Superior PE returns with investments in German IT assets
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With technology deeply embedded within every industry vertical and itself having been an industry vertical, it has now developed further to move on to become a horizontal. Technology is changing the way the world functions and operates, changing peoples lives and with this the potential of tech has become immense. This as one of the megatrends has attracted many strategic and financial investors over the last 20 years. With the growing interest and involvement of financial investors in this field, we turn back to take a look on how PE investment in IT assets in Germany has developed over the past 20 years and the returns that investors have made.

Market overview

- PE investments in German IT companies continuously increased over the past 20 years and reached a historical high in 2018. In the first three quarters of this year even more deals were transacted. However, due to a decreasing average deal value – as a result of a decreasing number of mega deals and increasing amount of smaller transactions – we expect the overall market value in 2019 to decrease.
- The lion’s share of all transactions (71%)\(^1\) don’t exceed €25m, although the average deal value lies at €59m, largely influenced by mega deals (2.3% of the total deal number).
- In the next three years, market experts expect PE houses to realise profits from their IT assets and to selectively continue to invest in emerging technologies.

Return on investments

- The average returns on PE investments in German IT assets lie in the range from 3.5x to 4.5x initial investment. The profits are on average realised within the first 5 years of the holding period.
- Disposals to strategic investors account for the largest proportion of exits (62%), with reported average multiples of 5 to 5.5 times initial investment and 82% IRR.
- Disposals to other financial investors make up 24% of total exits and deliver 2 to 3x money multiples and 35% IRR.
- IPOs amount to only 6% of all exits and result on average in 3.5 to 4x money multiples and 59% IRR.

Investment strategies

- PE houses undertake majority investments to gain control over key strategical and operational decisions in their holding companies, but the share of minority stakes gained through expansion and acquisition financing is comparably high (59% of total deal number).
- Buyouts account for \(\frac{1}{3}\) of all transactions: primary buyouts account for €13bn in value terms (127 transactions), followed by secondary buyouts mainly from VC firms (€ 7.7bn or 32 transactions)\(^2\).
- PE houses target developed companies aged on average 14 years with relatively mature business models.
- Software developers and programmers are first and foremost targeted by PE firms (64% of total deal number), followed by developers and providers of IT platforms and IT service companies (22% respectively 14% of total).
The market has grown exponentially over the past years and the outlook remains positive

PE investments in German IT companies steadily increased over the past twenty years. The deal value has surged fivefold immediately after the financial crisis in 2007 and by over 3 times in 2013 year on year reaching a historical peak in 2018 (€6.4bn or the 26-fold of the market volume in 2007).

In the first three quarters of 2019, even more deals with the participation of PE investors was observed (56 deals compared to 40 deals in the same period of the previous year). Given this trend, we expect the German market to outperform the previous year in volume terms. Nevertheless, the market value in 2018 has been significantly influenced by two large deals – the €2.7bn buyout of SUSE by EQT and General Atlantic’s minority investment in Nucom with an estimated enterprise value of €1.8bn. Year to date 2019 has seen only one mega deal – the €1bn buyout of Inexio by EQT’s infrastructure fund. Thus, the overall market value is likely to fall as compared to 2018. Removing the three mentioned transactions from the data set, average deal values would increase from €57m to €58m year-to-year and the market would be bound to reach a new high by the end of 2019 not only in volume, but also in value terms.

Fig. 1  PE Investments in German IT companies in the period from 1999 to 2019 by deal value and volume

Fig. 2  PE Investments in German IT companies in the period from 1999 to 2019 by average deal value
The market has grown exponentially over the past years and the outlook remains positive.

