VLERICK BUSINESS SCHOOL

ENTREPRENEURIAL BUYOUT MONITOR

A CLEAR VIEW ON INVESTMENT

RESULTS 2014 – OUTLOOK 2015

BDO

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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. Our clients particularly value us for our straight forward and pragmatic approach, availability, proximity, integrity and our international network. In Belgium BDO has more than 500 Partners and staff which work out of 9 offices. 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 Kenny De Geeter, 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, Elke Janssens, Sophie Manigart, Johan Vandenbroeck, Hans Vanoorbeek, Peter Vermeiren and Hans Wilmots, for their contributions.

Belgian Science Policy Office

belspo

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The pictures in this report were taken by Grégoire Verbeke.

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

FOREWORD

AN EXPERT PERSPECTIVE

Welcome to the second edition of the Entrepreneurial Buyout Monitor – a snapshot of the trends and challenges involved in management buyouts[1] and buy-ins of SMEs in Belgium from a practitioner's perspective.

We captured the opinions of 169 buyout experts in Belgium – including bankers, private equity investors, mezzanine players, family offices, lawyers, brokers and M&A advisers.

Overall, the results indicate the investment climate has considerably improved – as expected from last year's edition. The outlook for 2015 remains positive. The key insights from the survey are:

- **DEAL FLOW IS INCREASING** – however, with higher levels of competition and more favourable lending conditions, we've also seen higher multiples – especially for medium sized and larger deals. It's tougher to achieve attractive returns, so the deal origination process is critical.
- **MORE FAVOURABLE DEBT MARKETS** – overall debt multiples increased and the cost of lending significantly dropped. This was true for medium sized and larger deals. However, lending conditions continue to be challenging for smaller deals – so they may need more creative deal structures.
- **ALTERNATIVE INVESTORS BECOME MORE PROMINENT** – both family offices and mezzanine investors become more active in smaller MBO/MBI transactions.
- **PRIVATE EQUITY INVESTORS NEED A CLEAR STRATEGY** – they need a more focussed approach to finding opportunities for growth while cutting costs. And so they must gain a deeper understanding – and further insights into the sectors they're targeting.

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 169 M&A experts, collected during November and December 2014. The respondents are all active in management buyouts 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.

We received 255 responses from a sample of over 900 experts after six weeks. To make the responses more valid, we left out any that did not identify its professional activity or were completed in less than five minutes – giving us 169 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 the questions was 137, unless otherwise stated as we had specific questions based on the respondents' professional activity.*

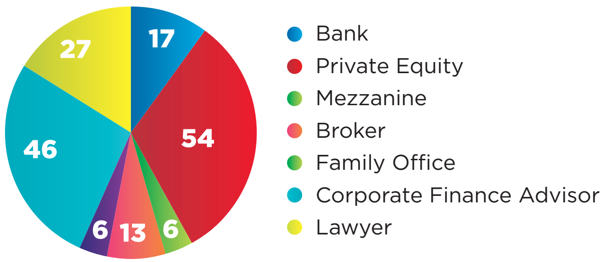
ABOUT THE RESPONDENTS

The insights of this report reflect the view of 169 experts who represent a complete view of active professionals in the SME buyout market in Belgium.

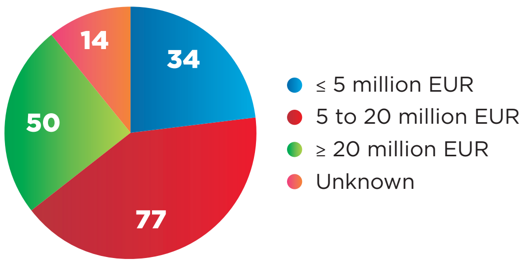
They:

- Cover a wide variety of professional roles, deal segments and industry sectors
- Have an average of 13 years' professional M&A experience – and worked on an average of 3.5 buyout deals over the last year
- Are active in the three main regions of Belgium – 131 in Flanders, 93 in Brussels, and 78 in Wallonia

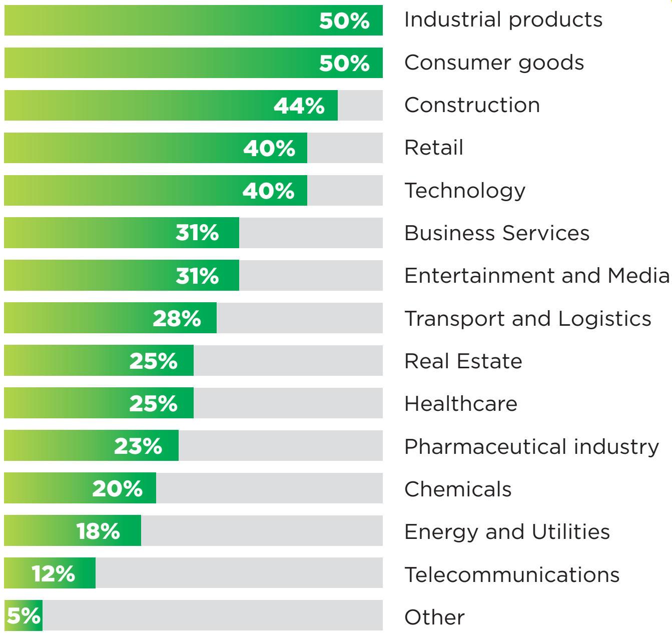
NUMBER OF RESPONDENTS PER PROFESSIONAL ROLE



