




**BUSINESS
SCHOOL**

ENTREPRENEURIAL BUYOUT MONITOR

**A CLEAR VIEW ON INVESTMENT
RESULTS 2013 - OUTLOOK 2014**





This work is based on analysis of survey results provided to Vlerick Business School, and a range of interviews. This report reflects the views and opinions of the survey respondents – not necessarily those of Vlerick Business School or BDO Belgium. This work is copyright Vlerick Business School and may not be published, transmitted, broadcasted, copied, reproduced or reprinted in whole or in part without the explicit written permission of Vlerick Business School.

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TABLE OF CONTENTS

- 3 FOREWORD**
- 4 OUR METHODOLOGY**
- 5 ABOUT THE RESPONDENTS**
- 7 GENERAL MBO/MBI INVESTMENT CLIMATE**
- 9 DEAL-MAKING**
- 12 FINANCING**
- 18 OPPORTUNITIES AND CHALLENGES**



ABOUT THE PLATFORM FOR ENTREPRENEURIAL BUYOUTS

The Entrepreneurial Buyout Monitor is an initiative from the Platform for Entrepreneurial Buyouts (PEBO). PEBO was launched by Vlerick Business School in collaboration with BDO Belgium to raise awareness and develop state-of-the-art knowledge of the processes involved in successful entrepreneurial buyouts and buy-ins. It runs events and educational programmes for people looking to undertake a buyout or buy-in.

BDO - PRIME FOUNDATION PARTNER PLATFORM FOR ENTREPRENEURIAL BUYOUTS

BDO Belgium specializes in four areas: Audit & Assurance, Accounting & Reporting, Tax & Legal, and Special Advisory Services (Corporate Finance, Management Advisory & Interim Management). BDO equals high level expert advice. Availability, proximity, integrity, a pragmatic approach and our international network are our main strengths. In Belgium BDO has more than 500 Partners and staff spread over the whole country. We work from 9 offices located in Antwerp, Brussels (Airport), Brussels (Centre), Ghent, Hasselt, La Hulpe, Liège, Namur-Charleroi and Roeselare. BDO is part of a strong international network with about 55,000 Partners and staff active in more than 140 countries.

ACKNOWLEDGMENTS

This report was prepared by Miguel Meuleman, professor in Entrepreneurship at Vlerick Business School, and Jeroen Neckebrouck, research associate at Vlerick Business School. The authors thank all survey respondents for their participation; and the members of the PEBO Advisory Board Jan Camerlynck, Veerle Catry, Kurt Faes, Sophie Manigart, Johan Vandembroeck, Hans Vanoorbeek, Peter Vermeiren and Hans Wilmots, for their contributions. The pictures in this report were taken by Grégoire Verbeke.

Please direct questions and comments about this report via email to nathalie.lagae@vlerick.com.

FOREWORD

AN EXPERT PERSPECTIVE

Welcome to the first edition of the Entrepreneurial Buyout Monitor – a snapshot of the trends and challenges involved in management buyouts and buy-ins of SMEs in Belgium from a practitioner's perspective.

We captured the opinion of 175 buyout experts in Belgium – including bankers, private equity players, lawyers, brokers and M&A advisers.

There has been a general lack of understanding and transparency of the smaller segment of the buyout market. Here, we give insights and trends on the general investment climate for SME buyouts¹, including:

- Deal flow
- Deal-making
- Financing

Overall, the results indicate the investment climate has generally improved and this is expected to continue in 2014. The key insights from the survey are:

- Deal flow is increasing – but with greater levels of competition and a lack of professionally run SMEs with the potential to be transferred, sourcing high-quality deals remains challenging
- Lending conditions continue to be challenging – putting pressure on investment returns and urging investors to look for alternative deal structures
- Investors have to be more proactive – focusing on targets with the potential to add value through cutting costs or pursuing growth opportunities
- Potential vendors need to be realistic – and either adjust their price expectations or wait for improved operating results and an uplift in multiples when the economic climate improves

We hope you find these insights valuable.



Miguel Meuleman
Professor in
Entrepreneurship,
Vlerick Business School



Hans Vanoorbeek
Executive in Residence,
Vlerick Business School

¹ Unless indicated otherwise, we use the term 'buyout' to refer to both management buyouts and buy-ins (MBO/MBIs).

METHODOLOGY

The insights are based on survey responses from 175 M&A experts, collected during November and December 2013. The respondents are all active in management buy-outs and buy-ins (MBO/MBIs) of small and medium sized companies (SMEs) in the Belgian market .