Over the last 20 years, PE houses invested on average €59m in each IT asset, whereas the median deal value lies at around €12.5m. As mentioned above, the average transaction size is skewed by the effect of mega deals. Indeed, only 11 deals account for 2.3% in terms of volume, but 42% of the total deal value during the last 20 years. For example, SUSE Linux AG was acquired in July 2018 by EQT Partners from UK-listed Micro-Focus International for €2.2bn on a cash and debt-free basis. The open source enterprise software provider headquartered in Bavaria has changed hands relatively often and yet remained a strong player in its business – it was acquired by Novell in 2004 which was then acquired by Attachmate in 2010 and finally by Micro Focus in 2014. The other two mega deals involved Hellman & Friedman in a consortium with Blackstone for the €2bn acquisition of a 70% stake in Scout24 in November 2013 and General Atlantic with its 25.1% stake investment in the newly formed e-commerce business Nucom Group at an enterprise value of €1.8bn in February 2018.

Average deal size increased over time by more than 20% from €52.2m for realised investments to €64.2m for current PE portfolios, driven by persisting long-term trends such as low-cost financing, competitive deal processes and full valuations that among others have bolstered the deal values. Highlighting the general European trend, the multiples on German IT assets reached their historical heights of up to 26x EBITDA in the third quarter of this year.

Due to a lack of high-quality acquisition targets, a large number of small and medium-sized private equity and venture capital investors competing for smaller deals and the increasing presence of global PE investors in Germany, higher valuations are likely to persist. Given a stable macroeconomic environment, market experts predict continuing PE investments in selective emerging technology niches with a high potential for further growth, first of all data analytics, Internet of Things and artificial intelligence.

Historically high multiples are driving lofty entry prices, thus GPs are facing significant challenges to deliver value within relatively short holding periods. Thus, private equity investors are now focusing on various value-creation strategies, e.g. operational improvement and data-driven decisions.
The German market for PE investments in the IT sector is fragmented – the private equity houses are predominantly invested in one to two German IT companies, with larger global players holding 3 to 4 IT assets.

In 2019, the top PE players by deal value on the German IT market are UK, US and Scandinavian houses EQT, General Atlantic, Permira, HgCapital and Warburg Pincus. German private equity companies follow shortly behind – the Munich PE houses Deutsche Private Equity and Emeram hold the seventh and twelfth places, Berlin-based Capiton being fourteenth.

The top ranking of EQT results mainly from the €2.2bn acquisition of SUSE LINUX in 2018 and the €1bn buyout of Inexio in September 2019, whereas the size of other IT investments Utimaco Software (€130m) and Wandelbots (€6m) is comparatively small. Permira's ranking mainly relates to its investments in TeamViewer (€870m, Mai 2014) and P&I Personal & Informatik AG (€835m, September 2016). The 3rd place of HgCapital results mainly from its investments in Transporeon (€700m) and Medifox (€375m) accounting for the lion's share of its German IT portfolio. The largest German IT asset of General Atlantic is its 25.1% stake in ProSiebenSat.1’s Nucom (€813m), and Warburg Pincus is invested in United Internet (€550 to €800m estimated investment value).

The ranking is highly influenced by mega deals and varies year to year. For instance, Hellman & Friedman has held one of the top 3 places from November 2013 until February 2018, when it has been invested in the leading German online marketplace Scout24. Furthermore, it only indicatively reflects the positioning of PE investors on the German IT market as it is based on historical deal values and not the current market valuations of assets. For example, the estimated market value of Permira’s German IT portfolio after TeamViewer’s recent listing on the Frankfurt stock exchange (€3bn) significantly exceeds the initial investment value (€1.7bn).7

The competition for tech assets has never been higher – French Eurazeo Growth and Naxicap Partners, Norwegian Verdane and FSN, and US-based KKR and Warburg Pincus opened new offices in Germany in the last two years and have ambitious plans to force investments in German technology, media and telecommunications companies.

