



Economic and social effects of buy-outs in the Netherlands

*Increased employment and growth in
companies after a private equity
investment*

January 2008



This report examines the role of private equity firms in buy-outs. It is based on a study of Dutch buy-out companies conducted on behalf of the NVP and Ernst & Young by the Centre for Management Buy-out Research (CMBOR)¹, The University of Nottingham, UK.

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¹CMBOR was set up in March 1986 as part of the Nottingham University Business School with the aim of objectively studying and analysing management buy-outs. As an independent institution, CMBOR has built up a wide-ranging and detailed databank of almost 25,000 transactions which provides the only complete set of statistics on management buy-outs and buy-ins in Europe. CMBOR regularly publishes reports on the trends and the important issues in the buy-out market in its Quarterly Review and European Management Buy-out Review. www.cmbor.com.

Private equity in the Netherlands...

1000	companies in the Netherlands
320,000	employees in the Netherlands
€ 20 billion	under management of Dutch private equity firms
70%	of the capital invested annually goes into buy-outs

After the buy-out...

90%	of the companies develops a growth strategy
57%	of the companies creates more employment
21%	of the companies maintains the same level of employment
13%	annual turnover growth
9.9%	average profit margin

Without buy-out...

17%	of the companies would no longer exist
62%	of the companies would have experienced slower growth

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Preface

The buy-out² has become a familiar phenomenon in the business sector in the Netherlands. Dutch private equity firms invest in more than 100 buy-outs per year. The amount of private equity invested has increased over the past 10 years from € 165 million in 1996 to € 1.7 billion in 2006, which represents 70% of the invested capital each year³. The average sum of a private equity investment in a buy-out has increased considerably, from € 3.6 million in 1996 to more than € 14 million in 2006.

Despite the increased importance of buy-outs, there is insufficient knowledge about the economic and social effects of them. This is why the Dutch Private Equity & Venture Capital Association (NVP), in cooperation with Ernst & Young, commissioned a survey, for the second time, into the consequences of buy-outs for the companies, their employees and management. A total of 70 Dutch companies which were the subject of a private equity-backed buy-out during the period 1994-2005 reported on the impact of this event on, among other things, their investment and growth strategies, employment and performance. In addition, they provided information about the role of the private equity player as an equity provider and partner.

With this study we hope to provide entrepreneurs considering a buy-out with better information about the benefits and opportunities afforded by private equity funding. Moreover, we hope to use this report to demonstrate that management buy-outs can play an important and positive role in the realisation of growth plans, business succession and in the restructuring of companies.

We are grateful to the companies for their participations in this study.

André Olijslager

Chairman NVP



Recent years have again witnessed an increase in the number of management buyouts of Dutch companies in the form of private equity investments. The effect is that private equity is now a fully fledged alternative to the traditional forms of business funding, such as bank loans or listings.

The survey shows that a buyout using private equity has a healthy effect on a company's revenue, employment and profit. A major reason for this is that a private equity investor as a partner of management has a motivating effect on strategic as well as financial decisions about investing in, for example, research & development and marketing, employee training, acquisition policy, and expansion of the product range. Over 75% of the companies had monthly or even weekly meetings on these topics with the private equity managers.

The media's interest in recent years has been mainly on the large delistings, which represent only a fraction of the buyout transactions in the Netherlands. In discussions about private equity, it is often forgotten that the mid-market segment is the favorite area for most of the private equity parties. The survey results make clear the contribution of private equity to this segment, which is one of the major pillars of the Dutch economy.

Toine van Laack

Partner Ernst & Young Transaction Advisory Services



² In this report, the term buy-out is used to refer to every type of management buy-out or buy-in construction. See also Appendix 3.

³ Source: Enterprising capital. The Dutch private equity³ market in 2006 (Ondernemend Vermogen. De Nederlandse private equity markt in 2006'.) NVP, April 2007

Summary:

More employment and growth after a buy-out

In the Netherlands, more than 100 buy-outs are effected annually by management teams which acquire a company in cooperation with a private equity firm. This study shows why the great majority of these buy-outs are successful. It shows that, after a buy-out, companies make new strategic and financial choices which have a positive impact on turnover, profit and employment.

The study was conducted by means of a written survey sent to 427 Dutch companies that effected a buy-out in cooperation with a private equity firm between 1992 and 2005. A total of 70 questionnaires were completed and returned (16%) relating to the period 1994-2005. The sample was representative of the entire Dutch buy-out population in terms of sector and size of the company.

