



Private Equity Trend Report 2007

Outlook and criteria for international investment in Germany

Preface

Over the last ten years, private equity¹ has developed into an important asset class in Europe, and total private equity investments have seen an almost continuous increase since 1996.

Many surveys have demonstrated the positive impact that private equity has on the development of portfolio companies in Germany and other European countries. Compared with other companies, private equity backed businesses tend to create more jobs, show higher productivity and experience better sales growth².

In order to promote international private equity investment and attract investors, the right legal and fiscal environment is necessary. The regulatory frameworks for private equity, however, vary across Europe. The United Kingdom, for example, has an environment that is generally acknowledged to be one of the most favourable in Europe. At the same time, it has always stood out for the highest level of private equity investment and fundraising in Europe.

In Germany, a framework for new asset classes is currently under development following the coalition agreement among the ruling parties of 11 November 2005, and a private equity law is scheduled to come into force in January 2008.

Against this background, PricewaterhouseCoopers (PwC) has conducted a trend survey among top management representatives of international private equity funds with a view to identifying:

- trends in relation to Germany as a business and investment location;
- patterns in future global private equity investment; and
- factors that they consider important when investing in a country.

It is these aspects which are considered particularly key to creating a favourable environment and securing future investment and capital flow.

¹ In this survey, "private equity" refers to equity financing across all investment stages, including venture capital and buy-outs.

² Surveys include: Deutsche Beteiligungs AG, FINANCE Research, "Economic Impact of Private Equity in Germany" (2004); CEFS, EVCA, "Employment contribution of Private Equity and Venture Capital in Europe" (2005); BVK, PwC, "Der Einfluss von Private Equity-Gesellschaften auf die Portfoliounternehmen und die deutsche Wirtschaft" (2005); AIFI, PwC, "The economic impact of Private Equity and Venture Capital in Italy" (2006).

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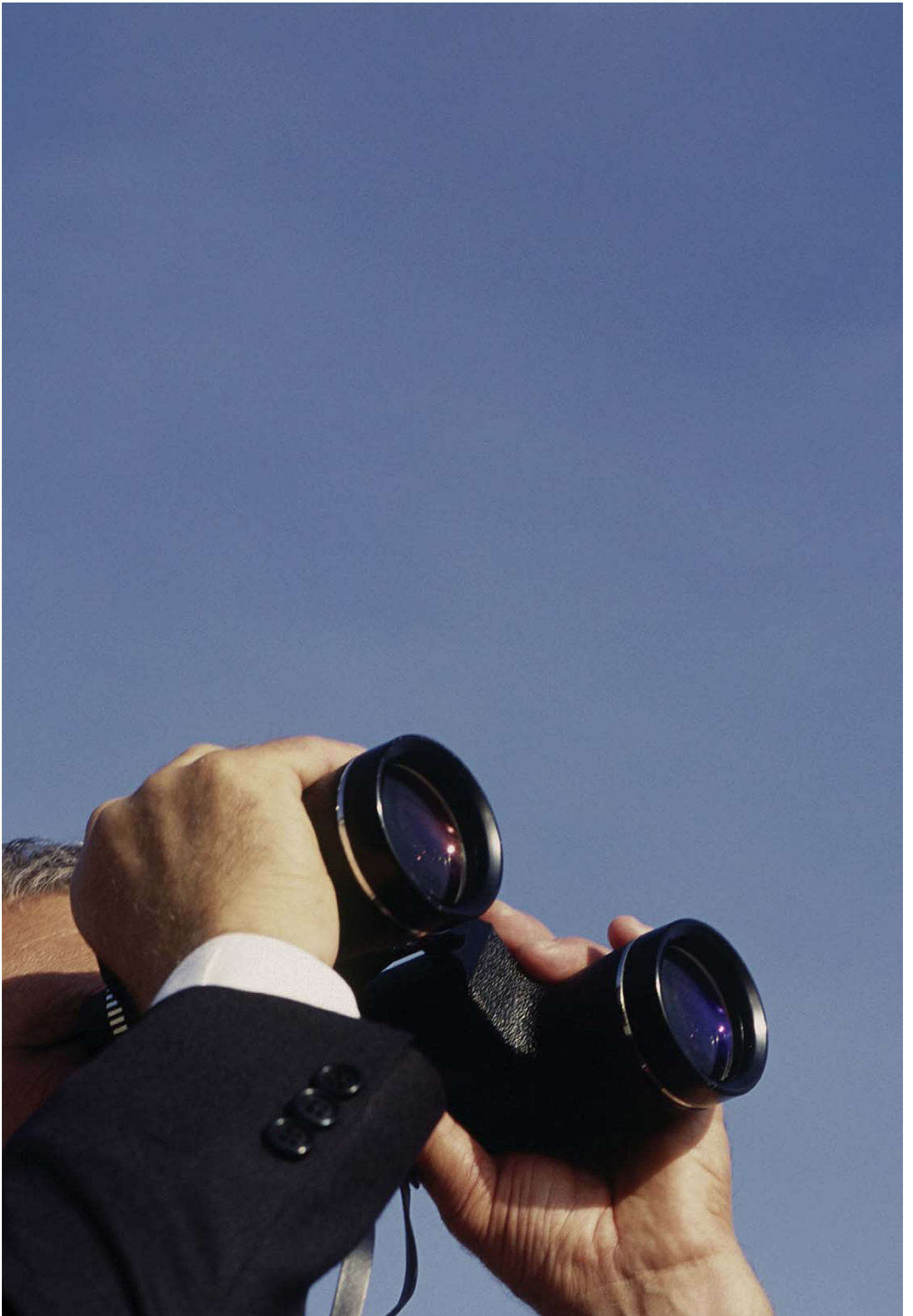
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A Overview