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### Fig. 5  Largest PE players on the German IT market by deal value

<table>
<thead>
<tr>
<th>Rank</th>
<th>PE House (equity lead)</th>
<th>DV(€m)</th>
<th>#deals</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>EQT</td>
<td>3,306</td>
<td>4</td>
</tr>
<tr>
<td>2</td>
<td>Permira</td>
<td>1,705</td>
<td>2</td>
</tr>
<tr>
<td>3</td>
<td>HgCapital</td>
<td>1,263</td>
<td>5</td>
</tr>
<tr>
<td>4</td>
<td>General Atlantic</td>
<td>1,000</td>
<td>3</td>
</tr>
<tr>
<td>5</td>
<td>Warburg Pincus</td>
<td>675</td>
<td>2</td>
</tr>
<tr>
<td>6</td>
<td>BC Partners</td>
<td>397</td>
<td>1</td>
</tr>
<tr>
<td>7</td>
<td>Deutsche Private Equity</td>
<td>375</td>
<td>3</td>
</tr>
<tr>
<td>8/9</td>
<td>Bain Capital/Advent¹</td>
<td>350</td>
<td>1</td>
</tr>
<tr>
<td>10</td>
<td>Eurazeo</td>
<td>203</td>
<td>1</td>
</tr>
<tr>
<td>11</td>
<td>Main Capital</td>
<td>194</td>
<td>1</td>
</tr>
<tr>
<td>12</td>
<td>Emeram</td>
<td>188</td>
<td>4</td>
</tr>
<tr>
<td>13</td>
<td>Oakley</td>
<td>184</td>
<td>1</td>
</tr>
<tr>
<td>14</td>
<td>Capiton</td>
<td>175</td>
<td>1</td>
</tr>
<tr>
<td>15</td>
<td>CapVis Equity Partners</td>
<td>175</td>
<td>1</td>
</tr>
<tr>
<td>16</td>
<td>Vitruvian Partners</td>
<td>160</td>
<td>2</td>
</tr>
<tr>
<td>17</td>
<td>Apax</td>
<td>155</td>
<td>1</td>
</tr>
<tr>
<td>18</td>
<td>Carlyle</td>
<td>150</td>
<td>2</td>
</tr>
<tr>
<td>19</td>
<td>Deutsche Beteiligungs AG</td>
<td>113</td>
<td>2</td>
</tr>
<tr>
<td>20</td>
<td>Waterland Private Equity</td>
<td>113</td>
<td>2</td>
</tr>
</tbody>
</table>

¹ Including largest IT investments of Bain Capital and Advent, estimated value as of 2019.
Do PE investments in German IT assets deliver superior returns?

Due to the digitisation needs of key German industries, IT assets have seen an increasing interest from strategic and financial investors. But are the private equity investments in German IT companies profitable? Indeed, our analysis have shown that every 10th PE investment in German IT assets delivered superior returns of over 7.5x initial investment. Nevertheless, over 25% of all investments resulted in partial or total losses.

Fig. 6 Exit multiples on PE investments in German IT companies

<table>
<thead>
<tr>
<th>Outcome</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insolvency</td>
<td>18%</td>
</tr>
<tr>
<td>Negative returns</td>
<td>9%</td>
</tr>
<tr>
<td>Profit up to 1x initial investment</td>
<td>13%</td>
</tr>
<tr>
<td>Profit from 1x to 2.5x initial investment</td>
<td>23%</td>
</tr>
<tr>
<td>Profit from 2.5x to 5x initial investment</td>
<td>23%</td>
</tr>
<tr>
<td>Profit from 5x to 7.5x initial investment</td>
<td>5%</td>
</tr>
<tr>
<td>Profit over 7.5x initial investment</td>
<td>10%</td>
</tr>
</tbody>
</table>
Sales to corporates provided the highest proportion of all exits (62% by number and 61% by value) that can be well explained with the highest average exit multiples of 5 to 5.5x initial investment and average IRR of 82%. Obviously, strategic buyers are ready to pay higher premiums for assets with more mature business models that could provide additional value and synergies in combination with their own businesses. PE firms go beyond historical financial engineering models and increasingly collaborate with strategies to meet their demands and to develop the business models of their IT holdings according to the market’s expectations.

One of the successful exits to strategics was Oakley’s sale of Damovo Europe, a provider of enterprise information communication technology services, to Eli Global. This deal brought Oakley a 5.4 multiple on invested money following a holding period of three and a half years, equivalent to an IRR of approximately 57%. Oakley’s most profitable deal in terms of IRR is the consolidation of two German dating platforms EliteMedianet and Parship acquired in April and June 2015. Oakley sold the combined business to ProSiebenSat.1 Media in September 2016 with a return of 3.6x and a 150% IRR. Its equity investment generated a 2.3x cash return, with the interest in Parship valued at €67m, including expected net cash returns of €44m.