Companies develop more quickly after a buy-out

The study shows that companies grow more rapidly after a buy-out:

■ **Greater turnover growth**

The average annual turnover growth increased from 6% in the year prior to the buy-out to 17% in the year after the buy-out. The average annual turnover growth for the three years after the buy-out was 13%.

■ **More employment**

A majority of 57% of the companies indicated that their employment had increased after the buy-out. In the companies where employment had increased, the increase was also substantial at 96%. A further 21% said the number of employees had remained unchanged.

■ **Accelerated development**

A total of 62% of the companies said they had developed more quickly because of the buy-out. In addition, 17% of the companies said they would no longer have existed without the buy-out. Another 15% said their development would have been the same.

These results show that buy-outs have a very positive effect on the companies involved.

Buy-outs adopt growth strategies

More than 90% of the companies said they developed a growth strategy after the buy-out. These strategic choices were expressed in a number of ways:

■ **Increased investments**

The average spending (expressed as a percentage of turnover) on training of personnel, capital goods, marketing and R&D increased in the period after the buy-out. Most notably, investments in marketing increased by 38%, while investment in training courses increased by 31%.

■ **Product and market development**

In almost two-thirds of cases, the companies had expanded their product range, while the majority indicated they had also invested in new locations.

■ **Growth through acquisitions**

Six out of 10 companies reported they had effected take-overs or had been involved in mergers or joint ventures since the buy-out. Acquisitions were made not only locally, but also internationally. Almost two-thirds of the companies that had been involved in an acquisition, merger or joint venture said they had acquired firms in other EU countries or outside the EU.

■ **More efficient operations**

More than 70% of the companies said that, after the buy-out, they had taken strategic action to improve the efficiency of the existing company operations. Improved cash flow, more efficient operations and targeted investments were the main factors the companies saw as creating value.

The investments bore fruit. The strategy aimed at growth and efficiency resulted in an increase of the profit margin (before interest and tax) from an average 9% annually before the buy-out to an average 9.9% in the three years after the buy-out. Turnover increased by an average of 13% per year in the same period.

The weighted average profit margin of the buyouts (from the year of the buyout till three years after) was 9.6% in the period between 1994 and 2005. The ave-

verage profit margin of smaller companies⁴ that were quoted in the same period was 7.1%⁵.

Buy-outs increase stakeholder involvement and motivation

A crucial success factor for buy-outs lies in the fact that shareholders, management and employees cooperate closely. Companies after a buy-out are characterised by:

■ Active shareholders

Companies are supported by their private equity firm, not only with capital, but also with know-how. The main contributions from the investors according to the companies related to monitoring the financial performance, providing financial advice, challenging the status quo and acting as a sounding board for the management. More than three quarters of the companies had contact with the private equity firm on a monthly or even weekly basis.

■ Motivated management

Over half the buy-outs were the result of parts of Dutch or foreign parent companies being divested, while in more than one-third of the cases the sellers were family or private owners. Both situations offered managers a unique opportunity to take the helm of the company themselves.

■ Committed employees

Generally speaking, the management indicated that, after the buy-out, they made a substantially greater effort to involve employees in drawing up objectives and to consult them on matters of strategic importance. Remuneration structures were also used to allow employees to share the profits. The percentage of employees who received a performance-related bonus increased from 12% to 21% after the buy-out.

⁴ With a market capitalisation lower than € 50 million at the time of the IPO.

⁵ Source: Datastream

1 Where and why are buy-outs taking place?

Profile of the selling parties

Buy-outs usually take place in the context of parts of a company being sold off or of business succession:

- In more than half of the cases, the sellers were Dutch or foreign concerns that decided to divest parts by means of a buy-out.
- One-third of the buy-outs were initiated by private owners/families.

The usual reason for the sale was that the activities in question were no longer considered to be among the company's core activities (49%). Private equity firms therefore play an important facilitating role in the restructuring of companies and sometimes even sectors. In 17% of the companies, the retirement of the former owner was the reason for the buy-out. In 10% of cases, the former owner expected investments to be necessary in the future, investments they were unable or unwilling to make. What is notable is that only a very small minority of 6% of the companies cited a lack of profits or poor growth prospects as the reason for the buy-out.