We chose experts from firms who focused on deals with a minimum transaction value of one million EUR. Before we sent out the survey, several academics and practitioners verified and tested the survey instrument.

We received 222 responses from a sample of over 900 experts after four weeks. To make the responses more valid, we left out any that were completed in less than five minutes - giving us 175 responses in total.¹

TREND INDICATORS

Trends are measured using “net percentages” - defined as the difference between the percentage of answers indicating development in a specific direction and those indicating progress in the opposite direction.

Trend indicators are defined as:

i = [% of respondents reporting a significant improvement or increase]	*	1,0
+ [% of respondents reporting a slight improvement or increase]	*	0,5
- [% of respondents reporting a slight deterioration or decrease]	*	0,5
- [% of respondents reporting a significant deterioration or decrease]	*	1,0

The possible values of this indicator vary between -100% (significant deterioration or decrease indicated by all respondents) and +100% (significant improvement or increase indicated by all respondents). We account for the intensity of the evolution by applying a weighting factor to the answers (0,5 and 1).

¹ *The actual number of respondents may be lower for certain questions, because some questions were left open, or respondents had no opinion. The minimum number of respondents for any question was 127.*

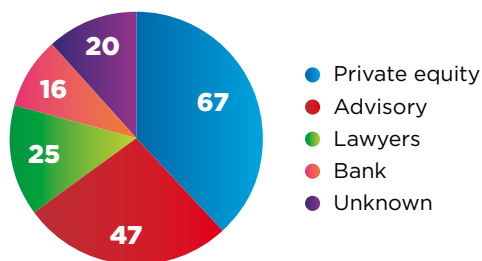
ABOUT THE RESPONDENTS

The insights of this report reflect the view of 175 experts who represent a complete view of active professionals in the SME buyout market in Belgium.

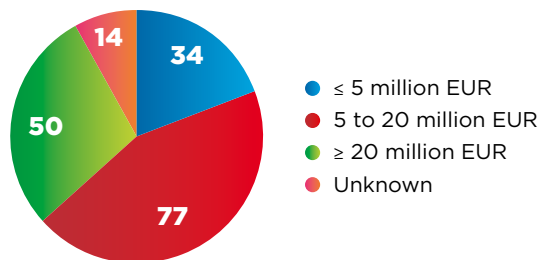
They:

- Cover a wide variety of professional roles, deal segments and industry sectors
- Have an average of 12 years' professional M&A experience - and worked on an average of 4.6 buyout deals over the last year
- Are active in the three main regions of Belgium - 154 in Flanders, 106 in Brussels, and 65 in Wallonia

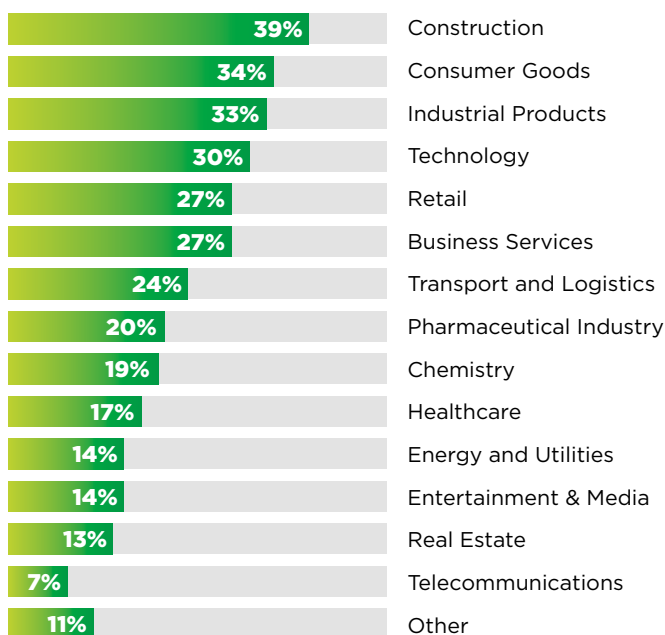
RESPONDENTS INCLUDED BANKERS, PRIVATE EQUITY PLAYERS, LAWYERS, BROKERS AND M&A ADVISERS



MOST RESPONDENTS ARE ACTIVE ON MEDIUM SIZED DEALS



RESULTS REPRESENT ALL INDUSTRY SECTORS



Percentage of respondents involved in a buyout in a given sector in 2013

BIO-RACER, MBO-MBI BY PETER CROONEN, DANNY SEGERS AND RAYMOND VANSTRAELEN

“Bioracer is a high growth company in a complex, competitive and international environment. Raymond Vanstraelen, Bioracer’s founder, surrounded himself with talented managers ready to take over the company. Peter Croonen - S&M, and Danny Segers - COO, acquired growth financing and made the necessary arrangements with Raymond, thereby assuring the company’s succession.” (BDO)



**IS THE FUTURE OF
INVESTMENT LOOKING
OPTIMISTIC?**

GENERAL MBO/MBI INVESTMENT CLIMATE

GROWING CONFIDENCE AND CLEAR SIGNS OF IMPROVEMENT

Overall, our results show the SME buyout market is improving and will continue to grow in 2014.