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 2014

SIMLA, MBI BY CARLO RATHÉ AND FRÉDÉRIC SANTENS

"The entrepreneurial drive throughout the negotiations and their knowledge of the sector convinced the seller to trust his baby in the hands of Carlo and Frédéric who have teamed up to secure Simla's future growth. While both were very enthusiastic to close the deal, they were careful to ensure a realistic price and solid deal structure." (BDO)

A BRIGHT FUTURE FOR INVESTMENT?

GENERAL MBO/MBI INVESTMENT CLIMATE

CONTINUED GROWTH IN INVESTOR CONFIDENCE

In 2014 the SME buyout market improved, as predicted in last year's edition. Overall, our results indicate that it will continue to improve in 2015.

SELLING

63% of the experts we surveyed indicated the market improved in 2014 - giving us a trend indicator of 37%. This is particularly true for medium sized and larger deals.

BUYING

66% of respondents thought the investment climate would improve – giving us a trend indicator of 23%. This was mainly caused by an improvement of investment climate for medium sized and larger deals.

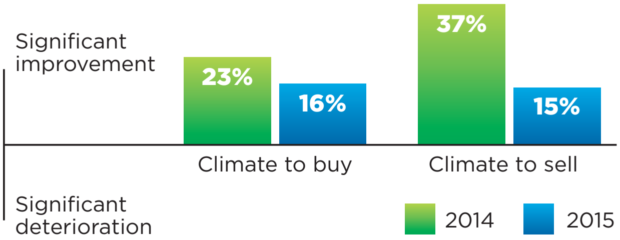
This confidence can be seen in the number of deals that happened in 2014. There were an increasing number of companies for sale – and the practitioners we surveyed believe figures will continue to accelerate in 2015.

Factors for this improved climate include:

- Favourable lending conditions
- More available capital – private equity firms, family offices and mezzanine investors increasingly invest in small and medium sized deals
- Owner managers are more willing to look for succession
- A growing number of seasoned managers are considering changing career and becoming a MBO/MBI entrepreneur

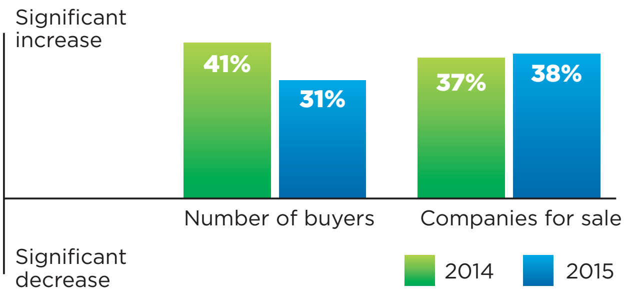
However, qualitative evidence suggests that there continues to be a lack of high quality deal flow. A large number of SMEs lack the professional structures to make them transferrable.

IN 2014, THE BUYOUT INVESTMENT CLIMATE HAS SIGNIFICANTLY IMPROVED FOR BOTH SELLERS AND BUYERS.



MBO/MBI investment climate – Trend indicators

IN 2015, THE NUMBER OF BUYERS AND COMPANIES FOR SALE ARE EXPECTED TO FURTHER INCREASE.



Number of buyers and companies for sale – Trend indicators

FURNIBO, MBO BY STEVEN MAEYAERT

"With the financial and professional support of a private equity investor, Furnibo secured a successful MBO. Steven, CEO had been with the company nearly 20 years, and first took a minority stake in early 2014. Together with The Talent-Capital Bridge, Steven has subsequently acquired 100% of Furnibo – and has ambitions to further grow the company in a very competitive environment." (BDO)

TOO MUCH MONEY CHASING TOO FEW DEALS?

DEAL-MAKING

INCREASED COMPETITION

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

There are several factors for this:

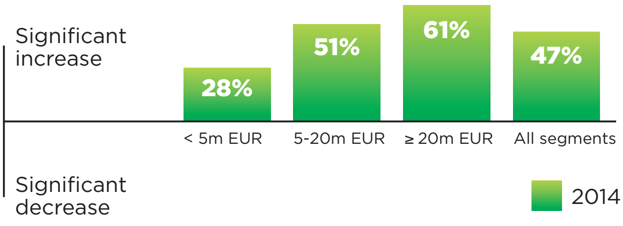
CORPORATE BUYERS – private equity investors have seen more corporations investing in deals.

