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# Private equity and infrastructure funds in public services and utilities

By

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## 1. Introduction

The main form of ownership of large companies operating in all parts of the economy has been ownership by shareholders, who can buy and sell shares freely through the stock market. The companies are typically groups specialising in one or more sectors, such as water, electricity and gas. Because they are quoted on the stock market they have to publish a lot of information about the company, for the benefit of investors, but this information is also helpful to others, including employees and trade unions.

More recently, financial investors have begun to take major shareholdings in some companies. Some of these are 'private equity' firms (PE), which specialise in buying all shares so they become 'privately' owned. The PE companies normally expect to make their money by improving the value of companies to investors, and then selling the company at a profit a few years later, and meanwhile load the companies with heavier debt burdens. As the funds buy a company, they normally remove it from the stock exchange, and so there is no obligation to publish detailed data, eg quarterly earnings figures, and can operate without public scrutiny.

The activity of PE investors has become very controversial. In Germany, they were described as "locusts" during the 2006 election campaigns. This is because PE funds have often introduced sharp cuts in employment, or sold off parts of a company, in order to make the company more valuable when they sell it on. The companies are thus seen as a threat to jobs, stability, and to local control of utilities and other businesses. Financial commentators have also expressed concerns that the funds activities may not be sustainable, so there are greater dangers of bankruptcies.

The PE funds are active in all sectors of the economy, including manufacturing, services, and retail, and also including private companies operating in public services, such as water, electricity, waste management and healthcare. Thus an increasing number of workers in these services are now employed by companies owned by PE funds.

One category of funds, the so-called infrastructure funds, is of particular relevance to public service operations. These aim to invest specifically in network industries such as electricity, gas, water, telecoms, roads, airports, post, and health and social care, to give a steady return over a long period of time. There is also a global trend to reduce the use of equity finance in utilities and replace it with debt. These two developments may have different implications from the activities of the private equity funds.

This paper discusses the implications of the growth of PE in public services and utility companies in Europe.

It consists of three main sections:

- the nature and size of the PE firms
- the investments of the major PE firms in public service sectors
- some of the issues raised by these developments

# 2. Private equity funds

## 2.1. Private equity

Private equity (PE) consists of the shares of companies which are privately owned, i.e. not publicly quoted on the stock exchange and so not subject to the disclosure rules of the stock exchange.

PE funds are created as partnerships by financial services firms, by inviting investors like pension funds or rich people to commit a certain amount. The funds are then used to invest either in companies which are not quoted on the stock exchange – 'private' companies - or in companies which are listed, following which they are usually turned into private companies and so 'de-listed'. Each firm may have a number of different funds.

The firms make money by charging commission fees on the money invested, and by getting a return on their own investment in the deal. The other investors get their return through cash payments made by the fund out of the profits from the investments, and from their share of the sale price of the company, or parts of the company, when they are sold on.

## 2.2. PE firms

The largest private equity firms are listed in the tables below. The sector is dominated by a number of large firms, mainly based in the USA, but operating internationally.

Compared with top US buyout groups, European private equity firms tend to be small and confined to national markets, but a number of UK firms, such as Terra Firma, are very active elsewhere in Europe. In 2004, only 14% of all private equity and venture capital investments in Europe were outside the country of origin.[1] Macquarie Bank of Australia is also a significant international PE firm, especially in utilities and infrastructure.

The main groups may act alone in buying companies, or in partnership with each other. For example, in 2006 the Dutch publishing company VNU was bought by a consortium of AlpInvest Partners N.V., The Blackstone Group L.P., The Carlyle Group, Hellman & Friedman LLC, Kohlberg Kravis Roberts & Co. L.P. and Thomas H.Lee Partners, L.P. One reason for this is that funds need to combine in order to amass the money to bid for such large companies. In 2006 authorities in the USA started investigations of joint buyouts by a number of PE firms because of concerns over collusion and insider trading. [2]

**Table 1. Largest private equity funds 2005**

| | | Total funds (USD $ billions |
|---|---|---|
| Goldman Sachs | USA | 35.9 |
| Blackstone Group | USA | 30.9 |
| Carlyle Group | USA | 28.9 |
| Warburg Pincus | USA | 21.8 |
| Kohlberg, Kravitz, Roberts (KKR) | USA | 20.5 |
| Apax Partners | USA | 20.1 |
| Apollo | USA | 19.0 |
| Harbourvest | USA | 17.7 |
| Oaktree | USA | 17.6 |
| CVC | USA | 15.3 |

Source: Thomson Venture Economics, NVCA

**Table 2. Other private equity firms active in Europe**

| PE firm | Country |
|---|---|
| 3i | UK |
| Barclays Bank | UK |
| Bridgepoint Capital | UK |
| Macquarie Bank | Australia |
| Montagu PE | UK |
| Morgan Stanley | USA |
| PAI partners | France |
| Penta | Czech republic/Cyprus |
| Permira | Germany |
| Terra Firma | UK |

## 2.3. Sources of finance: investors in PE funds

PE funds have become popular with investors in recent years because they have achieved good returns compared with traditional investments in publicly quoted shares. Large amounts of money are thus being invested in them: in 2005 the total invested in European PE funds was nearly €60 billion – more than double the amount in 2004.

The biggest single investors in European PE funds are banks and pension funds, followed by insurance companies. These three groups account for two-thirds of all money invested in PE funds in 2005. They also account for almost the whole of the large increase from 2004 to 2005. Investment in PE funds by pension funds and insurance companies is expected to continue growing. In the USA, such institutional investors allocate about 7.5% of their funds to PE, whereas European institutions invest only about 4% in PE (and Japanese institutions only about 2.5%).[3]

Some pension funds are beginning to act like PE investors themselves, as well as participating in funds of PE firms. The Ontario Teachers Pension Plan (Canada) is a large investor in Macquarie's infrastructure fund (see below), and has also bought direct major shareholdings in utility companies like Northumbrian Water (UK), and Scotia Gas, a gas distribution company in Scotland, in which it owns 25%, in partnership with another Canadian pension fund and the UK energy company. Ontario Teachers have also set up their own PE operation, Teachers Private Capital, which partnered the PE fund Providence Equity to buy the German cable TV company Kabel Deutschland – Ontario teachers own 8%, Providence owns 88%.

**Table 3. Sources of new finance for private equity funds (€billions Euros)**

| Type of investor | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|
| | | | | | |
| **Corporate investors** | 2209 | 1896 | 1205 | 1646 | 3959 |
| **Private individuals** | 2506 | 1571 | 804 | 1778 | 2588 |
| **Government agencies** | 2282 | 2894 | 1727 | 1442 | 1410 |
| **Banks** | 9189 | 6845 | 5436 | 5091 | 17908 |
| **Pension funds** | 10231 | 4253 | 4922 | 4534 | 14926 |
| **Insurance companies** | 4700 | 3588 | 2214 | 2812 | 7165 |
| **Fund of funds** | 4645 | 3413 | 4154 | 3164 | 3430 |
| **Academic institutions** | 823 | 428 | 385 | 346 | 290 |
| **Capital markets** | 198 | 38 | 85 | 506 | 996 |
| **Other n/k** | 1425 | 1110 | 4379 | 2166 | 4409 |
| | | | | | |
| **Sub-total: new funds** | 38210 | 26036 | 25311 | 23486 | 57081 |
| **Realised capital gains** | 1802 | 1497 | 1709 | 3965 | 2462 |
| | | | | | |
| **Total funds raised** | 40012 | 27533 | 27020 | 27451 | 59543 |

Source: 2005 record year for European private Equity Thomsons/EVCA/PCW 16 March 2006 http://www.evca.com/images/attachments/tmpl_8_art_190_att_935.pdf and Annex 1 http://www.evca.com/images/attachments/tmpl_8_art_190_att_936.pdf

### 2.4. Size of funds

PE funds are becoming so large that they are capable of buying even the largest companies in the world. According to one estimate in May 2006, there were only 200 companies globally that were too big to become the target of a private equity syndicate, and this number is rapidly shrinking as fund sizes continue to rise. [4] In 2005, eight funds were opened which aimed to raise more than $5bn, compared with just one $5bn-plus fund for the whole of 2004.[5] Performance so far suggests that the very large funds do not produce better profits, however.

**Table 4. Size of funds and rate of return**

| Size of funds | Return on funds (IRR) |
|---|---|
| <250m. | 11.5 |
| 250-500m | 17.1 |
| 500m-1000m | 21.8 |
| >1000m | 3.8 |

Source: TVE/EVCA European Benchmark performance Statistics 2006 Fig. 6
www.evca.com/images/attachments/tmpl_9_art_109_att_774.pdf

### 2.5. Types of funds: venture capital, buyouts, infrastructure funds, hedge funds

PE firms use different types of funds for their investments. There are four main categories: venture capital, buyouts, infrastructure funds, and hedge funds. Most PE firms have funds in a number of different categories, and so the same firm may operate venture capital, buyout, and infrastructure funds. The different types of funds may also draw money from the same sources – pension funds, rich individuals etc.

- **Venture capital**

These funds invest in new companies, and the investment is regarded as 'venture capital' because it takes a risk on less established companies. Profits are made from the dividends of the companies but, more importantly, from selling the company to new owners at a profit after a few years. Venture capital funds are not interested in established companies, but may provide the financial support for new companies to compete for business in public services, such as healthcare.

- **Buyouts**

PE funds are now mostly invested in buyouts of existing companies. These existing companies may already be private, or they may be public, in which case the buyout normally leads to the newly acquired company being taken off the stock market, and so made private. As with venture capital funds, profits are made from the dividends but also from selling the company to new owners at a profit after a few years, either through an 'initial public offering' (IPO) or a sale – the 'exit'. Established companies are likely to be targets for buyouts, and so buyouts are the most important category in terms of the impact on existing public service operators.

- **Infrastructure funds**

More recently, a number of funds have been set up specifically to buy stakes in companies operating in infrastructure – including utilities such as water, electricity, and gas, but also toll roads, ports, airports. These funds expect long-term steady returns, and so are less likely to seek a short-term 'exit' by selling the company. Utilities and other companies operating regulated public services may be targeted by infrastructure funds or by the "buyout" funds of the various firms.

- **Hedge funds**

Hedge funds are investment vehicles set up to make any kind of investment in search for short-term profits better than could be achieved by just investing in the stock market investments. The risks and complexities of their strategies mean that hedge funds are more volatile than other investors, but less likely to buy companies in long-term regulated sectors like utilities.

**Table 5. Venture and buyouts as % of target for new PE funds**

| Expected destination of funds raised during | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|
| Venture capital | 37.6 | 31.0 | 22.4 | 31.9 | 21.2 |

| Buyouts | 58.3 | 66.3 | 76.5 | 64.8 | 76.6 |
|---|---|---|---|---|---|
| Other | 4.1 | 2.7 | 1.1 | 3.3 | 2.1 |
| | 100 | 100 | 100 | 100 | 100 |

Source: 2005 record year for European private Equity Thomsons/EVCA/PCW 16 March 2006 http://www.evca.com/images/attachments/tmpl_8_art_190_att_935.pdf and Annex 1

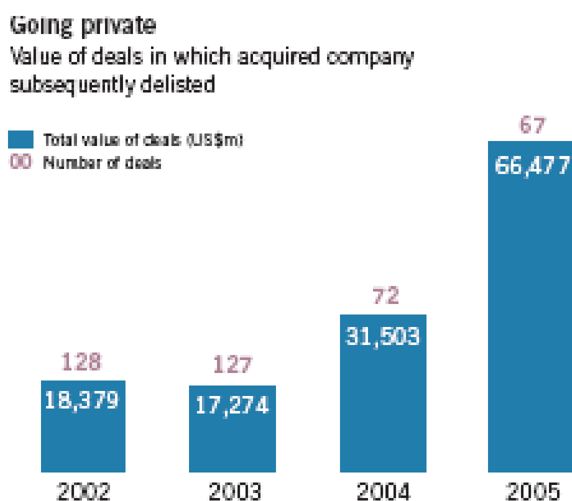
## 2.6. Buyout targets: listed companies, privatisations, PPPs, family businesses, spin-offs, secondary buyouts

Buyouts are now the major activity of PE firms. There are six different types of companies which may be targeted by PE funded buyouts.

