

Tales of four markets

Deal flow in the Nordic region is plentiful, but the forces shaping it differ starkly in each of the four countries. In two articles Philip Borel talks to five local experts about the current investment scene and the pressures placed on them by a sceptical public

SPONSORED BY
Nordic Capital
Permira
PwC
Verdane Capital

Stockholm: deal flow is strong in the Swedish capital

It's a high-powered private equity conversation on a late-September afternoon in Stockholm, and the first order of business is to assess the current deal environment in the Nordics. Unsurprisingly, given the world's ever-deepening pool of uninvested capital, those present are united in their view that finding deals at sensible valuations can be challenging.

The reasons why this is so vary markedly across the four markets of Sweden, Norway, Denmark and Finland that make up the region, more of which later. But the universal theme playing out in all of Scandinavia is that wherever there is an attractive asset available for investment, the list of would-be acquirers can get quite long quite quickly.

"Deal flow is strong," confirms Fredrik Näslund of NC Advisory AB, advisor to the Nordic Capital funds, about the Swedish market – "but so is competition."

A rising stock market in particular has been making it challenging for private equity funds to invest in recent times. Prior to a correction in May, the Stockholm Stock Exchange was "on fire", as Näslund puts it, prompting vendors to list their businesses

rather than seeking to sell to private equity.

"The IPO market has been providing such a buoyant exit environment that what otherwise might have been an opportunity for funds to invest has largely gone to the very aggressive public market, or else to strategics," agrees Ola Nordquist, head of the Nordics at Permira.

Stephan Révay, head of transaction services at PwC, has noted that because of the intensely competitive market dynamic, auctions for mid- to large-cap companies are often being shunned by all but the keenest of suitors: "The key change we've seen relative to a year ago is that there are often only a few parties getting into a process. This is partly because of the IPO market valuing assets so highly, but also because sponsors have become more cautious about process risk and tend not to be particularly aggressive when there are many bidders involved, unless they have a clear edge. They really are being selective when it comes to deciding where to spend their money and concentrate their efforts."

Even so, the focus on selectivity doesn't mean sponsors aren't pounding the pavement hard in search for investments. Each



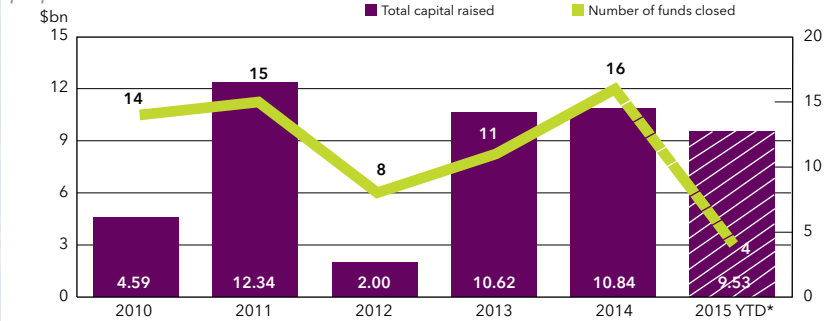
of the three GPs at the table have their own distinct way of trawling the region for opportunities. And each is adamant that, despite the crowded field, they continue to successfully source transactions that fit their investment criteria and can be underwritten at sensible valuations.

Verdane is a direct secondaries investor specialising in small to medium-sized businesses in the energy, IT and advanced industrial sectors. Managing partner Bjarne Lie says the strategy works well: “We’re pure-play growth, and the average company we’ve exited has grown the top line by more than 20 percent per year during our holding period. We try to avoid auctions, and of the 23 deals we’ve done to date, 21 have been proprietary, by which we mean there was no sell-side advisor involved in the transaction. To find these opportunities, we do more than 1,000 outbound sourcing meetings a year, which typically results in three or four completed deals.”