1 Executive summary

As part of the research for the Private Equity Trend Report 2007, the PricewaterhouseCoopers International Survey Unit interviewed a total of 98 top management representatives of international private equity funds based outside of Germany. They were asked to give an opinion about Germany as a business and investment location and assess a number of criteria that are considered to have a substantial impact on private equity investment. Their responses also gave insight into future global investment trends for private equity.

The key findings of the survey are:

Trends for Germany

- Germany has established itself as one of the most popular investment locations for international private equity funds. 63% of respondents already invested there in 2006 and this is set to increase further to 67% in 2007.
- In addition, 56% of respondents expect Germany to gain in importance as an investment location by 2012.
- Nevertheless, only 32% of the respondents consider German attractiveness for private equity investment to be "quite good" or "very good" compared with other countries, with 45% remaining neutral. 23% of respondents consider it to be "quite poor".
- Between 62 and 70% of the respondents consider German laws and regulations, corporate and personal income taxation and the level of bureaucracy to be a disadvantage of Germany as a business location. Other major disadvantages in the eyes of the survey participants (80%) are labour and labour-related costs.
- The main advantages of Germany are considered by the majority of the interviewees to be the availability of sources of capital, bank lending and R&D subsidies, and the country's innovation potential.

International trends

- While Western Europe will remain a major focus for private equity in the medium term, there is increasing competition for capital from other regions: 78% of the survey participants still have plans to invest there within the next five years, but this represents a decrease from 94% currently (-16%).
- There is a clear shift towards Central and Eastern Europe: The region is expected to attract more private equity funds within the next five years (+6%). Asia is also expected to attract marginally more investors (+1%).
- In relation to critical investment criteria for private equity funds, a country's overall political and economic environment for private equity plays a major role: almost 90% of the respondents consider the legal system as well as political and economic stability to be important or very important.
- A country's overall openness towards private equity is the factor that is considered by the respondents as the most important of all criteria impacting the willingness of private equity funds to invest in a specific location.

Conclusions

- The current balance between the strengths and weaknesses of Germany as a location for private equity investment is a fragile one.
- As such, the lawmakers responsible for the proposed German private equity and tax legislation changes bear a heavy weight of responsibility for securing the country's future as an attractive location for international investors in the face of increasing international competition.

2 Structure of the survey participants

The data for the sample is based on information from private equity and venture capital associations across Europe and the United States as well as from private equity information providers. Only international private equity funds were selected for the sample. The criteria that qualified a fund as "international" comprised an investment focus that went beyond the firm's country of origin, for example, having portfolio companies in at least two countries outside of the fund's home country. The list obtained from this research as a basis for the telephone interviews included 244 private equity funds based outside of Germany. As a result, a total of 98 private equity firms participated in the survey (40%). The interviewees were representatives from the top management of these firms (partners, chief executives or managing directors). Only one person per private equity house was interviewed. 56% of the international private equity funds participating in the survey are headquartered in Continental Europe. Respondents from the United Kingdom make up 35% of the survey, and 7% of those surveyed are based in the United States. The sample included representatives from 16 European countries: Austria, Belgium, The Czech Republic, Denmark, Finland, France, Hungary, Ireland, Italy, Luxembourg, The Netherlands, Norway, Spain, Sweden, Switzerland and the United Kingdom.