- **Listed companies**

The first category is companies which are currently listed on stock exchanges. For example, the Danish services multinational, ISS, was taken over by PE funds in 2005. This type of PE investment converts companies from public, listed companies into private ones, which involves a loss of information as the firms are no longer subject to the disclosure rules of the stock exchange. The chart shows how the impact of this category of investment has grown rapidly in recent years.

**Chart A. Public listed companies made private as a result of PE buyouts**




- **Privatised companies**

The second category is companies being sold by governments or municipalities as part of a privatization programme. PE funds became involved in privatizations because the sale of a state- or municipally-owned company is a special case of a buyout of an existing company. Even if a privatised company is initially sold to investors on the stock market through an IPO (initial public offering), or to an established company already operating in the same sector, it may later be sold on to a PE fund.

PE funds are increasingly important buyers of privatised companies in Europe. In the first half of 2006, "private equity investors purchased €7 billion of the €22 billion worth of assets sold by European governments".[6] These deals included the sale of 4.5% of Deutsche Telekom to Blackstone; the purchase of Dresden's housing company Woba Dresden, by a USA fund, Fortress; and the purchase of Rotterdam's waste company AVR by the PE funds CVC and KKR.

PE funds were also involved in large privatisations in 2005, including Macquarie Bank's partnership with Eiffage to buy one of the French motorway groups; Italian telecoms company Wind was bought from Enel by the Weather consortium, which did not include PE funds but was backed by major banks - ABN Amro,

Deutsche Bank and Sanpaolo IMI - which have to borrow large sums to finance the purchase, in line with the PE buyout model. [7]

A recent FT article identified the potential for further privatization as a key issue for PE buyout investment opportunities:

> "Another important source of demand for private equity will be the privatisation of state-owned assets. …With state-owned assets of approximately €700bn privatised in Europe over the last 30 years, the key question is: how much is left? EU governments still hold direct and indirect stakes worth almost €300bn, mostly in France, Germany and Italy. However, the actual privatisation potential is substantially larger if one takes into account wholly- owned state enterprises as well as public infrastructure. …. More than half appear to be unsuited to private equity because their performance or public ownership structure makes them difficult to acquire. However, research by McKinsey, the management consultancy, suggests that the remainder is still big enough to provide the private equity industry with plenty of growth." [8]

- **Public private partnerships (PPPs), including PFI**

Public private partnerships (PPPs) are a specific form of privatisation which usually creates a company with the right to a long-term stream of revenue from the state, or a monopoly license. PE funds have invested in these companies, usually as the financial partner in a joint venture with a construction company and/or an operating company, especially in the UK's private finance initiative (PFI)

- **Family business**

The third category is family-owned businesses. On average, about 1 in 5 buyouts target these companies; in Europe, there have been over 2,250 such deals since the 1990s, and in some years they have accounted for 1 in 3 buyouts. [9] This category is of particular relevance in the waste management sector, where a number of leading operators are family-owned, for example Rethmann in Germany and Van Gansewinkel in the Netherlands.

- **Non-core spin-offs**

The fourth category is where larger groups are selling 'non-core' parts of their operations. One recent example of this is the sale of the car-owners' service company Automobile Association, by Centrica, the UK energy group.

- **Sales by other PE funds ("secondary buyouts")**

The final category is of companies owned by other PE funds. Funds expect to realise their profits by selling the companies they have bought to new owners, but if there are too many such companies being sold, or not enough demand, then the funds may sell to each other. For example, in 2006, PE fund Terra Firma sold Sutton and East Surrey Water to Aqueduct, a fund run by Deutsche Bank.

## 2.7. Partial shareholdings

Investment by PE funds in existing companies has normally taken the form of 100% buyouts, so the fund becomes the sole owner of the target company. However, the funds have also begun to buy stakes of less than 100% in companies, so they become joint owners alongside others, with the target companies themselves remaining listed.

Some of these investments are minority stakes in public service companies whose major shareholder is still the government. Blackstone own 4.5% of the shares of Deutsche Telekom, which remains a listed company, whose largest shareholder is still the German government with 32%.[10] CVC has bought 22% of the shares of Post Danmark, while the Danish government retains ownership of 75%.[11]

Investments in PPPs may involve the PE firm as one member of a consortium. For example the PE company 3i holds 25% in Octagon Healthcare, a PFI company running a new hospital in Norwich, UK, with the other shares owned by other partners including a construction company and a facilities management company (see below). Another example of this kind of partnership was the consortium of Blackstone, Providence Private Equity and France Telecom which bid for a 51% stake in Cesky Telekom, the Czech republic's phone

company (the bid was not successful).[12] Blackstone states that one-third of its investments involve an industrial partner.

Finally, PE firms may form joint ventures with each other to buy a company. Examples of this include: the partnership between the PE firms CVC and KKR as joint owners of the Netherlands waste management company AVR (see below); and the ownership of the USA company, Healthmarkets, by a consortium of the Blackstone Group, Goldman Sachs Capital Partners and DLJ Merchant Banking Partners.

## 2.8. Exits

The buyout funds usually need an ‘exit' to realise the return on investment. Exits may be of three types: companies may be refloated on the stock exchange through an ‘initial public offering' (IPO); or sold to other PE funds, a process known as a ‘secondary buyout' ; or sold to stock exchange listed companies.

In practice, very few are IPOs (only 105 out of 5,917 exits by European PE funds in 2004 – less than 2%). One example was the IPO in July 2006 of Southern Cross Healthcare by Blackstone as a way of realising its investment. [13]

Secondary buyouts—in which one private equity owner acquires an asset from another—form an increasingly popular exit option. Dealogic reports that from 2003 to 2004, the total value of secondary buyouts in the US rose from US$6.3bn to US$21bn. In the UK, Barclays Private Equity estimates that secondary buyouts now account for 40% of the total value of the buyout market, compared with 5% in 2001.[14] One recent example was when Montagu sold a shipping company to Macquarie Bank. [15]

Exit sales to industrial companies are also occurring. For example, in 2006 PE fund Terra Firma sold its UK waste company, Waste Recycling group, to the Spanish waste management and water group FCC[16]. This kind of exit is a reversal of the trend towards PE buyouts.

## 2.9. Profitability and commissions

PE funds have performed better than the stock market overall, and so it is believed that they are able to generate returns independent of general economic trends. One big investor in PE funds, the Yale University endowment fund, is quoted as believing that PE funds can "generate incremental returns independent of how the broader markets were performing."

A recent empirical study found that, despite their higher levels of return, the profits of the funds are closely linked to general economic trends, including GDP and overall stock market returns. This is not surprising, given that the funds rely on selling their investments to make a return. It found that "Performance significantly increases with the average GDP growth rate and decreases with both the average level of corporate bond yields and average credit spreads" and concluded that: "in reality, the performance of private equity funds is highly pro-cyclical as it positively co-varies with the business cycles and the stock market"[17].

This is reflected in the fact that the profitability of PE funds varies over time, and between types of investment. One reason for the shift from venture to buyouts is simply the greater profitability of buyouts, as shown in the table below for all funds up to and including 2005: buyouts are twice as profitable as venture start-ups.

**Table 6. Average annual rate of return for PE funds**

| | % | % | % |
|---|---|---|---|
| | **1980-1989** | **1990-1995** | **1996-2003** |
| **Venture** | 8.0 | 14.3 | -2.1 |
| **Buyout** | 12.8 | 20.2 | 6.0 |
| **All PE** | 9.8 | 17.6 | 3.6 |

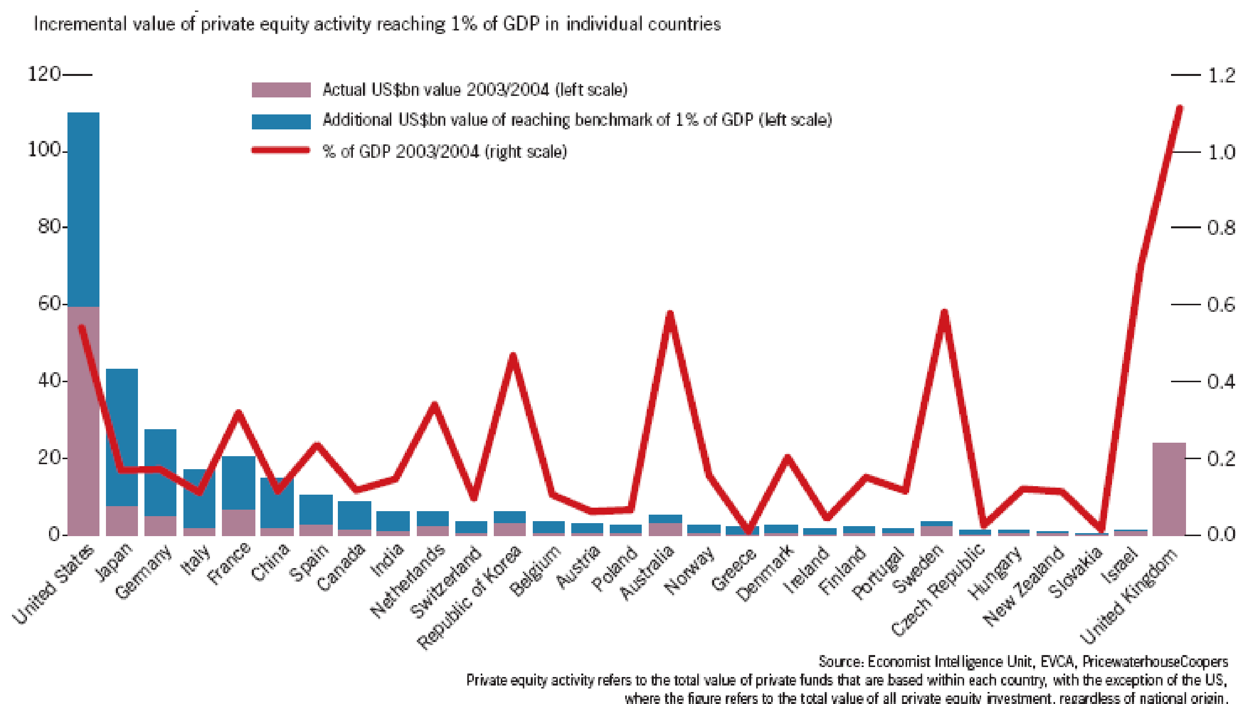
Source: TVE/EVCA European Benchmark performance Statistics 2006 Fig. 7
www.evca.com/images/attachments/tmpl_9_art_109_att_774.pdf

Rate of return = IRR = annualized compound rate of return from monthly cash flows inc final clash flow from exit sale.

