Portfolio update: Golden oldies

An ageing population with time and money has meant the grey pound is a red-hot target for private equity.

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By Real Deals

A heated bidding battle for Siemens' hearing aid business last year came as no surprise. Financial investors and trade buyers keenly pursued the world's largest supplier of hearing instruments, which had a mooted €2bn price tag.

Siemens Audiology, a "leader of innovation" in the sector, employs over 4,000 people across Asia, Europe and North America. The business is part of Siemens Healthcare, which generated profits of €750m on a turnover of €12.4bn in the year ending 30 September 2010.

The auction attracted some of the largest private equity houses, including Cinven, Bain Capital and two consortia with strategic buyers from Germany and Australia. The target's principal appeals were its high margins and leading position within the rapidly expanding market. iData research estimates that the European hearing aid and audiology device market is worth some €3.8bn, with the majority of sales generated in Italy, Germany, Switzerland and the Netherlands.

Unlike Siemens, which shelved plans for a sale as bids fell short of its price expectations, Gresham Private Equity was able to swiftly offload its stake in another business that targets the older market. Gresham backed UK stairlift manufacturer Minivator's existing management in 2004 for an undisclosed sum. In 2010 it sold its interest to European health group Handicare in a deal that generated a 3.4x return on the original investment. Under the mid-market buyout firm's ownership, Minivator capitalised on buoyant consumer demand for stairlifts, bath lifts and personal hoists by rapidly expanding overseas, causing export sales to soar by 60 per cent in 2009.

Meanwhile, Norwegian buyout firm Herkules Capital made buy-and-build the cornerstone of its investment strategy with Handicare, a European provider of technical aids for the elderly and disabled. The business represented an opportunity to create a solid platform for multiple bolt-ons, and during the investment period 12 acquisitions were made. Handicare has since positioned itself as the market leader, with revenues rising from NKr605m (€77.5m) in 2005 to NKr2.5bn in 2009. Although certain financial details of the sale to Nordic Capital remain undisclosed, Herkules says the business made "good returns on equity" during the partnership.

Strong demand in the living and mobility aids markets has come on the back of ageing demographics. People are living longer and will inevitably require support in their old age. Those close to the deals confirm that these segments of the market have remained relatively unscathed by the recession as certain products, such as mobility aids, have shifted from being discretionary to essential health-related purchases, which has kept revenues stable throughout the downturn.

In spite of concerns over measly pensions, low interest rates eroding the value of savings and stock market falls, UK consumers aged over 65 are spending up to £100bn (€111.4bn) a year, according to Age UK. There is no doubt that the market is large and lucrative – however, it is equally complex, sub-dividing into a number of sectors that span active, healthy 50-somethings to cash-poor and infirm 75-year-olds.

That said, there are several characteristics that are universal, spanning the entire market group. First, mature consumers will experience a decline in memory, eyesight and mobility, and second, their financial and time demands will diminish as they become mortgage-free and their children leave home. There is little doubt that the spending power of this group is on the rise.

With this in mind, the asset class continues to identify profitable, cash-generative businesses with fast growth potential. A prime example is Tunstall Group, a UK provider of alarms, sensors and monitoring services for the elderly and infirm. Bridgepoint sold the business to Charterhouse Capital Partners in early 2008 in a transaction worth £514m. Bridgepoint was already familiar with the sector through its investment in Attendo of Sweden when it acquired Tunstall in 2005 in a £225m buyout. The buyout house subsequently merged the telecare division of Attendo with Tunstall to build scale and create "manufacturing and marketing synergies". The exit is believed to have generated 2.5 times the original investment. Bridgepoint also took the opportunity to reinvest some of the proceeds.

However, not all investments have fared so well. In 2008, Cognetas' portfolio company Travelsphere suffered as luxury holidays were put on hold. According to reports, the UK escorted holiday provider for travellers aged 45-plus was forced to renegotiate its loan facilities after high numbers of cruise holidays were cancelled. Cognetas subsequently faced heavy losses as banks took control of the business via a debt-for-equity swap.