PRIVATE EQUITY FUNDS – in the last year a noticeable number of funds have been set up specifically aimed at small and medium sized buyouts.

INDIVIDUAL INVESTORS – more and more family offices and wealthy individuals are investing directly into small and medium sized deals.

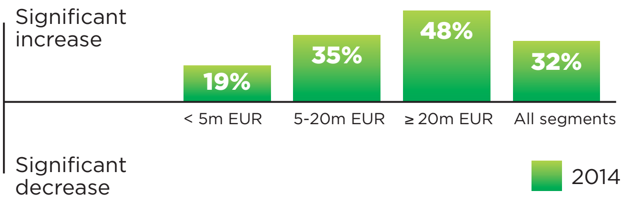
It's becoming more and more difficult to secure attractive deals. Investors need to be more rigorous in their deal origination process – and draw on their personal networks and specific knowledge of the industries they are targeting.

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



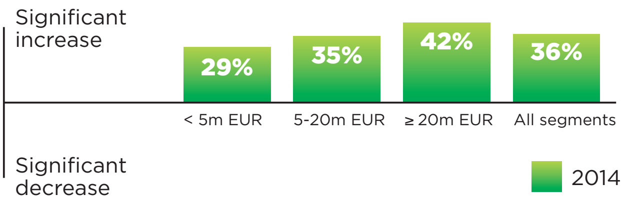
Level of competition - Trend indicators per deal segment[1]

FINANCIALS BUYERS EXPERIENCED MORE COMPETITION FROM CORPORATE BUYERS



Level of competition posed by corporate buyers – Trend indicators per deal segment[1]

MORE COMPETITION FROM FAMILY OFFICES



Level of competition posed by family offices – Trend indicators per deal segment[1]

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

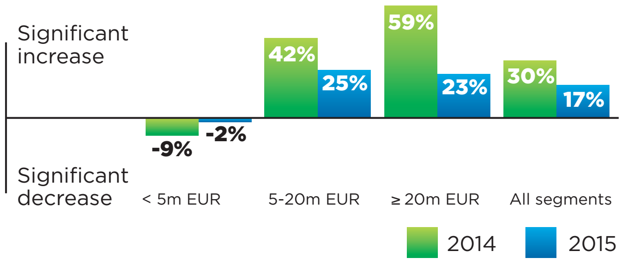
PRICES ARE ON THE UP FOR LARGER DEALS

More competition and favourable lending conditions have meant higher prices for medium sized and larger deals – making it harder to achieve attractive returns. The people active in the smaller deal segment indicated that EBITDA multiples were stable.

The average EBITDA multiple paid increased from 5.0 in 2013 to 5.6 in 2014, with the biggest increase in the larger deal segment.

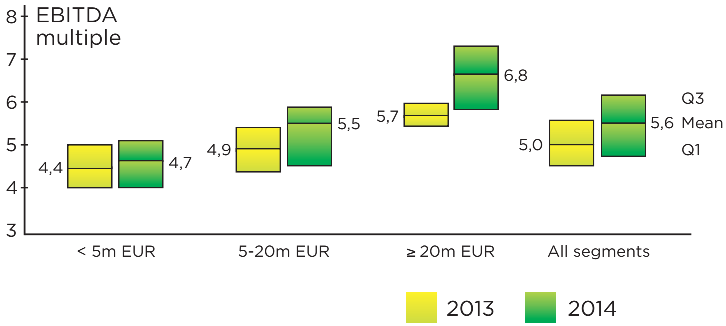
Medium sized and larger deals are expected to demand higher prices in the future. As prices increase – or become more inflated – it might become more difficult to finance buyouts. Similarly, qualitative evidence suggests that bankers become more cautious in offering debt to finance deals that appear to be overpriced.

SIGNIFICANTLY HIGHER EBITDA MULTIPLES EXPECTED FOR MEDIUM SIZED AND LARGER DEALS



EBITDA multiples – Trend indicators per deal segment[1]

THE AVERAGE EBITDA MULTIPLE PAID WAS ESTIMATED TO BE 5.6



Estimated EBITDA multiples – Mean, Q1 (25th percentile) and Q3 (75th percentile) values per deal segment[1]

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

IT GENERALLY TAKES SLIGHTLY LONGER TO CLOSE A DEAL

Whereas 45% of the respondents indicated that the time to close a transaction has remained the same, 42% reported that it has increased slightly.

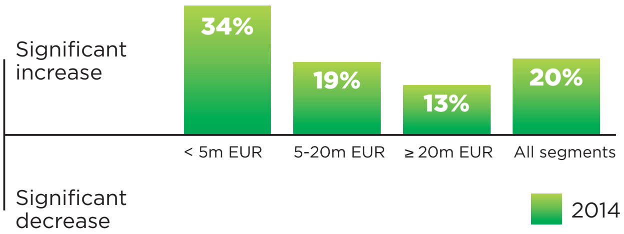
BUYERS ARE MORE CAUTIOUS – and with increased prices further scrutinised their business plans to deliver value.