## 2.10. PE fund activity in different countries

PE funds have made most of their acquisitions in the USA, then the UK. In the UK, this activity represents more than 1% of GDP: even in the USA this proportion is only 0.6% of GDP, elsewhere the figure is much lower. Apax argue that the variation is due to the favourability of the regulatory frameworks; capital structures in each country – e.g. whether there are major pension funds- the extent of 'entrepreneurial culture'; and also 'restrictive labour laws', which presumably indicates that PE funds are more attracted by investments in countries where it is easier and cheaper to shed labour. [18]

**Chart B. Private equity activity in different countries, 2003/2004**




## 2.11. Developing countries and public sector funds

PE firms are still much less active in developing countries. So far they have failed to make adequate profits, with an average return of only 3% in developing countries (compared with nearly 14% in USA and 11% in Europe). PE firms are only investing in Asia at present, where $10.5 billion was invested in 2005, but profits have already been made: Warburg Pincus made a return of nearly 4 times its original investment of $300m. in the Indian company Bahti; Carlyle made a return of over 3 times its investment of $171m. in Taiwan Broadband, which it sold on to Macquarie for $888m. in 2005. By comparison, PE firms invested only $1 billion in Latin America and nothing at all in Africa, the Middle East, or former Soviet Union: a survey indicated that PE firms would expect returns of 26% before investing in Africa. [19]

Surprisingly, some public sector financial organisations operate as equity investors and promoters of PE funds in transition and developing countries.

The European Bank for Reconstruction and Development (EBRD), wholly owned by the member states of the EU, is one example. Originally created as a development bank to finance former communist states in transition, it has taken significant equity stakes in some companies – such as the private water companies in Tallinn (Estonia) and Sofia (Bulgaria) - and is also a leading promoter of private equity funds in Eastern

Europe and former Soviet Union countries. In 2005 the EBRD itself made returns of 82% on its PE investments, and was "the leading private equity investor in former communist states". [20]

The CDC, formerly the Commonwealth Development Corporation, is wholly owned by the UK government, it operates as a PE investor in developing countries, running a number of funds. Through its subsidiary Globeleq it is one of the few international companies still active in privatisations of electricity companies in Africa, Asia and Latin America. [21]

The International Finance Corporation (IFC) is a division of the World Bank which is dedicated to making equity investments in private companies in developing countries, although the IFC itself always takes minority stakes. It also invests in and encourages private equity funds, and created an association to promote this activity, the the Emerging Markets Private Equity Association (EMPEA).[22]

There are also some much older firms which survive from the colonial era, which share some features with PE firms. One example is the Jardine Matheson Group, founded in 1832, which invested in trading between Britain and China - exporting opium to China in exchange for tea – and financed much of the expansion of Hong Kong. In 2006 Jardine Matheson became 49% owners of the Jakarta water concession of Suez.

## 3. Sectors

PE investors have invested in companies in all sectors of the economy. These include manufacturing and private services as well as infrastructure and public services. The larger PE funds have investments in companies which operate in completely unconnected sectors. This section concentrates on some recent investments in three main public service areas: water, waste management, and healthcare and social care – but it should not be assumed that the PE funds concentrate in these sectors.

### 3.1. Water

**Table 7. Water companies in EU bought by PE funds/financial investors 2003-2006**

| Country | Company | Date | Bought by PE investor | % | Comment |
|---|---|---|---|---|---|
| *Czech republic* | *SMVAK* | *2004* | *Penta* | *98* | *Sold by Anglian. Penta sell on to Aqualia/FCC in 2006.* |
| Estonia, Bulgaria, Poland | IWL/United Utilities Europe | 2003 | EBRD | 25 | Sold by Bechtel and Edison: EBRD buys equity stake and loans money to UU to buy the remaining equity |
| France | SAUR | Dec 2004 | PAI (Paribas) | 100 | Bouygues retained African and Italian operations |
| UK | Sutton and East Surrey Water plc (SES) | Mar 2006 | Aqueduct Capital /Deutsche Bank | 100 | Bought holding company East Surrey Holdings Group (ESH) for £189m from Kellen Acquisitions Ltd – part of Terra Firma. Kellen had bought ESH only in October 2005, and then sold off gas companies. |
| UK | Portsmouth Water Ltd | Feb 2005 | Secondary Market Infrastructure Fund UK | 36 | Bought stake in South Downs Capital Ltd, the ultimate holding company |
| UK | Mid Kent Water (and ? South East Water) | Feb 2005, October 2006 | Hastings Diversified Utilities/ Westpac/HFM | 50 | Bought Swan Group, the holding company of Mid Kent Water. Swan also owns 51% of Halcrow water Services. Bought South east water from Macquarie in October 2006, subject to approval. |
| UK | South Staffordshire | Nov 2004 | AquaInvest Acquisitions/ Arcapita Bank * | 100 | Bought for £142m. |
| UK | Thames Water | October 2006 | Macquarie | 100 | Macquarie sold South East Water, which it had bought in 2003 from SAUR |

*formerly known as First Islamic Investment Bank

Since 2002 many multinational companies have been seeking to sell their water supply operations. Because of a lack of buyers in the industry, many of these water companies have been (or are in the process of being) sold to PE funds.

- The German energy multinational RWE sold Thames Water in October 2006 to Macquarie Infrastructure.[23] In the lead up to the sale, RWE announced that the workforce of Thames would be cut by 15% - 1500 jobs – by 2010. [24]

- The French construction multinational Bouygues sold its water and waste subsidiary SAUR in December 2004 to a PE investor, PAI, a subsidiary of the French merchant bank Paribas. The only other bidders were also PE companies.

- In 2003 the USA construction multinational, Bechtel, sold its stake in privatised water ventures in Europe to the European Bank for Reconstruction and Development (EBRD). While EBRD is a

development bank rather than a PE fund this investment was a similar operation, whereby ownership was transferred to a financial investor.

- In 2004 Anglian Water Group (AWG) sold their shares in the Czech water company SMVAK to a Czech private equity group, Penta. In April 2006 Penta sold SMVAK on to Aqualia, the water division of the Spanish construction and infrastructure services group FCC.

- In November 2006 AWG themselves were the subject of a takeover bid by a PE consortium Osprey, consisting of Canada Pension Investment Board; Colonial First State Global Asset Management, a division of Commonwealth Bank of Australia; Industry Funds Management; and 3i Group [25]

PE funds have also developed an increasingly strong presence in water in the UK, especially with the smaller 'water-only' companies. Again, this reflects decisions by the water multinationals to reduce their ownership of shares in UK water companies. In 2006 Veolia announced it would sell its stake in Southern Water to a financial investor, the Royal Bank of Scotland (an apparent exception to this trend is the bid by Aguas de Barcelona to buy Bristol Water).

## 3.2. Waste management

**Table 8. Waste management companies in EU bought by PE funds, 1999-2005**

| Country | Company | Date | Bought by PE investor | % | Comment |
|---|---|---|---|---|---|
| France | Seche-Environnement | 1999 | Apax | 100 | |
| Germany | Sulo | 2004 | Apax, Blackstone | 100 | 50% bought by each fund |
| Germany, Austria, Sweden, Switzerland, Baltics | Cleanaway Germany | Oct 2005 | Sulo (Blackstone Group, Apax) | 100 | Sulo was bought by Apax and Blackstone in 2004. |
| Netherlands | AVR | Dec 2005 | CVC Capital Partners, KKR, ONG | 100 | Sold by municipality of Rotterdam. |
| Netherlands | Essent | Jan 2005 | ING/De Raekt/Van Gansewinkel | 45 | Sold by municipal utility Essent. |
| UK | Cory Environmental | 2005 | Montagu PE | | |
| UK | Shanks | 2004 | Terra Firma | 100 | |
| *UK* | *WRG (Waste Recycling Group)* | *2003* | *Terra Firma* | *100* | *Sold in 2006 to Spanish waste group FCC* |

Waste management has become a popular sector for PE firms, in a number of countries in Europe. [26]

The Dutch municipal utility Essent formerly held 45% of the shares of Van Gansewinkel, which is active in Netherlands, Belgium, France, Portugal, Czech Republic and Poland. In January 2005 this stake was bought by the Dutch financial group ING and venture capital firm De Raekt, for an undisclosed sum. De Raekt was acting for the private owner, Van Gansewinkel, who now owns 80% of the company directly and indirectly.

In December 2005 a consortium of private finance investors CVC Capital Partners (CVC), Kohlberg Kravis Roberts & Co. (KKR) and Oranje-Nassau Groep B.V. (ONG) agreed to buy all the shares in AVR from the municipality of Rotterdam.

In October 2005 Cleanaway Germany was bought by the Sulo Group. The purchase also covers Cleanaway's activities in Austria, Switzerland, Sweden and the Baltic States. The Sulo Group already owns a waste operation, Altvater. Sulo itself has been owned by the Blackstone Group and Apax Partners since 2004.

In October 2005 Montagu Private Equity led a management buyout of Cory Environmental, from the logistics group Exel. Montagu stated that "Montagu was attracted to Cory because of its contracted revenue streams, well-placed landfill sites and its very experienced and highly regarded management team.

Montagu's early identification of this opportunity, our longstanding relationship with the management team and open dialogue with the vendor throughout the process, were all key to our success in this transaction." [27]

In 2003 Terra Firma bought the Waste Recycling Group (WRG), and subsequently also bought the landfill business of Shanks – both UK waste management companies. It now claims to be the largest supplier of waste to energy in Europe. In May 2006 however Terra Firma sold WRG to the Spanish industrial group FCC (whose water division, Aqualia, has also bought water operations from a PE firm in Czech Republic – see above)[28]

## 3.3. Energy

PE funds investments in the energy sector so far consist mainly of investments in gas or electricity distribution networks. Electricity and gas distribution network companies are utilities where long-term, reliable income can be obtained from a regulated environment, and so may be particularly attractive to infrastructure funds. An energy conference in 2005 noted that "These investment funds… are attracted by the stable, index-linked regulated cash streams, long-term interest rates of 3-4%, cash yields of 9-10% and internal rates of return on capital of 14-16% enjoyed by these network businesses:"[29]

In most cases the buyouts have included PE firms as partners in a consortium in conjunction with other funds or operators, although CVC has completely bought a transmission grid in Spain, as well as the metering subsidiaries from E.on. In 2005, Macquarie European Infrastructure Fund bought a 49% stake in NRE Holding, a Netherlands-based operator of gas and electricity distribution networks, and the UK National Grid Transco sold three gas distribution network companies.[30]

**Table 9. Energy companies in EU bought by PE funds**

| Country | Company | Date | Bought by PE investor | Comment |
|---|---|---|---|---|
| Bulgaria | EDC Varna, EDC Gorna Oriahovitsa | 2005 | EBRD, E.on | "The Bank's stake will support the privatisation of the electricity distribution sector in Bulgaria" |
| Netherlands | NRE Holding | | Macquarie Infrastructure | 49%. Gas and electricity distribution network |
| UK | Kellen Ventures | 2005 | Terra Firma | Also takeover of Centrica gas connection business |
| UK | Wales & West Utilities | 2004 | Macquarie Infrastructure | 31.00% |
| UK, France, Sweden | Energy Power Resources | 2004 | Macquarie Infrastructure | Wind-farms |
| Spain | Inalta | 2002 | CVC | Transmission grid |
| Germany | Ista | 2003, 2005 | CVC | Meter services. CVC bought Viterra from E.on in 2003, then Ruhrgas Industries, also from E.on, in 2005: both are meter companies, merged by CVC into Ista |

## 3.4. Healthcare and social care

PE firms have invested in health and social care activities in the UK, France, Sweden and Denmark. [31] The companies purchased include private hospital operators, care home operators, and companies which provide support services or technical services to public healthcare systems.