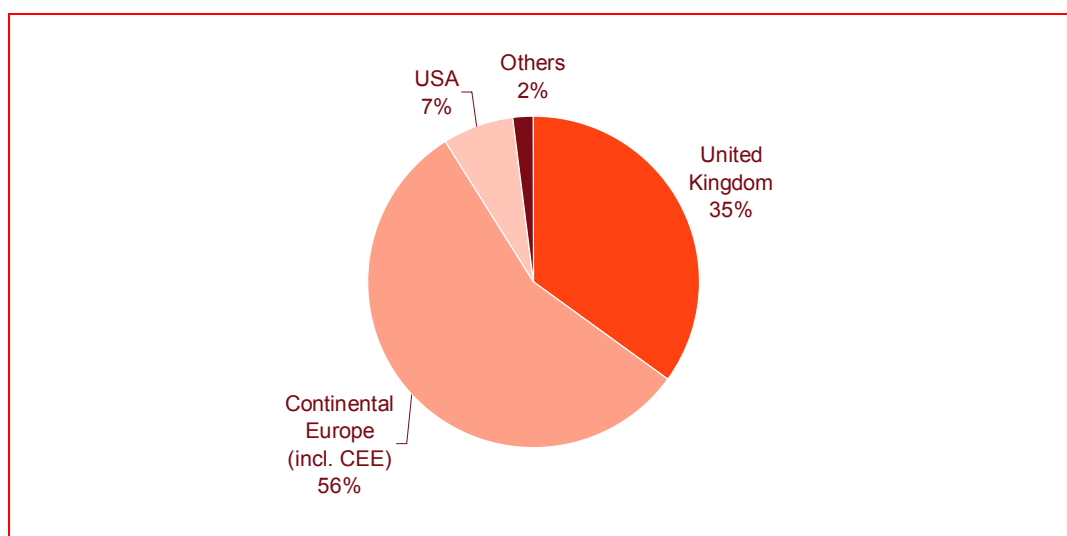


Fig. 1 Interviewees by headquarters

The majority of the participants (62%) have up to €500 million capital under management. A total of 8% have between €500 million and €1 billion capital under management, and 30% of the participants manage large funds of over €1 billion.

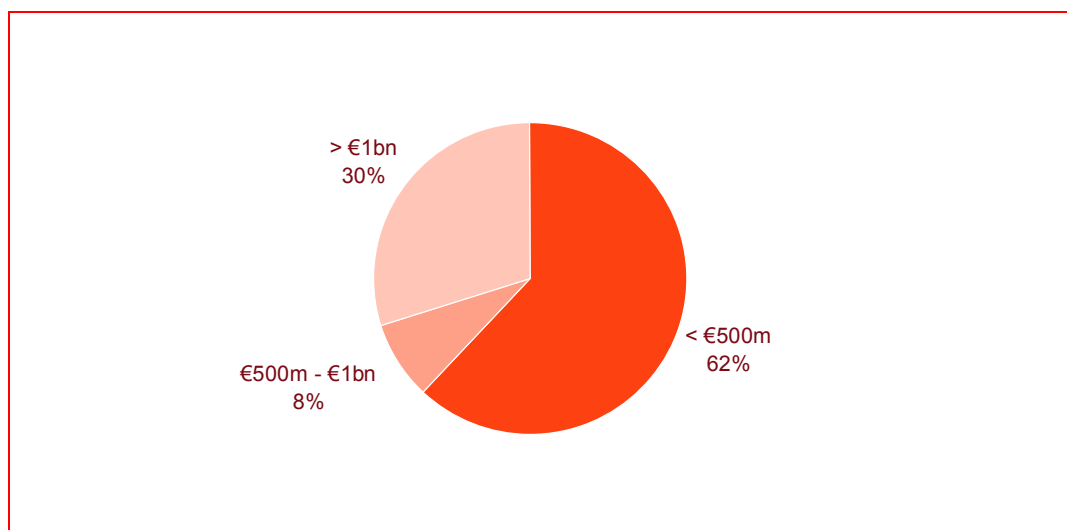


Fig. 2 Private equity funds by volume (capital under management)

B German private equity investment trends

1 Commitment to Germany

The trend for private equity investment in Germany among the international survey participants for 2007 is clear: The majority of them demonstrate a strong commitment to Germany which remains an attractive location for private equity funds in 2007.

When asked whether they invested in Germany in 2006 and whether they had plans to invest in Germany in 2007, a total of 63% of the respondents said that they invested there in 2006. In 2007, 67% of all respondents have investment plans for Germany, indicating a net inflow of funds being targeted at Germany. While 8% of interviewees intend to discontinue their investments in Germany in 2007, 12% have plans to start investing there in 2007.