Profile of the buyers

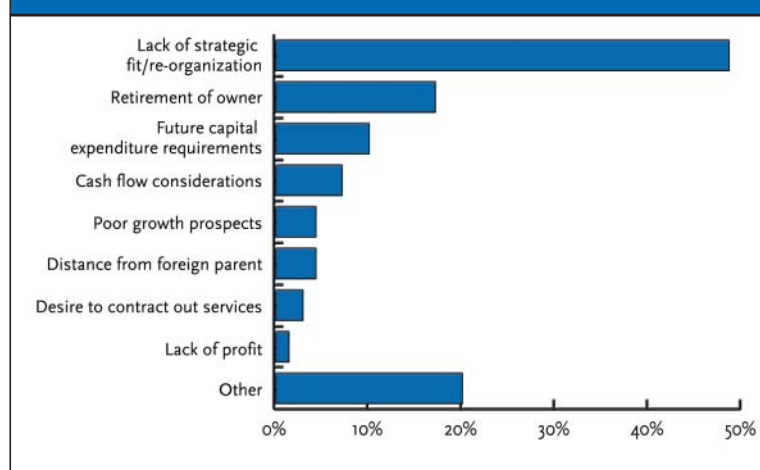
Buy-outs are seen primarily as an investment for the medium to long term. Only 13% of the companies expected a predicted exit in less than four years. More than three quarters of the buy-out managers expected an exit after four years or more.

In two-thirds of the buy-outs, the private equity firm obtained a majority of the company. The management usually acquired an interest of less than 25%, but in a quarter of buy-outs the management was able to acquire a substantial minority interest of 25% to 50% of the shares.

Profile of the companies

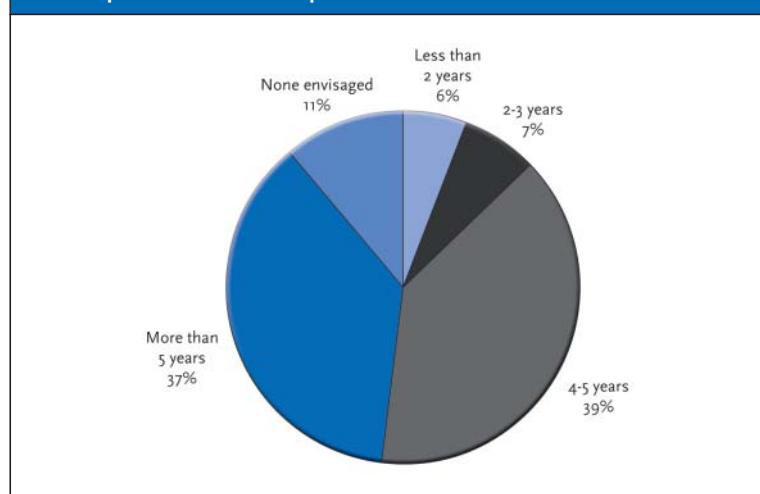
Buy-outs take place in all industry sectors. It is notable that buy-outs are not limited to more mature sectors and companies. The high-tech sector, including biotechnology, computer software and services, semi-conductors and electronics, accounted for 10% of the sample.

1.1 Reason for sale



Note: Respondents could select more than one option. The total therefore exceeds 100%.

1.2 Expected time until a possible exit



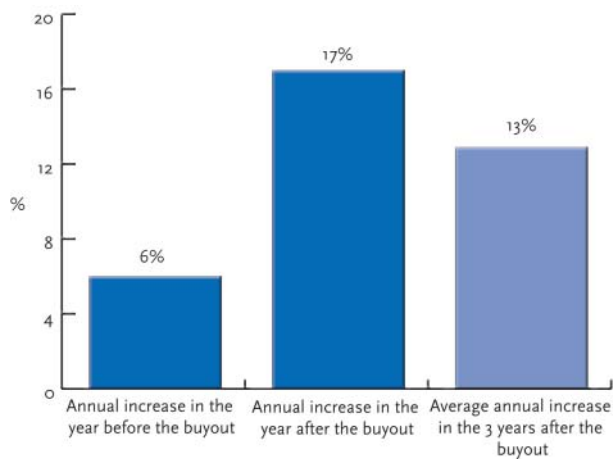
The companies in which buy-outs took place varied widely in terms of their size. The number of employees varied from 20 to 9185, with a median of 150. More than a third of the buy-outs involved companies with less than 100 employees. Relatively large companies, with more than 250 employees, accounted for 41% of the companies surveyed.