Nordic Capital, one of the largest and longest-established regional buyout houses, maintains full-service offices staffed with at least five investment professionals in all of the four countries, and is also active >>

STRONG DEMAND

Not for the first time in the industry’s history, Nordic funds are proving popular with LPs

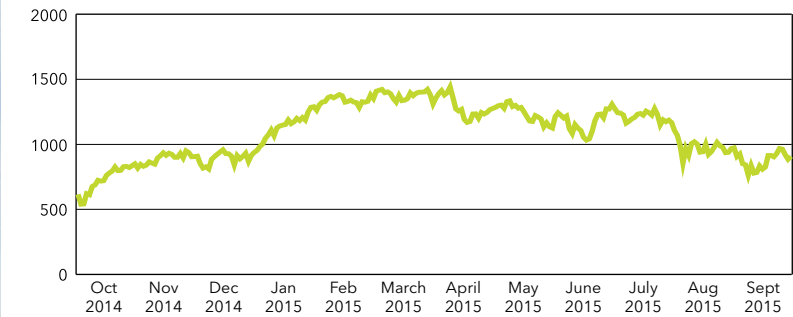


Source: PEI Research & Analytics

*As of 16 September 2015 there is an additional \$4.52 billion raised from interim closes

ON FIRE

Prior to a correction in spring, the rapidly rising Stockholm stock exchange was the exit route of choice for vendors



Source: Bloomberg



MEET THE ROUNDTABLE



BJARNE K. LIE
VERDANE CAPITAL

Lie is the managing partner of Verdane. Based in Oslo, Lie has worked with the firm since 2001 and currently serves

as CIO. A former entrepreneur and McKinsey alumnus, he has led several of the firm's trademark direct portfolio acquisitions.



FREDRIK NÄSLUND
NORDIC CAPITAL

Näslund is a partner and member of the investment review committee at NC Advisory, advisor to the Nordic Capital Funds.

He joined in 2001 and his investment experience includes for example Point, Permobil and Capio, a healthcare business which listed this year.



OLA NORDQUIST
PERMIRA

Nordquist joined Permira in 2005, became a principal in 2009 and heads the firm's Nordic office in Stockholm. His

track record includes work on TDC and Pharmaq. Prior to Permira, Nordquist worked for Apax Partners in London.



STEPHAN RÉVAY
PWC

Having been with the firm since 1999, Révay is head of transaction services and a partner in PwC's advisory practice. Based in

Stockholm, he leads the private equity services platform for the Nordic region and has worked on several landmark transactions.



PER OLOFSSON
AP FONDEN 7

At the beginning of this year, the 7th Swedish National Pension Fund had SKr254 billion (\$33 billion; €27 billion)

of assets, of which 3 percent is invested in private equity allocation. Olofsson is head of alternative investments and has been with AP 7 since 2002.



» in Germany. Healthcare is the most important sector for the firm, accounting for 30-40 percent of the investment portfolio historically.

“Nordic Capital has largely kept away from auctions over the last four to five years, which is probably one of the benefits of having a large team and being able to direct resources from one market to another, depending on where the most attractive targets are,” says Näslund. “As a generalist investor and a market leader, we can go slightly smaller for instance, and go in earlier.”

Permira, which over the past 10 years has evolved from a primarily European investor into a global operator, covers the region from Stockholm. Nordquist says the Permira model is necessarily different from that of the large indigenous players: “As an international house concentrating on growth and consolidation potential, we cannot try to replicate what Nordic and EQT do up here. We have to be clear about the specific sectoral themes we believe in, and how we can partner with multinational businesses in ways that let us utilise our

“You can't let yourself be fooled by the extraordinarily high valuations we are seeing; you have to take a view on what the assets you're buying are worth fundamentally in light of their growth profile”

Ola Nordquist

international network in other parts of Europe, Asia and North America to help them grow.”

