Back in favour

The French private equity industry is seeing strong fundraising and plenty of deals. So where do the country's GPs go from here? By Adam Le and Victoria Robson

***From left**: Cameron Graham, Benjamin Arm, Rémi Carnimolla*

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France was in the grip of election fervour when *Private Equity International*'s panel of experts met in Paris at the end of April to discuss the French market. The contest between the two remaining presidential contenders, far-right candidate Marine Le Pen of Front National and centrist Emmanuel Macron of La République en Marche! had turned vitriolic. Each was arguing for starkly different policy approaches, including how to kick-start economic growth. Among their disagreements, they were poles apart on how to tackle unemployment and whether France should remain a member of the EU and the eurozone.

Former economy minister Macron, who favoured closer co-operation with the EU, would go on to win by a decisive margin in a final vote on 7 May. He still needs to garner plenty of parliamentary support in the mid-June polls for his policies to be implemented.

But our panel was sanguine about the impact of political and economic changes on the investment environment.

"It's business as usual," says Omnes Capital managing partner Benjamin Arm, who heads the SME-focused firm's buyout and growth investment activities. In fact, Arm notes, he participated in an investment committee meeting earlier that day about a deal due to be completed by the summer, and was scheduled to attend two more investment committees the following day. "I didn't see any slowdown in terms of dealflow or fundraising," he says.

In January, Omnes, which spun out of Crédit Agricole in March 2012, closed its first vehicle raised as an independent manager. Omnes Croissance 4 mid-cap fund overshot its initial target of €180 million by some way to close on €210 million.

There is a growing disconnect between economics, politics and finance, says 3i »

> **_Generally speaking, European companies have forgotten how to navigate through a high-inflation environment_**
>
> **Rémi Carnimolla**

» Group's Paris-based managing director Rémi Carnimolla, who heads the London-listed firm's French and Spanish private equity teams. He points to the UK's decision to leave the EU and the election of Donald Trump to the US presidency as examples of events that in earlier years might have brought business to a halt. "But now business carries on."

In any case, Carnimolla says, 3i looks for investee companies that are immune to political change in terms of activity and business model and are "agile enough to sail through political storms". The GP avoids companies reliant on government funding or exposed to state-controlled tariffs. "These are less resilient or predictable than they used to be," he says.

MARKET DYNAMICS

Macron's win is unlikely to have the same impact as that of Socialist candidate François Hollande five years earlier, which "essentially shut the market for a period of time", says SL Capital Partners private equity investment director Cameron Graham, who is responsible for the firm's private equity investment activities in the French market. "I'd be surprised if we got anything like that this time around," he says.

Observers, including the OECD, continue to flag up tax and labour reform as pressing structural issues in France. However, the fundraising market appears immune to such criticism, as it soared last year.

According to industry body the Association Français des Investisseurs pour la Croissance, French GPs raised €14.7 billion in 2016, the highest in 20 years. That was up 51 percent on the previous year and above a pre-crisis peak of €12 billion in 2005. Of that total, which was largely targeted at French companies, 45 percent was committed by international LPs.

"All private equity market asset classes drew LP interest in 2016. It's a very dynamic market," says Arm, who compares fundraising today with 2013-14 when "the market was really quiet".

"Foreign LPs were very cautious following the French government's announcement on taxes. It was tough. And it was just two years on from the Greek crisis, which was another huge shock."

Arm attributes the boost in fundraising to continued low interest rates and the need for institutional investors, including insurance companies, to improve the performance of their portfolios, as well as ongoing support for the asset class from state-owned investors like Fond de réserve pour les retraits, Établissement de retraite additionnelle de la fonction publique, Ircantec and Bpifrance, and the return of French insurance companies and pension funds.

"There is also a huge trend for high-net-worth-individuals [as investors] which represent 10-15 percent of fundraising. This is new compared with five years ago," Arm adds.

Concerns about the French economy were "amplified in the early Hollande years" and some LPs pressed pause, says Graham. Worried about the absence of dealflow, SL Capital switched focus from primary to secondaries investments at that time. "Now, the tap has turned back on and investors are coming back to France," he says.

The reason is clear. "France is a huge market and you can't ignore it if you want to build a balanced portfolio across Europe," Graham says. "If you look at returns across our portfolio, France has been a profitable market across size segments. Given the maturity and efficiency of the market, median returns are pretty much in line with headline European statistics, plus or minus a little. But the dispersion of returns tends to be narrower than in many other markets. It's a nice engine room to have in the portfolio."

SL Capital is "slightly underweight" in France from a pure country fund perspective, but has additional exposure through several regional players with strong French franchises that provide mid-market exposure, he adds.

In November, the firm co-invested alongside 3i in Ponroy Santé Group, a French manufacturer of natural healthcare and cosmetic products.

"France has been one of our more active co-investment markets recently. There have been a couple in the healthcare space, diagnostics and pharma, all with very significant international expansion angles. That's been a key pillar of many of the equity stories we've backed recently," says Graham.

Dealflow overall is accelerating. GPs invested €12.4 billion in 2016, up 15 percent on the previous year. More than half of the roughly 1,900 investee companies took on new shareholders for the first time, according to AFIC.

The ability of French GPs to demonstrate deal origination and instigate »

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Benjamin Arm

MEET THE ROUNDTABLE

BENJAMIN ARM
managing partner
OMNES CAPITAL

Arm is managing partner in charge of buyout and growth capital activity. He started his career in 2001 working for Arthur Andersen, before moving to EY. He joined Omnes Capital as an associate in 2006 and was director until 2013. Arm is a member of the firm's executive committee.