SELLING

65% of the experts we surveyed expect the market to improve in 2014 – giving a trend indicator of 29%.

BUYING

70% of respondents thought the investment climate would improve – giving us a trend indicator of 32%.

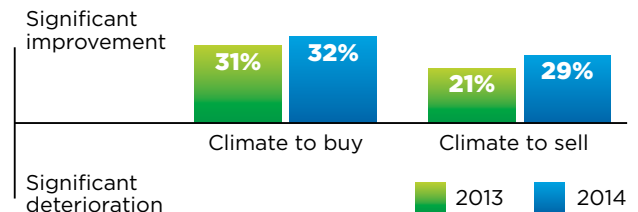
This confidence can be seen in the number of deals that happened in 2013. There were an increasing number of companies for sale – and the practitioners we surveyed believe figures will accelerate in 2014.

Drivers of the improved flow of activity include:

- Improved economic outlook
- Owner managers approaching retirement being increasingly willing to look for succession
- A growing number of managers are becoming aware of the opportunities in buying a company.
- An increase in the supply of capital. Some private equity firms and family offices are starting to invest in deals that until recently would not have satisfied traditional requirements for high returns.
- A substantial number of so-called ‘zombies’ looking for turnaround investment

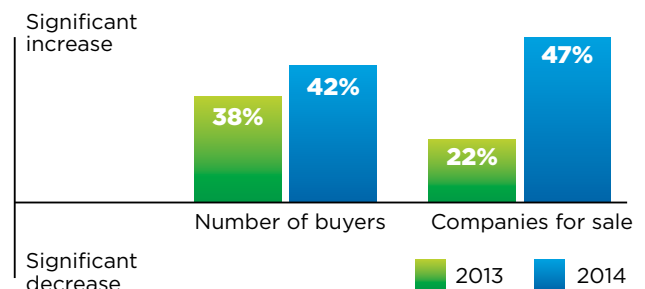
However, the qualitative evidence suggests that there is still a lack of high quality deal flow. A large number of SMEs lack the professional structures to make them transferrable. Overall this means buyers have to rely increasingly on proprietary deal flow.

IN 2014, THE BUYOUT INVESTMENT CLIMATE IS EXPECTED TO IMPROVE FURTHER FOR BOTH SELLERS AND BUYERS.



MBO/MBI investment climate - Trend indicators per deal segment¹

IN 2014, THE NUMBER OF BUYERS AND COMPANIES FOR SALE IS EXPECTED TO INCREASE.



Number of buyers and companies for sale - Trend indicators per deal segment¹

¹ Represents the trend indicator expressed as a net percentage. For more details, please read the Methodology on page 4.

SQUARE +, MBI BY ANDREAS VERHEYE

“Andreas showed exceptional entrepreneurial drive throughout the negotiations. His enthusiasm was balanced with a realistic and practical approach to pricing – and some caution around the company’s professional structure.” (BDO)



**WITH MORE
COMPETITION, WILL
INVESTORS FIND THE
RETURNS THEY ARE
LOOKING FOR?**

DEAL-MAKING

MORE COMPETITION

The majority of buyout experts say the level of competition in the buyout sales process has increased over the past year – and it’s particularly noticeable in the larger deal segment.

One major reason for this is increased competition from family offices and newly launched private equity companies. There are more buyers looking for the same investment opportunities.

Investors need to be more proactive – they realise there may be too much capital chasing too few deals. And a lack of high-quality opportunities makes it more difficult for investors to complete deals.

RISING PRICES

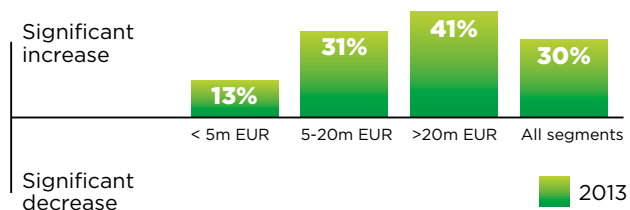
After the pre-crisis peak – and the drop during the crisis – average price levels seem to be returning to normal. They have increased slightly – except in the smaller deal segment.