Disposals to other financial investors (24%) represent the exit route that yields the lowest average return of 2.4x initial investment and an average IRR of 35%. This category includes partial exits when minority stakes are sold to other financial investors providing acquisition and expansion finance. Obviously, this category comprises companies in earlier stages of their development seeking additional capital to finance their organic or inorganic growth as well as companies with less mature business models that are not yet ready to be takeover candidates for strategic buyers. This conclusion is supported by the fact that holding periods for assets sold to financial investors (5 years) are somewhat longer than for assets disposed to strategic investors (4.5 years) and assets listed on stock exchanges (3.8 years). The prices that other financial investors are ready to pay for these assets are lower due to the fact that their business models, management and operations still need to be improved.
One example is the secondary buyout of P&I Personal & Informatik AG by Permira from HgCapital in September 2016 that has been acquired by Hg for €438m in November 2013 and sold to Permira Advisers for €835m in September 2016, resulting for Hg in 36% IRR and 2.3x money multiple. During the 3 years holding period, P&I had achieved a double-digit EBITDA growth through expansion of its product and cloud-based offering and sale of its new human capital management, recruiting and analytics software to existing and new customers. Permira bought the asset to support its organic growth and to draw on consolidation opportunities in Germany.\textsuperscript{10}

Exits by taking an asset public usually involve major divestments and are less common compared to the period before the financial crisis of 2007. During the last two years, only two IT companies – Scout24 and TeamViewer – have been listed on the stock exchange\textsuperscript{11}. This trend goes in line with the overall market – the number of publicly listed companies in Europe continues to fall.\textsuperscript{12} The complex, lengthy and costly process of preparing and conducting an IPO could be making this route less appealing. This hesitancy is magnified when fresh economic downturn predictions and risk-off tactics surface as well.\textsuperscript{13} According to our estimates, the profitability of listings suffered over the past 12 years - the average multiples on recent IPOs didn’t exceed 2.5x initial investment compared with 3.5x to 4x money multiples and an average IRR of 63% in the period prior to 2007.\textsuperscript{14}

Investments are realised within 4.5 years on average.

The private equity investments in German IT assets are realised after a median holding period of 4.5 years. The average holding period of IT investments decreased over the past 20 years from 5 years in the period from 1999 to 2009 to 3.5 years in the last ten years. This fact can be explained by steadily increasing exit multiples. The strong economic growth over the last decade and a record quantity of capital pursuing a limited number of high-quality IT assets has driven median buyout multiples to record highs of up to 26x EBITDA.\textsuperscript{15}

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**Fig. 9** Average holding period of German IT assets in PE portfolios

<table>
<thead>
<tr>
<th>Holding Period</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;1 year</td>
<td>6%</td>
</tr>
<tr>
<td>1–3 years</td>
<td>25%</td>
</tr>
<tr>
<td>3–5 years</td>
<td>30%</td>
</tr>
<tr>
<td>5–7 years</td>
<td>25%</td>
</tr>
<tr>
<td>7–10 years</td>
<td>11%</td>
</tr>
<tr>
<td>10–12 years</td>
<td>4%</td>
</tr>
</tbody>
</table>
Although PE investors prefer buyouts, the share of expansion financing is high

PE houses mostly undertake majority investments that allow them to gain control over key strategical and operational decisions in their holding companies and to realise buy-and-build strategies. Over the past 20 years, primary buyouts accounted for nearly half of all PE investments in German IT assets (£13.3bn of overall deal value), followed by secondary buyouts mainly from VC firms (£7.7bn). Expansion financing follows on in third place in terms of deal value (£6.2bn), but holds the first place by number of transactions (57%, 269 transactions).

