

Candover Investments plc

Statements given at the 2009 Annual General Meeting by Gerry Grimstone, Chairman of Candover Investment plc and Marek Gumienny, Managing Director of Candover Partners Limited

Gerry Grimstone, Chairman, Candover Investments plc

As you will know, at the preliminary results announcement in March, I said that we would be examining all strategic options with the aim of achieving financial stability for Candover. Clearly Candover is not in good shape at present and both I and your Board deeply regret this.

In short, our long standing business model – a listed plc which invests, realises and recycles profits through an independent but wholly owned Candover Partners – has been severely tested over the last six months or so. At the present time we cannot see this model resuming in quite the same way ever again.

I would like to talk to you about Candover's current position, as openly and transparently as I can, to explain how that position has come about, and to outline the steps we, the Board, have been taking to address the situation on your behalf.

2008 has been an extremely turbulent time for the global economy, and in particular, for financial markets. The effect of the global economic crisis on the European buyout industry is stark, with investments, realisations and funding all substantially affected. Inevitably Candover has been caught up in this turbulence, and we have found ourselves facing a set of challenges which we have never faced before.

In summary the challenges can be characterised as how to deal with a rapid fall in the value of our assets, and how to make sure the Company has access to sufficient cash and liquidity to fund its ongoing operations and to meet the commitments we have to invest in the Funds raised by Candover Partners. The challenges are all interlinked and I would like to explain how they are impacting on your Company.

Candover has an unusual structure. Candover Investments plc has a wholly-owned subsidiary, Candover Partners Limited, which raises Funds and invests them on behalf of the Limited Partners who commit to invest in those Funds. At the beginning of a Fund raising cycle, Candover Investments agrees an amount it



will co-invest in the companies which Candover Partners will select for the Fund. But under the terms of the Funds, Candover Investments has no say in either the making, or the realisation of those investments.

Candover Investments has always relied on the realisation of investments to fund its future commitments, be they new investments, commitments to new funds, or new ventures. Over the past five years we have had realisations of £495 million and made investments of £367 million – our investments were funded from our realisations. In 2008, we invested £169 million but only realised £47 million, down from £162 million realised in the previous year, as a global lack of liquidity affected the ability of both trade and private equity buyers to acquire companies. This shrank our available cash.

Moving from a position of net cash to a balance sheet with borrowings, which we did two years ago, has exacerbated our current situation. As you will recall, in 2006, your board decided to pay back over £100 million to shareholders in order to distribute the cash on the balance sheet, and in 2007, a bond of £160 million was raised for future investments. Over previous cycles, Candover Investments had accumulated large cash balances and this gearing was to make the balance sheet more efficient over a cycle. At the time, with NAV increasing at a compound growth rate of 21.6%, realisations rebuilding the cash absorbed by investment, and a widely-accepted view that markets would remain benign, your board was comfortable with the headroom in the covenants attached to the bond, the principal one of which requires our net debt not to exceed 40 per cent of the value of our investments.

Our decision to take on debt was applauded at the time but, with the benefit of hindsight, it was the wrong thing to do.

The global economic crisis last year severely impacted two aspects of the management of Candover's balance sheet: not only the impact on realisations which I have already outlined but also the value of our net assets. After five successive years of increases, NAV declined by more than 50% in 2008 to £224 million or 1026p per share compared to £451 million or 2065p per share a year earlier. We value our investments against quoted company multiples which naturally vary with the economic cycle, and the significant falls in these quoted multiples during 2008 resulted in our having to value our own portfolio downwards accordingly. Softening trading in the final quarter of the year at some of our investee companies was also a factor. The situation was made worse by one of the investments, Ferretti, which had been close to realisation, not being able to meet its obligations. Candover Partners' decision not to participate in the resultant restructuring made the investment worthless.



Turning then to the commitments we have made to co-invest in the Funds raised by Candover Partners.

