2013 SPECIAL REPORT

THE NORDIC PRIVATE EQUITY WAY

A MODEL THAT WORKS

BerchWood Partners

The Nordic countries are doing something right when it comes to macroeconomics and private equity.

Introduction

This marks the first issue in BerchWood Partners' new series of private equity market surveys, which are intended as a vehicle to share our views and insights with colleagues in the private equity community about specific regions, sectors, and types of funds.

We have been following the Nordic private equity market since BerchWood's launch 13 years ago. What has continued to attract our attention is not only the region's strong and stable economies, but its shared values of transparency, education, technological adoption, and entrepreneurship. Together, these have created conditions for the region's private equity market to grow and flourish such that today it is home to a number of globally recognized fund managers and an emerging secondary market.

The Nordic region includes Denmark, Finland, Iceland, Norway, and Sweden. For the purpose of this report, we have largely excluded Iceland. These countries have the distinction of being consistently rated near the top of global competitiveness indices. "The Nordic Way" is synonymous with having high living standards, inclusive welfare states, responsible environmental policies, along with meaningful social cohesion and trust.[1]

The four main countries have an average per capita personal income of over €32,000 with diverse and vibrant economies. Although they share certain cultural, social and economic affinities, they have distinct political differences and strategies for participating with the outside world (see Figure 1).[2]

As indicated on the pages to follow, the Nordic countries are doing something right when it comes to macroeconomics and private equity. In its recent special report on the region, *The Economist* gave good reasons for political leaders to take notice of "the next supermodel."[3] We think those reasons extend to the environment, which is conducive for private equity to create value for investors and productive companies for consumers, workers and the broader society.

Figure 1: *Political and Economic Affiliations*

	EU	Eurozone
Denmark	Yes	No
Finland	Yes	Yes
Iceland	No	No
Norway	No	No
Sweden	Yes	No

1. "The Nordic Way: Shared Norms for the New Reality," World Economic Forum, Davos 2011.

2. Norway and Iceland are members of the European Economic Area (EEA), which enables them to participate in the EU's Internal Market without being members of the EU.

3. The Economist, *"Northern Lights," Special Report on the Nordic Countries, February 2, 2013.*

"It's not just the airports' beautiful hardwood floors that give the Nordic region international appeal. Finland is the safest country in the eurozone, Norway is sitting on a continent's worth of oil and Sweden had its banking crisis a decade before everyone else and avoided the euro."

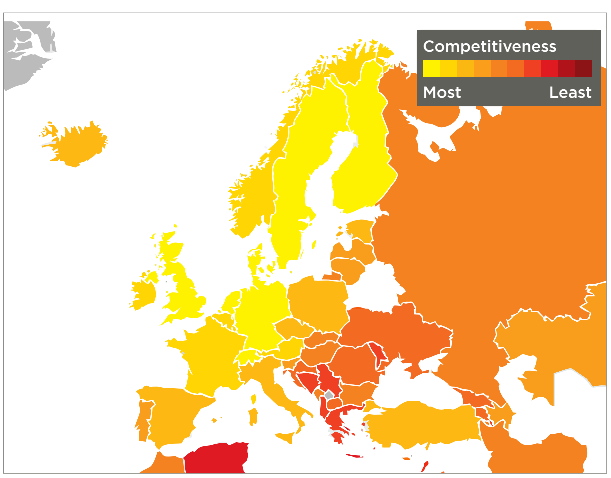
James Mackintosh, *Financial Times*, Investment Editor, October 14, 2012

Macroeconomic Environment

The Nordic region has become one of the most economically vibrant parts of Europe. Although the Eurozone crisis has negatively impacted its exports and appreciated its currencies, the Nordics generally experienced less economic stress than the broader region. This is not only owing to the fact that Finland is the only Nordic country that uses the Euro, but also has to do with the region having experienced its own set of financial crises in the 1980s and 1990s and put its collective economic houses in order.

The region's economic stability and strong macroeconomic fundamentals are reflected in its consistently high ranking in the World Economic Forum's global competitiveness index. In its 2012 report, Finland and Sweden were ranked third and fourth, with Denmark at No. 12 and Norway at No. 15 (see Figure 2). The four countries also made it into the top 15 of the World Bank and the International Finance Corporation's most recent ranking of countries where it is easiest to start and run a business (Doing Business 2013).