2 Companies develop more quickly after a buy-out

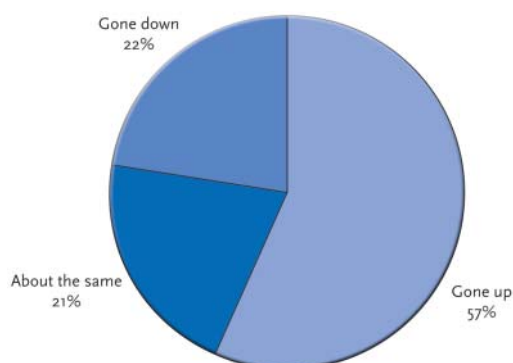
Higher turnover growth

The period immediately after the buy-out is often characterised by a strong increase in turnover. From an initial growth of 6% in the year before the buy-out, the annual turnover growth jumped to 17% in the year after. Although the growth figure in general dropped again after that, the average growth over the three years after buy-out was 13%. This clearly demonstrates that company divisions that are not part of the core activities of large concerns and companies that are facing a transfer of ownership often have a lot of unused potential. After the buy-out these companies have a dedicated management, new plans, and the financial means to allow them to grow.

2.1 Annual turnover growth before and after the buy-out



2.2 Development total number of employees



More employment

Realising a growth plan often requires additional staff. The majority of the companies (57%) indicated that the total number of employees had increased after the buy-out. Where employee numbers had increased, the change was substantial, at an average of 96%.

Some of the jobs were created in the base location / region of the company. Local employment increased in 26% and decreased in only 7% of the companies. Two-thirds of respondents said that the buy-out had had no effect on local employment.

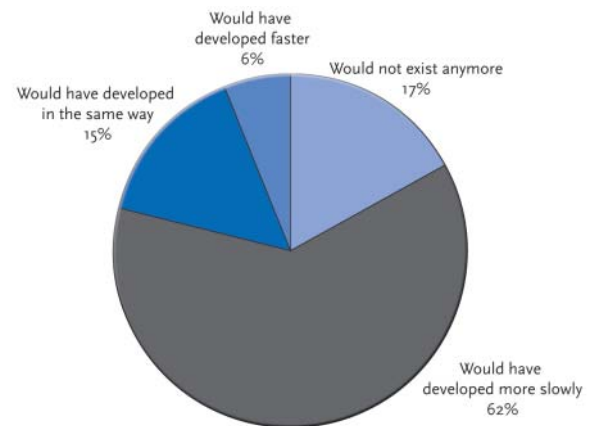
There was an increase at all management levels, but the most common were increases in marketing and sales management (46%). The increase in the number of employees active in finance (in 30% of buy-outs) reflects the importance private equity firms attach to plan-based operations, financial planning and reporting. It also reflects the fact that companies often require more experienced financial management after becoming independent.

Accelerated development

The overall impact of the buy-out on the companies concerned was seen as very positive. A total of 17% of the companies said they believed their continued existence was due to the buy-out. A total of 62% said they would have developed more slowly without the buy-out, while a minority of 15% said they would have developed in the same way. Only 6% said they would have developed more rapidly without the buy-out.

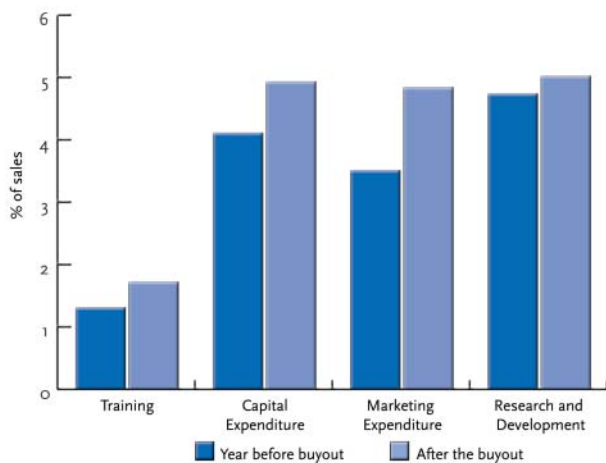
2.3 Effects of a buy-out on the continuation and growth of the company

Without the buy-out the company...

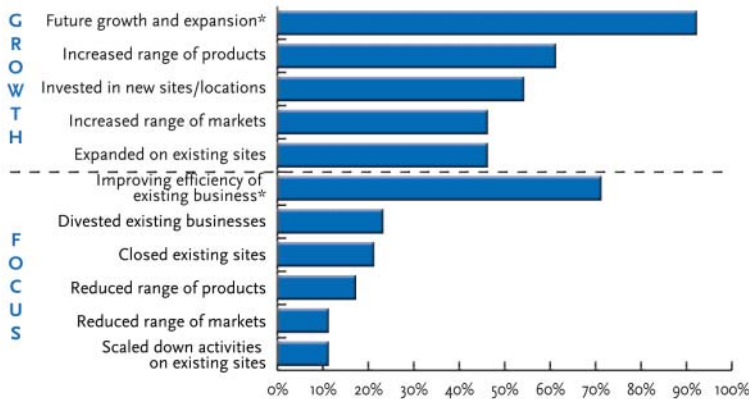


3 Buy-outs adopt growth strategies

3.1 Spending activities before and after the buy-out



3.2 Strategic actions by buy-out companies



Note: Respondents were able to select more than one option; the total is therefore greater than 100%.