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

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

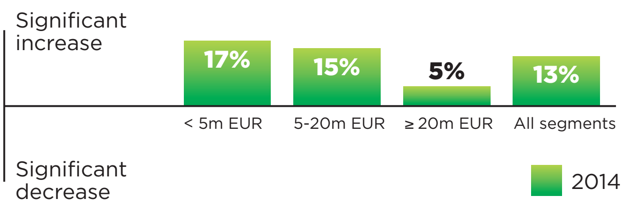
In general, a significant number of buyout experts indicate that the sales process continues to become more professional for smaller sized and medium sized deals.

IT TAKES SLIGHTLY MORE TIME TO CLOSE DEALS, ESPECIALLY FOR SMALLER DEALS



Time to close a deal – Trend indicators per deal segment

THE SALES PROCESS BECOMES MORE PROFESSIONAL FOR SMALLER SIZED AND MEDIUM SIZED DEALS



Level of professionalism in the sales process – Trend indicators per deal segment

ANTENOR, MBI BY GEERT PAUWELS AND BART DECKERS

"To continue the successful growth of Antenor Payment Systems, private equity investor Invale teamed up with Geert Pauwels. Given the size, technical nature and international growth opportunities of the company, an MBI backed by a professional investor was the best setup for the deal. Bart Deckers, MD of Invale, and Geert Pauwels, MD of Antenor, both attended the Entrepreneurial Buyout Academy organized by Vlerick Business School."

WITH MORE COMPETITION, WILL INVESTORS FIND THE RIGHT STRATEGY FOR ATTRACTIVE RETURNS?

FINANCING

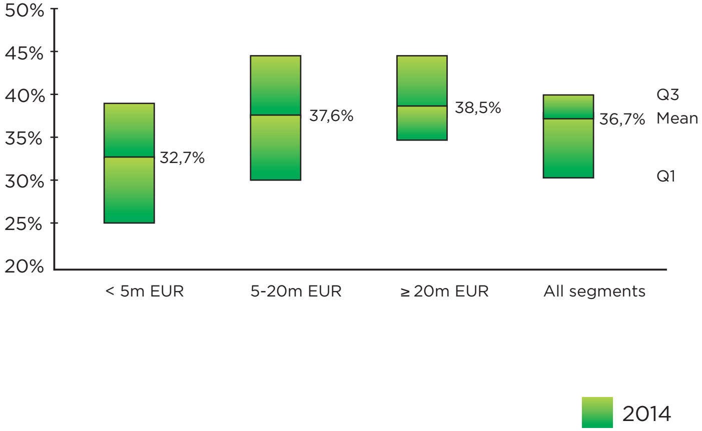
EQUITY INJECTIONS ARE STABILISING

The amount of equity or semi-equity investors need for MBO/MBIs has remained in line with last year's figures – with an average of 36.5% equity. In reality this figure varied very little with the size of the deal. However the perception is that smaller deals need more equity and larger deals need less.

Most respondents expect equity injections to remain similar over the coming year – with slightly higher levels for smaller buyouts.

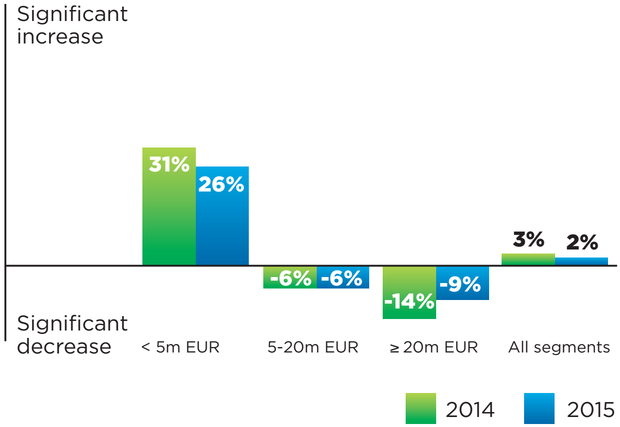
The results indicate that banks continue to be cautious in lending to finance smaller deals. This combined with increased competition for deals and low macro growth means that investors may struggle to get the same attractive returns. It's more important than ever for investors to develop more creative deal structures.

