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YOUNG TURKS

TurkVen's Seymur Tari and Kerem Onursal give local street cred to BC Partners' market-defying Migros takeover.

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SUPERRETURN 2008: NO PROTESTERS THIS YEAR – EXCEPT ON THE PODIUMS

A NEW HUNTING GROUND

BC Partners' successful financing of the $3.25bn Migros deal is evidence that in Turkey, unlike the rest of the Western world, banks are still eager to do business. More deals are set to follow.

BY **ROSS BUTLER** AND **CLARE NUTTALL** IN LONDON, AND **REETA CEVIK** IN ISTANBUL

THE $3.25BN (€2.2BN) ACQUISITION OF supermarket chain Migros Türk by a consortium led by BC Partners is the largest Turkish private equity deal ever closed. If it completes, the deal – supported by TurkVen Private Equity (pictured) and De Agostini Group – will also be the country's first take-private. But it was observed with keen interest by the world's big buyout houses for another reason entirely.

At a time when debt finance for large buyouts in the Western world is extremely sparse, a deal of this size, financed entirely by domestic banks, symbolised what was possible outside the usual transatlantic hunting grounds (see box, overleaf).

But it isn't just the ability to raise credit that is attracting the world's big buyout groups to a country that sits on the bridge of Europe and Asia. Turkey has a stable, fast-growing economy, a young population and an open capitalist

acquisitions include Kohlberg Kravis Roberts's purchase of shipping company UN Ro-Ro for €910m late last year, and the acquisition of 50 per cent of clothes chain Beymen by Citigroup Venture Capital International for $193m.

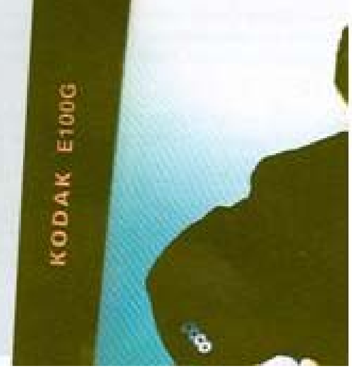
"[Foreign] investment in a single company is usually around $200m," says Güray Zora, managing director of Standard Ünlü Corporate Finance, adding that foreign private equity interest really kicked off in 2005. "When we started to cover private equity firms in 2002 there was not much of a market in terms of international players. Things picked up only in 2005, when substantial inflows of foreign direct investment started to arrive in the country."

Local players, on the other hand, are still largely focusing on the mid-market. They also face some competition from smaller private equity firms from Europe and the Middle East culture. And yet it is also a very alien land to most mainstream investors.

Undertaking all but the very largest deals requires a thorough understanding of the market that can only be gleaned by a local presence, or a strong partnership in the region. As a result, the Migros deal is in some ways typical of foreign investment in Turkey, which has focused on large and upper mid-market deals. Other major

Among them is Kuwait's NBK Capital, which held a $200m interim close on a fund for Turkey and the Levant last year, and Great Circle Capital, a specialist fund for emerging markets transportation investments that has backed Turkish shipping company Balnack.

However, local players are moving up in size. "The follow-up funds now being raised are huge compared with previous ones. For local private



"Only a handful of deals succeed because the market is still very young. The process is slow and high valuations are typical"

SEYMUR TARI, TURKVEN

PHOTOGRAPHY BY
RICHARD GLEED

Eastern pioneers: TurkVen managing director Seymur Tari (right) and principal Kerem Onursal. The firm helped put together Turkey's first take-private – Migros Türk.

equity firms the minimum investment criteria that would stand at $10m a few years ago is around $40m to $50m today," says Zora.

This combination of domestic fund growth, increasing foreign investment, and a more stable economic outlook means the Turkish market is becoming a virtuous cycle of investment.

"In the past two years the market reached new records and saw the arrival of numerous new players, including local funds, follow-on funds and international funds setting up offices in Turkey," says Levent Bosut, chairman of Turkey's private equity and venture capital association, TurkVCa. New local funds on the scene include Actera, which closed its debut vehicle on €475m in late 2007.

Foreign exchange

Foreign interest in Turkish private equity is not a new phenomenon; it started to emerge after the European Union decided to grant Turkey candidate country status in 1999.

"During the 1990s there was very limited funding available for private equity deals in Turkey. The right environment for private equity was not there: the economy was not stable enough and achieving successful exits was very challenging," says Murat Cavusoglu, managing partner of Actera. "But today the environment is different. Turkey is now a stable economy."

The country's youthful population (well over half of Turkey's 70 million residents are under 30 years old) is driving consumer spending – and as a result, private equity interest in consumer-related sectors. "There are numerous growing companies in industries such as retail, healthcare, security and media, and various opportunities in real estate," says Seymur Tari, managing director at TurkVen Private Equity. "The increasing disposable income is the main driver behind the growth of private equity in Turkey."