We have an outstanding commitment of £90 million to the Candover 2005 Fund which may be drawn over the next two years to fund follow-on investments or to strengthen the capital positions of the portfolio companies. Ensuring we have the capital required to fund this commitment, whilst ensuring we can comply with our bond covenants, is an important priority of ours.

Next, Candover Partners launched a €5 billion Fund in April last year and were very confident that they would meet or surpass this target. The Fund had its first closing last August having raised nearly €2 billion in a short space of time and was well on track. Candover Investments has always been the cornerstone investor in the Candover Funds and, having discussed it closely with Candover Partners and having taken external advice, a commitment of €1 billion to the 2008 Fund, to be drawn down over five years and half of which could be syndicated under the terms of the co-invest arrangement, seemed at the time to be entirely realistic. Although the economic outlook was challenging, your board thought this environment would provide Candover Partners some excellent investment opportunities.

It is now clear that too much investing was done by Candover Partners in 2008 and that the pace of realisations was too slow. This had the effect of absorbing our cash too quickly. The reduction in cash increased our gearing, which was in turn increased by the fall in asset values.

Regrettably, given our weakened financial position, we had to come to the conclusion that Candover Investments could not maintain its commitment to the Candover 2008 Fund. We informed Candover Partners of this, and in March they entered into discussions with the Limited Partners of that Fund about a restructuring, including the possibility of a suspension of the investment period. Formal agreement has now been reached with the LPs and the 2008 Fund has been suspended for up to six months from 6th April whilst discussions with the Limited Partners continue. Absent a change of ownership or a significant improvement in the liquidity position of Candover, it is not realistic to think that we will be making any further investments in that Fund in the foreseeable future. The future of the Fund depends on the outcome of discussions between Candover Partners and the investors in the Fund.

I hope that this has been useful to you in terms of understanding the background to our current situation. So, where do we go from here? The Board, as I have just outlined, is committed to doing all it can to restore value to Candover's shareholders. Preserving the value in our existing funds, including Candover's



share of the carried interest in those funds, is our top priority. We continue to believe that there is considerable value within many of our portfolio companies and that this will be realised significantly above the current valuations once global economies recover. This is why we announced at the Prelims in March that we would be reviewing the various strategic options available to us.

This review encompasses a wide variety of options including an equity funding possibly involving third parties in the funding of Candover. To bring you up to date on the review, we have received several expressions of interest covering a range of options, varying from preliminary proposals to acquire the Company in cash or a mixture of cash and shares to third parties taking a minority stake which could occur in a variety of forms.

The value to shareholders from any of these options remains highly uncertain and is subject amongst other things to completion of due diligence. I should emphasise that there can be no certainty as to the outcome of the review at this stage as we continue to consider a range of options in detail.

We are facing a particularly complex situation because of Candover Investments responsibilities to its shareholders and bondholders, and Candover Partners responsibilities towards the investors in its Funds. Your Board is clearly focused on ensuring that we work through these complexities to find a solution that is in the best interests of all the various stakeholders. The choice, as seen at the present time, which may of course change, is between a sale of the company which would mean immediate value for shareholders or to put the Company into a position where the value of its investments could be realised over a period of time.

In the meantime, Candover has reduced its cost base to reflect the current financial position, very sadly by making a number of staff redundant. In addition, we have put on hold our developing operations in Asia and Eastern Europe, with the teams aiming to become self-financing. If they do not succeed in raising funds, these operations will have to close down.

Clearly these are difficult times and it seems that the economic outlook will continue to make realisations and trading conditions challenging in the short term. As I said at the time of our preliminary announcement, the prospects for the private equity industry have altered radically over the last six months, and it is unclear what our industry will look like in the future or what will be Candover's position. As soon as matters clarify, I will, of course, communicate with all our shareholders.