*This question was used only in the final survey, where the maximum number of respondents is 24.

3.3 Merger and acquisition activities after the buy-out

%	Acquisitions	Mergers	Joint Ventures
In the Netherlands	69	5	18
Within the EU	31	0	8
Outside the EU	28	0	8

Increase in investments

The capital injection that takes place in a buy-out allows companies, which were previously often limited in their possibilities, to once again invest in their future, in the form of training of personnel, capital goods, marketing and R&D.

The study shows that the average spending (as a percentage of turnover) increased in each of these fields. The biggest increase was in the field of marketing, where spending increased by 38% to almost 5% of turnover. Spending on training courses increased by 31%, while investments in capital goods went up by 20%. R&D spending rose by 6% to almost 5% of turnover. These growth figures should also be seen against the background of the overall rise in turnover so, in absolute terms, spending increased even more.

Product and marketing development

The study shows that buy-out and buy-in firms engaged in a wide range of strategic actions following the change in ownership. More than 90% of the companies say that they developed a strategy aimed at growing the business. The strategy primarily pertained to:

- Increase in the number of products (61% of cases)
- Investments in new branches/locations (54%)
- Expansion of the market area (46%)
- Expansion of existing locations (46%).

There is also evidence that supports the assertion that after a buy-out companies develop a better focus, which leads to a reshuffling of activities and ultimately to a limitation of the number of products or market reach. However, the number of companies that reported the sale or closure of existing activities or scaling down of products or markets was very much a minority.

Growth through acquisitions

The change in ownership and the capital injection enable companies to grow both organically and through acquisitions. The majority of the companies made acquisitions or were involved in mergers or joint ventures after the buy-out. Almost 70% of these companies made acquisitions in their own country. There was also evidence of internationalisation: 59% of companies made acquisitions abroad after the buy-out while 15% entered into joint ventures with foreign companies.

More efficient operations

More than 70% of the companies said they undertook strategic actions to improve the efficiency of the existing activities. The study shows that financial factors, such as cash flow improvement, cost reduction and optimisation of the capital investments were seen as the most important factors in creating value after the buy-out.

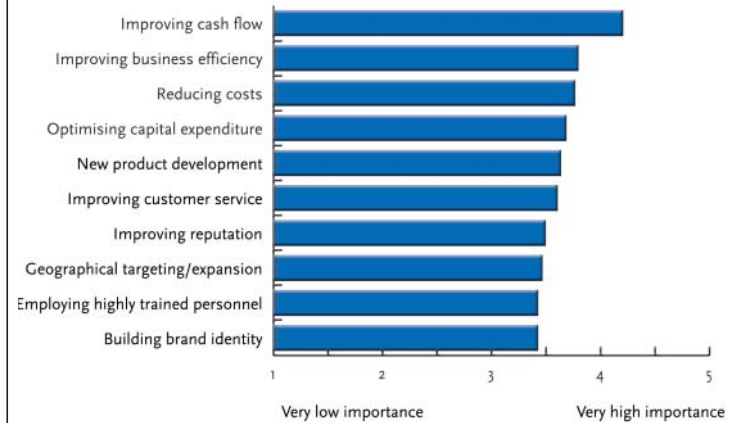
These findings also offered further proof that the management believes value creation is dependent on a combination of growth and improved cost controls and efficiency.

More profit

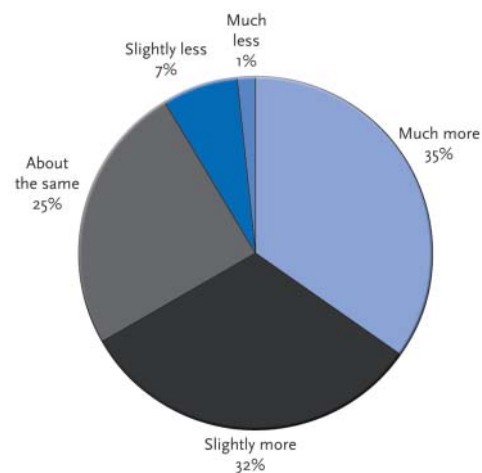
The average profitability (in terms of earnings before interest and tax – EBIT) as a percentage of turnover, in the year after the buy-out increased to almost 10%, compared with 9.0% in the year prior to the buy-out. The EBIT in the three years after the buy-out averaged 9.9%.