Almost half of the deals involving PE firms consists of a controlling interest in a privately held company with years of proven cash flow and profitability. Indeed, PE firms generally target mature IT companies aged on average 14 years since establishment with mature business models, which need a capital increase for funding further organic or acquisitive growth. To successfully overcome this inflection point, this can either take the form of a buyout (73% of all transactions by deal value) or expansion and acquisition financing (23%).

PE firms increasingly opt for buy-and-build strategies in highly fragmented IT segments that benefit from consolidation. This can go hand in hand with growing globally and entering new markets. A recent example of the consolidation within the European payments segment is the merger between a leading Danish payments services provider Nets (owned by Hellman & Friedman) and the German payments company Concardis (owned by Advent and Bain), in June 2018.

Minority shareholdings allow PE to benefit from steadily increasing profits of growing companies when supporting them in product development, expansion into new markets and add-on acquisitions. Additionally, PE houses increasingly use partial exits to realise profits and return capital without relinquishing the IT assets from their portfolio.

Many PE houses lock into their investments and provide multiple financing rounds to their portfolio companies. An example is Warburg Pincus who invested fresh capital as part of the acquisition of Strato by its portfolio company United Internet in December 2016, a month after Warburg invested €450m for a 33% stake in United Internet with the intention to float it in around 2 years.
Private equity firms target first and foremost software developers and programmers (64%), followed by developers, providers and operators of IT platforms (22%) and IT services providers (14%). The share of PE investments in the first and second categories has slightly increased over time and amounts to 67% and 23% respectively in the current PE portfolio in terms of deal volume.

In terms of value, software developers and programmers are again at the top of the ranking. The category includes TeamViewer, a provider of cloud-based technology solutions that enable online remote support and global collaboration, acquired by Permira from GFI Software for €750m in May 2014 and listed at the Frankfurt stock exchange in September 2019 for €3bn. Another notable private equity investment in this category is Personal & Informatik AG, a German provider of human resources software and services to small and medium-sized companies, that has been acquired by HgCapital from Carlyle in 2013 and sold to Permira Advisers three years later.

The second category consists of PE investments in developers, operators and providers of IT platforms. Representative deals include Transporeon, a provider of cloud-based logistics platforms that was acquired by HgCapital from TPG in January 2019 at an enterprise value of over €700m. The transaction generated a return of 2.5 times TPG’s initial investment. Another successful PE deal was the sale of Verivox, a web-based consumer price comparison site for energy and telecommunication services, by Oakley to ProSiebenSat.1 in June 2015. Oakley held the asset for 6 years and received proceeds of €53m on Verivox, generating a 2.5x return on initial investment and 43% gross IRR.16 Average portfolio returns from investments in this category might even be higher due to the fact that after the typical initial platform acquisition, the multiple arbitrage from smaller deals reduces the overall average costs per acquisition.

Firms providing IT solutions or services to end users and organizations are comprised within the third category. Large PE deals in this segment include e-shelter, a data centre operator that has been sold for €725m to NTT Communications in June 2015, and Inexio, a provider of fiber optic internet connections, telecommunications services and data center services, acquired by EQT from Warburg Pincus, Deutsche Beteiligungs AG and minority stakeholders for €1bn in September 2019. A further example is Oakley’s investment in Intergenia, a provider of web hosting services. The asset was sold to Host Europe Group in December 2014 resulting for Oakley in a money multiple of 2.5 times and a 36% IRR. The vast majority of recent investments in this category comprise data management and analytics providers, distribution systems, portfolio management, and regulatory technology services.

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Fig. 12  PE investments in German IT companies by sector

- **Software Developers and Programmers**: 64%
- **IT Services Providers**: 14%
- **Developers, Providers and Operators of IT Platforms**: 22%

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12 Superior PE returns with investments in German IT assets
Private equity houses have been able to consistently realise above-average returns on their investments in the German IT market – each 10th investment even delivered exceptional returns of over 7.5x the initial deal value. Nevertheless, due to a relatively high bankruptcy rate, the risks of investments in tech assets shouldn’t be underestimated.