Figure 2: *Global Competitiveness Snap Shot of Europe*

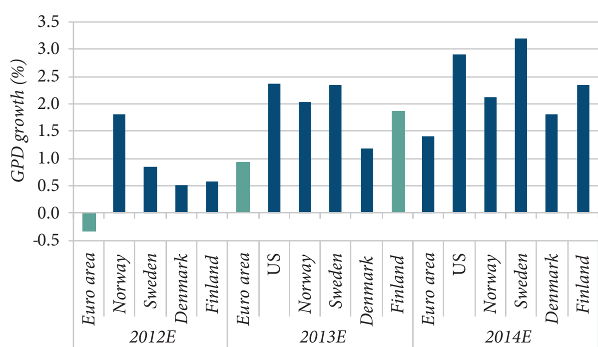


Source: World Economic Forum

A key factor identified by these reports is the region's strong public and private institutions, which help to create an environment conducive to innovation and enterprise by emphasizing transparency, open economies, education and training. Another key component is supportive local financing provided by well-capitalized and governed banks, which had limited direct exposure to the most crisis-vulnerable Eurozone countries.

As a result of their strong and healthy institutions and prudent economic management, the Nordic countries are posed to continue to grow faster than the countries within the Eurozone (see Figure 3).

Figure 3: *GDP Growth Forecast for the Euro Area and the Nordics*

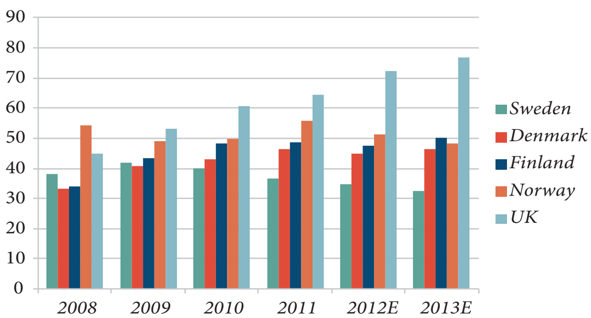


Source: IMF

Another important contrast the Nordic countries have with other European countries is the state of their public finances. Having undergone the difficult but necessary structural changes prior to the Great Recession, governments in the Nordic countries were in a stronger position to withstand the recent global turbulence. The Nordic countries stand out for having low government debt to GDP levels both in the last few years and forecasted (see Figure 4). With substantial oil wealth, Norway has a distinct advantage, but Sweden has benefited from instituting strict budget rules.

The Nordics' healthy economic climate and strong cultures of education and enterprise have made it a fertile ground for a growing number of world-class companies such as Statoil, Ericsson, ISS, H&M, IKEA, Skype, A.P. Møller – Mærsk, MySQL, ClickTech, and Spotify.

Figure 4: *General Government Debt as Percentage of GDP*



Source: UBS Global Economic Forecasts

The region's competitiveness and economic strength is also reflected in its current account position, which except for Finland, has been in surplus (see Figure 5). This performance is in stark contrast with other European countries. Sweden's exports are advantaged with a non-Euro currency, but it also leads the world in manufacturing productivity.[4] Denmark's economy is strong in transport and agriculture, and Norway has tremendous oil and gas wealth in addition to shipping and fishing, while Finland is somewhat weaker given its reliance on the pulp and paper industry, and falling star Nokia.

The region's focus on education and training are key drivers of its productive workforce and has helped to keep unemployment rates significantly lower than those in the Euro area (see Figure 6). That said, while Denmark is generally rated as having one of the more flexible labor markets in Europe, Sweden's is less so and struggles with high youth unemployment.

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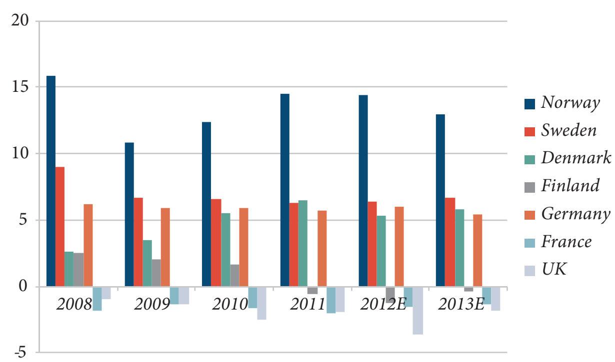
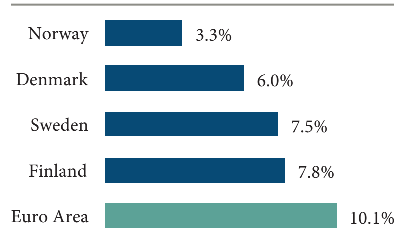
Figure 5: *Current Account as a Percent of GDP*



Source: UBS Global Economic Forecasts

Figure 6: *Unemployment Rates in the Nordics vs Eurozone*



Source: FactSet as of September 2012

4. Tomas Naucler, Magnus Tyreman and Charles Roxburgh, "Growth and Renewal in the Swedish Economy," McKinsey Global Institute, January 2013.