Since turnover growth and profit can be dependent on market developments, the management was asked to compare their financial results with those of their main competitors. A total of 67% of the companies indicated that, since the buy-out, turnover and EBIT had improved compared with that of their competitors. A third of these companies said the growth, compared with that of their main competitors, was “much more”.

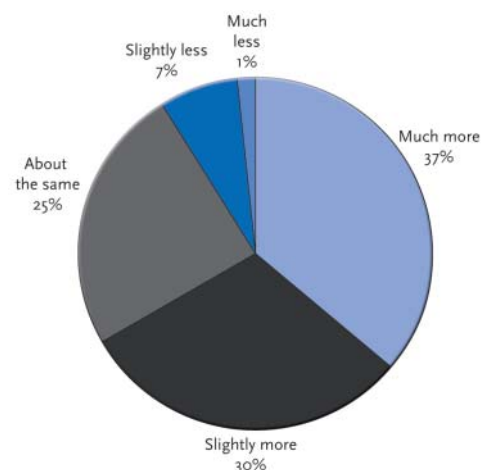
3.4 Main factors for value creation



3.5 Change in turnover since the buy-out compared to competitors



3.6 Change in EBIT since the buy-out compared to competitors



4 Buy-outs increase stakeholder involvement and motivation

Active shareholders

Most private equity firms are actively involved in their portfolio companies. More than three-quarters of the buy-outs maintained contact with their private equity firm on a monthly or even weekly basis.

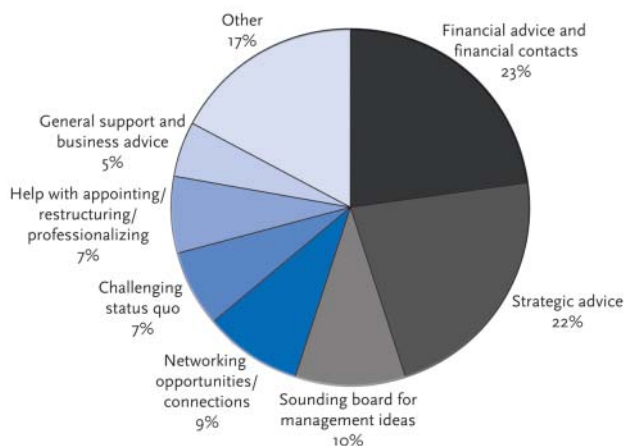
The study shows that the role of the private equity firm goes beyond simply providing financing and monitoring the results. When the companies were asked about the main contribution that private equity firms provide, almost a quarter mentioned the financial advice and contacts, 22% noted the strategic advice and 10% chose their role as a sounding board for the management.

Motivated management, involved employees

After a buy-out, companies often go through a change in culture. Former managers have become entrepreneurs and often bring new enthusiasm to the company. This has an impact not only on the style of management but also on the types of remuneration used.

Within this more enterprising environment, the management in this study seemed to recognize the crucial role the employees play in the success of the company. The management tried to involve the employees more in the company's future. Making employees feel part of the company, improving communications and enabling employees to have a greater influence on strategic issues were crucial elements in this effort. The companies indicated which changes in management style they had implemented after the buy-out and how important these were. It is remarkable that each of the ten factors mentioned scored above average. The top five are shown in figure 4.2.

4.1 Main contribution private equity firm other than provision of funding



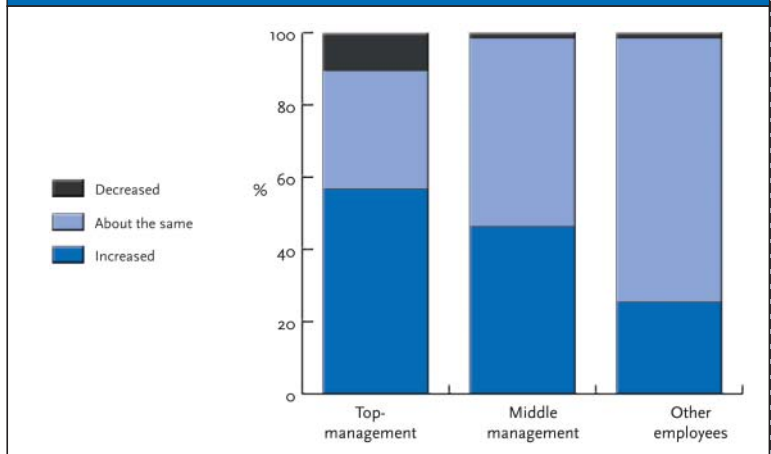
In some cases, employees were given the opportunity to become co-owners of the company; in other cases this involvement was embodied in the introduction of performance-related remuneration. The study shows that the percentage of employees who receive some form of performance-related remuneration increased strongly after the buy-out, from an average of 12% in the year before the buy-out to 21% in the year of the study.

