Montefiore's Eric Bismuth on the French private equity market

What is the make-up of the French private equity landscape?

"The vast majority of our competitors in the French private equity sector are generalists, this is true across all segments of the market. When we founded our firm, we believed that there could be value in having a specific sector-focus. This has proven to be very successful in markets like the US.

France has specific strengths and weaknesses as a country. Our analysis is that service-related sectors tend to have more strengths than weaknesses. This is due to a combination of core factors, including social regulation, intense competition and barriers to entry.

The core of our strategy is to focus on locally-supplied services. We do not invest in industrial businesses or industry-oriented services, which we believe have different key success factors and economics. Our portfolio includes distribution, hotels, leisure and travel, all of which are very important in France, as well as network services like health, education and support. The locally-supplied incarnations of those service sectors have demonstrated a stronger level of growth on average than the broader French economy. About 60 per cent of the net wealth created in France over the last about 20 years has been made in those sectors."

How would you characterise the French private equity market compared to the UK or Germany?

"It's a large market, and it was quite successful until the crisis, but a key characteristic is that most fund managers have similar backgrounds, similar strategies, and similar portfolios, with people coming mainly from M&A or financing, and much less from the business side of private equity. I think that is one of the main reasons that some teams lack the ability to exert sufficient influence over the direction of their businesses, and why their dependence on the management has been higher than in other markets. This was less visible before the crisis, but has become very clear since then."

Do you think it's a weakness to have so many of the players come from the same background?

"I do. Everybody seems to believe the same thing at the same time, everybody is reading the same magazines and are doing the same things. I think you make money when you go against what everyone else is doing."

Do you agree with the negative reports about the performance of the European private equity market over the next year?

"The French private equity market was pretty homogenous in performance terms in the past, but has become increasingly de-averaged today. The average is probably not going to be as high as in some northern European countries. There will be a much wider polarisation of return levels, with strong winners and strong losers cropping up more regularly now than four years ago."

Would you say some weaker firms were being buoyed up by the boom?

"Exactly, and also by the inflation of the marketplace. You don't need to be a genius to make money when everything is going well, so it tends to equalise the performance of all firms."

How fragmented are the markets for the companies you target?

"It depends on the segment, but most of the markets for companies with sales of below €100m have significant room for consolidation. The large French groups have been very successful at internationalising in the past 25 years, but this has not yet trickled down in any significant way to companies that are doing less than €200m of sales.

We aim for our portfolio companies to become more European, more international, and in some case we even go after emerging markets."

How important is internationalisation, and which countries do French companies tend to expand into?

"Internationalisation is a big opportunity for many of the companies at the level we target. Emerging markets are the theme of the day right now, but they don't tend to be the easiest options for lower mid-sized companies. It is much easier for companies at that level to go into a Europe, particularly if they have a product or service advantage. With budget hotel group B&B Hotels, we went first to Germany, which has proven to be very successful, and now we are rolling out into Poland and Italy first, before considering emerging markets.

For a company like campsite holidays operator Homair Vacances, we cultivated southern European countries like Italy, Spain and Croatia, for destinations, and grew into Northern Europe in terms of new customers, mainly in England, the Netherlands and Germany. So we have a different strategy for each company in terms of the markets we target, but very often there is significant room for growth at a European level, and it is easier for the management teams to understand the business and to recruit the right people. India and Brazil are more fashionable, but if you have a company with sales of €50m , it's more difficult to put the right people in place in order to build a significant presence in these countries."

How attractive is the Maghreb as a destination?

"I think it's a very interesting region for some businesses but less relevant for our companies. It's extremely relevant to the industrial sector, particularly for French companies: nationals of the Maghreb speak French, and it's pretty easy to recruit people in France who come from those regions, making for strong management teams. It's less relevant for the service side, as these tend to be smaller markets for consumer-related businesses with lower purchasing power.

France has been seen as kind as quite a strong opponent of financial deregulation, and was pushing some of the more aggressive aspects of the AIFMD. How is private equity perceived there, and does that affect how you operate?

The French market is quite well-regulated at present, and we are not really worried about the impact of AIFMD on the way we operate. I think what has the potential to be more significant are the Solvency II and Basel III regulations, which do not impact directly the GPs, but have an effect on LPs. In France, the investor base is historically made up of banks, insurance companies and family offices I think we need to acknowledge that the French insurance and banks will allocate less to private equity because of those regulations."

Montefiore raised its last fund in 2008 – how invested is it so far, and when are you planning to return to market?

"We have probably been the most active team in the French market in 2010. Not many people know it, because we tend to be very discreet, but we've done four new deals, we've invested more than €100m equity. We have also carried out two recaps and executed five , build-ups.

We invested in Sofibo, a low cost modern design sofas and furniture, a company called Iso, which is the leading training school in France for optometrists and opticians. We also invested in B&B Hotels alongside Carlyle, which also represented an exit for us on the other side, because we were also partners of Eurazeo in 2005.) Finally, we acquired a regional group of clinics in early December called Avenir Sante.

At this stage we have invested about two thirds of our second fund, as well as €70m of co-investments. So in aggregate, we will have invested around €200m, way above our second fund size of €120m, in less than three years, despite the crisis, and delivering returns of above 25 per cent gross IRR both on fund one and fund two."

Do you expect to stay as active in 2011?

"We'll do some new deals and we'll do more add-on acquisitions, so we're definitely going to be active, but at the same time, we are going to be thinking about what comes next in terms of fund three."

What size do you foresee targeting for fund three?

"It's a little too early to say, but it could be around €180-200m in light of what we've invested from fund two."

What characteristics do you look for in an investee company?

"When you look at the common themes uniting these companies, they tend to be in very resilient businesses, because we don't have any clue about what the economic conditions are going to be, particularly not in the next six months, but also in the next three to five years. So resilience is very important to us. Secondly, we need to have identified a significant opportunity for profitable growth, for about ten years. The first five years is our investment horizon, and the following five years is the horizon of the people who will acquire the business from us. Third, we need to have a management team we believe in, and with whom we feel comfortable partnering.

We have a specific detailed strategic and operational roadmap for each of our businesses. They are diverse in terms of sectors, because we need to have a diverse portfolio and to avoid having every business in the same cycle.. We also need to have a specific ability to support those companies through strategic catalyst role, identifying new avenues for growth, going faster in terms of leveraging opportunities, and attracting the best people to reinforce the management teams. These are things that we are implementing in a very systematic way across our portfolio."

You didn't use any leverage in your acquisition of car rental company Auto Escape. What is your attitude to leverage in general?

"Our characteristic to be very pragmatic on leverage. In the case of B&B, which we acquired in 2005, you were looking at a company with a lot of real estate, and a highly profitable 40 per cent EBITDA margin. We went for high leverage, and we were very comfortable doing so, because we knew it was a very resilient business, because of its business model and the structure of the French budget hotel market.

At the opposite end of the spectrum, Auto Escape has a thin model in terms of EBITDA, generating a lot of cash because of negative working cap. There are some potential for acquisitions, but the potential debt quantum was small in absolute terms, so it would require a lot of effort and time for a limited stake in terms of performance, so we thought it wasn't the right choice to use leverage. Depending on the specific business model for the next five years, we are comfortable in either situation."
