Butcher. “The convergence theme still has a couple of decades to run. There is no end in sight yet.”

Positive economic forecasts explain the increasing number of Western European and international buyout funds that are now building teams across CEE. Recent entrants to the region



Signs of growth:
Manufaktura
commercial hub
in Lodz, Poland



Healthy returns

Investment in the healthcare sector has come to the fore during the past year, with numerous deals culminating in the €800m secondary buyout of Budapest-based medical services company Euromedic by Merrill Lynch Global Private Equity and Ares Life Sciences.

Euromedic was a special case – no other Eastern European company has expanded westwards on such a scale, offering buyers a combination of the security of its Western Europe business with the growth potential of its eastern operations. However, as Craig Butcher of Mid Europa Partners points out, there are very strong opportunities in healthcare.

“The basic story is that as consumers get more disposable income, they demand a higher quality of services than are available from the public system,” he says. “Spending on healthcare is low as a percentage of GDP in Poland and elsewhere in Central Europe. Convergence with Western European healthcare standards is also a factor.” Enterprise’s Jacek Siwicki considers that the trend may have run its course: “Some valuations have reached quite crazy levels, at around 15 times Ebitda. In most cases, strategic investors have already come in and there are very few independent players that could be up for sale.”

However, others argue that the range of deals within the healthcare sector is now becoming more diverse, with opportunities opening up in areas ranging from drugs to service provision. Enterprise itself recently backed PharmaSwiss, a third-party pharma sales and marketing outsourcing company in the region. Advent International’s latest deal in this sector is LaborMed Pharma, a Bucharest-based manufacturer and distributor of generic pharmaceuticals. Meanwhile, Mid Europa will be rolling together new acquisition Centrum Medyczne with portfolio companies Lux-Med and Medycyna Rodzinna to create Poland’s largest private healthcare portfolio.

More deals are in the pipeline. Potential private equity and trade buyers are currently circling pharma company Zentiva, which has already turned down an offer from PPF Investments.

include Bridgepoint, 3i and the Carlyle Group, which is setting up a 20-strong team headed by former Enterprise managing director Ryszard Wojtkowski.

Four years after the first wave of EU accessions, local legislation is coming into line with European law and the business landscape in most of the EU’s newest countries looks much more familiar to western deal-doers. In the early days, each investor had to build networks from scratch to hunt down deals and overcome deep suspicion about what private equity involved. Now, most deals are intermediated, and many London-based law firms and corporate finance houses have set up shop in the region.

“The ways that deals are organised and executed are now much more similar to Western Europe, especially in the buyout and development capital segments of the market,” says David Dederick, managing partner of Weil, Gotshal & Manges’ Budapest office. “However, as auctions become more competitive, the ability to identify proprietary opportunities is a big differentiator.”

Russia and Ukraine, despite their obvious potential, have been treated more warily by western firms. However, one or two have leapfrogged across the CEE region to invest in Russia. TPG has returned to Moscow and, in April 2008, announced it was buying 50% of pharmaceuticals distributor SIA International after beating competition from other potential buyers, including Roman Abramovich’s Millhouse Capital Management. And Lion Capital has played to its expertise in the consumer products sector by following up its debut Russian investment in juice manufacturer Nidan Soki with the buyout of Russian Alcohol Group.

International buyout houses have sensibly been cautious when putting their money to

work. It took TPG more than a year to close its first Russian deal after setting up in Moscow. 3i and Bridgepoint have announced one deal each, backing Euro-Druckservice Aktiengesellschaft and CTL Logistics respectively.

“A lot of new money is coming into the region. There are not so many very big deals, although there will be more as the Eastern European economies grow,” says Franz Hoerhager, executive director of Mezzanine Management. And Dederick adds: “These new entrants are bringing more competitive pressure to what is already a competitive business. At the same time, the credit crunch has impacted on the process, although players with the right relationships with lenders can still put deals together.”

The telecoms sector was a fertile source of big deals for early birds Advent and Mid Europa. But today such opportunities are fewer. Political infighting scuppered the Blackstone Group’s Lattelecom acquisition, while the planned privatisation of Telekom Slovenija has been put off until this autumn’s parliamentary elections. The one big telco deal still on the cards looks to be TDC’s sale of its Hungarian unit.

As Mr Siwicki points out, there have been only 15 to 20 deals of €100m upwards closed in the past four years. If the market contracts or more money continues to flow in, he warns that deal flow could become an issue at the upper end of the market: “With so many large pots of money looking for investment opportunities, we may see a situation where there’s a lot of money chasing relatively few deals.”