Nonetheless, the asset class's enthusiasm for "grey" assets has not been dented by failure as the facts are too compelling to be ignored: people are living longer than previous generations, are healthier and are willing to work longer. They also have increased influence and spending power. The long-term macroeconomic and demographic drivers all point to a golden opportunity for private equity.

Stairlifts

Attitudes to stairlifts are changing. As people live longer and mobility becomes an issue, owning a stairlift has become a more accepted way of maintaining a mobile lifestyle.

Around 132,000 stairlifts are sold worldwide each year. The global market is estimated to be worth close to £230m and is growing at a steady rate of five to six per cent a year, according to the British Healthcare Trades Association.

There is strong demand from mainland Europe – predominantly France, Germany and the Netherlands – where 39 per cent of all stairlifts are sold, followed by the UK (36 per cent) and North America (20 per cent). In the UK, the stairlift market is driven by the nation's preference for two-storey buildings.

Demographics are driving demand, as is social care, which is actively encouraging older people to retain their independence by staying in their own homes. Government grants have also become more widely available.

Recent UK M&A activity includes Gresham's sale of Minivator to Handicare, and Acorn Mobility Services' acquisition of Brooks Stairlifts – the creator of the original stairlift – and Bison Stairlifts. The deals strengthen Acorn's position within the fragmented local authority market.

Hotter Shoes
Country: UK
Buyout backer: Gresham Private Equity
Year of investment: 2007

In December 2007, Gresham Private Equity backed the management buyout of Hotter Shoes for £21m. The house took a significant minority stake in the UK footwear designer and maker, with plans to develop the niche retailer and dip its toes into the US market.

Hotter Shoes, founded in 1959, began life as a slipper maker and has evolved into a multi-channel operation that targets the affluent grey market through its catalogues and website. The company also has 14 retail outlets across the country, with plans to open more this year.

Hotter Shoes generated annual revenues of £45m last year, and they are expected to reach £50m this financial year on the back of strong growth. While consumers have reined in their spending amid the VAT increase and higher inflation, Hotter's grey devotees have kept the tills ringing. It designed and manufactured some 1.3 million pairs of shoes last year, making it the largest shoe manufacturer in the country.

In addition to the classic attractions of a privately owned business that had reached a glass ceiling and required a rethink, Gresham was drawn to the strong brand and fierce customer loyalty. "Our customers are primarily women aged over 50, and 70 per cent of them are repeat purchasers. Higher customer retention rates have been driven by the quality of our products, high service levels, the ‘comfort’ concept and the ‘made in Britain’ element,” explains Gresham partner Andy Marsh, who led the deal.

At the time of Gresham’s investment, Hotter’s profits had stagnated at around the £4.5m mark. Three years on, they have reached £7.5m. Marsh adds: “From the outset our objective was to treble profitability, and a new management team was needed to achieve this.” With a new chairman, financial director and direct marketing expert in place, the business embarked on a multi-channel retail strategy to boost Hotter’s customer acquisition programme, roll out more stores across the UK and take its first steps outside of the UK.

“The initial results of our US expansion plans are encouraging. The response rate and order values are above expectations, but it’s still early days to talk about numbers. We tested the market last year with positive results and are now stepping up the investment to £2m,” he says. The company will use the investment to target 70 million older consumers across the Atlantic through its new US website, catalogues and marketing collateral, as well as a 24-hour call centre that will cover time difference issues.

Marsh adds: “At home and abroad, our niche of the market is all about quality of product and service. Broadly speaking, price sensitivity and reputation are essential to succeed in the “grey” market. Big-ticket items such as guided holidays have been hit badly by the recession, but we have not seen an impact on our business. We have managed to grow right through the recession.”

A-ROSA Flussschiff
Country: Germany
Buyout backer: Waterland Private Equity Investments
Year of investment: 2009

In 2009, Waterland Private Equity Investments entered the river cruise market with a major investment in German operator A-ROSA Flussschiff. The firm backed existing management for a majority stake in what was then Deutsche Seereederei’s luxury leisure business.

Konrad Meyer, investment manager at Waterland, notes: “A-ROSA was a profitable and growing business, with sustainable revenues and a strong position in this niche market in Germany. The deal was a pure equity one as the company was already fairly leveraged through a recent sale and leaseback transaction.”

