

## PRIVATE EQUITY NEWS

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## Relationships are key to surviving the downturn

The deal-doing world has changed; we all know that. Perhaps one of the biggest consequences of the repricing of risk has been the realisation of how important relationships are in our industry. Deliverability and certainty carry far more currency in the market today than in recent years, and ultimately confidence in the other parties' ability to deliver on their commitments within the agreed time frame comes down to a bond of trust rooted in experience and aligned interests. On the current economic roller coaster, it is important to know who your friends are.

The most obvious and visible manifestation of the credit crunch has been the end of perceiving debt as a commodity. Twelve months ago, the last thing one worried about when going into a transaction was where the debt element would come from. Today, we would be foolish to incur the costs of financial and legal due diligence without initially getting good visibility on the debt package, which, in recent months, has been easier said than done.

At times, it seems that credit committees have been moving faster than the transaction teams. There have been numerous examples of a dislocation between the terms the deal team believed they could agree on and those they could actually get through credit. This is why developing a strong relationship is so important: most banks do not grant final approval until a few days before completion, and such a relationship provides you with a better opportunity to understand exactly where the bank is in its approval process and what its key commercial issues may be.

Clearly, this isn't all one-way traffic. Banks are becoming increasingly selective in choosing the sponsors they want to work with. Ideally, they prefer to have worked with a sponsor previously and, as a minimum, to understand the sponsor's track record to estimate how they are likely to

## Guest comment

**Ian Wallis,**  
partner, MML  
Capital Partners



behave after the deal has been secured. This is imperative should the business underperform, when the quality of the relationship between sponsor and bank is really tested. Knowing and trusting how people will behave is crucial.

The increased importance of the relationship with advisers and investee companies' management teams also reflect this new market paradigm. While, as ever, price and terms need to be right, the final negotiation in the current climate usually hinges on deliverability. A good safeguard for the adviser is the longevity of their relationship with the private equity house and, indeed, the individual members of the deal team. Good market reputation is essential for all buyout firms: you only let an adviser down once.

Crucially, relationships with management teams need to be fostered carefully, particularly when backing owner managers, as MML often does. Thorough due diligence of a target company continues to be important, but while it may be less quantifiable, trust between an incumbent management team and the sponsor is just as vital to ensure an appropriate financing package is tailored to the specific needs of the business and that value is created after the deal has closed.

Thus, particularly in the current market conditions, the ability to execute deals falls more on the often intangible factors such as the extent of the relationship, trust and experience than purely having the right numbers. Cultivating trust and predicting behaviour is not an exact science and the ability to give confidence to others comes at a premium. Market players who have earned trust by investing and behaving consistently over the cycle should be well-placed in these challenging times.

## Comment: Highlights from penews.com

### KKR's listed fund should reject initial merger offer

James Mawson  
July 29  
Kohlberg Kravis Roberts' decision to float through a merger with its Euronext-listed private equity fund is no 'slam dunk' of a deal and investors could be better off rejecting the initial offer to force better terms.

KKR, advised by Goldman Sachs, Morgan Stanley and lawyers Simpson Thacher & Bartlett, needs 51% of KKR Private Equity Investors (KPE's) shareholders to vote in favour of the deal.

The board of KPE has recommended the offer and is deemed independent according to requirements under the New York Stock Exchange, where KKR the firm wants to list, rather than under the Euronext Amsterdam regulations where the fund is sited.

The board and KPE, after fairness valuation from Citigroup and Lazard and legal advice from Bredin Prat, have accepted the offer, which involves taking 21% of the enlarged company.

KKR's executives, primarily founders Henry Kravis and George Roberts, will retain the

other 79%, of which six percentage points can be transferred to KPE shareholders if its net asset value is below trading levels in three years' time.

KPE's shares traded at \$10.50 per share until KKR's merger offer was revealed on July 27. This was a discount to its net asset value of \$22.25 per share at June 30 after KKR wrote down German media group ProSiebenSat.1's equity to near zero with a \$138.2m value reduction. At this net asset value, KPE had a market capitalisation of \$4.56bn.