AUCTUS Capital Partners

Tailor-made solutions for a complex world

Since its launch in 2001, AUCTUS has carved out a reputation for excellence, recently named among the Top 10 Best Buy-Out Funds in the world for the 4th consecutive time. **Daniel Meuthen** shares how AUCTUS finds solutions for myriad interests when a family-held business seeks outside capital and talks about current opportunities in the German market.

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Dr. Daniel Meuthen
Partner
AUCTUS Capital Partners

Dr. Daniel Meuthen, Ph.D., is a Member of the Management Board at AUCTUS Capital Partners AG. Daniel joined AUCTUS in 2006 with a main focus on healthcare, retail, and consumer goods. Previously, he was an Investment Director at 3i Group plc., working in Hamburg and Munich and focusing on funding growth and ownership successions for medium-sized companies.

AUCTUS Capital Partners has been featured four consecutive times by the Preqin Alternative Assets Performance Monitor as among the Top 10 Best Buy-Out Funds in the world. What is driving your success story?

In short, we focus on creating what we call "tailor-made solutions"; adding value in areas where we have expertise; and on bilateral negotiations rather than auctioned deals. In addition we are focused on Buy-and-Build strategies, which in combination with a post merger integration strategy very often lead to what we call "learning systems" in order to increase performance. We take the time to understand the dynamic between the parties involved and bring highly flexible structures to create a transaction that works for everyone. Empathy and anticipation is key to understand the parties involved in a transaction and develop motivations into aligned strategies in favour of the company.

We have a very open dialogue with sellers about our agenda and vision for the business – very often we also share the operational model in combination with different financial deal structures to demonstrate where we see value and describe different risk-return combinations. Being honest and transparent is critical to building trust with owners and entrepreneurs involved in potential transactions.

In my view, our success is also necessarily linked to being selective in our investments and in our ability to say "no". For a lot of PE firms this may be a challenge because investing is their reason to exist and, without a consistently strong deal pipeline, they may feel forced to make investments just to keep investors happy. I think real investment strategy begins when you see the potential, work on aligned interest but also have the courage to decline the opportunity if you see too many issues in the transaction. Then you know exactly what you're looking for and what you're not.

What challenges are you facing in your investments, and how do you best overcome these?

On one side to encourage owners and management to drive the growth of their companies by detailed strategies e.g. through organic growth or acquisitions. Very often they are too busy with daily operational business and have less time for forward looking strategies. This is where we start with questions like: "What do you think, if you ..." or "Have you ever thought about ..." and "Why didn't you ...".

On the other side, we often see complex ownership structures with multiple shareholders across different branches of a family, where everyone could have a different agenda. Some want to sell 100% of their

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shares, others want to remain invested, and others want to stay invested and take an active role. These are challenging but also very interesting deal situations because you become kind of a consultant to the family. It is essential to take the time to talk to everybody and understand their personal perspectives on the future of the company and how it fits their personal plans. I have never encountered a situation where there was no solution.

Additionally, organizational development is key for our investment strategy. It starts very often with a situation we call "premature succession". This means, that at the time we invest, we still see high dependency on the founder. A lot of investors see this as a risk. We see this as a good investment opportunity as long as the owner and AUCTUS have a common and shared view on how to reduce this dependency in the forthcoming years.

This is very much linked to the question of who will execute the strategy as most of the time forward looking strategies need more management. So, therefore, in the mid-market you often have a lot of dependency on the founder and owner. They are looking for a partner because they want to grow, but also because they may be thinking about taking a step back and taking a different role. This can be a challenge for the company, so open discussions about a clear vision for the future are critical.

How do you think the German PE market has been, or is likely to be, affected by global political events such as Brexit or the decisions made by President Trump in the US?

We are not living on an island in isolation. Economic and political developments, both in Europe and worldwide, influence our daily business, of course. For example, we have a lot of companies with material export exposure e.g. to the US, UK or China, so we have to ask "what does this mean for us?" in the context of those businesses. You can see a changing environment as a threat or an opportunity. For me the key question is, "Is this a short term change or a trend?"

How do you ensure your portfolio companies develop and grow despite challenges in the market?

The tougher the general environment is, the more important anticipation of operational and strategic scenarios becomes. You have to have a good understanding of what happens in the market of the company and also what could happen in the future. Based on this you have to develop strategies that can turn challenges into opportunities. It is important to pursue what we call defense strategies to safeguard the achieved goals. At the same time you have to develop the organization and structure of the company to be able to realize the envisaged strategies. The aim is always to beat market growth numbers. This all has to be well balanced. So therefore it is very important to focus on the single steps of the value chain instead of just investing in a company, keeping it in the portfolio and then selling it to make gains through de-gearing or de-leveraging. Those times are over.