AVERAGE PERCENTAGE OF EQUITY AND SEMI-EQUITY NEEDED TO FINANCE AN MBO/MBI IS 36.5%



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 EQUITY AND SEMI-EQUITY NEEDED TO FINANCE SMALL MBO/MBIS IS EXPECTED TO INCREASE



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

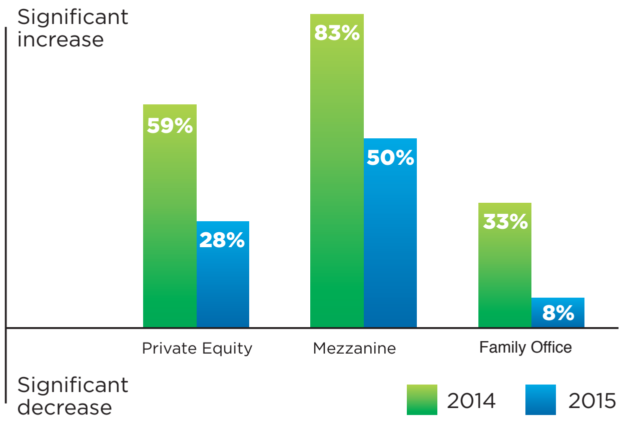
MORE PRIVATE EQUITY TO INVEST

In recent years we have seen a steady increase in private equity funds, family offices and high net worth individuals targeting MBO/MBIs of small and medium sized companies. 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.

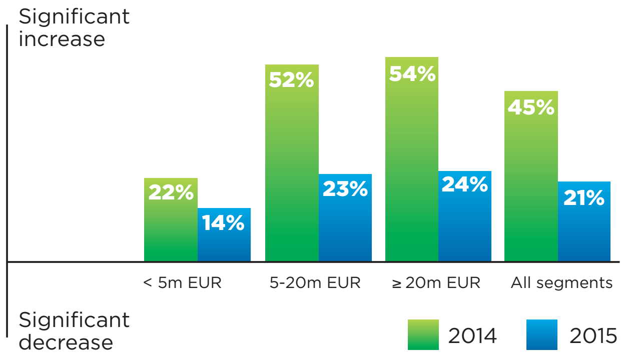
Private equity investors, mezzanine investors and the experts we surveyed all share the same view. There is increasingly more external equity available for financing MBO/MBIs – and this is expected to grow further.

EXTERNAL EQUITY TO FINANCE MBO/MBIS CONTINUES TO INCREASE



Availability of external equity to finance MBO/MBI – Trend indicators per respondent type

EXTERNAL EQUITY TO FINANCE MBO/MBIS IS EXPECTED TO INCREASE IN ALL DEAL SEGMENTS BUT IN PARTICULAR FOR MEDIUM SIZED AND LARGER DEALS



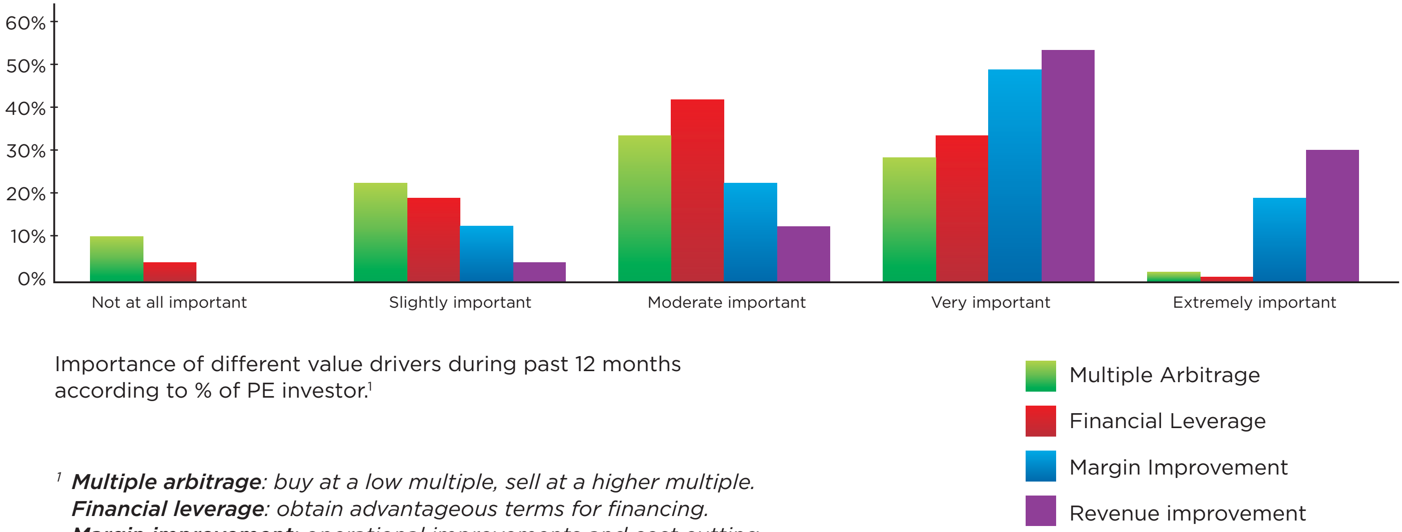
Availability of external equity to finance MBO/MBI – Trend indicators per deal segment

TAKING A STRATEGIC VIEW

So how can investors put their money to work? Multiple arbitrage alone may not be enough to create satisfactory returns. Pricing multiples are increasing – and private equity investors suggest that the key is to combine improvements in both revenue and margins. They know they need to cast their net wider by exploring new markets, offering new products or services – or following buy-and-build strategies.