More than half the companies said the total remuneration for the top management (including fixed wages, variable components and options/shares) had increased between the year prior to the buy-out and the year of the study. The same was true for the middle management in 46% of cases and for the other employees in 25% of cases. Performance-related pay can, of course, also result in a drop in remuneration if the performance is below expectations. This happened to the top management of 10% of the companies surveyed, while it happened very rarely to the remainder of the employees.

4.2 Changes in management style



4.3 Changes in remuneration of management and employees after the buy-out



Appendix 1: Survey methodology

Aim

This survey was designed to examine the following dimensions of the economic and social impact of management buyouts:

- Background of buyout deals including reason for sale and expected timescale to exit
- Performance of the buyout
- Corporate and business strategy
- Personnel and management issues
- Relationship with private equity investor.

Sample

The survey was carried out among buyouts that had taken place in the Netherlands between 1992 – 2005. This timeframe was chosen in order to obtain a sufficiently long period post-buyout for changes in performance to be identified. The sample for the survey was derived from the Centre for Management Buy-out Research (CMBOR) database, which contains details of over 25,000 management buyouts carried out in Europe. Only private equity backed deals were considered. Three separate questionnaire surveys have been conducted at different times and the data have been combined.

The results presented consist of data from 70 returned questionnaires. These 70 responses were received from 427 questionnaires sent out, representing an overall return rate of 16.4%.

Questionnaire

The questionnaire was based on one used in an earlier pan-European survey carried out by CMBOR on behalf of the European Venture Capital Association (EVCA) in 2000.

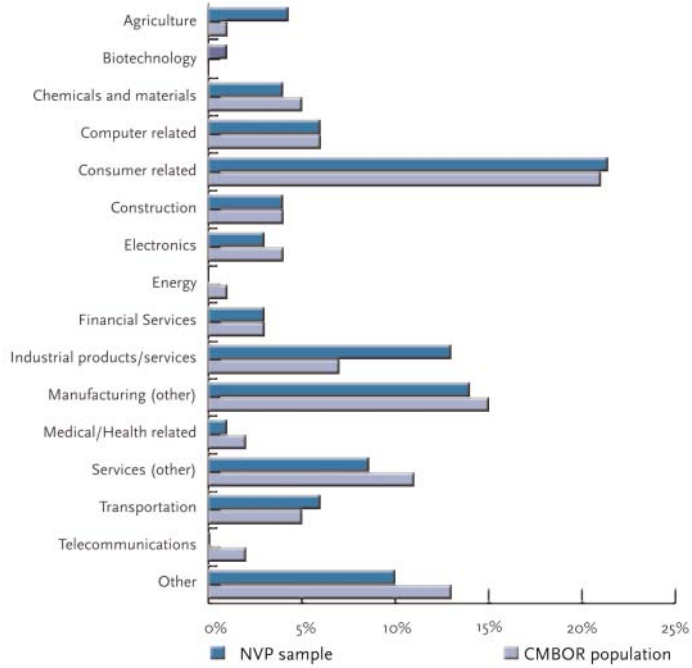
Respondents

Responses by year are shown in Table A.2. The table indicates a fairly even distribution between 1994 and 2005.

A.1 Summary of surveys				
Survey No.	Date of survey	Year of buyout	Number sent	Number completed
1	Apr-Sep 2000	1992-1997	112	23
2	May-Aug 2004	1998-2002	162	23
3	Jul-Oct 2007	2003-2005	153	24

A.2 Response by year of buyout	
Jaar	Totaal
1994	6
1995	8
1996	7
1997	3
1998	6
1999	3
2000	6
2001	5
2002	7
2003	5
2004	5
2005	9
Total	70

A.3 Industry sectors: survey sample vs. CMBOR population



Responses to the survey have been analysed by business sector in order to assess how representative the sample is. This has then been compared to the industrial sector distribution of the overall population using CMBOR's database, which shows good correlation as illustrated in Figure A.3.

Appendix 2: Profiles

Dutch Private Equity & Venture Capital Association

The Dutch Private Equity & Venture Capital Association (NVP) acts in the interests of private equity companies in the Netherlands. The aims of the NVP are to:

- Improve the climate for private equity investments in the Netherlands
- Inform investors about the characteristics of private equity as an asset class
- Inform entrepreneurs about the financing possibilities of private equity
- Raise awareness and improve the image of private equity to achieve aforementioned goals
- Contribute to further raising the level of professionalism of the private equity sector.