Marek Gumienny, Managing Director, Candover Partners Limited

The last few months have been difficult in many ways. As you know, our portfolio of assets was written down by approximately 50% at the end of the year, the dividend has been cut, the plc has had to cancel its €1 billion commitment to the 2008 fund and we have seen the share price fall as low as 10% of NAV. All of this has been widely reported in the press – there has been nowhere to hide. For somebody who has worked in this firm for nearly 23 years and has taken enormous personal pride in the way our business, culture and reputation has developed, these past few months have been awful.

I am more than aware of the financial consequences of the fall in the share price and the cut in the dividend to many of you in this room today. For that, I am immensely sorry. Please be assured that it is our utmost priority to find an acceptable solution for all of Candover's stakeholders, to persuade the stock market of the real value inherent in our portfolio of assets and to rebuild Candover's reputation in the markets in which we operate.

All of this will take time and it will not be easy given the economic headwinds that we face. You have been a loyal and supportive group of shareholders over a long period of time. I hope we can count on your support and trust going forward.

Gerry mentioned some of the reasons why we have found ourselves in this position. None of us should ignore the effect of the collapse of Lehman and the complete meltdown in the banking market which occurred after September 2008. I joined Candover in early 1987 and have lived through several market cycles. I thought I had seen a few market downturns and recessions. Nothing, however, prepared me for what we have seen over the past five months. Numerous banks and AIG being nationalised; the global banking system on the point of collapse; countries on the point of collapse; government intervention on a scale never seen before. Collateral damage everywhere. I have never known such fear in the markets. And sadly Candover was caught up in the chaos and became one of the walking wounded. In retrospect, our financial structure and outstanding commitments were inappropriate going into this tsunami.

Ferretti which had increased its EBITDA from €120 million to €180 million under our ownership quickly and suddenly became another such casualty. The company was poised to list on the Milan exchange when in October demand for its boats started to evaporate, orders were cancelled and liquidity dried up. Earnings collapsed and on that basis its geared financial structure was no longer viable, and our equity became worthless. Ferretti became one of the businesses we had to write down in our year end results.



Another consequence of the market chaos was that the stock market fell dramatically from 5,636 on August 29th to 4,561 at the year end, and to a year to date low of 3,512 on March 3rd. As you are aware, we value our investments in accordance with BVCA guidelines which require us to use public market comparables to arrive at a current valuation. These guidelines also recommend that investments less than 12 months old are held at cost, but we decided to revalue all our portfolio companies, regardless of their age, in response to the dire market environment. Multiple contraction as a result of the collapse in the markets therefore, accounted for a substantial part of the fall in our NAV from approximately £20 at 30th June to £10 pounds at the year end. This fall in our NAV immediately put pressure on our bond covenants, the stock market sensed we were in financial difficulties, and in March, our share price collapsed. These were our darkest days and the board quite rightly embarked on a strategic review to put the business on a better financial footing.

I would now like to talk specifically about the investments we made in 2008 - Stork, Expro and Technogym.

Stork is a 185 year old diversified Dutch conglomerate involved in technical services for the power and energy industries and aerospace. It is one of the highest regarded Dutch institutions known for its heritage and engineering expertise. Stork was under siege from a group of hedge funds who were trying to force management to break the business up. We spent over a year working on this transaction, finally completing it in January 2008. We paid €1.7 billion for the business, and sold one division as part of the deal for €400m. In 2008, Stork increased its pro forma EBITDA from €94 million to €167 million and reduced its debt from €600 million at the time of the acquisition to €530 million. However, despite these achievements, we wrote Stork down by 25% at year end solely due to a fall in comparable multiples. In my opinion, Stork will be a classic Candover buyout. It has all of the ingredients of how we make money and a hugely respected management team.

We paid £2 billion for Expro in August, leading a consortium made up of Alpinvest and Goldman Sachs in a battle with American oil field specialist Halliburton. This is the second time we have owned Expro having first backed the business in 1993. That transaction delivered an IRR of 37%. Expro's main business is well flow management with a particular focus on the most challenging deepwater environments. Expro's operations are critical to the development of oil and gas reserves and it enjoys a market leading position alongside Schlumberger. Expro increased its EBITDA from \$330 million to \$364 million in its last financial year. However, despite this increase, we wrote Expro down by 50% at the year end, again due to a fall in public comparables. We continue to believe there is real value in Expro.