Healthcare is an important sector for PE firms in the USA and internationally. In July 2006 a consortium of three funds - Kohlberg Kravis Roberts, Bain Capital and Merrill Lynch – paid $33 billion for HCA, the biggest private hospital company in the USA. [32]

The activity of PE firms in this sector is illustrated by the case of Capio, which was created as a venture capital startup by a Swedish PE firm in the 1990s. It was then floated on the stock exchange and became an independent company. In 2006 it was taken over in a buyout by PE firms Apax and Nordic Capital.

Table 10. Healthcare and social care companies in EU bought by PE funds

| Country | Company | Date | Bought by PE investor | Comment |
|---|---|---|---|---|
| Denmark | ISS | 2005 | Goldman Sachs and others | Capital Partners and EQT |
| France | Medica | 2003 | Bridgepoint | 23% |
| France | Vedici | 2006 | Apax | Six private hospitals, employing 800 people |
| Sweden | Attendo | 2005 | Bridgepoint | |
| Sweden | Capio | 2006 | Apax, Nordic Capital | |
| Sweden | Mölnlycke Health Care | 2005 | Apax | |
| UK | Alliance Medical | 2001 | Bridgepoint | |
| UK | Ashbourne care Homes | 2005 | Southern Cross (Blackstone Group) | Blackstone bought Southern Cross Healthcare in 2004 |
| UK | Clinical Assessment Services (CAS) | 2005 | Bridgepoint | |
| UK | Firstpoint Healthcare | 2000 | Bridgepoint | |
| UK | General Healthcare Group Limited (GHG). | 2006 | Apax and others | Network Healthcare Holdings has 50.1% |
| UK | Match Group | 1999 | Bridgepoint | |
| UK | Medisys (MDY) | 2006 | 3i | |
| UK | Tunstall | 2005 | Bridgepoint | minority<50 |

## 3.5. Other public infrastructure or public services

PE groups have also been investing in a range of other sectors which include public services or infrastructure which has been recently privatised. Another example was the purchase by Carlyle Group of a minority stake in the defence research agency Qinetiq in the UK in 2001. Carlyle realised a substantial profit on this investment when Qinetiq was floated in an IPO in 2006.

Table 11. PE buyouts in other public infrastructure or services (examples)

| Sector | Country | Company | PE firm | | |
|---|---|---|---|---|---|
| Housing | UK | Annington Homes | Terra Firma | 1996 | |
| Housing | Germany | Deutsche Annington | Terra Firma | 2000 | |
| Housing | Germany | Viterra | Terra Firma | 2005 | |
| Outsourcing | _ | HBS | Terra Firma | 2000 | |
| Post | Belgium | Belgian Post | CVC | 2005 | 50% |
| Post | Denmark | Post Danmark | CVC | 2005 | 25% |
| Roads | France | Autoroutes Paris-Rhin-Rhône (APRR) | Macquarie Infrastructure | 2005 | |
| Transport | Sweden | Arlanda Express | Macquarie Infrastructure | | |
| Transport | Belgium | Brussels International Airport | Macquarie Infrastructure | | 80% |

## 3.6. PFI

The private finance initiative (PFI) in the UK has created a number of private entities which have concessions to build and maintain public infrastructure including hospitals and schools. These projects have attracted widespread criticism for their impact in reducing facilities and services and threatening jobs. PE funds have invested in many of these schemes, taking advantage of the fact that PFI projects are long-term public sector infrastructure with implicit guarantees from government.

For example, Barclays Private Equity, together with other financial groups including 3i, has been involved in a number of such PFI schemes in healthcare and social care. However, the impact of their investments has led to strong public criticism. A 2006 report by a parliamentary committee denounced a PFI scheme for a hospital in Norwich, which involved Barclays and 3i:

"BARCLAYS Bank and top venture capital house 3i fleeced the taxpayer of tens of millions of pounds, "lining their own pockets" in the construction of a flagship Private Finance Initiative hospital, a powerful committee of MPs said today. Labelling them the "unacceptable face of capitalism", Edward Leigh chairman of the Commons Public Accounts Committee said the consortium which financed and built the Norfolk and Norwich Hospital - Barclays, 3i, and their partners Innisfree, John Laing and Serco - had bamboozled inexperienced executives at the local National Health Service Trust. With the NHS said to be nearly bust, the MPs' report into the £590 million PFI hospital reveals the extent to which private-sector financiers have milked the massive Government spending on health. The report found that the consortium trading as Octagon Healthcare and headed by Richard Jewson, the multimillionaire heir to the Jewson family timber fortune, geared up the hospital project's borrowing in 2003 from Pounds 200 million to Pounds 306 million in a bid to make refinancing gains of Pounds 116 million. Of that, Pounds 82 million cascaded back to the consortium, helping the partners increase the rate of returns on their investments from under 20% to 60%. "The refinancing of the Norfolk and Norwich project lined the pockets of the investors in Octagon," said Leigh. "This was a poor deal in which the NHS Trust might now have to pay Pounds 257 million if it needs to terminate the contracts early. "This is taxpayers' money and the risk of this large liability was incurred essentially so that investors could have fatter returns. "We believe this to be the unacceptable face of capitalism, with such a face shown by this private sector consortium in its dealing with the public sector." Barclays and 3i, who each hold 25% of Octagon, declined to comment, as did Jewson, its chairman and a pillar of the local establishment as Lord Lieutenant of Norfolk and a Pro-Chancellor of the University of East Anglia. While 3i, a giant of the venture capital industry, has had limited involvement in PFI hospitals, Barclays Private Equity has been highly active in the healthcare bonanza with a string of investments including the new Dartford & Gravesham and Bromley hospitals and elderly care homes in Ealing. Low-profile City finance house Innisfree - which has another 25% of Octagon - has one of the biggest reputations as a specialist PFI investor. It is a partner with John Laing in the consortium that was named as preferred bidder for the Pounds 1 billion Barts Hospital PFI. Laing, whose PFI investment success has helped it win a strong stock market following, holds 20% of Octagon. Serco, the fifth member of the consortium, is one of the Government's favourite outsourcing groups, running dozens of prison, railway, education and defence contracts." [33]

More information on PFI can be found on the Unison website at http://www.unison.org.uk/pfi/, and at http://www.unison.org.uk/positivelypublic/ppbriefing.asp

# 4. Issues

## 4.1. Information

Companies taken over by PE are no longer listed on stock markets and so no longer have the same reporting obligations. It becomes more difficult to find information on the activities, except the relatively low level of data held in national company registration systems.

For example, CVC Capital Partners is a private company, owned by its partners, not quoted on the stock exchange, so no published annual reports are available. It is now formally registered as a company in the UK at Companies House Company No. 04726084, but the reports only started in 2004 and the data e.g. on sales relates only to fee income (£29.5m in 2004/5) and employees (43) of CVC itself, not the total sales of all its companies.

So there is no information published on the collective performance of its companies. CVC publishes very basic data – sales, employees - on its separate subsidiaries. The only other financial information available on these subsidiary companies is what they publish under their own national company registration rules, which they may or may not choose to publish on their websites (eg in the UK Halfords does not, Kwik-fit does). CVC press releases are the only way of telling if they have made a new acquisition or sale.

This is part of the attraction of PE takeovers, which has been reinforced in the USA by the new stricter laws on information disclosure by publicly quoted companies, which were passed following the Enron scandal, and are known as the Sarbanes-Oxley legislation. According to the Economist, the funds are strongly against disclosing more information because it would expose them to short-termism: "they are desperate to avoid having to disclose details about the performance of individual firms in their portfolios. Such disclosure, they say, would quickly subject those companies to the same sort of damaging short-term pressures that they would face in the public equity markets." [34] The CEO of Blackstone similarly argues that: "the same people managing the businesses, when freed of the tyranny of quarterly earnings and - and other types of restrictions that go with being a public company, know exactly what to do to create more value". (Stephen Schwarzman, CEO Blackstone, 1 May 2006)[35] .

Some investors have sought more information, because if the shares of companies in which a PE fund has invested are not publicly traded then between being bought and sold by a PE company, how can pension funds etc know what the value of their investment is? Thus:

> "Private equity firms will nevertheless face increased pressure to put more performance data in the public domain. Large public pension funds in the US have already faced a series of freedom of information suits for greater disclosure of their private equity investments. In 2002, for example, the San Jose Mercury News sued the California Public Employees' Retirement System (CalPERS), in an attempt to force the pension fund to disclose its private equity returns. The same year, a similar suit was filed against the University of Texas's investment fund by a Texas newspaper. In many other US states, similar freedom of information suits have either been filed or are pending. The result has been a rash of laws enacted by state legislatures that define how much public pension schemes and endowments must reveal about their private equity holdings. Given their inconsistency, the overall impact of these rulings on the US private equity industry is still unclear. In one case, a private equity firm expelled a state university from its new fund, rather than see performance data released for wider inspection. On the other hand, an increasing number of large US public pension funds now publish the performance of private equity funds where they are invested." [36]

But this increased information only applies to information about the PE funds themselves – not to the individual companies which they buy. Apax Partners claim that this distinction is important, and so more disclosure is bearable "provided the public spotlight does not extend to individual company balance sheets. Making such detailed information public would undermine the whole point of taking a business private." [37] The EVCA issues guidelines, which it claims are recognised by 30 countries, based on principles for

investors to be able to monitor their investments in the PE funds, but not for disclosure of information about the target companies.[38]

Information on companies owned by PE funds can be required by regulators of public utilities, however. The UK water regulator OFWAT has imposed regulatory conditions to address the information problem. In relation to Sutton and East Surrey water company, following its takeover by a PE fund in 2005, he has required the company to continue to publish the same information that it would have done if they were still listed, as a license condition: "one of the licence modifications we propose requires SES to publish financial information as if it were listed and subject to the rules of the London Stock Exchange. SES has agreed to act as if this modification is already in place."[39]

### 4.2. EWCs

European Works Councils (EWCs) are important in relation to PE Funds, partly because they provide another instrument for forcing information disclosure, and partly because they can provide a way of bringing union reps from the different companies together. Companies bought by PE funds may be eligible for EWCs in two ways.

Firstly, each specific company may still be eligible for an EWC in the same way as it would if it was a listed independent company. So for example the French water company SAUR, which operates in France, Spain and Poland, remains eligible for an EWC in its own right, even after its takeover by PAI. The metering group Ista, formed by CVC Partners after buying Viterra and Ruhrgas Industries from E.on/Ruhrgas, is clearly eligible for an EWC (though none exists at present).

Secondly, the PE Funds themselves are certainly eligible for EWCs. The directive covers "undertakings and groups of undertakings", without any restriction on whether they are private or public, industrial companies or finance companies, headquartered in an EU country or elsewhere. Many PEs certainly own enough companies with sufficient employees in 2 or more EU countries, to qualify: and in most cases they own either 100%, or a controlling stake.