Now, more than ever, private equity investors need to gain more management expertise and greater insights into the specific industries they wish to invest in.

REVENUE IMPROVEMENT MOST IMPORTANT DRIVER TO GENERATE RETURNS



Importance of different value drivers during past 12 months according to % of PE investor.[1]

[1] ***Multiple arbitrage****: buy at a low multiple, sell at a higher multiple.*
Financial leverage*: obtain advantageous terms for financing.*
Margin improvement*: operational improvements and cost cutting.*
Revenue improvement*: increase sales by new product/services, internationalization, buy-and-build, etc.*

MORE FAVOURABLE LENDING CONDITIONS

Debt funding has become significantly cheaper with rising debt multiples.

The average senior debt/EBITDA multiple has increased from 3.1 in 2013 to 3.3 in 2014 – and is expected to continue to grow in 2015. This follows a European wide trend where debt multiples have increased significantly – and some experts at the international stage have even warned of a new credit bubble in the larger deal segment of the buyout market.

This is unlikely for the small and medium sized deal segment in Belgium as banks are still cautious and selective about the businesses they are willing to lend to.

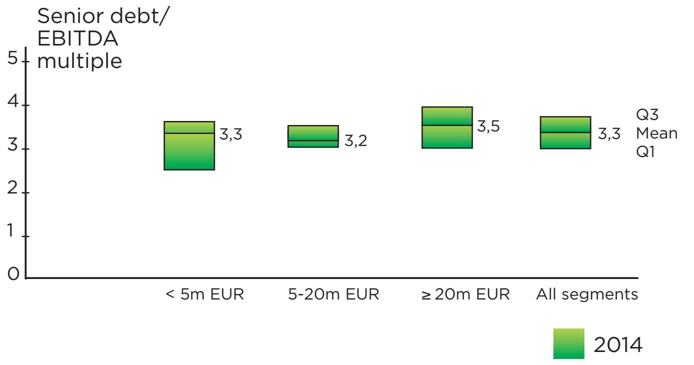
THE LENDING LANDSCAPE IS CHANGING

Contrary to last year's predictions, the EURIBOR has declined considerably – and so too has the cost of lending. But it's expected to remain stable over the next 12 months. The average maturity of loans to finance an MBO/MBI has increased slightly in the larger deal size segment.

Last year's survey indicated that it had become more difficult to get a loan to finance a buyout – and they often needed personal guarantees, pledges and mortgages. This remains true for smaller deals, but it seems that lending conditions became slightly more flexible for the larger deal size segment.

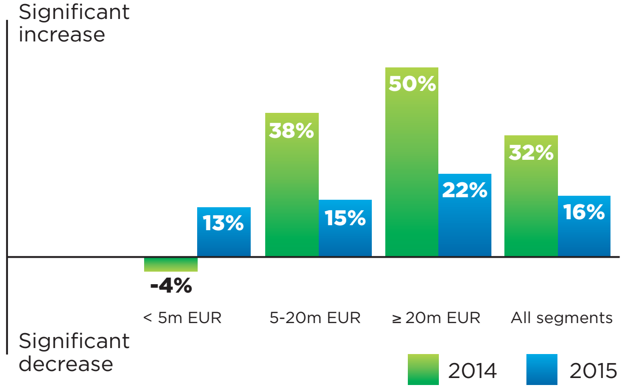
If banks are less willing to fund smaller deals – or offer competitive terms and conditions, buyers might turn to alternative funding such as mezzanine debt or government guarantee schemes.

THE AVERAGE SENIOR DEBT/EBITDA RATIO IS 3.3



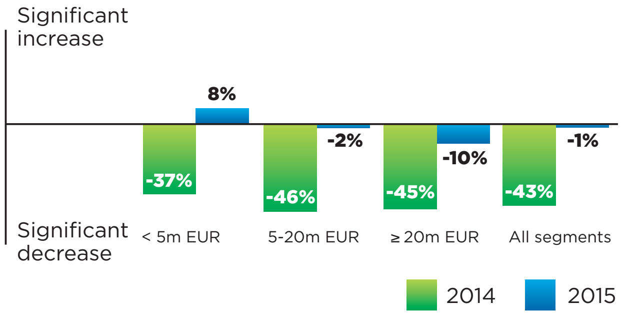
Average senior debt/EBITDA ratios for MBO/MBI transactions – median and Q1 (25th percentile) and Q3 (75th percentile) values per deal segment