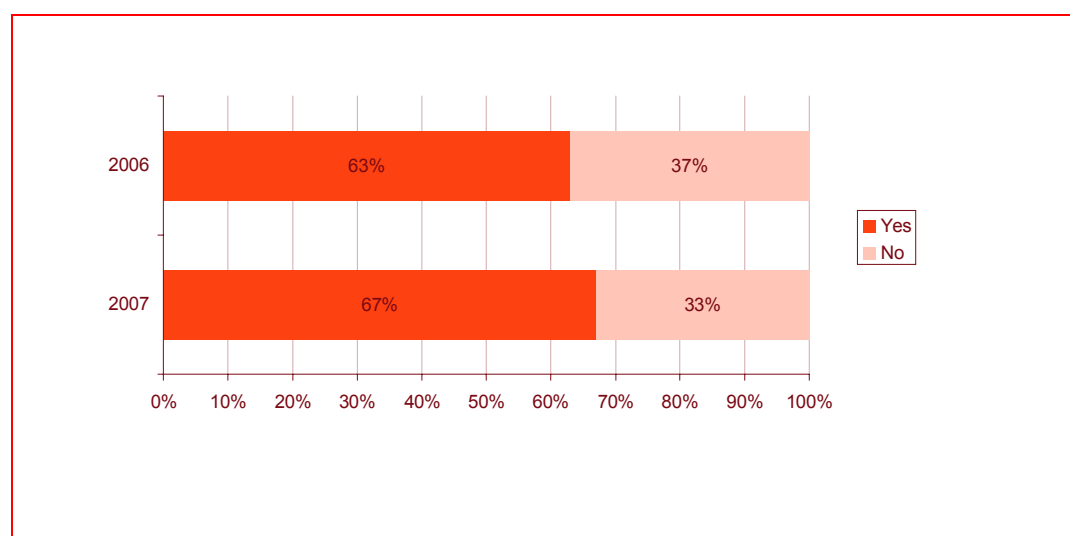
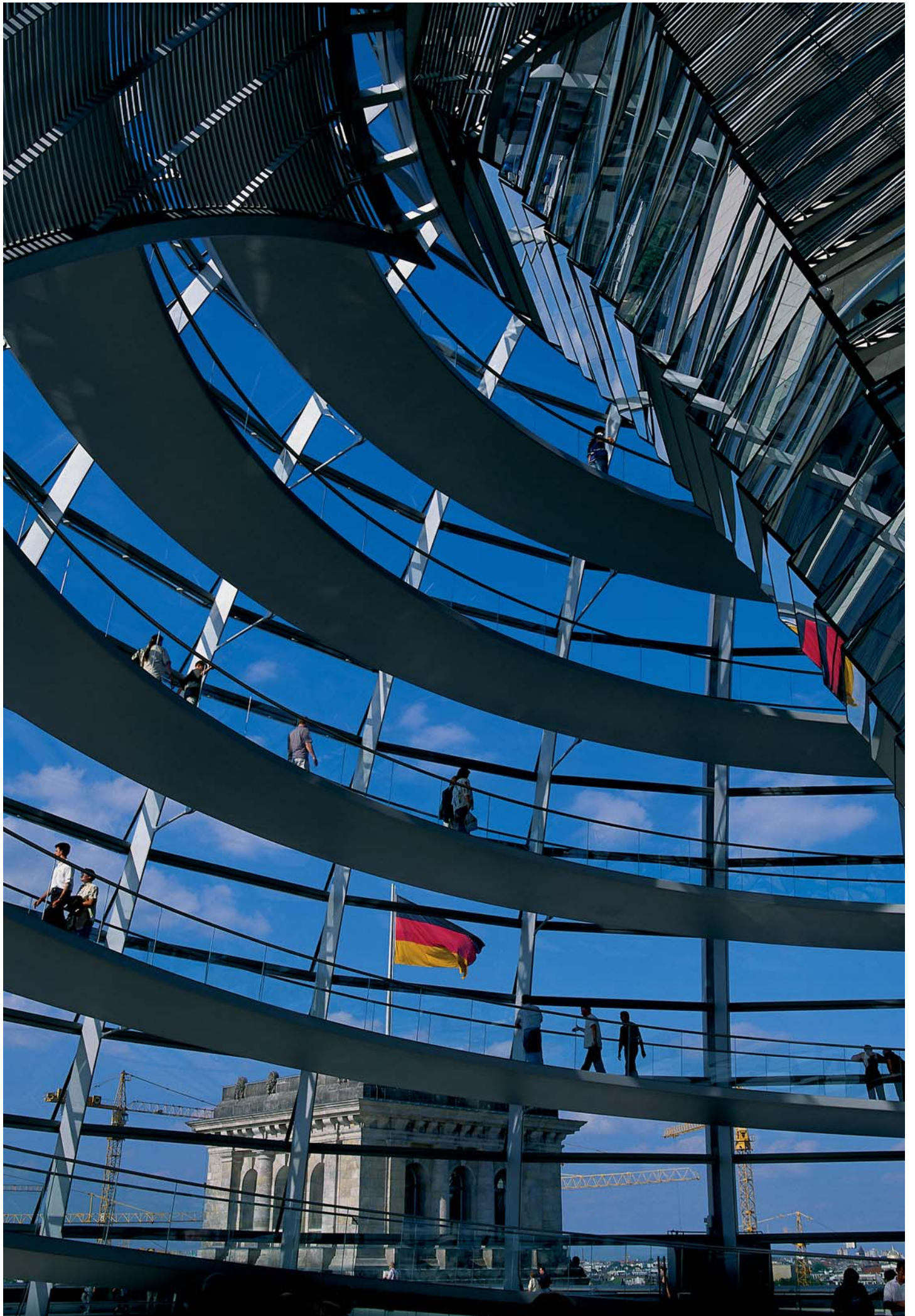