It’s not only the new entrants that are bringing more money into the region. The local fundraising cycle started in late 2006 with Enterprise Investor’s €658m Polish Enterprise Fund IV, continued through Mid Europa’s record-breaking €1.5bn third fund, finishing with Advent International’s fourth CEE fund, which closed on €1bn in April. Mid-sized players such as Innova (€225m), Global Finance (€350m) and Mezzanine Management (€261m) also raised funds within this period, as have many of the smaller firms.

Those firms that have built up a track record in the region are finding it increasingly easy to raise money. “Central Europe is definitely in LPs’ minds because of growth in the region and because things are now becoming more professional. We are seeing a lot more interest. However, LPs are moving eastwards more slowly than GPs, and will not invest in poor or even average-performing funds,” says D’Amico.

For the big players, the fundraising cycle came

Growing consumer
confidence is evident
across the region



It’s not only the new entrants that are bringing more money into the region

to an end with Advent’s latest vehicle, and they now have money to put to work before coming back to the market. However, several small and mid-sized firms are believed to be on the road, among them Royalton, Arx Equity (formerly DBG), Askembla Asset Management and Genesis Capital. Regional funds are also becoming more diverse, with specialist mezzanine, clean energy and restructuring vehicles being raised.

Debt less important

One of the reasons behind this enthusiasm is that the region has been relatively unscathed by the credit crisis. While there has been some contraction in liquidity, debt is less important in this and other emerging markets. As Mid Europa’s Craig Butcher points out: “Growth is higher so we are less dependent on half a point of Ebitda to make the numbers work.” The equity component of deals in the region has been increasing slightly, with a typical deal comprising around 40% equity. Mr Hoerhager of Mezzanine Management says the difficulties some have experienced in obtaining bank finance have been a good thing for mezzanine. “We have never been so busy,” he says.

It is the exit markets that have been hit the hardest, according to firms in the region. Trade sales are still a possibility. However, IPOs, particularly on the Warsaw Stock Exchange, are off the agenda for the time being. “The IPO market is closed,” says Hoerhager. “We don’t see major exits

on the stock markets, at least not from our fund. Mostly people are hanging on until they can get better prices.”

Siwicki adds: “Just three weeks ago, we tried to float another company from our portfolio, but pulled it because the prices the level of demand was suggesting did not match our expectations. We’ll probably try again towards the end of the year if the market sentiment improves.”

Meanwhile, the lacklustre performance of Warsaw and other stock exchanges has caused private equity investors in the region and elsewhere to think again about take-privates. “We’re seeing a situation where public companies are relatively cheap, which creates an opportunity for public-to-private deals,” says Mr Siwicki, adding that Enterprise is actively looking at a couple of such opportunities.

Private equity may have to wait some time before sellers’ expectations fall to realistic levels and, with a growing population of cash-rich investors, most of the best opportunities will be trawled over. But if you are looking for a market that offers strong growth potential, sound macroeconomics, diversification and a degree of insulation from turmoil in more mature markets, Central and Eastern Europe scores very well.

Clare Nuttall is the Central Asia correspondent at Business New Europe. She was previously a senior reporter at Real Deals, where she focused on private equity in Central and Eastern Europe.

SOCIETY'S EXTREMITIES

Charities are the extreme sport of entrepreneurialism. They deserve better than casual, magnanimous donations. A two-year-old Foundation has reversed the direction of gratitude with laser-targeted involvement.

By Ross Butler

You may make money through clever investment decisions, but do you give away money in a similarly thoughtful manner? If you have a regular standing order to a charitable cause, you are in the minority. In contrast to the US, where virtually all charitable giving is planned or by subscription, nearly 90% of European donations are spontaneous. The average Joe gives to collecting tins at tube stations. The average Fat Cat might spend £50,000 in an auction for Wimbledon tickets to a soon-forgotten charity. It's all rather ad-hoc and inefficient.

In fact, on every measure, the act of charitable giving in Europe is backward. In the UK for instance, charitable donations represent 0.6% to 0.7% of GDP, compared with more than 2% in the US. Corporate giving stands at 0.2% of pre-tax profits in the UK compared with 1% in the US.

It is from this low base of engagement that the Venture Partnership Foundation (VPF) was set up two years ago to change the way the commercial sector interacts with the charitable world. VPF is going further, by harnessing the skills of the venture capital industry to leverage charitable investments for the best social return.

