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Private Equity, Public Exits

A tale of two markets

Robust issuance in first half gives way to a slow second half as markets slide on macro headwinds

Private Equity, Public Exits is published quarterly by Ernst & Young to provide insight and analysis on capital markets trends as they apply to the private equity-backed IPO market.

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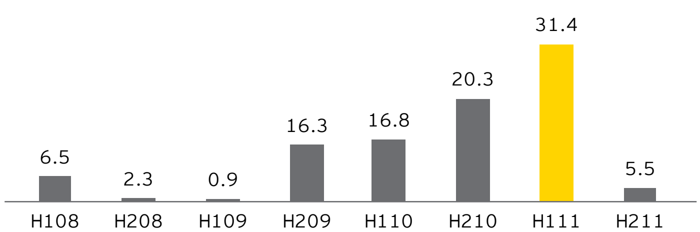
Global IPO markets started strong in 2011, but new issuance dropped dramatically midway through the year. Through November, more than two-thirds of the US$155.8b raised in 1,100+ IPOs had priced in the first half of the year. PE-backed IPOs followed suit in the first half of 2011, continuing to rise from 2010, which saw 168 PE-backed companies raise nearly US$37b. Seventy companies raised US$31.4b in the first six months of 2011, putting the industry on pace for its best year on record. Issuance reversed course midway through the year however, as investor concerns about sovereign debt issues in Europe, Standard & Poor's downgrade of the US and corporate governance concerns in Asia combined to bring the IPO markets to halt. PE firms have raised just US$5.5b between July and November 2011 an annualized decline of 79% from H1.

Despite the challenging environment, pricing generally improved for PE-backed deals compared to 2010, resulting primarily from a number of large deals that took advantage of the wide-open window in the first part of the year. Overall, PE-backed deals have accounted for 24% of the global proceeds raised in 2011, the highest percentage on record.

Figure 1. PE-backed IPOs over the last four years (in US$b)



Source: Dealogic.

Moving into 2012, the outlook remains heavily dependent upon external factors — namely, stabilization in Europe, accelerating growth in the US and improved investor confidence in Asia. There are currently more than 95 companies in active registration to go public, which in aggregate could raise more than US$20b. Behind them are many more high-quality companies with excellent growth prospects that are likely to soon follow. In a new normal, where volatility in public equities markets and in the global economy are constant and expected, PE firms have become more nimble. This nimbleness — and the ever-present quest for growth and profit — will have them properly positioned when the IPO window opens next.

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Despite H2 downturn, PE-backed companies raise record amounts on Americas exchanges

Sixty-one PE-backed deals raise US$28.4b as deal sizes climb

Through November, listings on exchanges based in the Americas raised US$28.4b in 2011, an 88% increase in value over the same period in 2010, when sponsors raised US$15.1b. Proceeds rose on the strength of a number of large deals, including Kinder Morgan, HCA Holdings, Nielsen Holdings and Arcos Dorados, all of which drove average deal sizes higher — the average IPO in 2011 raised US$465.0m, well over double the average deal in 2010, and the highest average deal size on record.

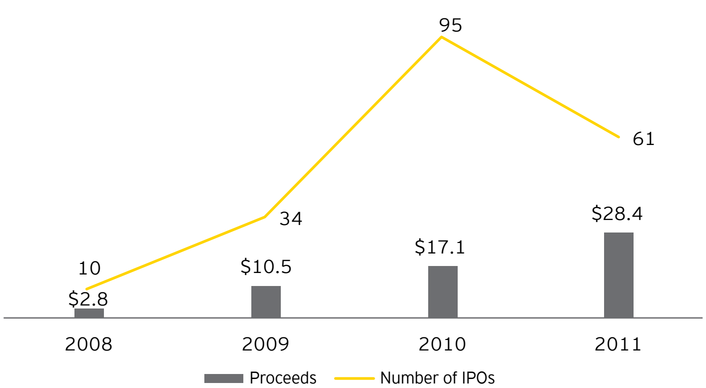
While proceeds were up, volume was down — the 61 deals that priced in the region represented a decline of 30% from 2010. The drop-off in volume was particularly acute in the second half of the year. In line with broader IPO market trends, Americas-sponsored issuance dropped markedly between the second and third quarters — on a volume basis, PE-backed deals declined by 34%; on a value basis, proceeds dropped a remarkable 79% over the same period.