Fig. 3 Survey participants investing in Germany in 2006 and 2007



2 Germany in an international comparison

Based on the destination of private equity investments, Germany ranks third in Europe and fifth worldwide³. When asked to assess German attractiveness in relation to private equity investment compared with other countries, almost one third of the survey participants consider Germany to be globally attractive, while 23% of the interviewees are more critical and assess German attractiveness to be "quite poor". A large number of the respondents (45%) remained neutral on this issue.

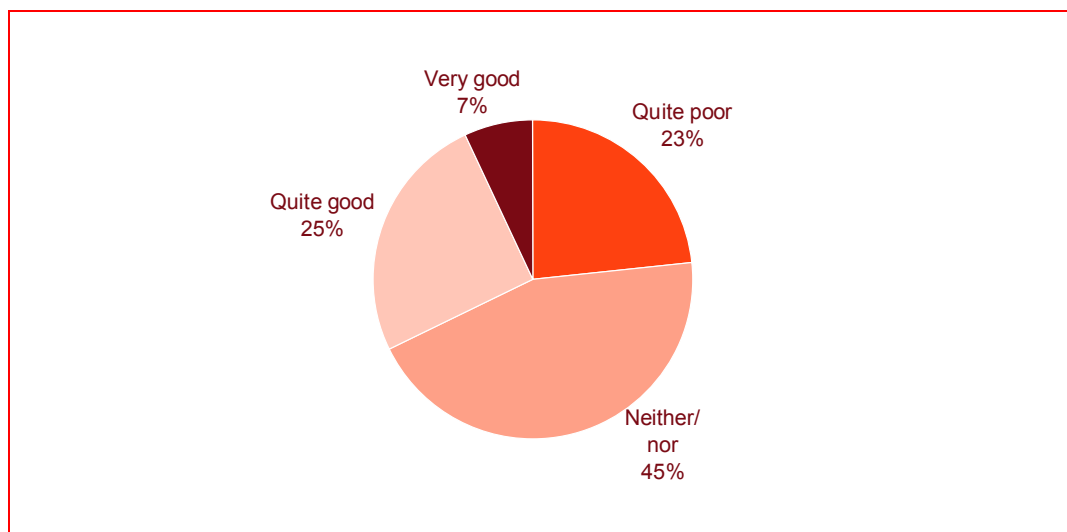


Fig. 4 Assessment of the attractiveness of Germany in relation to private equity investment compared with other countries

When asked to assess how the position of Germany in the international ranking will change by 2012, 56% of the respondents think that the country's position will improve, and 32% believe that it will remain stable. Only 12% believed that Germany's ranking would deteriorate.

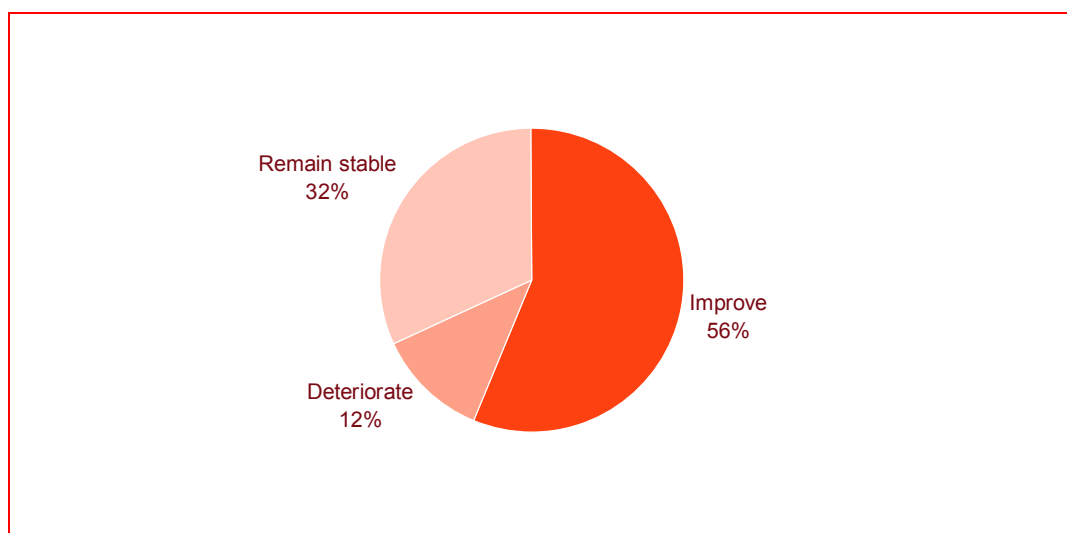


Fig. 5 Germany's future position in an international ranking for private equity investments

³ Sources: EVCA Yearbook 2006, PwC Global Private Equity Trend Report 2005.