The average EBITDA multiple paid was an estimated 5.0, with slight differences according to the deal size segment of the market.

Tougher lending conditions continue to put pressure on the prices investors can pay to buy firms. But sellers have been slow to lower their price expectations to reflect current conditions – some of them might be waiting for better times to sell.

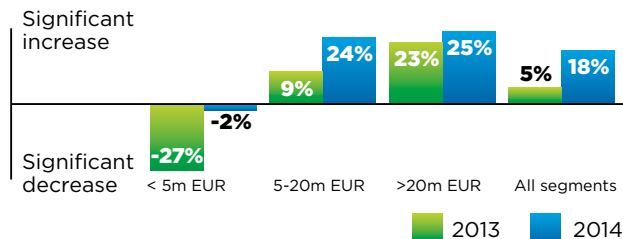
Most buyout experts expect similar or slightly higher prices to close a deal in the future.

BUYERS EXPERIENCED MORE COMPETITION IN THE SALES PROCESS – FOR MEDIUM SIZED AND LARGER DEALS IN PARTICULAR



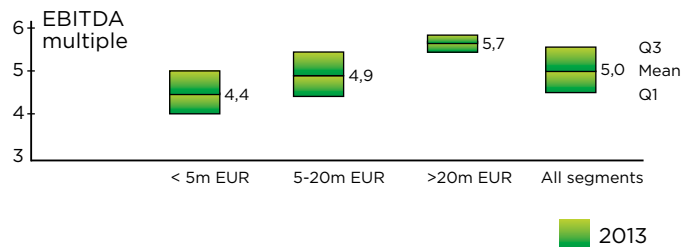
Level of competition - Trend indicators per deal segment^{1,2}

BUYOUT EXPERTS EXPECT SIMILAR OR SLIGHTLY HIGHER EBITDA MULTIPLES



EBITDA multiples - Trend indicators per deal segment^{1,2}

THE AVERAGE EBITDA MULTIPLE PAID WAS ESTIMATED TO BE 5.0



Estimated EBITDA multiples - Mean, Q1 (25th percentile) and Q3 (75th percentile) values per deal segment¹

¹ Responses were categorised according to the respondents' main deal segment activity.

² Values represent weighted net percentages indicating the percentage of respondents indicating an increase reduced by the percentage of respondents indicating a decrease.

A MORE THOROUGH INVESTMENT PROCESS

Half the people we surveyed feel that it now takes longer to close a deal.

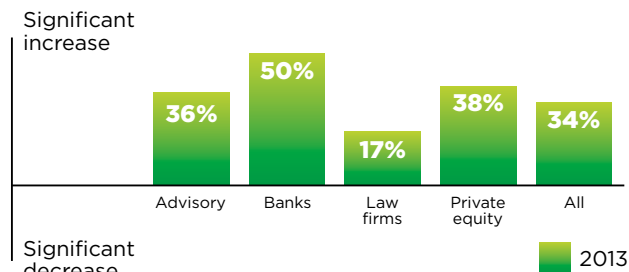
BUYERS ARE MORE CAUTIOUS – and since the economic crisis have further scrutinised their return targets.

PROCESSING TIME HAS INCREASED – according to bankers in particular, regulatory and tax compliance checks are more detailed.

THOROUGH COMMERCIAL DUE DILIGENCE – a weak economic outlook and turbulent marketplace has led private equity investors to dedicate greater resources to identify possible risks

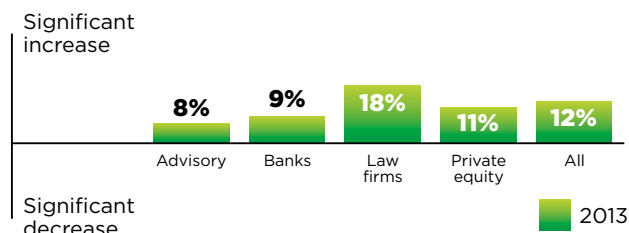
In general, a large number of buyout experts note that the sales process is becoming more professional.

THERE IS A GENERAL PERCEPTION THAT IT TAKES MORE TIME TO CLOSE DEALS.



Time to close a deal - Trend indicators per respondent type¹

EXPERTS BELIEVE THAT THE SALES PROCESS IS BECOMING MORE PROFESSIONAL.



Level of professionalism in the sales process - Trend indicators per respondent type¹

¹ Values represent weighted net percentages indicating the percentage of respondents indicating an increase reduced by the percentage of respondents indicating a decrease.

ARE INTERMEDIARIES TAKING A MORE PROFESSIONAL APPROACH?