### 4.3. Employment

Takeovers by PE funds are normally expected to lead to job losses. In the short term, the PE fund may expect to increase profit margins by cutting jobs or other elements of labour costs, or relocating production to areas where labour is cheaper. In the long term, the extra debts loaded onto the company as a result of the takeover create further pressures for cost-cutting. For example, in August 2005 a major dispute was provoked in the USA operations of Celanese, when management locked out 148 workers for refusing to accept cuts to their health care plan, loss of 41 jobs to contract labour and a three-year wage freeze. [40] Similar cuts in jobs and healthcare benefits were demanded by other industrial groups in the USA at the same time, including for example General Motors, so this may reflect general company strategies in the USA rather than one particular category of owner.

However, because the PE fund has no historic commitment to the company, it is less constrained by social and political pressures to maintain the workforce, than the historic local owners. This was illustrated in April 2005 when Macquarie reportedly pulled out of buying Hochtief because RWE declined to sell its 9.5% stake after the Australian bank refused to provide job guarantees for Hochtief's 8,500 German employees. [41] This suggests that the possibility of major job reductions is important to such financial investors; and also that making employment protection a public issue can be an effective deterrence, during the period when a company is up for sale.

Some of the problems may result from the privatization process itself rather than the type of buyer. When Budapest airport was put up for sale in 2005, the Hungarian unions opposed it because of concerns over job losses: they initially won a court case declaring the privatization illegal because of failure to consult, but this decision was subsequently reversed. [42] The bidders for Budapest airport included companies operating in the sector (BAA (UK), Fraport (France), in partnership with Deutsche Bank; a construction company, Hochtief; Copenhagen Airport (Denmark); and a PE fund operated by Macquarie Bank. By the time of the final bids,

Macquarie had bought Copenhagen Airport and both pulled out of the bidding. The tender was won by BAA – which bid twice as much as either Fraport or Hochtief. The problem now faced by Budapest airport is that this price may be too high to be profitable, and so there is a higher probability of major job cuts. This employment impact was a result of the privatization process: the withdrawal of the financial bidder, Macquarie, did not reduce this impact.[43]

Any form of takeover is expected to threaten cost-cutting, and it may be that with PE funds there is less risk of cost-cutting from 'synergies', because the typical PE fund owns an incoherent set of companies, between whom there are no synergies. If and when PE funds begin to specialise in sectors, however, job losses from such synergies may appear: for example with CVC's acquisition of both Viterra and Ruhrgas Industries, and their subsequent merger under Ista; or with Terra Firma's purchase of the waste companies Shanks and Waste Recycling Group.

There is also the possibility of action by regulators to control possible employment strategies of new owners. In the UK water sector, the acquisition of Sutton and East Surrey Water company by a PE fund in 2005 prompted OFWAT to show concern over possible outsourcing. OFWAT, like other regulators, had not paid attention to this issue in the past, but following the takeover it warned: "There are currently no plans by Deutsche Bank AG to separate the ownership of SES's assets from their operation through substantial outsourcing of the company's functions. Should it choose to do so in the future, we might require further licence modifications, including modifications to ensure that the regulated business retained control of its outsourced functions, to enable it to meet its responsibilities as a water undertaker." [44]

### 4.3.1. ECVA study: faster employment growth in buyout companies?

The European Private Equity and Venture capital Association (EVCA) has tried to respond to these concerns with "a pan-European study on the overall employment contribution of private equity and venture capital industry to European job creation. It examines both the current levels of employment by private equity and venture capital financed companies as well as the new jobs created by the industry in recent years." The study is based on a survey of 99 buyout companies and 102 venture capital financed companies. (Employment Contribution of Private Equity and Venture Capital in Europe. EVCA. December 2005. http://www.evca.com/images/attachments/tmpl_9_art_129_att_953.pdf ). The conclusions and claims made by the report and the EVCA appear very favourable to PE funds in respect of both buyouts and venture capital, until the sectoral patterns are examined.

In total, it finds that 6m people are employed in PE-financed companies (of which 5m. in buyouts), 3% of total employment in Europe. PE-financed companies also represent 25% of the employment in the top 600 European private companies. The ECVA study claims that 1m. new jobs were created by European PE-financed companies between 2000 and 2004: 420,000 (net of post-purchase reductions) were in buyouts, and 630,000 in venture-backed companies. PE-financed buyout companies experienced employment growth of 2.4% per annum, compared with only 0.7% across Europe as a whole in the same period, and an average annual decline of 0.2% in employment in the largest 6000 private companies. [45]

Two-thirds of buyout companies increased their employment, while one-third saw reduced employment. Family-owned companies increased employment most, by 7.1% per year, (which the survey suggests is because family firms do not capitalize on all their growth opportunities), but the category they describe as "turnaround" buyouts shows an annual average reduction in employment of 3.8%. They also found that in management buyouts, employment grew by 3.1% per year, but where new management was brought in (which happened in only a small number of cases), employment fell by an average of 2.3% per year. Venture start-up companies showed the fastest employment growth, not surprisingly.[46] The study references other research reports on Spain, France and the UK. Separate results for buyouts, excluding venture capital, are only given for the two UK studies, which concluded that the average annual employment growth rate in PE-funded buyouts in the UK was 7% or 11%. [47]

**Table 12. EVCA claims of growth in employment in PE-funded buyout companies**

| | Annual % increase in employment, 1997-2004 | Total % increase in employment 2000-2004 |
|---|---|---|
| PE-funded buyout companies | 2.4 | 10.1 |
| EU 25 total employment | 0.7 | 0.9 |
| Top 600 EU private companies | -0.1 | -0.2 |

Source: Employment Contribution of Private Equity and Venture Capital in Europe. EVCA. December 2005. Fig. 5

One weakness in the study lies in the comparisons between buyout companies and other companies in the same sector. This sectoral comparison is important because buyouts are likely to concentrate on growth sectors, and so are likely to show a faster growth profile than the economy as a whole. In section 3.4 the study does note that the buyouts comparative performance is not better across all sectors: the report does not present a table, but the text allows the derivation of the table below. This suggests that in at least some sectors, companies subject to buyouts do worse in employment terms than the largest listed companies in the sector. indeed, transportation and computing may be the only two out of ten sectors in which buyouts appear to do better.

**Table 13. PE Buyouts: employment results compared with largest companies in sector**

| Sector | PE Buyout companies | Largest EU companies in sector * | Difference (+= buyouts better) | Buyouts BETTER or WORSE than sector average |
|---|---|---|---|---|
| | Employment growth % | Employment growth % | | |
| Transportation | 17.3 | 0.6 | +16.7 | BETTER |
| Computer-related | 10.3 | 1.4 | +8.9 | BETTER |
| Healthcare | 6.7 | ? | ? | ? |
| Construction | 5.0 | ? | ? | ? |
| Consumer-related | 4.0 | ? | ? | ? |
| Manufacturing | 2.7 | ? | ? | ? |
| Other services | -2.3 | 0.6 | -2.9 | WORSE |
| Chemicals and materials | -3.0 | -2.8 | -0.2 | WORSE |
| Financial services | -3.8 | 0.4 | -4.2 | WORSE |
| Communications | -6.3 | 1.3 | -7.6 | WORSE |

Source: text of EVCA study section 3.4 *DJ STOXX 600 companies ? = no figure given by report.

These comparisons may conceal a further problem. Within each sector, companies which are the subject of buyouts by PE funds are selected according to whether they can deliver sufficient growth to be worth more in 6 years time. This selected set of companies should therefore, **in every sector**, be generating faster growth in output and employment than others, before the PE fund bought them: if they are not, then the PE funds' own performance as selectors of growth companies would be worse than random. Yet the data suggests that in many, indeed most, sectors, the buyouts are actually performing worse than average.

This analysis thus leaves open the distinct possibility that **the contribution of PE fund buyouts to the companies' growth in employment or output may be consistently negative**. The companies, if well selected, may have continued to exhibit faster than average growth if they had not been the subject of buyouts.

## 4.4. Volatility of ownership

PE funds engage in asset-stripping, reductions in employment, increases in charges to users, or extraction of profits from a company, with the intention of increasing its sale value when the PE fund exits. This behaviour has been widely observed and stems directly from the fact that PE funds rely on sales of their companies in order to make profits, which requires them to increase the market value of the company in the relatively short term.

Multinational industrial groups also engage in similar practices. For example, before selling Thames Water in 2006, the RWE group announced reductions in employment of 25% and extracted an exceptionally high final dividend payment. In the last two decades the great majority of these traditional companies have become subject to financial targets with short-term perspectives.

Thomsons claim that "the normal life cycle of private equity funds requires at least 6 years to deliver significant returns". [48] Private equity funds sell on nearly all of their investments less than 10 years after buying them: in most cases, after 3-6 years, in some cases even after a few months. For example, out of 34 investments made by Montagu PE in service sector companies, only 6 remain owned by Montagu. The longest lasting company has been owned by Montagu PE for 9 years, since 1997; but 8 out of 13 companies bought since then have already been sold on.

If 6 years is the length of time for which PE investors are expected to retain companies, this may not in fact be much less than the practice of multinational groups. In the waste sector, the USA groups Waste Management Inc and Browning-Ferris bought many European companies in the late 1980s and early 1990s, but had sold them all again by the end of the 1990s. In water, Veolia, SAUR, Suez - and now RWE - have all sold off UK water companies within 5 or 6 years of purchase. In electricity and gas, the wave of mergers in Europe continues, fuelled by the internal market, but in the process there have been exits and sales by some multinational groups, including USA groups such as Texas Utilities selling their UK and German operations.

### 4.5. Illusion or sustainable growth?

It is not certain that PE funds can continue to perform as well as they have done. The evidence suggests that their profits move in line with the business cycle, and so basically reflect the same factors as company profits in general. The apparent success of PE funds in performing better than the overall level is usually attributed to them identifying companies which were undervalued by their owners. The PE fund could therefore buy them at a bargain price, and selling them on later at a price which reflects their real profitability. It is unlikely that there is an endless supply of such bargains, and so it is doubtful that the apparently superior performance of PE funds can continue on this basis alone.