Kinder Morgan and HCA complete record listings

There was a succession of record-breaking sponsored deals listing in the US in 2011. In February, Houston, TX-based pipeline operator Kinder Morgan completed a US$3.3b IPO on the NYSE. The company was acquired in a 2007 take-private by The Carlyle Group, Goldman Sachs Capital Partners and Highstar Capital. Market reaction to the IPO was positive, and the shares priced above range. Secondary trading was likewise robust, and traders added an additional 3.5% to the stock by the end of its first day.

For a short time, the Kinder Morgan offering was the largest PE-backed IPO in history. Then in March, HCA Holdings, the largest hospital operator in the US, went public on the NYSE to raise nearly US$4.4b in proceeds. The sponsors, which acquired HCA in 2006 for approximately US$33b, included Bain Capital Partners, KKR & Co. and Bank of America Merrill Lynch (BAML) Capital Partners. The IPO priced at the high end of its range. Investor interest continued into the aftermarket, and the stock closed up 3.4% from its offer price.

Figure 2. PE-backed listings on Americas exchanges, 2000–2011 ($USb)



Source: Dealogic.

Figure 3. Top Americas listings 2011

Company	Exchange	Offer date	Gross proceeds (US$m)	Sponsor
HCA Holdings Inc.	New York	9 Mar 11	$4,353.0	Bain Capital Partners, KKR & Co., North Cove Partners
Kinder Morgan Inc.	New York	10 Feb 11	$3,293.6	Carlyle/Riverstone, The Carlyle Group, Goldman Sachs Capital Partners, Highstar Capital
Nielsen Holdings NV	New York	25 Jan 11	$1,889.3	Thomas H. Lee Partners, The Carlyle Group, The Blackstone Group, Hellman & Friedman, KKR & Co.
Arcos Dorados Holdings Inc.	New York	13 Apr 11	$1,436.6	Capital International, DLJ Merchant Banking Partners
Yandex NV	NASDAQ	23 May 11	$1,434.8	Baring Vostok Capital Partners

Sources: Dealogic, regulatory filings.

EMEA sees 71% decline in IPO value as debt crisis intensifies

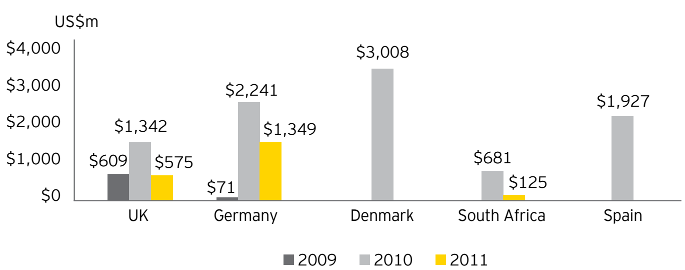
Twelve PE-backed deals raise US$2.9b in 2011

European investors were far more cautious throughout the year compared to their Americas and Asia Pacific counterparts. In total, just 12 PE-backed deals raised US$2.9b on EMEA exchanges, a 71% decline in value, and a 45% drop in volume from the year prior, when 22 deals raised more than US$10.2b.

Declines occurred across all major exchanges. The UK saw just one PE-backed company go public in 2011, down from three in 2010. Russian real estate property developer Etalon Group debuted on the London Stock Exchange in April, raising US$575m. The company, which is backed by Baring Vostok Capital Partners, launched with a market capitalization of approximately US$2.1b.

Germany saw similar declines in the amount of capital raised. In 2010, US$2.2b was raised by three sponsored companies; thus far in 2011, US$1.3b has been raised by four PE-backed companies, a decline of 41%.

Figure 4. PE-backed listings on selected EMEA exchanges, 2009–2011



Source: Dealogic.

Bright spot in Emerging Europe

While Europe's developed markets saw marked declines in activity, some of the region's emerging markets showed life. In Poland, three PE-backed companies went public, raising US$201.3m adding to the four which had debuted in 2010. The largest of these was Warsaw-based Kruk SA, backed by Enterprise Investors. The company, which operates in the receivables management space and was acquired in 2003, raised US$134.9m in an April offering, and returned a reported 8x the sponsor's initial equity investment.

South Africa has also seen significant recent PE-backed deals. In 2011, sporting goods retailer Holdsport went public on the Johannesburg Stock Exchange to raise US$124.5m in a July offering. This followed Life Healthcare Group's IPO in 2010 that raised US$680.5m.

As more PE money flows into these and other emerging economies, the capital markets of Poland, South Africa and other developing nations will continue to play a greater role in providing listing venues for PE-backed deals.