"The young age structure of the population means further population growth in the future," adds Zora. "The services sector is experiencing strong growth, and so are heavy industries and cement due to the infrastructure investments and need for additional housing stock."

Add to this attractiveness the widespread credit restraints in the Western world, and large

Migros Türk buyout takes the credit

Even given the size of the deal, the $3.25bn (€2.2bn) sale of Turkey's largest supermarket chain wouldn't normally have garnered so much publicity. But with Western banks chocked up with overhung debt, the battle for Migros Türk became the buyout event of the year so far.

It escaped nobody's notice that the winning consortia was banked out of Turkey, unlike several of the competing bids, including that of the Blackstone Group and Croatian retailer Agrokor.

BC Partners acquired the business with debt finance from a club of three Turkish banks – Garanti Bank, Is Bank and Vakifbank – which supplied around half the total funding required.

Nikos Stathopoulos, a senior partner at BC, attributes the consortium's success to the fact that it was able to deliver the vendor a deal at the time it wanted in a very difficult market. "We did that by spending a lot of time in due diligence and getting comfortable with the business," he says.

"We focused on financing the transaction with local banks. The reason we approached them is that they knew and understood the business very well because it is a very strong brand in Turkey. But also my sense is

group Carrefour and the Blackstone consortium.

BC teamed up in the second half of last year with Bülend Özaydinli, the former chief executive of Migros and Koc Holding – the parent company and vendor. Özaydinli will now become chairman of the group.

In addition, BC partnered with TurkVen Private Equity. "TurkVen was a good partner for us, as it allowed us to have a local partner who is on the ground, speaks the language and understands local dynamics," says Stathopoulos.

Given the size of the business, BC was also eager to bring on board another powerful financial partner to split the equity cheque. "De Agostini Group has been a good partner for us historically, and they were interested to invest alongside us in this transaction too."

Migros was a coveted asset for a variety of reasons. "The sector fundamentals are very strong, as the organised food retailing market is growing in Turkey," says Stathopoulos. "You still have strong GDP growth in Turkey, there are some favourable demographic trends, with a large and

growing young population, and there is a continuing shift from 'mom and pop' shops to organised retailers

On top of that, Migros is the undisputed leader in the grocery market, with a 22 pe cent share of the organised food market, putting it way ahead of the number two, Carrefour. It employs more than 14,800 people. In 2006, it generated aroun TRY4.3bn (€2.4bn), on Ebitda of around TRY250m. Analysts project Ebitda for 2007 to be nearer TRY300r

"Migros is a multi-format business, so is able to address all customer needs, says Stathopoulos. "And there are good growth prospects through organic and acquisitive growth."

However, one sticking point could be Turkey's lack of squeeze-out rules, which could make a full delisting of the business unlikely. Indee the consortium developed i plans assuming the compar would remain listed.

Whether the investors are able to push debt into the operating company and so benefit from the tax deductibility of interest repayments will depend on the take-up following the tender offer.

companies in a high-growth economy that still has an open banking community become even more appealing.

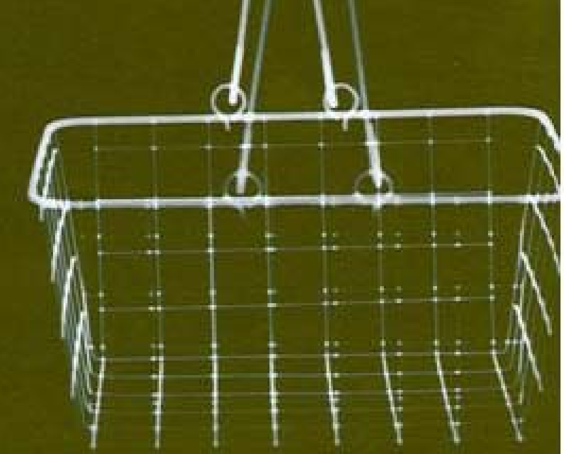
However, the relative youth of the Turkish private equity market is a challenge for both local and foreign funds. "Only a handful of deals succeed because the market is still very young. Many sellers are doing deals for the first time in their lives and therefore the process is slow and high valuations are typical," says Tari.

Some smaller firms also still struggle to accept the principles of private equity deals, says Zora. "Not all local firms understand how private equity deals function and how the transactions are structured in the process. These small firms, which usually have a turnover less than $30m, may also have difficulty accepting a new management style in the company. But

that they were less hit by the overall credit crunch, so they had more appetite, more liquidity and were able to be more competitive."

The consortium has acquired 50.8 per cent of the business and will launch a tender offer for the remaining shares listed on the Istanbul stock exchange.