Technology, Nordquist adds, is one sector where the formula is currently yielding results: “We look for opportunities to invest behind fundamental growth trends across sectors which allows us to grow into the valuation. Technology is particularly attractive because it is going through a major transition towards internet-based

services at the moment, and we continue to find good assets, including in the Nordics.”

Unsurprisingly, all three managers employ Scandinavian natives with strong local connections. As Révay points out, anyone lacking these attributes will struggle to get close to an off-market deal: “If you don’t have enough firepower on the ground, you will be more dependent on the wider processes. If you want to be successful over the long-term, especially when you’re hoping to buy from local entrepreneurs outside the main cities, you need to have local presences through established offices.”

Which is why, according to Näslund, the number of private equity firms maintaining dedicated platforms in the region has actually slightly shrunk in recent years, as fewer groups are willing to invest in the requisite local infrastructure: whereas 10 years ago “everyone and their mothers decided to open an office here, today people have learned that it isn’t so easy to invest here after all. Having a presence is expensive, it’s four countries rather than one region, and the local firms are pretty well set up. At the same time you have more sector expertise coming in. So competition has shifted from ‘everybody should be here and bidding on everything’ to a more selective, better differentiated and ultimately smarter approach based on sector expertise, local market knowledge or both.”

For investors allocating capital to the region, this move away from the feeding frenzy of the past is obviously good news. Limited partners have long been fond of the Nordic region and, on the whole, achieved high returns on their investments here. And according to Per Olofsson, who heads the alternative investment group at Swedish state pension fund AP7, the same attractiveness still prevails.

Olofsson says: “One thing we continue to see is that most Nordic funds are showing good performance, and when

we together with our advisors work on fund selection, the Nordic GPs tend to rank highly. The region accounts for about 10 percent of our total private equity portfolio, and in hindsight we probably should have had more, even though we also had some very good returns coming out of the US as well, which is by far the largest piece of the portfolio.”

To continue along this trajectory, managers will need to tread carefully. If he were to give other LPs a piece of advice on how to shape their exposure to the region, Olofsson says he would urge them to stay disciplined: “You don’t want to get too concentrated on certain vintages. For instance, our overall portfolio has performed so strongly in recent years that in the last six months I could easily have gone back to our investment committee and asked for another couple of billion SEK to commit – but I chose not to. Over the long term, keeping your discipline really pays out.”

The same principle applies to the GPs of course, but, in addition, for managers aiming to invest across Scandinavia, it is essential to understand the idiosyncrasies of

each of the four markets. Energy-dependent Norway, heavily industrialised Sweden and Finland, plus Denmark with a strong presence in pharmaceuticals – each country follows its own macro-cycle, and right now the differences are stark.

Verdane’s Lie highlights the fundamental shift of sentiment that has occurred in Sweden and Norway over the past two »

“ In Sweden people are underpricing risk and overestimating access to liquidity, whereas in Norway what you get is ‘I-don’t-want-to-be-the-guy-who-sold-at-the-bottom-of-the-cycle’, combined with poor visibility on future revenues and earnings

Bjarne Lie





» years. “In 2013, we couldn’t do anything in Norway. The currency was way up, salaries were way up, everyone thought oil and gas prices were going to go through the roof. Whereas in Sweden you still had this post-financial crisis sense of worry. Now it’s almost the reverse. In Oslo it’s all fear and paranoia, there are headlines about headcount reductions every day, and there is plenty of deal flow, but the question is will people dare do anything about it. In Sweden, it is dotcom 2.0. Everybody is talking about the next unicorn, new venture firms are popping up, and there is a very different, frothy feeling compared to 2013.”

These contrasting sentiments make it tough to convert deal flow into actual transactions in both markets. Lie again: “In Sweden people are underpricing risk and overestimating access to liquidity, whereas in Norway what you get is ‘I-don’t-want-to-be-the-guy-who-sold-at-the-bottom-of-the-cycle’, combined with poor visibility on future revenues and earnings.”