GROENBEDRIJF VAN VLIERDEN, MBO BY ROB LENAERS, PATRICK LAEVERS AND MARC TIMMERMANS

“With the financial and professional support of two entrepreneurs, Groenbedrijf Van Vlierden secured a successful MBO. We helped them to carry out a due diligence investigation and draft the SPA. This resulted in more balanced conditions and realistic pricing expectations. Our pragmatic approach and assistance helped the entrepreneurs to close the deal.” (BDO)

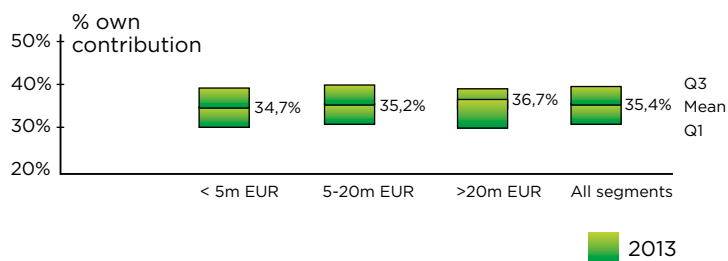
FINANCING

GROWING LEVELS OF EQUITY INJECTIONS ARE SET TO STABILISE DURING 2014

Our respondents estimated that MBO/MBIs needed an average of 35.45% equity or semi-equity, with very little variance for differing deal sizes – this has increased greatly compared with pre-crisis levels.

And the equity and semi-equity contribution has grown significantly over the past year, but is set to stabilise during 2014. However, deals that are less than five million EUR are still expected to see a small increase in own contribution.

AVERAGE PERCENTAGE OF EQUITY AND SEMI-EQUITY NEEDED TO FINANCE AN MBO/MBI IS 35.4%

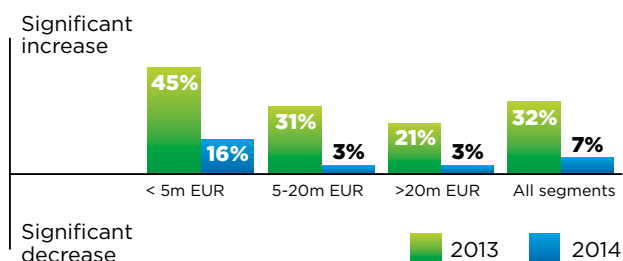


Percentage of equity and semi-equity needed to finance an MBO/MBI – Mean, Q1 (25th percentile) and Q3 (75th percentile) values per deal segment

The major driver for this has been that banks have taken a more prudent approach to lending since the credit crisis. Banks are increasingly looking to de-leverage deals. They are more cautious about lending – and many entrepreneurs may need to reassess the deals they target if they want banks to become involved.

When you also consider increased competition for deals and low macro economic growth expectations, returns can seem less attractive for investors – unless they can drive down prices for acquiring a company.

THE EQUITY AND SEMI-EQUITY NEEDED TO FINANCE AN MBO/MBI HAS INCREASED OVER THE PAST 12 MONTHS, BUT IS EXPECTED TO REMAIN STABLE IN 2014



Percentage of equity and semi-equity needed to finance an MBO/MBI - Trend indicators per deal segment¹

¹ Values represent weighted net percentages indicating the percentage of respondents indicating an increase reduced by the percentage of respondents indicating a decrease.

MORE PRIVATE EQUITY TO INVEST

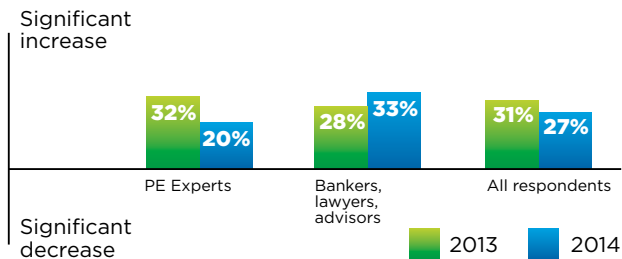
The total number of investors focused on SMEs is still limited. But in recent years we have seen a steady increase in private equity funds, family offices and high net worth individuals targeting this segment of the market. There has been a surge in deal-by-deal investment vehicles, further increasing the supply of capital.

Also, private equity investors have unspent commitments - known as 'dry powder' - which they will be looking to invest.

This increase is reflected by the buyout experts' opinion: the availability of external equity for financing MBO/MBIs has increased strongly, and is expected to grow further.