Figure 5. Top EMEA listings 2011

Company	Exchange	Offer date	Gross proceeds (US$m)	Sponsor
GSW Immobilien AG	Frankfurt Prime	13 Apr 11	$675.5	Goldman Sachs Capital Partners, Cerberus Capital Management, L.P.
Etalon Group Ltd.	London	15 Apr 11	$575.0	Baring Vostok Capital Partners
AMAG Austria Metall AG	Vienna	7 Apr 11	$519.8	One Equity Partners
Norma Group AG	Frankfurt Prime	7 Apr 11	$480.0	3i Group
Kruk SA	Warsaw	19 Apr 11	$134.9	Enterprise Investors

Sources: Dealogic, regulatory filings.

Asia Pacific IPO proceeds down 36% on sliding sentiment and governance concerns

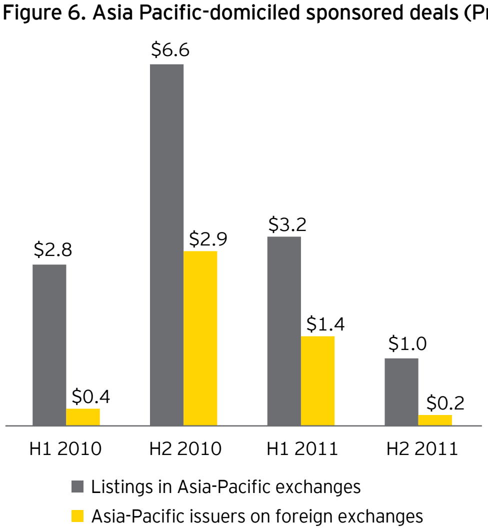
PE-backed deals raise US$5.6b in 35 Asia Pacific listings

The Asia Pacific region has been a key driver of the IPO resurgence in the days following the global recession. In 2010, Asia Pacific exchanges led the world in bringing new companies to market. However, 2011 brought many of the same stiff headwinds experienced throughout the globe accompanying elevated risk aversion among primary market investors.

Through November, PE-backed companies raised US$5.6b in 35 IPOs, a marked 36% decline from the US$8.8b raised in 45 IPOs over the same period in 2010. As in the Americas and EMEA, there was a pronounced decline as the year progressed — the first and second quarters saw an aggregate US$4.5b raised in 18 deals, while the balance of the year saw 17 companies raise just US$1.1b in new offerings, a decline of 71% on a value basis.

Hong Kong remains the most popular exchange, especially for the largest deals. So far this year, six PE-backed deals have raised US$2.8b. However, mainland China exchanges are rapidly gaining ground — the Shanghai, Shenzhen main board and ChiNext exchanges hosted five sponsored deals in 2011, which raised US$1.4b in total proceeds.

Figure 6. Asia Pacific-domiciled sponsored deals (Proceeds, $USb)



Source: Dealogic.

Despite the increasing profile of Asia Pacific's exchanges, many companies, particularly in the technology sector, have sought US listings in order to connect their companies with the region's large appetite for high-growth technology stocks. In 2010, 20 companies headquartered in China listed in the US. However, investor appetite has diminished for such deals in recent months following several high-profile governance failures among recently IPO'd companies. In 2011, just six companies based in China completed US listings. As regulator and investor scrutiny increases, companies seeking such cross-border listings will need to ensure that governance and transparency are at the highest levels possible in order to optimize their chances for a successful launch.

CVC Capital Partners' listing of US luggage maker Samsonite was the largest PE-backed deal to go public in the Asia Pacific region in 2011. The company raised US$1.3b in June as global market sentiment was starting to slide. Samsonite's decision to list in Hong Kong reflects an increased investor appetite in Asia Pacific for deals focused on the growing luxury goods market. Shortly following Samsonite's debut, Italian design house Prada (not PE-backed) executed a US$2.1b listing, also on the Hong Kong Stock Exchange.

The largest domestic issuer to list in 2011 was the Hong Kong IPO of Far East Horizon, backed by KKR and GIC Special Investments. The firms invested in the financial leasing company in 2009, and the public market debut in March raised more than US$750m, and placed an enterprise value on the company of approximately US$ 2.2b.

Figure 7. Top listings on Asia Pacific exchanges, 2011

Company	Exchange	Offer date	Gross proceeds (US$m)	Sponsor
Samsonite International	Hong Kong	9 Jun 11	$1,296.9	CVC Capital Partners
Far East Horizon Ltd.	Hong Kong	24 Mar 11	$757.3	GIC Special Investments, KKR
Tongkun Group Co Ltd.	Shanghai	9 May 11	$499.0	Morgan Stanley Private Equity
Hi Mart Co Ltd.	Korea	17 Jun 11	$386.9	H&Q Asia Pacific
Beijing Jangho Curtain Wall	Shanghai	11 Aug 11	$340.2	CITIC Capital Partners

Sources: Dealogic, regulatory filings.