A-ROSA operates river cruises on the Danube, Rhône/Saône and, more lately, the Rhine. Last year it delivered buoyant revenues of €64m, up 25 per cent from 2009. Meyer predicts the demand for river cruises will continue to grow year on year as a result of favourable demographics and high levels of repeat business.

Cruises (sea and river) are the fastest-growing segment of German tourism, with river cruises growing by an estimated ten per cent a year. Prior to investing, Waterland drilled down into the detail of the customer base to create a customer profile. Typically in their sixties, A-ROSA’s customers have safe assets and are less invested in shares and volatile commodities. They also prefer escorted holidays and want to enjoy the sights in the company of like-minded passengers. "For the most part, customers are affluent retirees who haven't been adversely affected by turbulence on the capital markets," Meyer adds.

A-ROSA's double-digit growth would suggest that the business is disconnected from the economic cycle since the recession has not diminished the "luxury leisure" spend of the over-sixties in Germany. "There was the risk with this investment that we would take a hit from the recession as tourism spend is always cyclical, but this has not been the case. The business is recession-proof," Meyer notes.

Post-deal, A-ROSA's management swiftly implemented a series of changes to improve the company's profitability, which involved cutting the number of cheaper charter trips to focus on higher-margin activity, expanding itineraries to include a new destination, additional routes and longer cruises of up to 14 days. Three new river vessels have joined the fleet and two more are on order that will open up the possibility of new routes and itineraries across Europe.

River cruise assets are riding the wave of market growth, and Meyer admits that there are high price expectations. Nonetheless, the firm is determined to expand A-ROSA through a buy-and-build strategy, but not at any cost. "A couple of German river cruise businesses went into administration recently, but buying a travel business out of administration is risky as the brand has frequently been destroyed and agent relationships are strained if they haven't been paid commission," he adds. Waterland continues to look at opportunities in the sector.

HSE24
Country: Germany
Buyout backer: Axa Private Equity
Year of investment: 2009

In November 2009, Axa Private Equity acquired HSE24, a German home shopping broadcaster, from troubled German retail group Arcandor. The collapse of that conglomerate put several retail assets up for grabs, including Thomas Cook, German department store chain Karstadt and parts of mail order business Primondo. The financial details of the HSE24 transaction remain undisclosed, but it is estimated to have fetched around €150m to €200m.

HSE24 is a frontrunner among German home shopping channels, ranking second after QVC. The broadcaster has 1.5 million active customers and one in ten Germans have made a purchase via the channel. Its key demographic are women aged 40-69, who represent 42 per cent of the female population. HSE 24 has a significant audience share, reaching around 40 million households across Germany, Austria and Switzerland.

At the time of the transaction, the debt markets were frozen. Nonetheless, Axa was prepared to fund an all-equity transaction. Stephan Illenberger, managing director of Axa Private Equity Germany, explains: "It was a challenging deal because we had three weeks to complete and there was no available debt. The holding company was in insolvency proceedings and there was limited information. Speed was crucial and the vendor couldn't give us warranties. We had to make a fast business judgement and do the investment without any real guarantees."

Cash flow is the lifeblood of any business and Axa was drawn to the cash-generative nature of the German home shopping business. Historically, cash flow had been absorbed by the parent company and the business had received very little attention. "We wanted to develop the business and release it from the constraints of the conglomerate," Illenberger says.

The buyout group promptly adopted a growth strategy that would entail grabbing market share through additional home shopping channels, improved internet sales and, more recently, a smartphone app for mobile shopping. The additional investment is in line with market forecasts that e-commerce, particularly the internet, will drive overall growth in the home shopping market for the foreseeable future. HSE24 achieved sales of €441m in 2010, up 12 per cent from 2009. Ebitda grew by 40 per cent over the same period.

Illenberger takes a pragmatic view on the over-50s market, which he suggests is largely untapped by investors. "I think products that are health-related and prolong life, as well as convenience products that make life easier for older people, are very attractive for financial investors because these markets are growing, and older consumers have money and are willing to spend it.

"There are still a number of products that could make life more comfortable for older people that haven't been developed into products yet. It's all about keeping your eyes open to identify them."