The Foundation, which was set up by a group active in the venture and private equity sector to help social entrepreneurs, has already given away £1m in eight charities, and has ambitious growth plans for both itself and the charities it backs.

The facilitator

Given the gross inefficiencies in both the ad hoc and foundation-giving segments of the European charity sector, VPF believes it is one of the first intermediaries to streamline the process. It manages the relationship with charities, channels information and ensures the cost-effective application of funds.

Beyond efficiency gains, the model combines the best of buyout and venture capital investment skills to make every penny count. Like venture firms, it does this by identifying the most promising entrepreneurs and fast-growing charities. "We have become convinced that giving to small charities is dimensions more effective than larger ones, in terms of bang for your buck," says Mike Risman, managing partner at Virtruvian and one of VPF's original founders.

"In small outfits you get the innovation, inspiration and entrepreneurial energy that you don't tend to get in bureaucracies, and they tend to be pretty efficiently run. It's just like in the commercial sector; if you get a VC investment right you can make 100 times your money."

By targeting investments so carefully, the model effectively leverages donations. "One result is volunteer leverage – volunteer ratios are much higher for small charities than large ones," says Risman. "The majority of people at big charities

"In small outfits you get the innovation, inspiration and entrepreneurial energy that you don't tend to get in bureaucracies"

get paid, but in a small outfit, people are inspired by their entrepreneurial leaders and get nothing. You put £1 in, you get £10 of effort." In turn VPF gears up the donations further through the volunteer labour it supplies from its members.

The professional expertise provided by those otherwise active in the private equity arena can prove invaluable. "We are working on the idea of franchising our Model for Mental Health and Development," says Chris Underhill, CEO of VPF

charity Basic Needs. "VPF has been instrumental in finding the right pro-bono and low-cost, high-quality advice and support we need at this very testing but exciting time. The involvement of considerable expertise has given us great confidence to get on with this new approach."

Andrea Coleman, CEO of Riders for Health, agrees: "We have found that because of the background of the VPF team, we benefit from a keen appreciation of the nature and potential of

social enterprise. This gives the whole relationship a very positive and lively feel. This in itself is new to the field of international development."

Searching high and low

But finding small charities is tough. "It's like sniffing out truffles. You can't just Google them, there are no reports available and all information is very unstructured," says Mike Risman. With persistence, VPF has compiled a charitable equivalent of the *Sunday Times* Fast Growing Companies Index, but the hit rate is very low: "For the size of organisation we are focused on – between £250,000 and £5,000,000 of turnover – there are tens of thousands of charities in the UK. We've only been able to identify about 200 that have grown consistently at interesting rates."

This depressing realisation suggests that the whole growth process in charities is broken and unsupported. Structures are not put in place to keep up momentum, and even if they



‘The sorts of challenges you face every day bear no comparison with the financial world’

resulting from that, by putting up boundaries around the nature of the donor’s engagement by hand-holding, providing detailed guidance, and in the background there are plenty of checks and balances to ensure things work. The charities have always found it a very positive experience.”

VPF’s final quirk is that it is reluctant to accept the tag of philanthropy and as yet has not aligned itself with the nascent venture philanthropy movement in Europe. Risman worries that philanthropy is too closely associated with the act of giving, and prefers the term partnership, adopted in the VPF title. “The whole spirit of this is that we have just as much to gain from this encounter as they do. Social entrepreneurs are extraordinary people, and running a charity is the extreme sport of entrepreneurship. You have to raise your funding every day from donors. The sorts of challenges you face every day operationally bear no comparison with the financial world – people are dying, you are dealing with genuine crises, and you have to persuade everyone to work for free. Volunteers are particularly difficult to manage and motivate. So there is a genuine sense that the giving is the other way round. It is a privilege to be involved with these organisations and we enter each relationship with that partnership philosophy.”

To question the venture philanthropic movement as overly magnanimous may seem harsh, but Risman and his fellow partners have clearly set out their stall within the fabric of social capital markets. If that helps venture philanthropy become an ever-more interactive and two-way engagement, so much the better.

More information on the Venture Partnership Foundation can be found at www.vpf.co.uk

are, foundation support is very difficult to attain (because there’s not much of it). Even if you attract it, it usually comes with strings attached – ‘thou wilt report to us regularly; the money will only be spent on project x,’ and so on. “We call it high friction funding,” says Risman. “Entrepreneurs can’t move with these sorts of constraints. You think it’s harmless to ask a CEO to write a report every month, but in an entrepreneurial business, where things are constantly evolving, it’s like operating with a cord around your neck and it kills the whole process.”