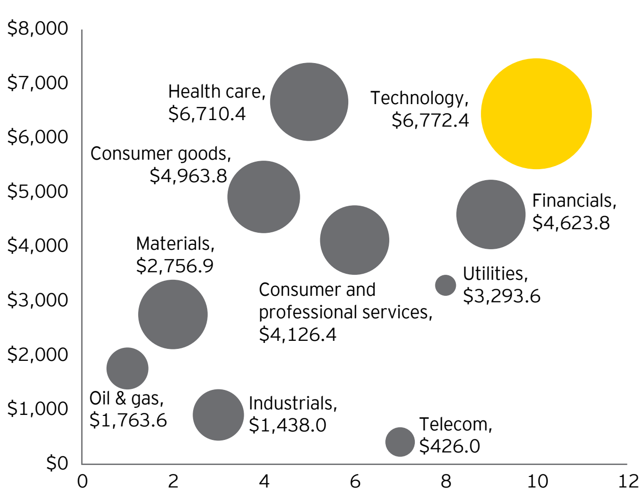
Tech deals lead the way in proceeds and volume

Deals in the technology sector accounted for 28% of sponsored deals during the year, and 18% of the total proceeds raised. The largest of these was Russian search engine Yandex NV, backed by Moscow-based Baring Vostok Capital Partners. The company raised US$1.4b in a May listing on the NASDAQ exchange that gave the enterprise a valuation of approximately US$8b. Another significant deal in the space was the IPO of Freescale Semiconductor. The company was acquired in 2006 for US$17.6b by a consortium led by The Blackstone Group, which also included The Carlyle Group, Permira and TPG. Freescale raised US$883m in a May listing on the NYSE.

Health care was another active industry for IPOs in 2011. Fifteen separate IPOs raised more than US$6.7b during the year; the exceptionally large take was driven primarily by the IPO of hospital operator HCA, which is backed by Bain Capital, KKR and BAML Capital Partners. The IPO, which was the largest sponsored offering in history, raised US$4.4b in its Q1 offering, accounting for two–thirds of the sector's total.

Other active sectors included consumer goods and financial services. Retail, part of consumer and professional services, saw five PE-backed deals this year raise US$1.8b.

Figure 8. Sector breakdown of 2011 PE-backed IPOs (US$m)



Source: Dealogic.

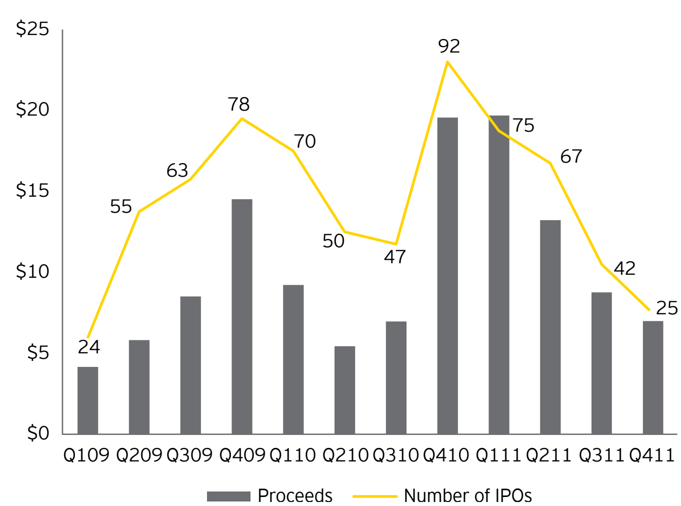
Follow-on/secondary offerings fall as year progresses

Follow-on offerings have been an important source of liquidity for PE investors as volatile markets have reduced the size of offerings at the IPO stage. To date in 2011, sponsored companies have executed over 200 secondary offerings with a combined value of more than US$48.7b, the second-highest value in history, behind the U$52.9b that was raised via follow-ons in 2007. In line with the IPO markets, volume trailed off significantly in the third quarter, dropping 37% from Q2.

Among the largest follow-on deals of the year was KKR and Silver Lake's sale of Singapore semiconductor company Avago Technologies over four tranches. The company went public in 2009, raising US$745.2m at its IPO. In subsequent sales, KKR and Silver Lake have sold an additional US$2.9b in shares, reportedly tripling their original investment.