Denmark is somewhere in between its two neighbours. Näslund says Danish growth businesses are being valued almost

“Sponsors have become more cautious about process risk and tend not to be particularly aggressive when there are many bidders involved, unless they have a clear edge

Stephan Révay

as highly as they are in Sweden. At the same time, as Révay observes, Denmark’s banking system, which is fairly large relative to the rest of the economy, was hit hard by the crisis and is still working through the recovery.

In Finland, meanwhile, the story is altogether bleaker. Following the demise of erstwhile technology champion Nokia, the next generation of Finnish tech companies has not grown sufficiently to boost employment and stimulate growth. (In this

context, says Näslund, Nordic discount retailers have proven a “very good investment” for Nordic Capital.) According to Révay, Finland’s recovery will take more time to gain momentum.

How might an increase in the cost of debt financing affect the picture going forward? Permira’s Nordquist gives a cautious answer: “Only one thing is certain: the new normal of negative interest rates is not going to last, but what we don’t know is when the environment is going to change. Crucially, you can’t let yourself be fooled by the extraordinarily high valuations we are seeing, you have to take a view on what the assets you’re buying are worth fundamentally in light of their growth profile. In addition, you need to take advantage of the highly attractive financing opportunities that are out there to build flexibility in the capital structures, as well as of the opportunity to exit the historic portfolio.”

Verdane, says Lie, has done just that: “Since Christmas, we’ve returned proceeds to our LPs equal to more than three-quarters of our beginning of the year NAV across all our funds. So we basically called the top of the market and sold a third of our companies in the last nine months.”

Nordic Capital has also been a “net seller” this year, adds Näslund, who recently helped orchestrate a high-profile IPO for Capio on the Stockholm market (see next story).

This is private equity responding to macro-driven cyclicity by making use of the strategic optionality that is hard-wired into its long-term investment model. With all the capital inflow and ever greater volatility affecting industries and markets everywhere, maneuvering through the coming years will not be straightforward. But seasoned managers, such as the ones at our roundtable, should have the right tools at their disposal to be able to navigate, even if the going should get a good bit tougher still. ■

RESPONSIBLE INVESTING

Public image overhaul

Nordic firms are working hard to improve what politicians, journalists, taxpayers and tax collectors think of them. Progress is being made, finds Philip Borel

In recent years, private equity in Sweden has been at the receiving end of a great deal of public criticism. And although the debate appears to have started to subside of late, the five practitioners at the *Private Equity International* roundtable agree that their industry isn't out of the woods yet. The consensus is that persuading local critics of its merits, and safeguarding its licence to operate, remain priorities for everyone.

Employing approximately 8 percent of Sweden's workforce, private equity plays a meaningful part in the economy. In 2014, according to Invest Europe, the amount of private equity capital invested equated to 0.37 percent of Swedish GDP – behind the UK (0.72 percent) and France (0.42 percent), but comfortably ahead of larger economies such as the Netherlands (0.29 percent), Germany (0.2 percent), Spain (0.09 percent) and Italy (0.05 percent).

With this much weight and economic influence comes a heightened public profile, scrutiny and often skepticism. In 2011, allegations against Carema, a retirement home operator owned by Triton and KKR, of providing inadequate care and employing questionable tax and remuneration practices, provoked such a furious public outcry that private equity professionals in the region to

this day continue to describe the episode as a public relations disaster with lasting impact.

The sponsors involved were seen as being slow to challenge the media's reporting of the story and to correct some of the misapprehensions it created. Calls for greater regulatory oversight of private equity followed, and left-wing politicians proposed rules to prevent the industry from investing in public services.

Since then much has been done to try to stem the tide. In February this year the Swedish Venture Capital and Private Equity Association (SVCA), in a bid to boost public confidence in the industry's commitment to acting responsibly and professionally, introduced a code of conduct as a self-regulatory framework that is binding for its members.