According to market experts, investments in emerging tech companies will continue to deliver superior returns in the next decade. IT companies are often based on rapidly scalable business models, founded specifically with the intention of becoming high-growth, disruptive companies. Technology assets are now much different to what they were some 20, 10 or even 5 years ago. The current innovation cycle is strong and will last another 10 to 15 years – very different to the capital markets cycle. With more focus on expansion and growth financing PEs can cover the early stage companies, where capital market cycles have little to no impact on valuations. Vice versa – later stage companies tend to be affected by the capital market cycles and thus would be more prone to a market slowdown or macroeconomic uncertainty such as the China-US trade war and Brexit that could bring new risks for private equity investors. However, not every box with the stamp “tech” on it promises superior returns. Amongst the many tech developments, it can be very tricky sieving out the assets that are the most promising and with the most potential to grow. Once the right technology is found and the asset is acquired, the key success factors are in-depth technology expertise, excellent market knowledge and the ability to support organic growth and cross-border acquisitions as well as pulling the vast majority of value creations levers to increase the value of a target company through operational improvements.
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PwC. Nearly 12,000 dedicated people at 21 locations. €2.3 billion in turnover. The leading auditing and consulting firm in Germany.
Footnotes in text

1 71% of all PE deals on the German IT market in the period from September 1999 to September 2019.
2 In the period from September 1999 to September 2019.
3 For a sample of 474 PE deals over €5m in the German IT market in the period from September 1999 to September 2019.
5 Inexio deal in September 2019.
6 According to the PwC Private Equity Trend Report/European survey of 250 PE principals performed by Acuris Studios (Mergermarket) on behalf of PwC, 2019.
7 According to Unquote, the total market capitalisation of TeamViewer after its listing ion the Frankfurt stock exchange in September 2019 amounted to estimated €5.25bn. The market value of Permira’s stake in TeamViewer is estimated based on the assumption that Permira-owned Tiger LuxOne will continue to hold a 58% stake in the company after the IPO.
8 Average multiples are estimated based on reported multiples for 194 realised PE investments in the German IT sector in the period from September 1999 to 2019 (sources: Unquote, Mergermarket, Preqin).
9 Average multiples are estimated based on reported multiples for 194 realised PE investments in the German IT sector in the period from September 1999 to 2019 (sources: Unquote, Mergermarket, Preqin).
10 Source: Unquote.
11 IPOs account for only 6% of exit routes in our sample of 194 realised PE investments in the German IT sector in the period from September 1999 to September 2019.
13 According to Pitchbook. See also the PwC’s publication “Managing the Downturn”, 2019.
14 We calculated the multiples based on the data reported by PE investors (Unquote, Preqin) and the average IRR based on the difference between estimated exit values and initial investment values under consideration of respective holding periods. Leverage effects have not been considered due to lack of data.
15 Recent example is the buyout of Inexio from Warburg Pincus and Deutsche Beteiligungs AG for €1bn (26x estimated EBITDA).
16 Reported by Oakey. Source: Unquote.

Footnotes in figures

1 IT deals over €5m deal value with participation of PE investors in the period from September 1999 to 2019.
2 Based on the assumption that each equity lead holds a controlling stake in each IT asset.
3 Indicative deal values based on Unquote and own estimations as of 30 September 2019.
4 Based on the assumption that Bain and Advent hold each 50% shares in Concardis.
5 Exit multiples are calculated as a difference between the exit value and the initial PE investment in German IT companies for the period from September 1999 to September 2019.
6 This analysis is based on Mergermarket and Unquote data for a sample of 194 realised PE investments in the German IT market in the period from September 1999 to September 2019.

Sources in figures

Fig. 2: Unquote, Mergermarket and Preqin.
Fig. 3, 4, 10, 11, 12: Mergermarket, Unquote, PwC analysis (based on a sample of 474 PE deals over €5m in the German IT sector in the period from September 1999 to September 2019).
Fig. 6: Unquote, Mergermarket and Preqin, own calculations, 2019.
Fig. 8, 9: Mergermarket, Unquote, Preqin, PwC analysis (based on a sample of 194 realised PE investments in the German IT market in the period from September 1999 to September 2019).