Other significant secondary offerings included Carlyle's sell-down of shares in China Pacific Insurance. Carlyle made its original investment in the company in 2005, and sold shares in two tranches in 2011 — US$1.8b in January 2011, and another, smaller tranche of US$990m in July. They followed on the heels of a similar share sale of the company in December 2010.

Figure 9. Secondary offerings lose momentum in line with IPOs (US$b)



Source: Dealogic.

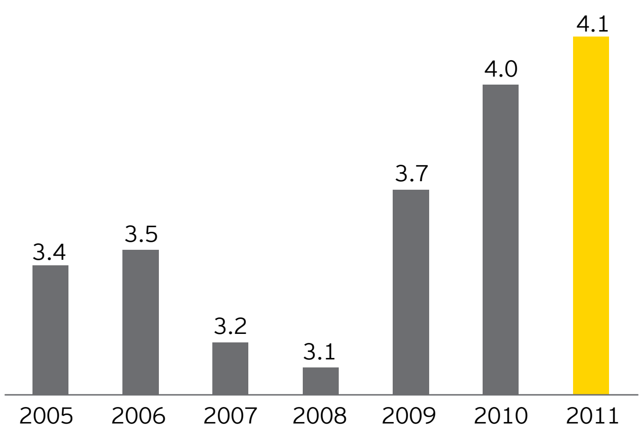
Hold periods increase to 4.1 years for sponsored deals over last three years

Volatility and the open-and-shut nature of the IPO and the broader PE exit market have had a substantial impact on average hold periods for PE-backed IPOs. Over the last three years, the average amount of time that a company has spent in the PE portfolio prior to going public has grown from 3.7 years to 4.1 years, an increase of 10.8%.

Hold period extensions were most pronounced in EMEA, where the average time from entry to IPO jumped from 3.8 years in 2007 to 4.6 years in 2011. Listings in the US and the rest of the Americas were also majorly affected — between 2007 and 2011, the average hold time went from 3.0 to 4.4 years.

Asia Pacific listings were less noticeably affected, in part because of the impact of short-term "pre-IPO" investments by PE firms in businesses already well on the path to going public. Hold periods for PE IPOs in the region grew by just 4.8 months.

Figure 10. Average hold periods, PE-backed IPOs, 2005–2011 (in years)



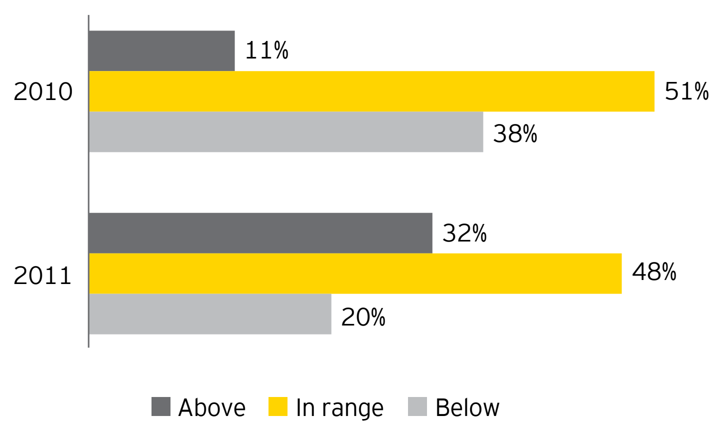
Source: Dealogic.

Eighty percent of Americas and EMEA listings price within or above expected range

Pricing generally improved for PE-backed deals over 2010 as a number of large deals were able to take advantage of the wide-open window in the IPO market during the first part of the year. The steep decline in the markets in the second half of the year caused many companies to pull their deals altogether, further improving averages. Companies that did manage to execute on their IPO plans in H2 2011 generally did so on the strength of exceptional performance which was able to override the broader market issues.

Through November, 78% of the companies listed on Americas and EMEA exchanges priced within or above their expected ranges, significantly higher than the 61% that priced within or above range in 2010. Many deals that priced in the second half of the year actually priced better than those in the first half of 2011 — 27% priced above their expected range in H1 2011, while 33% priced above range in the second half.

Figure 11. Pricing trends, Americas and EMEA listings, 2010–2011



Source: Dealogic.