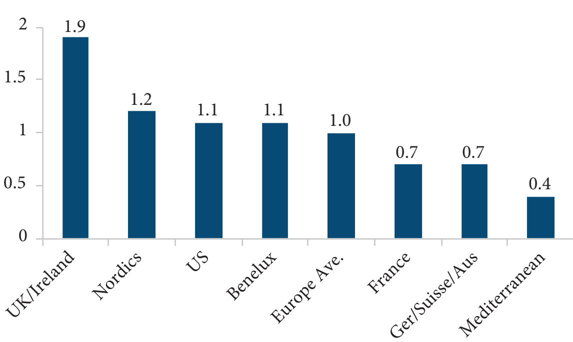
The Nordic countries have consistently outperformed their European and U.S. peers based on pooled horizon returns, which aggregate cash flows and residual value since a fund's inception.

The Nordic Private Equity Market: Maturing and Dynamic

Strong economies and enterprising cultures have provided a solid foundation for the Nordic region's private equity industry. As the home of nearly 200 private equity fund managers that have raised a total of nearly €50 billion in aggregate capital commitments over the last 10 years, the Nordic buyout market is both large and mature.[5] According to Preqin, there are 59 firms in the region that pursue buyouts and 129 that focus on venture capital.

The market has been one of the most active in Europe and helped to nurture some of the most successful private equity firms in the world. The Nordic market is second only to the UK and Ireland in terms of PE penetration, as measured by PE-owned businesses' enterprise value compared to a country's GDP (see Figure 7).

Figure 7: *PE Penetration by Region (Ratio of PE-backed businesses' EV to GDP, 2011)*

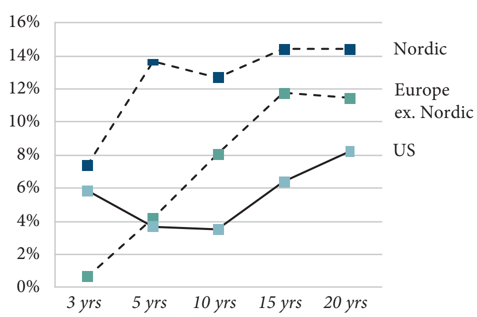


Source: Ernst & Young, "Branching Out: How Do Private Equity Investors Create Value? A Study of European Exits," 2012, p. 9

5. Luke Goldsmith, "Nordic-Based Private Equity Fund Managers," Preqin (online), November 28, 2012.

Critical to the region's historical attractiveness and strong growth has been its consistent outperformance relative to other markets. The Nordic countries have consistently outperformed their European and U.S. peers based on pooled horizon returns, which aggregate cash flows and residual value since a fund's inception (see Figure 8).

Figure 8: *Private Equity Regional Performance (IRR, Pooled Returns)*



Source: Thomson Economics, buyout funds since inception, September 30, 2011.

Some of the most respected Nordic firms include Nordic Capital, EQT Partners, Segulah, HiTecVision, Altor, IK, FSN, CapMan Norvestor Equity, and secondaries manager Cubera Private Equity. Stockholm-based Nordic Capital, which was launched in 1989, was ranked No. 4 in the Dow Jones top 20 global private equity performance rankings last year. This is the firm's fourth consecutive year to make the rankings, and over the past 10 years it has raised €7.7 billion. Bloomberg ranked the firm as the top seller in 2012, with six exits totaling €11.6 billion.

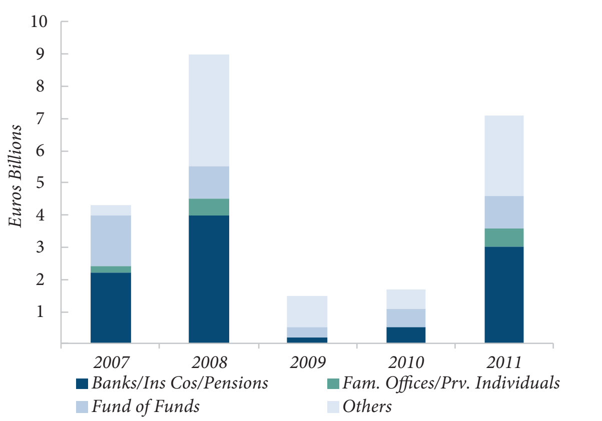
Following close behind Nordic Capital is the larger (by assets under management) EQT Partners, which was ranked the sixth most active seller last year with five exits valued at over €7.7 billion by Bloomberg. Since its first acquisition in 1995, EQT has grown and diversified into credit, mezzanine, and infrastructure funds and now invests across Europe, Asia and the United States. Both firms made the PEI 50, Private Equity International's

Secondary investments have become an integral part of the private equity investing cycle given their role in facilitating liquidity, portfolio re-balancing, and diversification.

ranking of the largest firms in the world. EQT was ranked No. 37 with a five-year fund raising total of €5.8 billion while Nordic Capital came in No. 47 with just over €4.5 billion.

