

Comment: Second thoughts on private-equity secondary buyouts

By: [Chris Brook-Carter](#) | 3 August 2010

Type the term 'private equity' into just-food and the site will return 26 separate articles in July alone. The high return is not only a reflection of the food sector's ability to attract investment in uncertain times, it is also an indication of a rising number of secondary buyouts – where private-equity sells to private-equity rather than back to the trade.

Last week, Picard Surgelés was sold for EUR1.5bn (US\$2bn) to Lion Capital – the third private-equity owner of the French frozen-food chain, which has also been owned by BC Partners and Candover over the last decade.

Strategy group Dealogic says some 35% of private-equity deals this year have been 'secondary buyouts' – the highest level in at least a decade.

In more 'normal' economic times, private-equity firms are more likely to sell back to the trade having grown the value of the business, often by driving short-term efficiencies. Trade buyers pick up lean and well-focussed assets they can invest in, whilst leveraging industry synergies. When a secondary buyout occurs, the options open to a PE company to drive value are reduced, by the very nature of who's selling.

But these, of course, are not normal economic times. The last 18 months of global economic turmoil have left trade buyers hard to find. Some in the industry have found credit impossible to come by, others are struggling to pay down debt. But there are businesses out there sitting on cash that are simply less keen to buy.

As the BBC's economics editor Stephanie Flanders pointed out in her blog last week, discussing the relationship between the banks and UK PLC: "But it would be easy to miss, in all this debate, that UK plc is actually in rude financial health. Come again? Yes that's right. British businesses are loaded. In fact, in the first three months of this year, they ran a financial surplus worth more than 5% of GDP."

Independent food industry analyst James Amoroso says: "Just because the food and beverage companies have money does not make them keen to spend it. These days, firms like Nestlé and Danone prefer to give back spare cash to shareholders rather than spend it on any old acquisition."

Data out last week from the Food Institute in the US, showed that M&A activity has picked up in the food and beverage sector in the US. There were 52 deals announced but not completed in the first six months of the year and a further 100 that had been sealed. The figure was up from the 44 announced in the first six months of 2009 and 73 completed.

However, it's still well down on levels before the crash, when in the first half of 2008 there were 94 deals announced and a further 144 completed.

Interestingly the number of new deals announced, but not yet completed, where PE is the end buyer, has jumped from five in the first half of 2009 to 13 in the first half of this year.



Picard Surgelés was sold for EUR1.5bn (US\$2bn) to Lion Capital last week, its third private-equity owner in the last decade

By contrast, food processors only announced nine new deals that are not yet completed in the first six months of this year, compared to 11 in the first half of 2009 and 33 in the first half of 2008 (although they did complete 25 between January and June this year, compared to 19 and 39 in the corresponding periods in 2009 and 2008).

Not only is this lack of investment activity by the trade a worrying indictment of what lies ahead – if companies with a cash surplus are not spending now, it says little about their confidence in the economic future – but it also creates a problem for private equity, whose businesses rely on a buy and sell cycle.

Having endured an M&A dry spell stretching back to October 2008, private-equity groups have had to kick-start the sale cycle at the first sign of economic recovery.

"PE firms are investors and, as such, speculators," continues Amoroso.

"Some PE firms may have bought certain assets cheaply (or not) and, now that valuations have risen they may want (or need) to realise the value. They will logically decide to sell below the investment's potential if they cannot find an industrial buyer in order to find another investor buyer (i.e. PE). They realise they have to leave residual value to make it attractive. So we have a nice round of musical chairs at the moment."

But there is a greater risk involved in being the secondary, and sometimes even tertiary, PE buyer as value gets harder to come by. And, only time will tell whether the PE firms have overstretched themselves.

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Seneca House, Buntsford Park Road, Bromsgrove, Worcs, B60 3DX, UK.

Tel: Intl +44 (0)1527 573 600. Toll Free from US: 1-866-545-5878. Fax: +44 (0)1527 577 423.

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