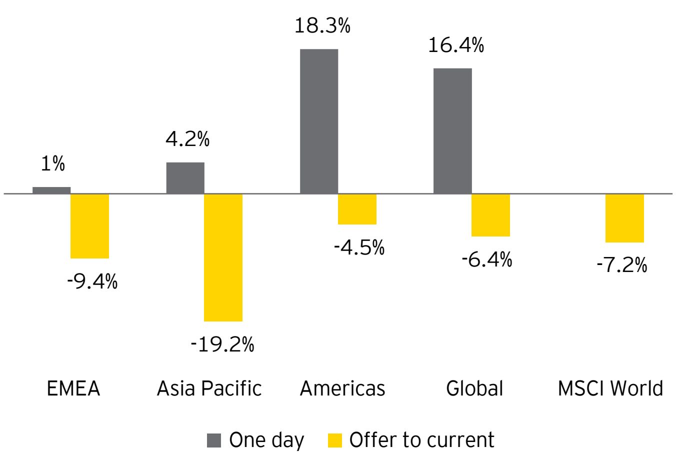
Performance in line with broader market

PE-backed deals average 16.4% first-day increase in 2011, but faced stiff headwinds as the year progressed

PE-backed companies which went public in 2011 through November enjoyed an average 16.4% first-day increase over their IPO price, driven largely by big gains from several large listings in the Americas, including Demand Media (up 33.2%), Yandex (up 55.4%) and the US listing of China-based Renren (up 28.6%). Listings in EMEA and Asia Pacific saw smaller first-day gains, but issues nonetheless closed in the black on average, gaining 0.9% and 4.2%, respectively.

Subsequent trading days were challenged by significant headwinds that impacted the entire market. However, a late-year rally in the US and Asia helped improve returns for many PE-backed deals. As of September, PE deals were trading down 13.6% on a capitalization-weighted average basis; through November, sponsored companies which went public in 2011 regained some of this lost ground, and were down an average 6.4% from IPO price, slightly better than the overall market.

Figure 12. 2011 PE-backed IPO performance



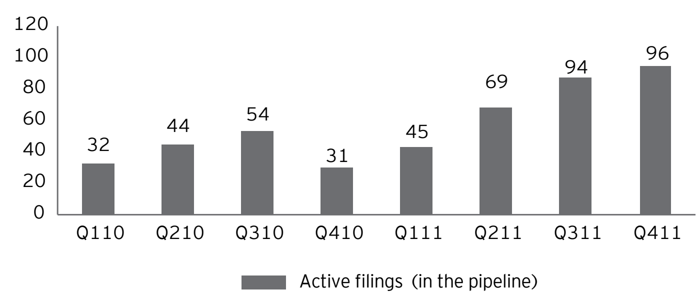
Sources: Dealogic; performance data based on weighted average of market capitalizations; IPOs categorized by listing region.

Looking to 2012 and beyond

Pipeline — filings outpacing offerings to form significant pipeline

Over the last two years, with the exception of one quarter, the number of filings for PE-backed IPOs have exceeded the actual number of PE-backed IPOs by a significant margin. Since January 2011, more than 160 companies have filed to go public, leading to a rapid expansion of the sponsored pipeline. There are still currently more than 95 active companies that have filed and are preparing to go public, which could raise more than US$20b in aggregate. This represents a significant portion of the overall IPO pipeline, which has grown to more than 700 companies globally seeking nearly US$112b in fresh capital. Add to that a sizeable shadow pipeline of companies which are interested in going public but have yet to publicly file, and there exists a sizeable accumulation of IPOs waiting for the right market conditions.

Figure 14. Growth of the PE-backed pipeline has accelerated over the last year as opportunities to go public have slowed



Source: Dealogic: excludes withdrawn filings.

Outlook

Moving into 2012, the outlook remains heavily dependent upon a stabilization in Europe, accelerated growth in the US and improved investor confidence in Asia. As we look forward, there is some optimism that January will exhibit a "restart", characterized by improved financing conditions and more stable equity markets.

While PE firms are eager to return monies to their investors, they will continue to be opportunistic in exiting companies and wait for the right conditions. Most firms have spent years effecting transformational change and making operational improvement in their portfolio businesses, and seek full realization of their efforts. Should the IPO markets be unable to provide it, alternative exit routes, including trade exits to cash-rich strategic buyers and secondary deals with PE firms seeking to deploy a measure of the industry's estimated US$367b in dry powder,will be attractive options.

PE firms have adapted over the last three years to a new status quo — where volatility in public equities markets and throughout the global economy is expected. As a result, PE firms have become more nimble than ever — and will be ready when the IPO window opens next.

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