The increase in the size of funds can be seen in part as an attempt to prolong the supply of bargains by targeting companies that were previously too big for PE funds. But this rise in the number and size of PE funds may, by itself, reduce the profitability of investments in buyouts. A recent study concluded that the profits of PE investments in buyouts are much lower when a lot of money in PE funds are chasing the same targets, because the price of buyouts, especially in Europe : "depend on the competition by a limited number of private equity fund managers for a limited number of attractive investment opportunities……..As capital commitments into buyout funds currently rise towards new peaks, investors may raise concerns about the expected future return to buyout fund investments." [49]

The high level of buyouts may reflect the interests of the firms themselves. Apart from the dividends and capital gains which are enjoyed by all the investors in the fund, the PE firms also make profits for themselves by charging commissions for their work in arranging buyouts. These commissions can be very lucrative, and mean that the partners of the firms benefit immediately from each investment. This creates an incentive to maintain a constant flow of new buyouts. When Macquarie bought Thames Water in 2006, the firm paid itself commissions worth £60 million (€86m.). Since Macquarie only invested £250m of its own money to the buyout, the firm got an immediate return of 24%. According to the FT:

> "The business model, largely pioneered by Macquarie, is to raise third-party funds and then use them to arrange infrastructure investments. The bank takes fees for advising on the deal, for arranging the debt, and for managing the asset all while committing limited amounts of its own capital. Analysts at UBS estimate that Macquarie earned more than GBP60m in fees from the recent GBP8bn buyout of Thames Water a deal where its own equity contribution is just GBP250m. Not surprisingly, banks are eager to imitate this model: "Macquarie has shown us all the way," says one investment banker."[50]

A number of PE funds and commentators suggest that PE funds also create extra profits by improving the performance of the businesses themselves, and so their companies are more profitable because they are better managed. One article suggests that “increasing emphasis lies on improvements in the fundamental performance of the underlying business, and the ability of the investing buy-out company to contribute to such improvements” [51] ; one large PE firm, Apax, suggests that “value creation will derive from active ownership of companies. ….Sectoral expertise, global reach, deep pockets and professional back-office operations will be the hallmarks of the leading private equity players”. [52] Apax further argue that this means that sector specialists will do best: “Healthcare is a good example of a sector whose potential only those buyout firms with deep industry expertise will capitalise on. Anyone can grasp that rising life expectancy in the developed world will bring increasing demand for such services as long-term care homes for the elderly. But it takes considerable time and analysis to master an industry landscape that is both highly regulated and fragmented.” [53] Apax also suggests that restructuring a company in the first three months after a takeover is a crucial, which implies a very interventionist behaviour.[54]

However, it is not very plausible that experts in investment can improve the strategies or operations of, say, a waste management company. It is unclear why or how PE firms like Apax can develop credible expertise in managing companies in a particular sector, that would give them an advantage over an industrial group (or public authority) specializing in that activity. If a PE fund develops special expertise in a sector, and buys several companies in the same sector, it would then become more like a conventional multinational group with one or more industrial divisions.

## 4.6. Excessive debt burden

### 4.6.1. Borrowing to pay out early profits (‘leveraged recapitalisations’)

The funds are expected to pay returns to their investors from the outset, and if a company is not immediately made more profitable, then the initial returns have to be found by borrowing more money to pay the initial investors. This is currently made easier because there is a lot of money looking for investments, and investors are now prepared to lend at much higher levels of leverage than before, even though it places increased debt burdens on operations.

According to the ratings agency Fitch, €25 billion Euros of debt was raised by leveraged buy-outs in the first half of [2005] alone, of which “nearly half of that was used simply to let private equity firms pay dividends to their investors”. [55] Fitch analyst Rachel Hardee was quoted as saying that "Money is coming out of these deals - and coming out very early, often in less than a year".

This is now called ‘leveraged recapitalisations’, described as ‘the cocaine of private equity’ by one US buy-out chief. A FT article in August 2006 defined it as:

> “the practice whereby a private equity group does a leveraged buyout and then quickly pays itself fat dividends from that company, funded not by anything as humdrum as corporate cash flows but the issuance of yet more debt…. "recaps" have been spreading like wildfire. A chilling report from Standard & Poor's, the rating agency, on Monday suggested that 63 such leveraged recaps have occurred in the US and Europe this year [2006], funded by a staggering Dollars 25bn of debt, mostly bank loans…. What a recap essentially does is let a buyout group extract dividends early in the life of their investment. That allows the financiers to pay themselves fat bonuses (ergo flash cars, smart houses in the Hamptons or ski chalets in Verbier). But recaps also keep investors in private equity funds sweet. And this issue has recently become very important. For the initial public offering market has been so lacklustre in recent years that some buyout groups have struggled to produce profits through their "normal" strategy of restructuring companies and selling them on. Recaps have thus become a tempting quick-fix alternative.” [56]

The companies may not be able to sustain these returns, and so employment and the company itself may be at risk by the strain of the extra debt burden. The Standard and Poor’s report “found that default rates among a sample of companies that have undergone leveraged recaps - a refinancing method that allows private

equity groups to suck out large dividend payments by loading their portfolio companies with additional debt - were as high as 6 per cent".[57]

### 4.6.2. Leveraged buyouts

Official agencies in the UK, Australia and elsewhere have now expressed alarm at the possibility of company bankruptcies resulting from an unsupportable level of debt loaded on them by these buyouts.

The UK Financial Services Agency (FSA) in November 2006 produced a report saying that it was seriously concerned about the possibility of a collapse of a PE buyout, because of excessive leverage, the risk of insider trading, and the possibility of a default. A senior FSA official, Henry Sants, warned that: "The default of a large private equity-backed company is increasingly inevitable," (Such defaults would have) negative implications for lenders, purchases of the debt, orderly markets, and . . . elements of the UK economy." [58]

The Reserve Bank of Australia also warned in November 2006 that : "Debt-fuelled private equity buyouts are making companies more vulnerable to swings in the economy ……It says that leveraged buyouts typically leave the company being bought with a debt to equity ratio several times higher than before the takeover, "potentially making it more sensitive to economic fluctuations".[59] Authorities in the USA are investigating the possibility of profiteering from collusion between PE funds since 2003. [60]

A further report by Standard and Poors in November 2006 also warned that the quality of the debt being used to support the buyouts has become very weak, and so there is a much a higher risk of bankruptcies: "at the end of August the loans backing three-quarters of European private-equity deals were rated in the single "B" range of junk debt. This means there is a one in five chance of the companies taken private using the loans as finance falling into default. That is a sharp decline compared with the situation at the end of 2002, when the agency started compiling figures: [at that time] less than one-third of debt was rated in the B range, while 57 per cent was rated in the BB range - just below investment grade. At that level, the risk of default is just one in 20." [61]

This decline in debt quality resulting from the leverage is a direct cost to the company's operations. In 2006 a consortium of private equity firms bought HCA, the largest health company in the USA, for $33 billion. The debt involved was in the purchase was then loaded onto HCA, and ratings agency Standard & Poor's moved its corporate credit rating down three notches to B+ - a 'junk' rating, which means HCA has to pay higher interest rates on all its borrowing. According to an analyst quoted in the Economist: "HCA will pay $1.5 billion more interest a year as a result…This debt load handcuffs their capabilities." [62]

Previous collapses of financial services companies have proved very costly to the public sector. In 1975 the threatened collapse of Slater Walker, a financial investment company specialising in buyouts and asset-stripping, led to the Bank of England giving the company the equivalent of $1 billion Euros of public money.[63]

### 4.6.3. Social and economic impact

Investors acknowledge that the short-termism of the funds is at odds with social considerations: one told the FT that "When we have companies controlled by people with five to seven year timeframes, it creates a certain amount of upheaval in the social fabric,"; another said that "It's hard for us to make a real distinction between hedge funds, private equity and distressed funds."[64]

In France there are similar concerns. The funds are criticised by unions and also by industrialists for a complete lack of respect for national economic interests ("sans le moindre respect du patriotisme économique"), even the president of insurance group Axa, Claude Bébéar, describes their operations as insensitive and demands greater regulation of their activities.[65]

Their activities also impact, through privatisations, on the social functions of operations which are privatised. For example many German cities have sold their social housing to private companies in order to reduce municipal debts.

> "In March 2006 Dresden city council sold its entire stock of 48,000 city-owned apartments to an American private equity firm, the Fortress Investment Group, for $1.2 billion. In a single stroke, Dresden wiped out its burdensome public debt…. Affordable public housing is a pillar of the German welfare state, and the prospect of vast pieces of it falling into the hands of pinstriped financiers from New York or London has unsettled many people here. In Dresden, 45,000 of them signed a petition opposing the sale. "When a new owner is profit-oriented, it brings changes," said Peter Bartels, the chairman of the Dresden renters' association. "We're not sure yet what kinds of changes. But we know there will be changes….. The tenants who opposed the sale said they feared that Fortress would raise rents or even throw people out on the street. They question how a private equity firm, with its need for hefty returns, could own public housing without squeezing the people who live there. "These investors have no social conscience whatsoever," said Thilo Kluge, 45, a tenant in a city-owned apartment who campaigned against the sale. "They have a single interest: Make my bank account fatter."………………. The residents will be protected by an agreement, known as the Social Charter, that Fortress had to sign to stay in the bidding. The contract limits its ability to raise rents -- including those that are below market rate -- and protects tenants from being evicted. People over 60 or with severe disabilities are guaranteed lifelong tenancy………………. Moreover, Fortress must hold on to 34,000 of the apartments for 10 years before it sells them. And when it does, it must offer existing tenants a 15 percent reduction from the market price. Finally, it cannot renovate the apartment complexes into luxury condominiums…………."The rule of thumb is that the firms only put in 25 percent of their own money," Mr. Saunderson of Property Finance Europe said. "The rest is bank financing. You take out your 25 percent in a few years, and you have a rolling program of sales. People grow old and die, or leave the apartments."" [66]

## 4.7. Political lobbying for influence and subsidies

PE funds are politically active in protecting their own operations, and have used public finance to support their own operations.

The European Private Equity and Venture Capital Association (ECVA) was founded in 1983 to promote and protect the "long-term interests" of the sector. It has an annual income of €6.8million. In 1993 it launched a private equity programme for central and eastern Europe, using public sector funding from the EU PHARE programme, and a similar programme in 1997 for Russia and the former Soviet Union.

The ECVA has also been successful in lobbying for influence on EC policies. It describes 2005 as "an extremely busy year for lobbying in terms of meetings with European Commission officials and members of the European Parliament……with the Help of ECVA, the EC has set up an expert group of private equity and venture capital professionals and advisers. This expert group will deliver a "manifesto" for national and European policy-makers". [67] The ECVA also produces reports on the economic and social impact of buyouts (see section on employment).

## 4.8. Infrastructure: longer term investments

There is currently a high level of interest by pension funds and others in investing in infrastructure: "infrastructure offers stable income streams for 20 to 30 years and has an implicit link to inflation. Infrastructure covers a wide range of services, often only recently privatised, such as ports, airports, hospitals, roads, broadcast towers and transmission and other pipelines and services for utilities as well as the water, gas and electricity companies themselves."[68] For pension funds especially, infrastructure is a long-term investment like gilts (Government bonds) which give low but secure returns for 20/30 year periods, especially as there is a general shortage of such government bonds.

Reflecting this demand, infrastructure funds have been created in recent years by a number of PE companies, including Macquarie Bank, Goldman Sachs, and others. These funds are interested in utilities in fields like water and electricity and gas precisely because they are predictable and regulated. According to a recent analysis in the FT, infrastructure funds use a different method of valuing a company which reflects this interest in long-term stable returns. Whereas PE buyouts are concerned about share prices, because they expect to make their return out of capital gains from selling the company on again, the infrastructure

investors expect to own the company for 20 years or more, and to make their return from a reliable flow of annual income. As a result:

> "most infrastructure analysts pride themselves on paying little attention to the price of something in the public markets. Instead, they attempt to model revenues, costs, investment requirements and cash flows for a particular business well into the future, and then work out what those cash flows are worth today. The final figure gives an indication of what an asset might be worth, and how much debt it can support. In both cases, the answer often differs significantly from the view of the stock market."[69]

This also means that infrastructure funds can afford to pay less for companies, because they can accept lower long-term returns. They are also under no pressure to sell rapidly: " … Private equity groups like to sell assets three-to-five years after acquisition, whereas infrastructure funds can hold assets for 10 or 20 years, or in some cases in perpetuity….That means they can put in longer term and cheaper debt".[70]

These funds may be more stable owners than PE funds, or multinationals. If the objective of these funds is to make long-term investments with steady returns in reliably essential services, matching the pension and insurance funds long-term liabilities with long-term assets, then there are fewer pressures for short-term returns. Macquarie Infrastructure Fund, for example, states that it does not plan for exits, and so far do not appear to have sold any of their operations. According to John Roberts, former CEO of United Utilities, now at PE firm Terra Firma: "The natural owners of utilities are long-term pension funds, so we shouldn't be surprised. It's a trend that that is going to run".[71]

These kind of investments thus may not lead to pressure for short-term asset-stripping or cost-cutting, and may even involve a move to more long-term, stable low-return ownership than with multinational groups. Such ownership may in the long-term be much more like utilities under public ownership. In both cases, the great majority of capital comes from debt financing, lower rates of interest can be achieved because of the long-term reliable demand for essential services and the implicit government guarantee, and both investors and the sector have a long-term perspective. It may therefore be useful to distinguish between this type of PE fund and others.