Critical to this leveraged form of giving is the identification and due diligence processes that VPF brings to the table, in order to find the hidden jewels. You have probably never heard of Twin. And yet it has incubated many of the Fairtrade brands in the UK – Café Direct, Divine Chocolate, Liberation – many of which are now in the supermarket. When VPF discovered Twin, this tiny charitable venture firm had taken upon itself to interface with 240,000 smallholder producers in the developing world to organise production so that their communities become self sufficient. “All of this is going on from a very small office in Shoreditch. For £25,000 per annum of unrestricted funding, you can have a major impact on an organisation like this,” says Risman.

In the past 12 months, VPF charities have made some startling progress: Kids Company for example recently raised £12m from the government to help expand its activities – VPF had funded a lobbyist to leverage this appeal. Basic Needs recently obtained WHO accreditation and VPF has been helping with franchising initiatives. Riders for Health and Training for Life have also expanded rapidly, and VPF has helped at the highest level assisting with succession planning and organisational transformation.

Innovative approach

An aspect of VPF that perhaps isn’t as streamlined is its structure. The founding partners may have successfully created the world’s first mutually owned foundation, so that each new donor can buy one share for £1, ensuring a high level of participation and ownership among its founder shareholders (there are now more than 40 of them, and counting). Donors also get a say in where they would like their money spent and can put themselves forward for due diligence work.

Risman admits this highly participative structure can be cumbersome to manage, but he says that getting people to engage, and sending them off on due diligence trips, is partly the point. “We protect the charities from any inefficiencies

A GUIDE TO CURBING INFLATION

How to cut the pain at a stroke. **By Ross Clark**



I have got a feeling that deep in the bowels of Her Majesty’s Treasury there is a team of officials working on a new improved official inflation index. Why should I think this? Because it’s what happened last time the inflation figures threatened to embarrass the Government. In 2003, with the housing boom in full swing, then-Chancellor Gordon Brown suddenly decided that the Consumer Price Index (CPI), which excludes all housing costs, would be a more suitable measure of inflation than the RPIX. Miraculously, inflation fell by half a percentage point in one day.

In 2008, with food and oil prices going through the roof, taking the CPI for June to 3.8 per cent, nearly twice its target, you can bet Prime Minister Gordon Brown is pondering whether he could possibly get away with introducing a new measure, based on ‘core’ inflation, which excludes those pesky and volatile elements such as food and energy.

There is certainly something going on. Deep in the Office for National Statistics’ website you can find some alternative inflation indices. There is the CPIY, which is the same as the CPI but excludes indirect taxes – which could prove very useful to fill the black hole of public finances. Then there’s something called the CPI-CT, which is the same as the CPI, but assumes constant tax rates.

But why stop there? I have a few more suggestions as to how the Government could better measure inflation. Why, for example, is the cost of private education – which, after all, is the

preserve of a few privileged kids and which just happens to have risen by 13.2 per cent during the past 12 months – in the index? It should be kicked out, along with private health insurance (up seven per cent). Who nowadays buys carpets (up 7.7 per cent) when stripped floors are all the rage? Now that we all use email, what are postal services (up 6.7 per cent) doing in the index? Likewise clocks and watches (up 6.5 per cent) – doesn’t the Government realise you can tell the time by your mobile phone?

Transport costs (up 7.3 per cent) are pretty volatile, being heavily influenced by oil prices –

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so, naturally, they will have to go. As will the cost of holidays (up 3.9 per cent), which are largely influenced by costs outside our economy and therefore of little relevance to public policy.

Strip out all those unwanted items and what are you left with? The CPIXEGU – the Consumer Price Index Excluding Everything that is Going Up. Admittedly there’s not a huge amount left to count. But there is still clothing (down eight per cent), household textiles (down 3.6 per cent), telecoms (down 1.7 per cent), audiovisual

equipment (down 12.2 per cent) and books (down 3.4 per cent). Add them up and inflation comes out at a more palatable 5.5 per cent.

Oh, there’s one item I forgot to exclude from the CPIXEGU; spectacles, which went up only 0.7 per cent. To judge by their popularity among Ministers, I wouldn’t be surprised if the rose-tinted variety actually fell in price.

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