The company, which was sold in an auction process run by JPMorgan, also attracted interest from Kohlberg Kravis Roberts, supermarket



" One of the difficulties is that many owner-managers are not aware of the private equity process and do not welcome the idea of sharing control " LEVENT BOSUT, TURKVCA

sophisticated local players are, of course, familiar with private equity culture," he explains.

Turkey is also subject to a certain amount of emerging market risk, with currency risk in particular affecting the retail sector. An important aspect of the retail market is that all income is in Turkish New Lira. "However, many businesses still have costs in dollars and are funded in hard currency," says Tari.

"This currency risk keeps foreign fund managers in Turkey awake. But there is no easy solution. The choice is either to live with the risk or to borrow in Lira, which remains prohibitively expensive. This can be a tough pill to swallow for funds from the euro and dollar world."

And as Isak Antika, managing partner of Actera, points out, the challenges associated with investing in a nascent private equity market also create investment opportunities for firms that understand it. Inevitably, more foreign players will seek to forge alliances with local firms or set up in the region themselves, in order to get a permanent foothold in the market.

"Local private equity funds are very active. If a foreign player does not have an office in Istanbul it will lose mid-size deals to the locals," says Zora.

Cavusoglu agrees: "These days Turkey is such a dynamic environment that companies' fortunes and what is attractive from an investment perspective can change overnight. It is important to know local business culture when dealing with shareholders and management teams. Ability to act quickly is also critical, which is possible only if one has a team based in Turkey."

Grey area

Tari says that comparing the Turkish private equity market to other emerging European countries is misguided. "Unlike most Eastern European countries Turkey has had a free market economy for decades. There are numerous entrepreneurs in Turkey that have been in business for a long time," he says. "In terms of the investment environment, the Turkish private equity sector is similar to Italy, Brazil and Mexico. Regulations are relatively flexible and most firms are run by families. The market is local and focused on exporting to the EU."

Even among companies listed on the Istanbul stock exchange, most are family owned. "In fact there are no public companies in the exchange," says Zora. "The float rate stands at less than 50 per cent."

"There is room for improvement on the squeeze-out rules, which make it almost impossible to buy 100 per cent of a public company," adds Cavusoglu. "Improving these regulations would benefit public shareholders as buyers will be able to offer higher prices

The grey economy is also an issue complicating the assessment of compan deals in Turkey, says Bosut. "Many comp keep different sets of accounting books, banking and management purposes. In c industries a part of sales are unregistere

"In terms of deal flow, one of the diffi that many owner-managers are not awa private equity process and do not welco idea of sharing control and full transpare Many lack effective corporate governanc management information systems and accounting standards. Ownership and management are mostly intermingled," h

A case in point was the auction of cig manufacturer Tekel in late February, whi attracted interest from several private eq firms before falling to trade buyer Britisł American Tobacco. The auction was tele an attempt to avoid allegations of corruj Bidders included a Cinven-led consortiu Citi Venture Capital International, which teamed up with Dongan Holding and Tu cigarette wholesaler Tutsab.

Industry players also note the current regulatory framework to be supportive c of foreign direct investment. "Of course, different regulations for different sector: one should know, and the legal framewo different than, for example in the Nether Zora says. "But overall, bureaucracy doe

Stathopoulos: double-first

Nikos Stathopoulos (pictured) is used to being ahead of the game. The 38-year-old senior partner at BC Partners graduated as top of his class from Athens University of Economics, with the highest distinction in business administration. He was awarded the Nato International Scholarship to Harvard Business School. And he speaks English, French, Spanish and Greek.

So getting a double-first in private equity would be no big deal. That is to say, he led the first take-private of a Greek company – BC Partners' acquisition of casino operator Hyatt Regency – and now, with his bid for Migros Türk, he could complete the first private equity acquisition of a Turkish public company.

Before BC, Stathopoulos was at Apax Partners. He joined the firm in 1998 and led the buyout of Greek mobile operator TIM Hellas. He left in 2005 to lead BC Partners into Greece.

When confronted with the double-first scenario, he seems embarrassed about the prospect. "Yes, it would be two firsts, but it hasn't happened yet. These are new markets for us and generally these aren't big buyout countries. But yes, I am having two firsts, so hopefully they will work out," he says.

have additional issues for foreigners ent market. The regulations support private

It is not difficult to make the case for equity investment in Turkey. However, fir search of more mega-deals on the scale Migros may be disappointed. The numbe firms with a turnover of $500m to $1bn i Zora points out. "Most big firms in Turkis standards are still mid-market for large international players."

A move from the mega-market to the market would almost certainly require fir have a local presence, and they would fa competition from investors already estat the country. "There are many players int in local private equity these days," says T could say Turkey is no longer low-hangir there are a lot of gardeners here." ●

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