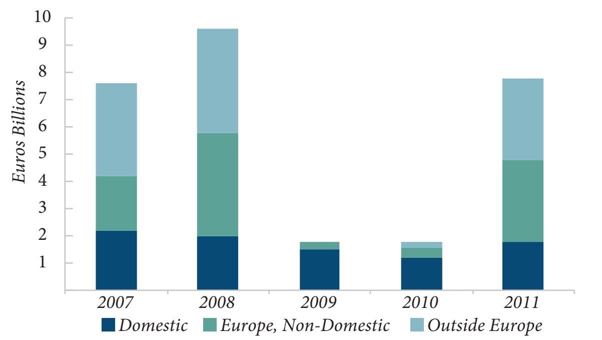
The region's firms have attracted a diverse investor base by type and geographic origin with banks, insurance companies and pension funds representing the vast majority of capital (see Figure 9a, 9b). The accelerated growth of the industry has meant that non-domestic investors have grown to account for nearly 75 percent of capital raised. A key pillar to private equity's early start in the region was sophisticated long-term, local investors, including insurance companies such as Skandia, Folksam and AFA.

Figure 9a: *LPs in Nordic Private Equity by Type*



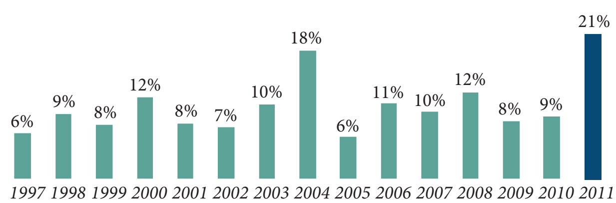
In 2011, the region raised over 20 percent of the total capital attracted for European private equity, which amounted to €8 billion (see Figure 10). Since 2011 the fundraising environment has become tougher: a number of well-established European firms such as Apax Partners and Cinven have had to ratchet down target fund levels. Nordic Capital had to lower its target last October. This contrasts with EQT Partners' experience in 2011 when it raised €4.75 billion in less than nine months, surpassing its initial target of €4.25 billion.

Figure 9b: *LPs in Nordic Private Equity by Geography*



Source: EVCA Yearbook 2012

Figure 10: *Nordic Share of European Fund Raising*



Source: EVCA Yearbook 2012

SECONDARY MARKET EMERGES

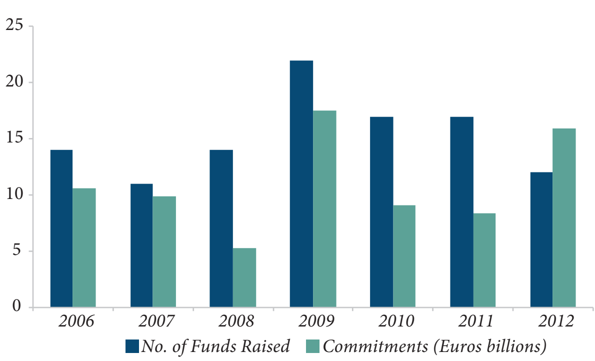
The emergence of a healthy secondary market is another sign of the region's maturing private equity market. Secondary investments have become an integral part of the private equity investing cycle given their role in facilitating liquidity, portfolio re-balancing, and diversification. Nordic secondaries specialist Cubera Private Equity values the secondaries market in the Nordics at €1 billion per annum and estimates that this will grow in the future as the primary market expands and the secondaries market develops further. Coller Capital's recent survey of investors found that "more LPs will use the secondaries market over the next 2-3 years than in its entire history."[6]

6. Global Private Equity Barometer, *Coller Capital, Summer 2012, p. 7.*

Over the near- to mid-term regulatory pressures on financial institutions investing in private equity funds are expected to be particularly acute.