Infrastructure funds are very new developments so it is not certain that their future behaviour will match these expectations. So far most investments by PE firms in water, energy, waste or healthcare companies have been through conventional buyout funds, not through infrastructure funds, and so they expect a return by selling on the company. For example, a consortium of four private-equity firms - the Blackstone Group, Hellmann & Friedman, Kohlberg Kravis Roberts and Texas Pacific Group – bought the electricity generating company Texas Genco for $900million in 2004, and a year later sold it on to the electricity group NRG Energy for $4billion in cash and $1.8billion in shares. [72] Water and similar shares may be bought and traded by financial investors looking for a quick profit , as seems to have happened in the USA, but this may just be short-term trading by hedge funds which fades when share prices settle at a new level. In the USA the main company Aqua America yields 1.8 percent, the average yield for the Standard & Poor's 500-stock index, with other main water companies yielding 3%.[73]

### 4.9. Debt financing and public ownership

In general PE purchases mean that there is more financing through debt (at fixed interest) rather than equity (with variable dividends). This should normally be cheaper in stable utilities and services: the UK water regulator, OFWAT, comments that "debt financing has, other things being equal, been a significantly cheaper source of finance than equity since privatisation".

This may make a switch to public ownership easier and cheaper: from the investors' point of view, the debt would remains at the same rate of interest, but would become government debt, which is more secure.

This reflects a number of arguments and developments in recent years.

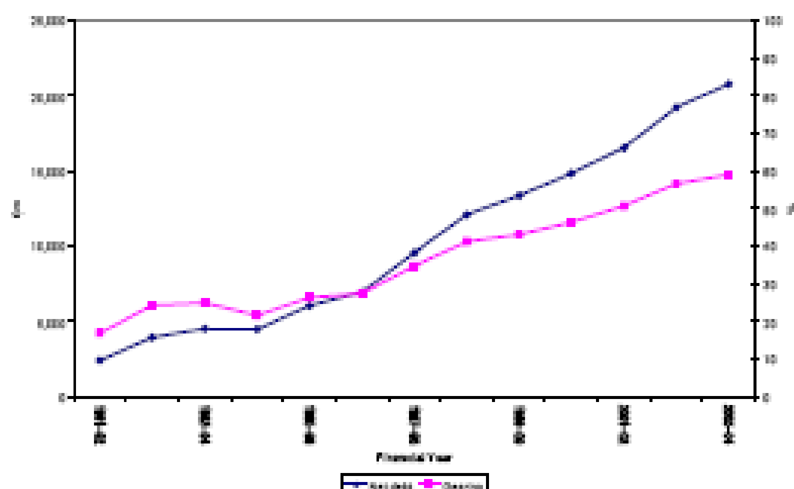
- Some economists argue that the extra return given to equity capital is one reason why public ownership, with debt replacing expensive private equity, may be justified on a range of projects. [74]

- Debt has been replacing equity as a source of finance for utilities and transport in developing countries since the 1990s. [75]

- Dieter Helm, a supporter of privatization, argues that the sectors can now be financed by separating operating costs, which should be subject to regulation and so be covered by price caps and allowed an equity-level rate of return, from sunk capital investment (whose cost should be totally guaranteed, ultimately by the taxpayer, thus allowing cheaper debt financing to be used at rates comparable with government long-term bonds: he also notes that an alternative, and traditional solution is public ownership. [76]

- There has been a distinct shift from equity to debt financing in the UK private water sector. The companies were privatised in 1989 with virtually no debt at all, and so the trend is very clear and remarkable. This trend has included the withdrawal and reduction of equity investments by multinationals; the increased role of financial investors, including private equity funds, as shareholder; and generally an increased use of debt to finance investment, rather than equity.[77] One effect of this shift is to reduce the argument for privatisation, which depends on the profit-maximising incentive as the key driver for efficiency: if equity is replaced by debt, then the profit-maximisation incentive disappears, as the company only has an incentive to earn enough to pay the interest on the debt, and so the efficiency incentives disappear.[78]

**Figure 7.5.2a Industry net debt and gearing since privatisation (2003-04 prices)**



Source: Ofwat

Source: The Development Of The Water Industry In England And Wales. Ofwat And Defra. 2006. p.96
http://www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/AttachmentsByTitle/development_of_water_industry270106.pdf/$FILE/development_of_water_industry270106.pdf

The structures that have emerged have generally contained levels of debt in the range 75 per cent to 85 per cent of regulatory asset value - the extreme case was the creation of Glas Cymru as the new owner of Welsh Water, as a company with no share capital at all, in 2001. This shift to a high gearing affects credit ratings, for example when Suez sold Northumbrian water to a debt-financed buyer: "Following the leveraged take-over of Northumbrian Water in 2003 by Aquavit plc, the credit rating …. fell from A- to BBB+ from Fitch Ratings and from A- to BBB from S&P". However, all the UK water companies retain credit ratings of at least investment grade, and often much higher, and so a very high level of debt appears . "MIS(Moody's) has indicated that debt to regulatory asset value (RAV) levels of 95 per cent may be consistent with investment grade credit quality". The UK regulators conclude firmly that "….There is no evidence that suggests that present levels of gearing for regulated energy and water businesses have lead to sub-optimal levels of investment". [79]

# 5. Annex A: Selected PE funds

## 5.1. Apax

http://www.apax.com/

Apax Partners is one of the world's largest private equity investment groups, operating across Europe, Israel, the United States and Japan. Apax Partners' Funds invest in companies across 6 sectors: information technology; telecommunications; healthcare; media; financial services; retail and consumer.

Apax investments in public services and utilities include:

- In France, Seche-Environnement, acquired in 1999
- In Germany, the Sulo Group, acquired in 2004 (50% Apax, 50% Blackstone) :
- Apax, with Goldman Sachs and Providence, invested in Kabel Deutschland - Europe's largest cable operator - in 2003: in 2005 Apax and GS sold their holdings to Providence.
- Apax has a special healthcare division. It invests in all aspects of the sector, including equipment and pharmaceuticals, but also private hospitals, including the following:
  - Vedici , France, 2006
  - General Healthcare Group Limited , United Kingdom, 2006
  - Mölnlycke Health Care , Sweden, 2005

## 5.2. Barclays PE

http://www.barcap.com/cgi-bin/bpe/index.pl

Barclays private Equity (Barclays PE) is the PE operation of Barclays Bank. It has a buyout division active across Europe in a range of sectors, and also an infrastructure division focussed on PFI and PPPs.

Barclays PE infrastructure activity is almost entirely in the UK so far, except for a single PPP venture in Cork (Republic of Ireland) in a joint venture with Hochtief. All the UK investments are in PPPs, mostly under the PFI initiative.

Barclays Private Equity in partnership with Societe Generale has established the Infrastructure Investors ($I^2$) Fund, to buy out stakes in established PFI schemes. Barclays and Societe Generale have each committed £150m to the $I^2$ Fund and in June 2005 3i committed a further £150m to take the total size of the fund to £450m.

To date, Barclays PE has invested in 17 schools PFI projects in the UK, in conjunction with Jarvis, Vinci, Gleeson and Bouygues. The projects, covering 76 individual schools, include: primary, secondary, special needs and faith schools. BPE is also active in Building Schools for the Future (BSF), a government initiative for the rebuilding or renewing of every secondary school in England over a ten to fifteen year period.

Barclays PE has made a number of investments in NHS PFI projects of varying size and complexity, from individual GP surgeries through to large Acute General Hospitals. Investments were made in five of the first wave of PFI hospitals, including the first hospital to be procured: the Dartford and Gravesham Hospital. All these facilities are now operational following completion of construction between 2001 and 2003.

## 5.3. Blackstone Group

http://www.blackstone.com/

Blackstone, started in 1987, is one of the leading USA private equity groups, and operates worldwide. Blackstone has invested over $110 billion in over 87 companies, in a range of industries, including manufacturing, chemicals, transportation, communications, insurance, lodging, entertainment, energy, and waste management. In many of its investments Blackstone has partnered with corporations including AOL

Time Warner (Six Flags transaction), AT&T (Bresnan transaction), Northrop Grumman, Sony, Union Carbide, Union Pacific (CNW transaction), USX, and Vivendi. These corporate partnerships account for about 51% of the equity capital invested by Blackstone.

Blackstone's current holdings include

- In energy:
  - Sithe Global Power (80%) a privately held international independent power development company which focuses on certain target markets in North America, Europe, Mexico, Africa and the Middle East.
  - Texas Genco
- In waste management:
  - Allied Waste, 1997 (and the takeover of BFI in 1999)
  - 50% of the Sulo Group, with Apax Partners holding the other 50% (see above)
- In water
  - Nalco
- In healthcare
  - Southern Cross/NHP (plus Ashbourne Homes in 2005)

## 5.4. Bridgepoint

http://www.bridgepoint-capital.com

Bridgepoint Capital is a UK based PE firm, started 25 years ago. It specialises in healthcare. Many companies bought by Bridgepoint have since been sold on. Current company holdings include:

**Healthcare**

| Company name | Description | Deal type | Deal size (m) | FTSE sector | Date | Location | Turnover (m) |
|---|---|---|---|---|---|---|---|
| Alliance Medical | Private operator of diagnostic imaging equipment | MBO | €178 | Health | 2001 | UK | €63 |
| Attendo | Elderly care home operator | MBO | €245 | Health | 2005 | Sweden | €275 |
| Clinical Assessment Services (CAS) | Clinical decision support software provider | IBO | €78.5 | Health | 2005 | UK | €36 |
| Match Group | Provider of flexible staffing to the healthcare sector | PTP/MBO | €117 | Health | 1999 | UK | €240 |
| Medica | Leading operator of nursing homes | MBO | €330 | Health | 2003 | France | €207 |
| Tunstall | Leading provider of personal and home reassurance telecare systems | MBO | €336 | Health | 2005 | UK | €103 |

**Support services**

| Company name | Description | Deal type | Deal size (m) | FTSE sector | Date | Location | Turnover (m) |
|---|---|---|---|---|---|---|---|
| Digica | IT infrastructure and services outsourcing business | MBO | €38 | Support Services | 2001 | UK | €16 |
| ERM | Environmental consultancy services | MBO | €446 | Support Services | 2005 | UK | €410 |
| Firstpoint Healthcare | Flexible staffing agency | MBO | €48 | Support Services | 2000 | UK | €38 |
| IPS Resourcing | Flexible staffing solution | MBO | n/d | Support Services | 2001 | UK | €15m |
| Management 2000 | Temporary staffing agency | MBO | €25 | Support Services | 2000 | Germany | €40 |
| Mory | Parcel delivery company | MBO | €123 | Support Services | 1999 | France | €760 |
| NES Group | Provider of contract technical and IT | MBO | €83 | Support | 1999 | UK | €200 |

| Company name | Description | Deal type | Deal size (m) | FTSE sector | Date | Location | Turnover (m) |
|---|---|---|---|---|---|---|---|
| personnel | | | | Services | | | |

## 5.5. CVC

www.cvc.com/

The company was set in 1981 as Citicorp's European private equity arm, and in 1993 it became independent through its own management buy-out. According to the company "Since 1981, CVC has acquired over 220 companies in Europe for a total consideration of more than €61.9 billion [some have since been sold, so…]. CVC's current European portfolio of 38 companies has a combined transaction size of over €32.2 billion."