3 German location factors

A number of quantitative and qualitative economic indicators and criteria were selected for an analysis of the environment for private equity in Germany. The list is by no means exhaustive. However, it identifies critical factors for private equity funds, including those directly affecting them or their portfolio companies, such as laws and regulations, taxation or sources of capital. The analysis also includes factors that have an indirect impact on the industry and take wider economic aspects into account, for example labour costs or innovation potential.

Countries such as the United Kingdom and Sweden have an environment for private equity that is generally acknowledged to be conducive to investment, which is also reflected in the private equity investment-to-GDP (gross domestic product) ratio: The United Kingdom and Sweden are the only countries in Europe exceeding 1%. Germany, by contrast, reaches only 0.12% of GDP⁴, which implies that private equity still has great potential if the framework permits.

For each indicator, the survey participants were asked to assess whether they considered it to be advantageous or disadvantageous to private equity investment in Germany. The responses were supplemented by additional comments, where available.

3.1 Legal and fiscal environment

A country's laws and regulations for private equity as well as its levels of taxation, red tape and fiscal research and development (R&D) subsidies have a direct impact on private equity. It is these factors that are focused on in the subsequent analysis.

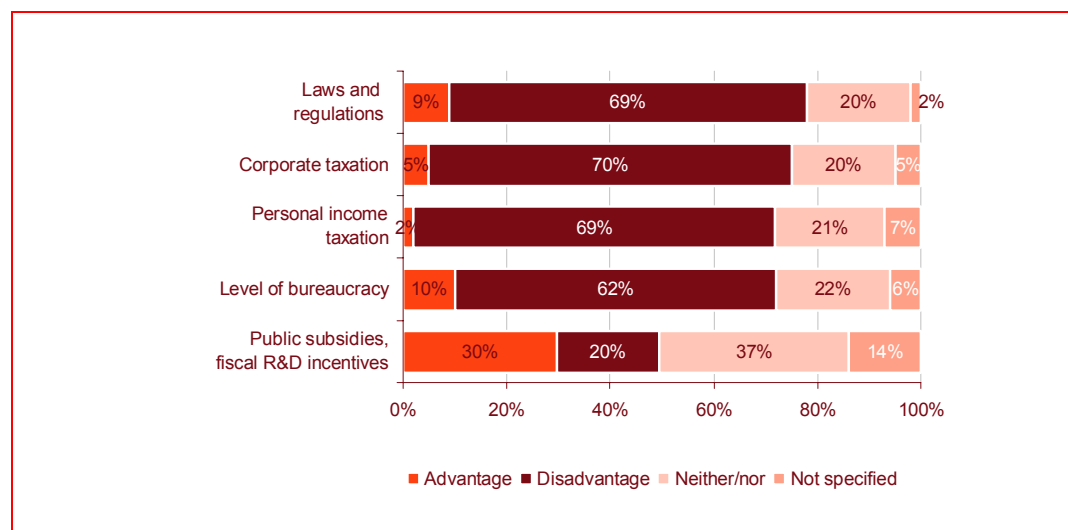


Fig. 6 Assessment of the German legal and fiscal environment for private equity

Laws and regulations

The survey shows that 69% of the respondents consider German laws and regulations to be a disadvantageous location factor and detrimental to private equity investment. Only 9% see advantages in the existing legislation.

Many comments on Germany as a location for doing business included a need for improvement of the regulatory and tax environment as a key factor to promote private equity investment.

⁴ Source: EVCA Yearbook 2006.

Current laws and regulations for private equity in Germany

In December 2003, the Ministry of Finance commented in a decree on the **income tax treatment of private equity and venture capital funds and its various investor types** and set out criteria for the differentiation between private wealth management and commercial enterprises. Consequently, the tax treatment depends on the nature of the fund. If it qualifies as a business enterprise, it is subject to trade tax ("Gewerbesteuer"). The decree also comments on the tax consequences of 'carried interest', the profit share entitlement of private equity managers. Nevertheless, uncertainty remains under what circumstances a private equity fund can be characterized as managing private wealth or as commercial ("gewerblich").

In June 2004, the "**Act on the Promotion of Venture Capital**" was passed. The Act clarified the taxation of carried interest, which is subject to the half-income system ("Halbeinkünfteverfahren") that also applies to dividends and other capital gains for individuals.