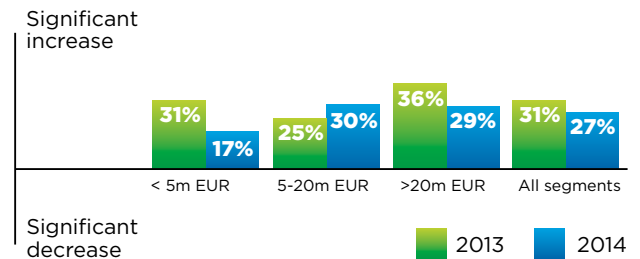
So will investors be able to put their money to work without compromising their proposed investment strategy? Some may have to ask limited partners to have more time, or not use the money at all. But the expected increase in deal flow may offer a way out.

EXTERNAL EQUITY TO FINANCE MBO/MBIS IS BECOMING MORE AND MORE AVAILABLE



Availability of external equity to finance MBO/MBI - Trend indicators per respondent type¹

EXTERNAL EQUITY TO FINANCE MBO/MBIS IS EXPECTED TO INCREASE IN ALL DEAL SEGMENTS



Availability of external equity to finance MBO/MBI - Trend indicators per deal segment¹

¹ See page 12

BANKS EXERCISING MORE CAUTION WITH LENDING

Debt funding remains challenging with reasonable and stabilising debt multiples.

The average senior debt/EBITDA multiple is 3.1 – and we can expect it to remain stable over the next year. This follows a European trend where debt multiples have returned to normal levels after the pre-crisis lift-up.

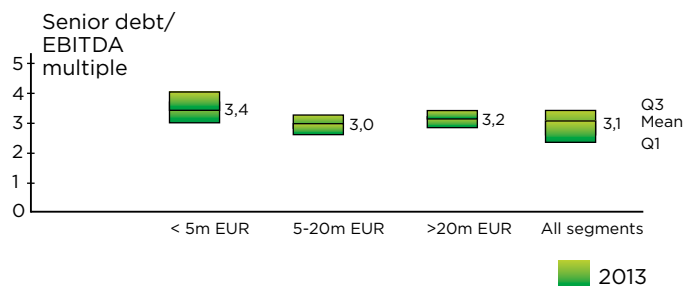
But banks are still being cautious and selective about businesses they are willing to lend to.

In general, the experts we surveyed agreed that the cost of lending was stable in 2013, and they expect a slight increase in the coming year. Respondents predict that the maturity of loans to finance an MBO/ MBI will stay relatively stable.

However, a fairly large group of respondents said personal guarantees, pledges and mortgages needed to get a loan or line of credit to finance an MBO/ MBI have tightened significantly over 2013. And commercial finance as a condition for banks to back a transaction is becoming more widespread.

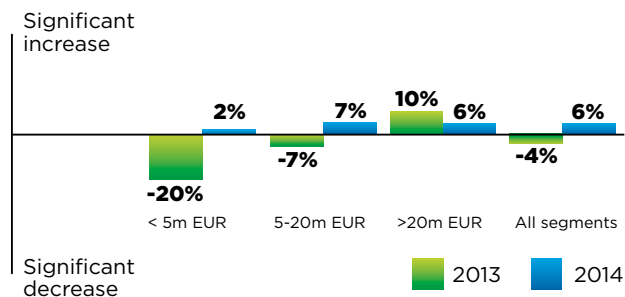
Clearly the effects of Basel III are taking hold – banks have become more prudent in their lending activities. This means investors may need alternative sources of debt and rely on government guarantee schemes to fund deals to realise satisfactory equity returns.

THE AVERAGE SENIOR DEBT/EBITDA RATIO IS 3.1, WITH SMALL VARIATIONS BETWEEN DEAL SEGMENTS



Average senior debt/EBITDA ratios for MBO/MBI transactions – Mean and Q1 (25th percentile) and Q3 (75th percentile) values per deal segment

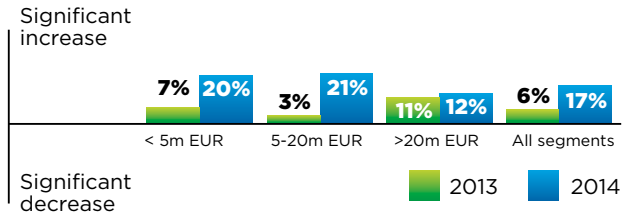
TOTAL SENIOR DEBT/EBITDA RATIOS ARE EXPECTED TO REMAIN RELATIVELY STABLE OVER THE NEXT 12 MONTHS



Total senior debt/EBITDA ratios - Trend indicators per deal segment¹

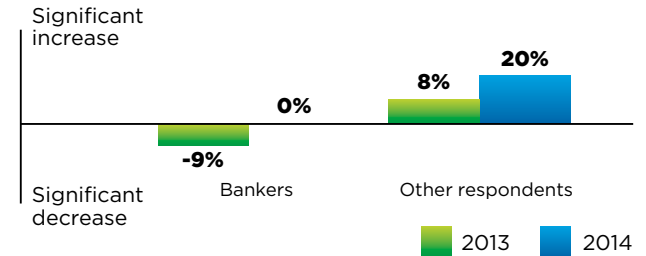
¹ Values represent weighted net percentages indicating the percentage of respondents indicating an increase reduced by the percentage of respondents indicating a decrease.