Oil and energy is a sector Candover has increasingly focussed on in recent years and our last 3 investments - Pipeline Integrity, Vetco and Wellstream delivered returns of 2.2x, 4.1x and 6.5x our money. We strongly believe in the thesis that oil is becoming an increasingly scarce resource as it becomes more difficult to extract, and that the long term growth in demand puts more pressure on reserve replenishment. The oil price is now \$58, up 70% from its low point in January, and most commentators believe the price will advance to \$70 by year end. This should lead to increased confidence by the major oil producers and national oil companies, driving earnings and consequently valuation multiples. Expro is well placed to benefit from these long term trends and currently has an order book close to record levels.

Technogym is the world market leader in high end gym equipment. The World Health Organisation estimates that there are now more obese people than starving people in the world and governments are increasingly focussing on illness prevention by promoting a healthy lifestyle and regular exercise. Technogym leads the market in innovation and technical expertise; it has numerous growth options geographically, by industry verticals and through brand extensions. We again made a substantial provision against this investment at the year end as its earnings fell below 2007. This was caused by a large number of its key accounts deferring expenditure and expansion due to market uncertainties. The position was exacerbated by the disappearance of leasing, a traditional form of financing for the industry, as the banks withdrew credit. We continue to believe that there is real value in the Technogym brand and that its growth drivers over the long term are attractive but again, like Expro, it will take time and patience to grow value in this investment.

And on that note, please do not lose sight of the fact that we invest over a long time horizon – three, five, seven years, or in the case of DM&E, over 20 years. Not all of our investments go up all the time. We regularly make provisions against them but our job is to work with our portfolio companies to generate value over a number of years.

Our investment in Wellstream illustrates this point. In the first 18 months of our ownership, Wellstream's earnings collapsed from £20 million to a loss of £10 million. At that lowest point, when we had written off our investment, management asked for further funds to build a new factory in Brazil. We supported them and subsequently Wellstream floated on the London Stock Exchange, generating a return of 6.5 times our investment.



Of course, I am not happy that the provisions we have taken against our 2008 investments have contributed to the problems we are facing today. But I strongly believe that these investments will provide attractive returns in due course. Our business has always been about long term value creation.

As regards the portfolio, I am unable to be too specific about current trading due to the constraints of the takeover code, but I am able to say that over 60% of our portfolio of 18 companies are trading above budget in Q1 2009 and ahead of prior year, after adjusting for seasonal factors such as Easter as well as currency fluctuations. Three businesses have covenant issues which we are working closely with the management and lenders to solve in a consensual fashion, and we did not ascribe any value to these investments in our year end accounts.

Whilst we took advantage of the availability of cheap debt in recent years in financing our investments, we maintained a relatively prudent approach and did not over-burden our portfolio companies with debt. At the year end, 81% of the funds' investments by value had gearing of less than 6.0x. Only one portfolio company has a major refinancing event prior to 2013 and we are already considering how best to tackle this. As Gerry has already said, all of our focus today is on preserving value in our portfolio companies.

In conclusion I would just like to say this. To have our troubles laid bare in the press has been a salutary experience. So too, has been the necessity to undertake a wide ranging strategic review and all that this entails. We are used to being the hunters not the hunted and this process has been a humbling experience and taught us many lessons. We have had to answer very difficult questions from our founders, shareholders, friends and family, fund investors, the press and analysts, of course, ourselves. It is an understatement to say that this has not been an easy time, but we are committed to rebuilding shareholder value.

I hope you can understand that our recovery from this position is intensely personal to every member of our staff. It matters to us and as importantly, it matters to our portfolio companies and our chief executives who have also had the spotlight shone upon them. We are going through a difficult time at Candover. The world is not an easy place at the moment, but I believe we can find an acceptable solution for our shareholders in due course.