Pursuant to current law, profits of a corporation are taxed with **corporate income tax** and income deductible trade tax totalling approximately 39% whereby the exact rate depends on the municipality levying the trade tax.

According to Ministry of Finance press releases, the German coalition government has reached agreement on certain elements of corporate tax reform, including a decrease of the aggregate nominal income tax burden for corporations below 30%. The tax reform package would enter into force on 1 January 2008.

Interest on shareholder loans is subject to **German thin capitalization rules** limiting the deductibility of interest expenses and qualifying non-deductible interest as deemed dividend distributions triggering withholding taxes. These "thin cap" rules are also under revision by the corporate tax reform 2008. For purposes of corporate income tax, debt financing of companies would be limited by an anti interest-stripping rule ("Zinsschranke"). Net interest expenses if exceeding €1 million would only be deductible to an extent of 30% of current year net earnings before interest. Non-deductible interest expense would be carried forward and would generally be deductible in subsequent fiscal years, subject to limitations similar to those applicable in the current year.

Only 5% of capital gains and dividends received by German or foreign corporations are subject to tax. In general double taxation treaties refer taxation rights to the home country of the shareholder.

Germany raises a dividend withholding tax on dividends distributions independent from the residence of the shareholder. With respect to the parent-subsidiary directive withholding tax is either not withheld or repaid if the requirements of the Anti-Shopping-Rule are fulfilled.

According to the coalition agreement among the ruling parties of 11 November 2005, a private equity bill is to be passed on to the German Parliament to enter into force at the beginning of 2008. Details regarding the contents of the law have not been published yet. Instead, a large number of requirements are under public discussion, such as a transparent taxation of private equity and venture capital funds or tax reliefs for losses in the venture capital area, including the promotion of investment in young companies.

Corporate and personal income taxation

By and large, Germany is considered a high-tax country by the survey participants. Approximately 70 per cent of them consider both corporate taxation and personal income taxation to be disadvantageous to Germany.

The latest available statistics partly reflect the survey respondents' subjective impression of German personal and corporate income taxation compared with other countries in the European Union. According to the European Commission Services, Germany had the highest statutory corporate income tax in 2006 of all the 25 EU countries. In relation to the top statutory personal income tax rate in 2006, Germany ranks in the middle field of the 25 EU countries, slightly below the EU average.