CVC operates across all sectors, and services and utilities are only a small part of their holdings. They include Formula One racing group, the UK's Automobile Association (bought from energy company Centrica), and various manufacturing companies. They have now sold a number of public service operations which they bought in the past. For example, in 1996 they bought a previously privatized road construction agency in the UK, but sold it on a few years later. In 1998 they bought a Spanish healthcare company, Iberica De Diagnostico Y Cirugia, which has since been sold on (To Capio). They have no holdings in water, although they twice bid for SAUR water operations (in UK 2003, France 2004).

The current investments in the utilities and public services area include:

- Ista (Formerly Viterra Energy Services) – heat, water and electricity meters. 3,700 employees Bought from E.on in 2003 (formerly known as Viterra)
- Ruhrgas Industries – also gas heat, water, and electricity meters: also bought from E.on (in 2005 – "the largest cross-border gas deal last year was the $1.8bn purchase of E.On's Ruhrgas metering business by the UK **private equity** investors **CVC** Capital Partners." [80])
- Inalta - Infraestructuras de Alta Tension (Inalta) owns and manages a high-voltage electricity transmission network in Spain. Bought from Iberdrola in 2002.
- Post Danmark (25%) and Belgian Post (50-50 partnership with Post Danmark, itself 25% owned by CVC) – the Danish and Belgian states retain the rest of the shares. Both holdings acquired in 2005.

## 5.6. KKR

www.**kkr**.com

Since its founding in 1976, Kohlberg Kravis Roberts & Co.(KKR) has completed more than 130 transactions involving in excess of $162 billion of total financing, including:

- Two of the largest buyout transactions ever (RJR Nabisco, 1989, $31.4B; Beatrice, 1986, $8.7B)
- The largest leveraged buyout ever in France (Legrand, 2002, €4.94B)
- The use of private equity in industries such as banking, insurance, utilities, and heathcare

In 2003 KKR bought control of a USA electricity transmission company ITC Holdings, which owns a network of 2,700 miles of electricity transmission lines that interconnect generating stations serving approximately 4.9 million customers.

In 2006 a consortium led by KKR and CVC bought 100% of the share capital in AVR for €1.4 billion from the municipality of Rotterdam. AVR is the largest waste management company in the Netherlands with an annual total turnover of more than €500 million, over 4 million tons of processed waste and approximately 2,100 employees. AVR also holds leading positions in domestic collection, recycling and separation of waste.

## 5.7. Macquarie

http://www.macquarie.com/

Maquarie Bank (Australia) invests in a range of sectors, through a range of funds including non-infrastructure funds, and has been criticised in Australia for being too short-term and demanding in its strategies with companies it has bought. Macquarie is also involved in advice and consultancy for a range of PPPs, off-balance sheet financing, cross-borderleasing, etc.

Macquarie invests in infrastructure worldwide. It has a set of listed and unlisted investment vehicles specialising in infrastructure, “which offer both private and institutional investors the opportunity to access new and existing infrastructure assets”. It says it invests for “sustainable cash yields and moderate capital growth”. The Macquarie Group has around 90 investments in 20 countries.

The Macquarie European Infrastructure Fund was launched in April 2004 to target investments in infrastructure and related assets located in European OECD countries: “The Fund aims to deliver sustainable cash yields and moderate capital growth from investment in a diversified portfolio of quality infrastructure assets. It invests in assets that provide essential services to the community, have a strategic competitive advantage and provide sustainable and predictable cashflows. Established in April 2004, MEIF is targeted at pension funds and other institutional investors seeking long-term stable returns matching their long-dated liability profiles.” By July 2005 it was closed after reaching its target of €1.5bn in commitments from major international investors.

To date the fund has made nine investments:

- 100 per cent of Arlanda Express, the high speed rail service linking Sweden's Arlanda airport to Stockholm city center
- 10 per cent interest in Brussels International Airport (within a Macquarie consortium that owns 70% of the airport)
- 100 per cent of Thames Water - technically 51% through the fund and the rest via various pension fund investments through Macqarie). A 50.1 per cent interest in UK utility South East Water was sold in October 2006 to enable the purchase of Thames to go through.
- 31.0 per cent of Wales & West Utilities, a UK gas distribution network
- 49 per cent of NRE Holding N.V., a gas and electricity distribution network in the Netherlands*
- 100 per cent of Energy Power Resources Limited (UK), which owns and manages the UK's largest portfolio of biomass fuelled renewable energy assets
- 100 per cent of Energy Power Resources (Europe), a portfolio of generation assets across six wind farms in France and Sweden
- 100 per cent of Wightlink Shipping Limited, the leading operator of passenger and ferry services between the UK mainland and the Isle of Wight
- a stake in the French motorway network, Autoroutes Paris-Rhin-Rhône (APRR), in partnership with the Macquarie Infrastructure Group and Eiffage SA.

### 5.8. Montagu Private Equity

http://www.montagu.co.uk/

Montagu is an European private equity investor, since 1968, backing management buyouts and other private equity deals, normally acting as the principal equity provider. It was formerly the private equity arm of HSBC, which sold it to a management buyout in 2003, when it was renamed Montagu PE. HSBC retains 19.9% of the shares. It operates through offices in London, Manchester, Paris, Düsseldorf and Stockholm, and invests in a wide range of businesses, across a number of sectors, including consumer goods and retail, manufacturing, and services. The following table shows the range of these investments: those in service sectors or utilities are highlighted in bold.

| Company | Business | Price | Year | Status |
|---|---|---|---|---|
| **Cory Environmental** | **Waste Management** | **£200m** | **2005** | **In Portfolio** |
| Survitec Group | Safety and survival products | £146m | 2004 | In Portfolio |
| Isle of Man Steam Packet | Ferry operator | £162m | 2003 | Realised |
| LINPAC | Packaging | £860m | 2003 | In Portfolio |
| Risdon Pharma | Pharma packaging | €97m | 2002 | Realised |

| **Dignity Caring Funeral Services** | **Funeral services** | **£235m** | **2002** | **Realised** |
|---|---|---|---|---|
| **M & M Medical** | **Private hospitals** | **£34m** | **1999** | **Realised** |
| Ashbourne Pharmaceuticals | Drug distribution | £32m | 1999 | In Portfolio |
| Auto Windscreens | Windscreen replacement | £98m | 1998 | Realised |
| TM Group (Thistledove) | Convenience stores | £184m | 1998 | In Portfolio |
| Harwich International | Port operator | £77m | 1997 | Realised |
| Warrior Group | Consumer credit | £104m | 1997 | Realised |
| **Abbey Hospitals** | **Private hospitals** | **£12m** | **1997** | **Realised** |
| Clinphone | Voice response systems | £10m | 1997 | In Portfolio |
| **Transport Research Foundation** | **Transportation research** | **£14m** | **1996** | **Realised** |
| Xtra-Vision | Video distribution network | £12m | 1996 | Realised |
| **Elysia** | **Bus operator** | **£6m** | **1995** | **Realised** |
| BCH Vehicle Management | Fleet management | £140m | 1995 | Realised |
| TM Group (Gallagher) | Convenience stores | £173m | 1995 | Realised |
| **ANC Group** | **Parcel delivery** | **£50m** | **1995** | **Realised** |
| **London General** | **Bus operator** | **£32m** | **1994** | **Realised** |
| **London United** | **Bus operator** | **£26m** | **1994** | **Realised** |
| **Belfast Airport** | **Airport operator** | **£35m** | **1994** | **Realised** |
| **Centrewest London Buses** | **Bus operator** | **£27m** | **1994** | **Realised** |
| Melville Exhibition Services | Exhibition contractor | £14m | 1994 | Realised |
| Benfield | Insurance | £50m | 1994 | Realised |
| Croydon Land / Estates | Property management | £58m | 1994 | Realised |
| **Greater Manchester Buses South** | **Bus operator** | **£28m** | **1994** | **Realised** |
| Security Pacific Insurance Group | Insurance | £5m | 1994 | Realised |
| **Innovex** | **Healthcare trials** | **£82m** | **1993** | **Realised** |
| Clydeport | Port operator | £20m | 1992 | Realised |
| First Corporate Shipping | Port operator | £42m | 1991 | Realised |
| Alan Turner | Insurance | £13m | 1990 | Realised |
| Yarrow Young | Insurance | £4m | 1989 | Realised |

## 5.9. Terra Firma

http://www.terrafirma.com/page____102.aspx .
Terra Firma was created in 2002 out of the Principal Finance Group, a division of Nomura that was created in 1994. It "focuses on buyouts of large, asset-rich and complex businesses in need of operational and/or strategic change". The company sees privatisations as a key source of opportunities: "the current focus across Europe on core activities by both governments and private companies is expected to provide a steady stream of divestments and privatisations of exactly the businesses and assets that we target."

It gets involved in managing its investments, emphasising its concern to maximise the returns for investors: " We add value through integrating ourselves directly into the companies we buy. Our in-house operational team works closely with our financial team during the due diligence phase of each deal and then, post-acquisition, they go directly into the company, often forming an integral part of interim management…..The firm has a hands-on management style, working directly with its portfolio businesses to overhaul operations and transform strategy."

The company has made just 22 investments since 1994. On average, Terra Firma invested about €345m in each one. The most recent include Tank & Rast, a chain of 340 restaurants and petrol stations throughout Germany; Odeon and UCI cinemas, the largest cinema operator in Europe; and Waste Recycling Group [since sold in 2006 to FCC].

In May 2005 Terra Firma "sealed the biggest private equity deal in Germany by agreeing to pay about €7bn for Viterra, a portfolio of 150,000 apartments owned by utility Eon.."[81] According to the FT "Germany's homegrown private equity sector is tiny and foreign companies, mostly from the US, have dominated the acquisition of German companies in recent years, prompting an outcry in some quarters that the country is selling out to foreigners."[82] In May 2006 the commercial property part of Viterra was sold off by the German subsidiary of Terra Firma, Deutsche Annington. Both this company, and its U.K. counterpart Annington

Homes Ltd. were formed from privatized government-owned housing: "The U.K. company held former British Ministry of Defence married-housing quarters, while the German company held former state railway properties." [83]

| | | | |
|---|---|---|---|
| Annington Homes | Housing | Sep-96 | 2,570 |
| Deutsche Annington | Housing | Dec-00 | 2,250 |
| HBS | Outsourcing | Dec-00 | 150 |
| Viterra | Housing | Aug-05 | 6,500 |
| Waste Recycling Group | Waste Management | Jul-03 | 836 |
| Shanks | Waste Management | Jun-04 | 357 |
| BGCL | Utilities | May-05 | 141 |
| East Surrey Holdings | Utilities | Oct-05 | 964 |

## 6. Notes

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