TOTAL SENIOR DEBT/EBITDA RATIOS HAVE INCREASED SIGNIFICANTLY



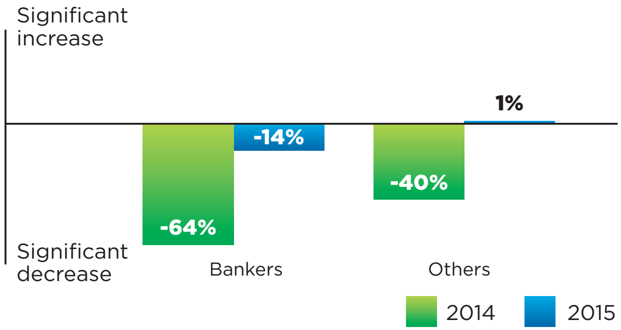
Total senior debt/EBITDA ratios – Trend indicators per deal segment

OVERALL, THE COST OF LENDING HAS DECLINED SIGNIFICANTLY IN 2014



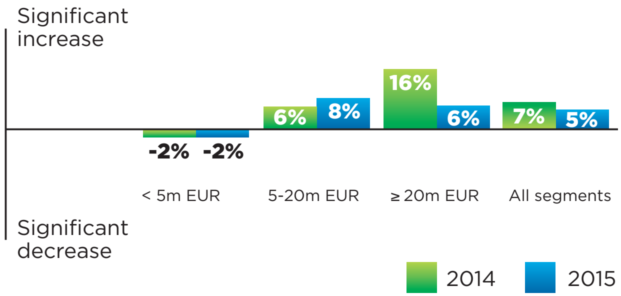
Cost of debt to finance an MBO/MBI – Trend indicators per deal segment

BANKERS SAY THE COST OF DEBT WILL CONTINUE TO DECREASE – OTHERS EXPECT THAT IT WILL REMAIN STABLE



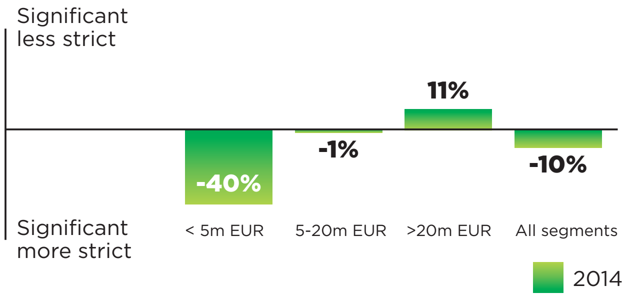
Cost of debt to finance an MBO/MBI – Trend indicators per respondent type

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 segment

PERSONAL GUARANTEES, PLEDGES AND MORTGAGES NEEDED TO GET A LOAN OR LINE OF CREDIT TO FINANCE AN MBO/MBI IN THE SMALLEST DEAL SEGMENT TIGHTENED SIGNIFICANTLY IN 2014



Guarantees, pledges and mortgages needed to get a loan or line of credit – Trend indicators per deal segment*

** +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

Even though debt funding generally has become more accessible, buyers turn to alternative funding mechanisms to bridge the financing gap or to boost returns.

MEZZANINE FUNDING

Investors will often use mezzanine debt to reduce the amount of equity they need to secure a deal. It's being used more and more in MBO/MBIs – particularly for smaller deals. Mezzanine debt sits between senior debt and equity on the balance sheet. And private equity investors and mezzanine players indicate that the median mezzanine debt/EBITDA multiple is currently 1 while the average equals 1.5.

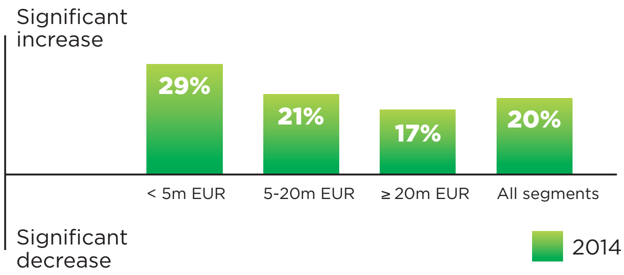
VENDOR LOANS

These are typically unsecured loans that are lower in priority than a company's senior debt and mezzanine debt. They help to close transactions – sellers are increasingly willing to stay involved in a deal with a vendor loan. Last year, they remained commonplace in early negotiations in smaller and medium sized deals.