The NVP has more than 50 members. Members are private equity companies whose principal activity is to provide private equity to private companies. The investment activities of the NVP members extends from providing seed and start-up financing, to expansion financing, financing buy-outs and other late-stage investments. A number of members are part of a bank, insurance company or pension fund (captives), whilst others are independent. Regional development offices are also members of the NVP.

More information about the activities of the NVP and its members can be found on our website www.nvp.nl.

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Appendix 3: Glossary

Buy-out financing Financing of takeovers whereby a portion of the shares are acquired by existing management (management buy-out, MBO) or by new management (management buy-in, MBI).

Captive (fund) Subsidiary of a bank or insurance company or sometimes institutional investor. One of the characteristics of a captive fund is that it can source funds from the parent company when an attractive investment opportunity arises.

Divestment Sale of (part of) a stake in a company to other shareholders or third parties, or (re-)payment of loans, interest and dividend, or write-off of an investment as a result of the decrease in value or bankruptcy. Also called exit.

EVCA European Private Equity & Venture Capital Association.

Exit Type of divestment, namely the sale of a stake in a company.

Expansion financing Investment to finance the further commercialisation of production and marketing for companies that have completed product development but that are not yet profitable. Also used to finance growth in mature companies.

Financing phase The phase in which a company is in when financing is extended. The following financing phases are used: seed, start, expansion, buy-out and other (turnaround and refinancing).

Investor buy-out (IBO) Sale of a company or division to a private equity company.

Management buy-out (MBO) Sale of a company or division to existing management. Large buy-outs usually involve a portion of the shares being bought by a private equity company in cooperation with management.

Market capitalisation The total value of capital invested in shares.

Private equity Investments in private companies. Private equity includes both investments in young, high growth (technology) companies – often referred to as venture capital – and investments in mature companies.

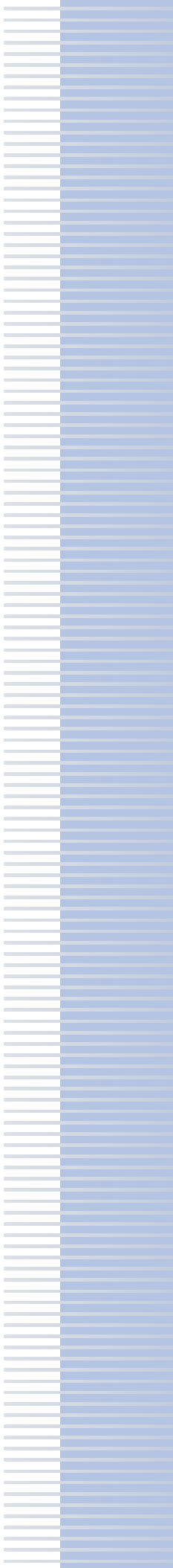
Secondary buy-out Buyout where the stake is acquired by another private equity company.

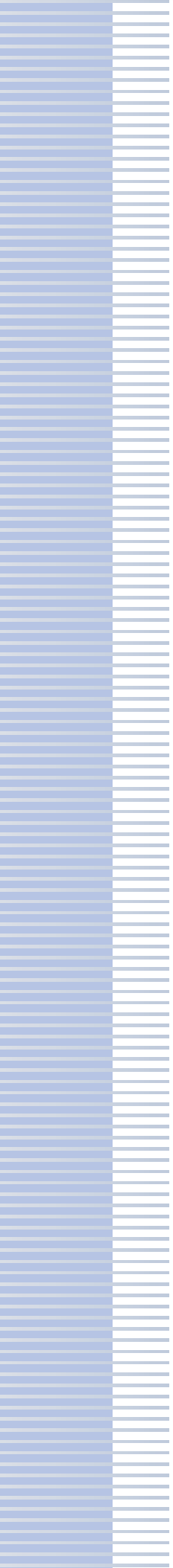
Seed financing/-capital Financing for research and development of the initial concept before the start-up phase has been reached.

Start-up financing/-capital Financing for product development and the initial marketing activities of a young company.

Turnaround financing Investment in a company that is loss-making and whose continuity is not safeguarded without external capital. A viable company can again be achieved through the investment and reorganisation.

Venture capital Capital that is available in the short or long term for relatively high risk investments (risk capital). Primarily for investments in young, high growth (technology) companies.





NVP

Nederlandse Vereniging van Participatiemaatschappijen/
Dutch Private Equity & Venture Capital Association

E info@nvp.nl

W www.nvp.nl