In 2011, global deal volume hit €19 billion according to the *Dow Jones Guide to Secondary Market Buyers*. Fundraising jumped from €8.4 billion in 2011 to nearly €16 billion in 2012 (see Figure 11). The three largest funds raised in 2012 were European: AXA Private Equity, Coller Capital, and Partners Group. One of the headline deals included Swedish insurance group Länsförsäkringar selling off a €1.5 billion portfolio of private equity interests to a consortium led by the Abu Dhabi Investment Council and Australian sovereign wealth fund Queensland Investment Corp.[7]

Figure 11: *Annual Secondary Fundraising*



Source: Preqin

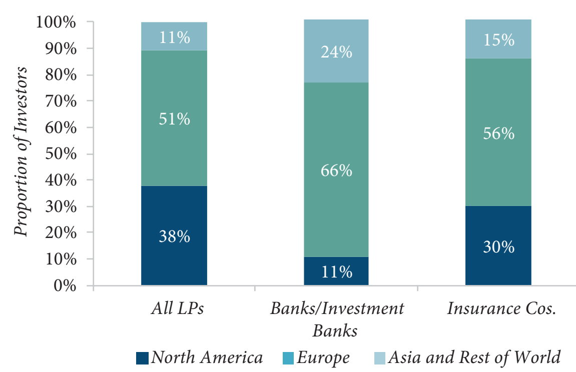
Like the global secondary market, the Nordic secondaries market is expected to accelerate as a result of a number of fundamental drivers including:

> Continuing economic growth in the Nordic region and associated growth in the primary market
> Growing demand and sophistication by investors for re-balancing their portfolios and consolidating their GPs
> Increasing supply of secondary positions in the Nordic private equity market as a result of regulatory pressures such as Solvency III
> Growing demand by investors to enter the Nordic market through cost-effective vehicles (e.g. mitigating J-curve effect, lower fees)

7. Kiel Porter, "Investors Back Secondaries in 2012," Financial News, *January 4, 2013.*

Over the near- to mid-term regulatory pressures on financial institutions investing in private equity funds are expected to be particularly acute. According to Preqin, 25 percent of banks and investment banks and 17 percent of insurance companies are likely to dispose of private equity fund interests on the secondary market in the next 24 months.[8] Over this time period, European investors are expected to make up the great majority of sellers of fund interests (see Figure 12).

Figure 12: *Breakdown of Potential Sellers by Location*



Source: Preqin

According to Idinvest Partners, within the European secondary space, the mid-market segment "remains inefficient with a limited number of dedicated intermediaries and room for value creation." Moreover, in 2012, the firm expected pricing to remain attractive "driven by forced sales due to the new regulations and liquidity issues."[9]

8. Private Equity Spotlight, *Preqin, June 2012, p. 14.*

9. European Private Equity Outlook for 2012, *Idinvest Partners, May 2012, p. 25.*

"The Nordics are wealthy, well run, with high levels of GDP, high levels of education, sound infrastructure and good companies."

Henrik Kraft, Director at KKR[10]

As attractive as the Nordic market looks, with opportunities come risks and there are always uncertainties and "wild cards" around the corner. Three that we see include:

> Eurozone contagion into the Nordic region that escalates economic uncertainty and negatively impacts economic growth and private equity activity

> Government regulatory and tax intervention that raise the cost of doing business and thus discourages investment and deal activity (e.g. the present debate over carried interest in Sweden)

> A broader global economic slowdown

Conclusion

The Nordic private equity market is exceptional. It is both an outgrowth of the region's stable productivity-enhancing institutions as well as a key economic catalyst for the region's continued growth and dynamism given its role recycling capital to build more competitive and productive companies.

In part, this synergy may explain private equity's general political acceptance (at least thus far), which has enabled it to flourish to the benefit of investors, companies, consumers, and the broader society. The region's emerging secondary market is the logical evolution of its maturing private equity market and today provides an efficient means for investors from around the world to gain exposure to the Nordic market.

Four ingredients have been especially valuable for the continued strength and vibrancy of the Nordic market:

> Strong public and private institutions as well as a stable macro-economic framework

> A competitive and diverse group of private equity managers

> Growing pool of regional companies with strong international growth potential

> A growing secondary market providing investors flexibility to optimize and re-balance their portfolios

At BerchWood Partners we are optimistic about the future of private equity in general and specifically with respect to the Nordic market. Although their economies are presently being tested, the Swedes, Danes, Norwegians and Finns offer some of the best reasons why we like the asset class—especially in the difficult and uncertain economic times in which we live.

We welcome your feedback and questions, and thank you for your interest.

10. Iain Morse, "Private Equity: Growth Markets of the North," Investments & Pensions Europe*, May 1, 2011.*

About Us

BerchWood Partners is dedicated to raising capital for alternative investment funds globally. The Firm's professionals have over 140 years of fundraising and institutional marketing experience raising capital from investors around the world for North American, Latin America, European, Middle Eastern and Asian fund managers focused on buyout, venture, real estate, and secondary strategies.

BerchWood has relationships with a diverse and growing group of institutional investors worldwide.

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