EARN-OUTS

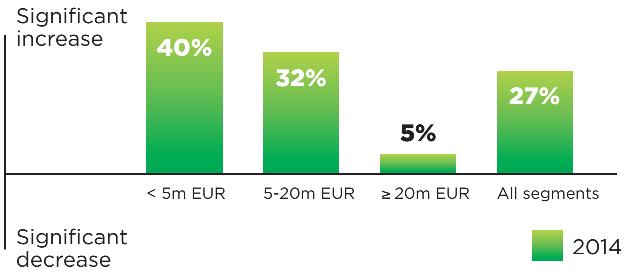
Overall, buyout experts again noted an increased use in earn-outs over the last year. They are an effective mechanism for balancing a seller's price expectations and a buyer's valuation – and they can help to eliminate risks from a deal in today's uncertain economic environment. Their use has increased,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

MEZZANINE FUNDING INCREASINGLY USED TO BRIDGE THE FINANCING GAP



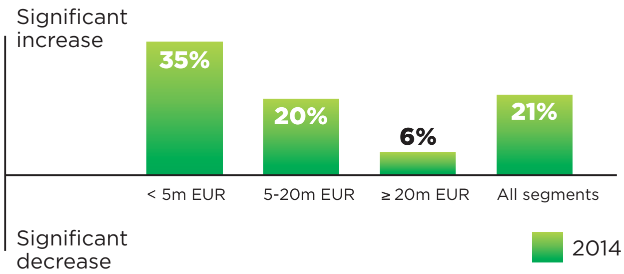
Use of mezzanine funding – Trend indicators per deal segment

VENDOR LOANS CONTINUE TO BE INCREASINGLY POPULAR FOR SMALLER AND MEDIUM SIZED DEALS



Use of vendor loans – Trend indicators per deal segment

EARN-OUTS BECOME INCREASINGLY WIDESPREAD IN SMALLER DEALS



Use of earn-outs – Trend indicators per deal segment

GOODWILL, MBI BY JOHAN VAN MAERCKE

"Johan Van Maercke realized his entrepreneurial ambitions by becoming a shareholder – and acquiring a significant minority stake in Goodwill. He was previously co-managing the company, but can now say he manages 'his own company'. Johan was a former participant at the Entrepreneurial Buyout Academy." (Vlerick Business School)

OPPORTUNITIES AND CHALLENGES

SMES NEED TO PREPARE FOR SUCCESSION

As the baby-boom generation plans to retire in the next few years, entrepreneurs are considering selling their business to reap the benefits of their efforts. As a result, a growing number of SMEs will be looking for a new owner.

The question remains though: will these firms be transferable? Many businesses are centred around the original owner and their personal networks. They may not be professionally structured – and may not be able to continue without their original owner managers.

This gives future sellers the opportunity to stand out in the marketplace. They can put the right structures in place – like reliable financial reporting – and develop relationship that go far beyond the existing owners. But if they choose not to, they risk liquidation.

Financial advisors and the government continue to raise awareness of this issue. But the main challenge investors are facing remains 'finding qualitative deals'. So more needs to be done to make entrepreneurs close to retirement see the need for change.

As well as targeting companies to take over, investors are looking for managers with industry specific experience who can lead a successful transition. This is a huge opportunity for the next generation of owner managers. But before individuals rush into buying a small firm to stay independent, they should take a broader perspective - if they look for partnerships, they might be able to target larger and more promising companies.

SPECIALISATION BECOMES MORE AND MORE NECESSARY

The promise of a new wave of SMEs that will be looking for new owners means the number of investment companies – including family offices, private equity firms and mezzanine investors – focusing on this market has grown. But has the industry become too competitive to offer good returns? Or are new players gradually filling up the industry?

More competition means more challenges. Investors will need to be more proactive – in both securing attractive deals and building industry-specific relationships early on. And to expand their portfolios and achieve returns, it will become more and more important for investors to gain sector specific insights and develop niche strategies.

RISING DEBT MULTIPLES IN AN UNCERTAIN ECONOMIC ENVIRONMENT

Many new investors have entered the buyout market – thanks to a rising number of companies for sale and a low return investment environment. Family offices, private equity firms and corporate investors are all bidding for 'qualitative' deals – and demand is exceeding supply.

Competition is increasing and debt markets are more favourable. So price multiples are rising – and with them, the amount of debt used as leverage. For larger deals commentators are saying the debt multiples are close to a pre-crisis high. The economic environment is uncertain. Banks must remain cautious to avoid encouraging leverage multiples to soar to unhealthy levels. Equity and mezzanine investors are equally keen to keep multiples at a 'healthy' level to make sure their risk is acceptable for the returns they can expect.

All this means that intermediaries need to set realistic expectations about pricing – taking the uncertain economic outlook into account.

UNCERTAIN TAX ENVIRONMENT

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

Since October 1, 2014, the withholding tax rate applied to liquidation bonuses has been increased from 10% to 25%. This tax rate increase might pose problems for a buyer trying to persuade a seller to accept an asset deal instead of a share deal.

In the meantime, investors face three major obstacles when closing a buyout deal – a lack of tax consolidation, being subject to uncertain tax treatment, and last but not least the future of our favourable and tax neutral systems is uncertain – especially around surplus values on shares and a wealth tax.

FINAL THOUGHTS

Overall, we believe the SME buyout market continues to have strong potential. However, investors need to take a specific perspective on how they will create value in a specific transaction. The insights in our second Entrepreneurial Buyout Monitor should help to create a mutual understanding to tackle the risks and challenges of an ever-changing environment.

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