RÉMI CARNIMOLLA
partner, managing director France and Spain
3i GROUP

Carnimolla is head of the French and Spanish private equity teams. He has been a key member of the investment teams on several of 3i's European buyouts including Ponroy, TCR, Etanco, Trescal, Vedici, Geka, Ineum and Keolis. He currently sits on the Board of Ponroy, Etanco and Loxam. Before joining 3i in 2003, Carnimolla founded a French venture capital firm in Tunisia.

CAMERON GRAHAM
investment director
SL CAPITAL PARTNERS

Graham joined SL Capital in 2008 and is based in its Edinburgh office. He plays a key role in managing SL Capital's secondaries investment activities and funds. He is also involved in private equity primary fund investments and co-investments. Graham serves as an advisory board member on several European private equity funds and has specific responsibility for SL Capital's private equity investment activities in the French market.

» operational improvements where managers "can point to real active ownership beyond just riding a curve" remains key to manager selection, says Graham.

"One of the main things we're looking at is deal sourcing. A number of managers that raised funds in '10, '11, '12 struggled with early deployment. As a result, we're looking at funds today, the next vintage on, which have relatively young back-ended portfolios and not much in terms of exit progress or trading visibility, frankly," says Graham.

However, in 2016, the number of exits grew by 14 percent on the previous year to almost 1,400, according to AFIC. Carnimolla maintains that more attractive opportunities will soon come to market thanks to the investment cycle. "2012 and '13 were good vintages for the industry with remarkable companies bought at that time and which are naturally coming up for sale now, ie, four to five years later," he says, adding that the local pipeline of secondary transactions is very transparent.

Looking ahead, the main challenge facing French managers will be to deploy the capital raised in 2016, says Arm. "[This year] also could be strong in terms of fundraising. There is huge pressure on pricing and it will be challenging in the future to obtain the same return for clients."

France is on a par with other western European markets for pricing, says Carnimolla. "Over the past 10 years, investors have become more disciplined and the pricing is more sophisticated. There is a premium for quality assets. Compared with the bubble of 2006-07 when any asset found a buyer, today if the asset is really poor there is no buyer or if there is one, it's at a very discounted price."

Being an "informed buyer means I'm going to buy at the right price", Carnimolla says. "Years ago, you could secure some of your returns because you bought well. We don't count on that any more as the market is competitive. I want to be sure that we can deliver value to the business over and above what management wants to do."

Rising prices could also have an impact at the portfolio company level, he adds. "Quantitative easing works when you have growth, but if you don't, the overflow of money will be tough to absorb. Generally speaking, European companies have forgotten how to navigate through a high inflation environment."

As a very intermediated market, paying the highest price "could be the only way to win [a transaction]", says Arm. A fund manager's job is to bypass intermediation and to identify an opportunity early and establish relationships, including in the regions beyond Paris, he adds. To do that, Omnes leverages its relationship with Crédit Agricole unit LCL Bank, which has active regional corporate finance networks.

In the current "benign" market of low interest rates and long-term positive fundamentals "managers need to stick absolutely steadfast to their stated strategy and make sure it makes sense in the context of [a] downturn that will inevitably hit", says Graham. "You're going to get B-class assets trading at A-pricing and they are the ones that will come unstuck."

FOREIGN LEGION

The earlier dearth of big-ticket deals in the French market has "accelerated the internationalisation of a few very credible Paris-based GPs", says Graham.

More French firms are "trying to push beyond the boundaries of their own turf", taking their portfolio companies into Europe, and have started to compete for assets with pan-European investors, says Carnimolla. They are also beginning to look even further afield, to the US and Asia.

"We have done that for many years. It will be the next phase for some of our competitors but it will take time," he says.

Omnes is one of the firms that has started to dip its toes into overseas markets. It acquired cybersecurity software distributor Exclusive Networks in 2010 while still part of Crédit Agricole. Executing a buy-and-build strategy, the Paris-based company bought a UK market leader and then companies across Europe, Turkey, the United Arab Emirates and Australia. Omnes exited the business in 2015, by which time revenues had risen by more than 500 percent, generating a 4.8x return.

> ***France is a nice engine room to have in the portfolio***
>
> **Cameron Graham**

"The next step for us is to be more present in Europe in terms of clients and investments," says Arm. "When you invest in companies in France, one of the many ways to develop them is to perform a buy-and-build strategy and very often you have to do that outside France." To compete in foreign markets, French managers "have to emphasise the fact that they have good knowledge of a sector or specific field", he adds.

As well as venturing beyond French borders, some local managers have shifted their internal investment parameters. "Rather than new players, I would say we are seeing new trends in the market and new risk-adjusted pricing," says Carnimolla. Some managers have opted to invest in more "protected, resilient" companies, accepting they will generate lower returns.

Carnimolla points to 3i's investment through its infrastructure arm into Brussels-based ground handling equipment leasing business TCR alongside Deutsche Asset Management. "Infrastructure" assumes lower returns for lower risk, "but to my big surprise, my traditional private equity competitors were competing neck and neck [during the acquisition process] at the same valuation and probably a more expensive financial package. They were prepared to lower their returns to a point that I didn't think that they could," he says.

When asked what advice they would give new managers seeking to enter the French market, both Carnimolla and Arm smile and agree that the local market is already well served with successful managers.

Looking ahead, the task for French managers is "to capitalise on that [opportunity]," says Arm.

"We have a sufficient number of managers now with very professional teams. They've seen the peak and the crisis. The market is well structured by size, strategy and sector." It is time to get to work. ■