OVERALL, THE COST OF LENDING REMAINED STABLE OVER THE PAST YEAR. A SLIGHT INCREASE IS EXPECTED IN 2014



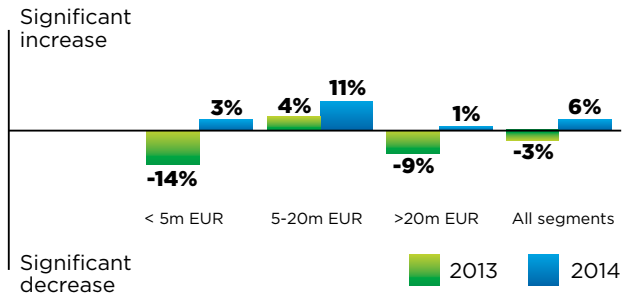
Cost of debt to finance an MBO/MBI - Trend indicators per deal segment¹

BANKERS SAY THE COST OF DEBT WILL REMAIN STABLE - BUT OTHER RESPONDENTS EXPECT A MODERATE INCREASE



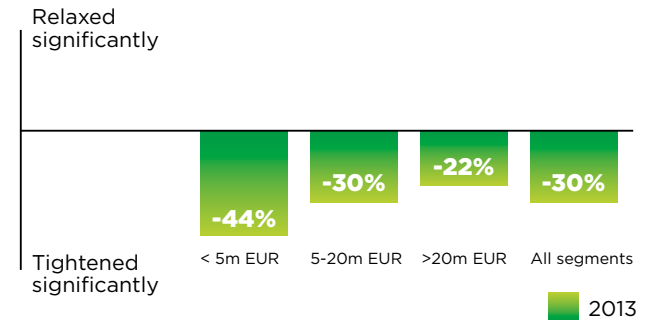
Cost of debt to finance an MBO/MBI - Trend indicators per respondent type¹

RESPONDENTS SAY THE MATURITY OF LOANS TO FINANCE AN MBO/MBI WILL REMAIN RELATIVELY STABLE



Maturity of debt to finance an MBO/MBI - Trend indicators per deal segment¹

PERSONAL GUARANTEES, PLEDGES AND MORTGAGES NEEDED TO GET A LOAN OR LINE OF CREDIT TIGHTENED SIGNIFICANTLY IN 2013



Guarantees, pledges and mortgages needed to get a loan or line of credit - trend indicators per deal segment^{1 2}

¹ See page 14

² +100% means all respondents indicated the guarantees needed relaxed significantly. -100% means all respondents said the guarantees needed tightened significantly

ALTERNATIVE FUNDING MECHANISMS – BRIDGING THE FINANCING GAP

Lending conditions have tightened and the general economic outlook is weak – so investors are turning to alternative deal structures.

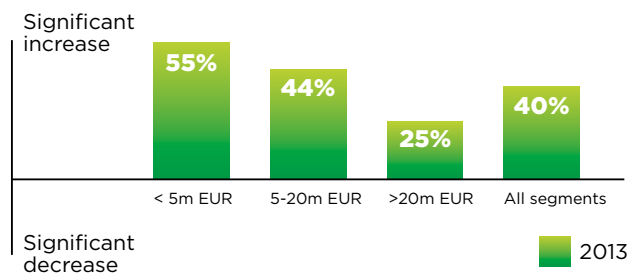
VENDOR LOANS

These are typically unsecured loans that are subordinate in priority to the company's senior debt. They help to close transactions – sellers are increasingly willing to stay involved in a deal through vendor loans. In the last year, they have become commonplace in early negotiations for investors.

EARN-OUTS

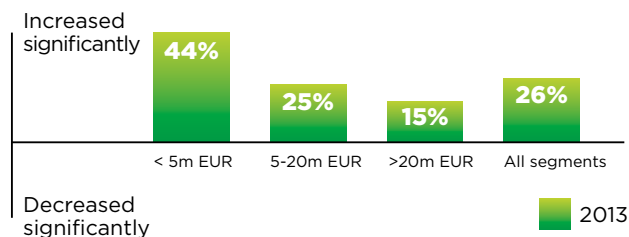
Overall, buyout experts noted an increased use in earn-outs over the past year. They are an effective mechanism for balancing a seller's price expectations and a buyer's valuation – and they can help to eliminate risks from a deal in today's uncertain economic environment. Their use has increased, particularly in smaller deals that allow for more flexible deal structures.