It is early days yet to assess the code's effectiveness, but according to Fredrik

Näslund at Nordic Capital, its setting the bar high is welcome because it "makes it harder for any gold diggers to invest in the region with no team on the ground, no website, no system in place to ensure responsible investment and ownership".

Bjarne Lie at Verdane Capital, who follows developments in Sweden mainly from his personal base in Oslo (Verdane has offices in Stockholm and Helsinki too), says his impression is that the SVCA-led push to better promote the industry in Sweden is "clearly communicated, very well executed and benefitting everyone, including ourselves".

However, cautions Per Olofsson at AP 7, there are also those industry players that continue to opt out. "Some GPs are still refusing to realise that they're acting in the political arena and need to engage with the media much more actively, and they're risking the public's view of private equity staying negative. As an LP, we too have to convince our savers of the merits of the asset class, but if GPs duck and refuse to make the case for private equity persuasively, others will make the case against it. »

“**The code of conduct makes it harder for any gold diggers to invest in the region**

Fredrik Näslund





“Private equity still needs demystifying, the public still think there’s too many secrets. More GPs need to go out there and push

Per Olofsson

Another hot button topic for private equity in the region is how firms, funds and the practitioners who work for them get taxed.

In November 2014, in a widely noted landmark ruling, the Swedish Supreme Administrative Court refused to allow the tax authorities to reclassify capital gains generated by Nordic Capital as income rather than carried interest. It also ordered the agency to pay Nordic’s legal costs, which the firm has committed to charity.

For the time being, the verdict has made it less likely that the tax authorities will elect to look into the tax arrangement of other private equity groups. However, the debate around carried interest taxation has not gone away for good, neither in Sweden nor in the other Nordic countries. In Norway, a similar test case involving Herkules Private Equity is pending, again with the tax man aiming to impose a higher levy on carried interest retrospectively.

For those employed by Norwegian private equity firms, the implications would be dramatic, says Verdane’s Lie. “This situation is very similar to where Sweden was a year ago,” he adds. “In all four countries, the authorities are trying to figure out what the appropriate tax structure for private equity should be. Ultimately, it’s a political issue: governments want the industry to stay here, but at the same time we’re an easy populist target. What’s required is a balanced approach.” ■

» “The fact is, private equity still needs demystifying, the public still think there’s too many secrets about it and an unwillingness to be more open. More GPs need to go out there and push.” Ola Nordquist at Permira agrees, and insists that the key is to give transparency wherever transparency can be given: “Obviously many private equity firms are private partnerships, so there are some limitations, but it is crucial that we openly communicate and explain to our investors, the companies we invest in and other stakeholders in society who we are and how we operate. There are still pockets in our industry where people take a different approach.”

Näslund says there are signs that public mistrust of private equity is beginning to soften.

In June, Nordic Capital together with Apax Partners floated Capio, the only privately-owned operator of a hospital offering emergency services in Sweden. Näslund believes the transaction has resonated positively: “I think the IPO has brought some transparency on the company and on Nordic Capital as private equity owners. You could read headlines about a competing hospital

that isn’t privately-owned and where people are refusing to work because staff are so stressed out; whereas less than one-and-a-half kilometres away we have [Capio’s] well-functioning hospital, operating on prices that are 25-30 percent lower and still making money.”

State pension plan AP Fonden 4 buying into the IPO as one of the largest investors was a public seal of recognition of the quality the company has developed and maintained under private equity ownership, he adds.

Even so, for the industry as a whole the project to win more hearts and minds among the people of Sweden requires further effort. Stephan Révay at PwC believes that firms with dedicated responsible investment capabilities are better positioned to support it than those without.

Sponsor demand for his firm conducting ESG-related due diligence on prospective portfolio companies is increasing, he adds: “We look at supply chain management and responsible sourcing. We conduct background checks on key personnel, and we’ve also seen private equity firms increasingly asking for social media-related due diligence.”