So you adopt mostly operational strategies, rather than financial strategies?
Operations come first and financial modelling follows, but it's important to have a balanced view. You need to be clear about how a new financial structure will affect the stability of your portfolio company.

We encourage the management to have a clear picture of the starting position, on day one of your investment, and make an operational plan for the following 100 days, 1 year, 5 years, etc., while remaining flexible so that the company can adapt to changes. You need to develop a deep understanding of what the future challenges will be and prepare the company to address them. Does the company need to invest in product development? Or is it necessary to invest in machinery to make production more efficient?

Benchmarking is also extremely helpful. When we make an add-on acquisition, we look at the KPIs of both companies to see which company does what better – this is our "Post-Merger Integration" process. It's a learning system that gives you the ability to look at your platform investment compared to other market participants and make improvements accordingly.

How important is it to you that management invest alongside AUCTUS?
Very often we face situations where the founder and owner wants to realize some of the created corporate value and at the same time wants to stay on board for several years. In addition to this "wealth strategy" he also has a "personnel strategy" like staying in the company for a transition period in the role as e.g. a CEO, but then wants to change to the Advisory Board. It is a very natural desire for someone who worked very hard for a lot of years. As mentioned we have to turn a premature succession situation into a real succession, which stabilizes the company. For this transition the owners very often are looking for experienced investors. The ideal situation is, that there is good management in the first or even second line. Personal strategies focus on developing these people to become full first line management, who will lead the company in the future.

Consequently we love having management invest because alignment is important to us. When everyone is putting their "neck on the block", as we do, it's much easier to discuss the future and grow the company. It also gives the manager the feeling that they are a true owner of the business and that's great motivation. If we have a top manager who isn't willing to invest in the company he is a key manager in, that would give us cause for concern. That said, while we encourage management to do this, it's not essential. Whether or not key personnel wish to invest depends on many things, but we can certainly prepare the offering and try to build support for the individual by offering flexible arrangements.

With the continuing increase of PE dry powder and average purchase price multiples rising in 2017 to a historic high of 10.3x, what is your strategy to do new deals without overpaying?
I think you have to dig a little deeper into multiple levels. As a general rule, small and mid-cap companies have lower multiple factors than larger companies in the same sector, so this average of 10.3x as a general rule isn't really relevant to us. In fact, it's one of the reasons why we focus on "buy and build" strategies. We can combine several companies to make the asset bigger – increasing turnover, profitability and stability, so it becomes more interesting for larger buyers.

One thing we don't like too much is to buy in an auction from another PE seller because, often, every obvious operational improvement or financial engineering has already been done. It's also difficult to offer a tailor-made solution in this scenario because the PE company typically wants to sell 100%. Our strength is trying to understand the entrepreneurial background of companies that need our help to grow, and by their nature these companies are not priced at the market average. We can help make the company more stable, independent from its founders, or gain a broader market share, so it is in a much better position for third parties.

You have a particular focus on healthcare. What current market trends are you seeing in this sector?
Healthcare is always a distinctly national issue because it's a regulated market, but there are some trends that apply to every country in Europe, such as an aging population and exploding costs. One key theme is how to increase treatment without increasing overall costs and this is driving several trends. Specialization in areas like elderly homecare, rehabilitation and diagnosis related grouping (DRG) clinics that focus on specialized treatments and operations is one way. Digitalization is another. A lot of treatments in the rehabilitation space have been transformed by technological developments and this will likely continue. In the neurological market, you can do a lot of brain training with a computer or mobile device. These are totally new and geography-independent developments – you don't have to go to a treatment center for them.

Corporate governance is also key because compliance is a hot topic in the healthcare sector. It's a real driver for consolidation because we can say, "if you come to us, we can review your processes and ensure you are compliant with changing regulations."

Finally, we understand that AUCTUS doesn't generally talk about its specific investments publicly. Can you explain why?
The thing about private equity is that it's private – not just in its source of capital but in terms of the importance of discretion generally, particularly given that many of our sellers are family businesses and individual entrepreneurs. For this reason, when we invest in a company we often don't make it public. We focus on being a partner in the business and finding the best solutions for everyone involved rather than publicizing our involvement.