VENDOR LOANS HAVE BECOME INCREASINGLY POPULAR



Use of vendor loans – Trend indicators per deal segment¹

EARN-OUTS HAVE BECOME INCREASINGLY WIDESPREAD



Use of earn-outs – Trend indicators per deal segment¹

¹ Values represent weighted net percentages indicating the percentage of respondents indicating an increase reduced by the percentage of respondents indicating a decrease.

MR BRICOLAGE, MBO BY QUENTIN LE BUSSY

“When Quentin chose to acquire “Mr.Bricolage” he turned to us. Our M&A team played a key role throughout the entire process from structuring the transaction and performing the financial due diligence, through to assisting with the legal aspects of the transaction and the fundraising to finance the deal.” (BDO)



OPPORTUNITIES AND CHALLENGES

SMES NEED MORE PROFESSIONAL STRUCTURES

As the baby boom generation plans to retire in the next decade, and try to reap the benefits of their entrepreneurial efforts, a growing number of SMEs will be looking for a new owner.

However, many buyout experts are concerned with how professionally structured many of these companies are – and how long they can continue without their original owner managers.

If these owner managers don't put the right structures in place and develop the right business models to sustain future growth, many of these companies won't find suitable buyers – and will risk liquidation.

There have been a number of government initiatives to raise awareness of this issue – but more efforts are needed to prepare these companies to be successfully transferred, and to create a new generation of professional owner managers.

CHANGING FUNDING LANDSCAPE POSES CHALLENGES

The promise of a new wave of SMEs that will be looking for new owners means the number of independent M&A advisory companies and new private equity firms focusing on this market has grown.

Also, a low return investment environment has attracted new non-institutional investors – such as family offices and high net worth individuals – looking for alternative investment opportunities. In contrast to most institutional investors, they often develop specific investment vehicles on a deal-by-deal basis.

This new competitive environment will pose some challenges. To get satisfying returns, investors will have to be more proactive in sourcing attractive deals. And less experienced investors and advisory companies may lack the experience and discipline to scrutinise deals and put appropriate governance structures in place to support long-term, sustainable value creation.

ALTERNATIVE FUNDING SOURCES NEEDED

There are encouraging signs that confidence and activity in the SME buyout market are picking up. But deals generally take longer to complete.

Debt markets are more restrictive and there are relatively low growth prospects for the overall economy. So investors need to be cautious, and look for alternative deal structures that are flexible and allow decent returns for both sellers and buyers.

To deal with these challenges, investors may need alternative funding sources such as mezzanine funding and vendor financing. If used well, these new funding sources will allow for a vibrant buyout market.

Finally, intermediaries should set realistic expectations about the new return environment.

CHANGING TAX ENVIRONMENT

Tax regulations play an important part in buyout structuring – and unstable and unfavourable tax regulations can impact how deals are structured.

From October 1, 2014, the withholding tax rate applied to liquidation bonuses will rise from 10% to 25%. This could lead to fewer potential targets in the smaller market segment – potential sellers might opt for liquidation before this new tax rate comes into force.

The tax rate increase might also pose problems for a buyer trying to persuade a seller to accept an asset deal instead of a share deal.

In the meantime, two major obstacles remain when closing a buyout deal – the absence of tax consolidation and the uncertain tax treatment authorities give to deal structures.

FINAL THOUGHTS

Overall, we believe the SME buyout market has strong potential. But the different intermediaries need to set realistic expectations. The insights in our first Entrepreneurial Buyout Monitor should help to create a mutual understanding to tackle the risks and challenges of an ever-changing environment.



Veerle Catry
Partner, BDO Belgium

DID YOU KNOW OF THE ENTREPRENEURIAL BUYOUT ACADEMY?

The Entrepreneurial Buyout Academy organized by the Platform for Entrepreneurial Buyouts targets individuals with significant management experience who have the ambition to perform their own management buy-out or management buy-in.

The program consists of 7 sessions which chronologically handle the steps needed to successfully undertake a buy-out or buy-in. As such, the Academy offers buyout candidates an excellent opportunity to prepare their buyout case.

For more information, please visit:

WWW.VLERICK.COM/EN/EVENTS/EVENTS/ENTREPRENEURIAL-BUYOUT-ACADEMY







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