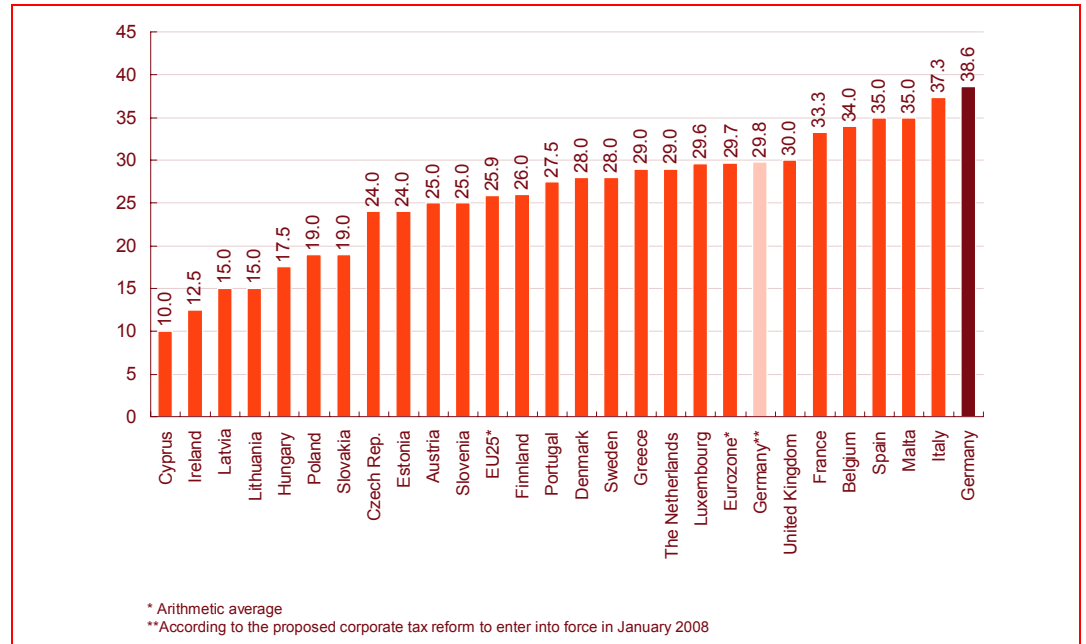


Fig. 7 Adjusted top statutory tax rate on corporate income in 2006, %⁵

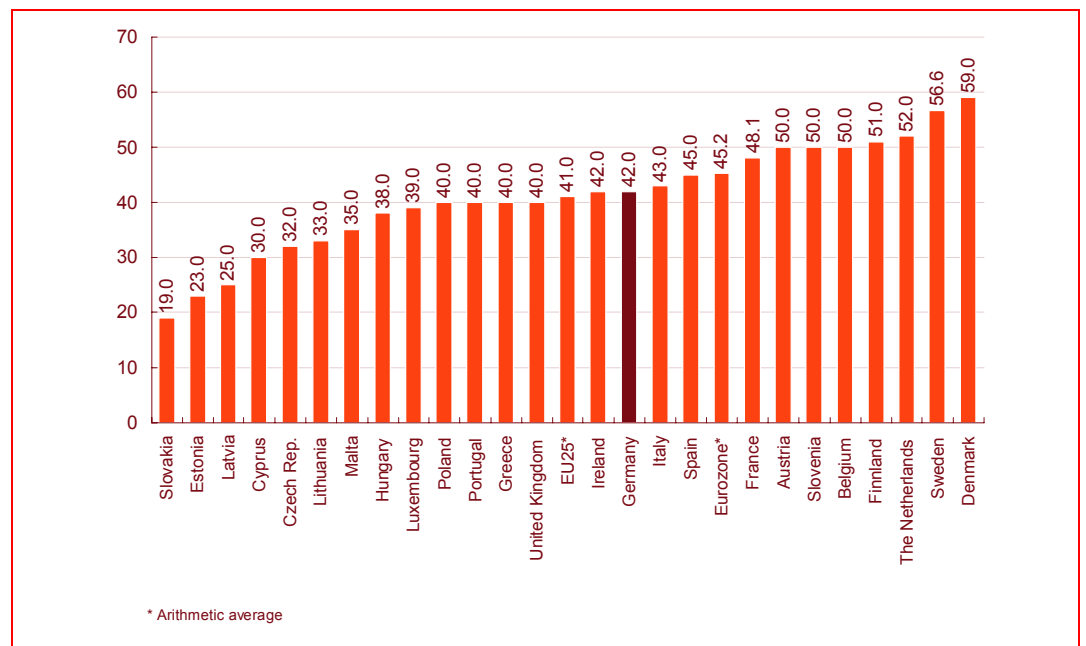


Fig. 8 Top statutory personal income tax rate in 2006, %⁶

⁵ Source: European Commission Services.

⁶ Source: European Commission Services.

The level of bureaucracy

Administrative barriers have been identified as serious impediments to investment, growth and economic dynamics. Every year, the German economy is burdened with high administrative costs.

Unsurprisingly, German red tape is considered a disadvantage by the majority of the survey participants: 62 per cent of the respondents do not consider it conducive to Germany as a private equity investment destination.

Red tape affecting private equity and venture capital

Costs incurred through administrative processes necessary because of German laws and regulations amounted to over €46 billion in 2003. The largest part of this amount – 84% – is borne by small and medium-sized companies, the German *Mittelstand*⁷. As these companies have become popular targets for many international private equity funds, German red tape has a direct impact on their investments and returns.

The World Bank Group has found that starting a business in the form of a limited company (GmbH) in Germany with all the necessary procedures involved took approximately 24 days in 2006. Compared with other OECD countries, Germany only reaches rank 19 out of a group of 23 countries⁸, which directly impacts on the seed and start-up investment stage and may hamper free entrepreneurship.

Public subsidies for private equity and fiscal R&D support

In relation to public subsidies, fiscal support for research and development (R&D) and other incentives to promote private equity investment, almost one third of the respondents consider the current situation advantageous, while 20% see disadvantages.

The promotion of venture capital in Germany

In 2005, the so-called "High-Tech Gründerfonds" was established by the Federal Ministry of Economics, Kreditanstalt für Wiederaufbau (KfW), BASF, Siemens and Deutsche Telekom. The €262 million fund invests venture capital in promising young technology companies over a period of five years. In 2007, fresh capital was injected in the fund by new and existing investors, Daimler Chrysler, Bosch, Carl Zeiss and KfW. The fund volume now amounts to €272 million (www.high-tech-gruenderfonds.de).

In 2004, the Federal Ministry of Economics and the European Investment Bank launched the €500 million ERP/EIF fund of funds for investments in early-stage companies in the IT, communications and biotechnology sectors.

In the context of the discussions about the new private equity law for Germany, demands for better support of German seed and start-up companies have been made. Venture capital is one of the areas that the new law is expected to focus on.

Further details on the German innovation potential are set out below.

⁷ Source: German Institut für Mittelstandsforschung, "Ermittlung bürokratischer Kostenbelastungen in ausgewählten Bereichen" (2006).

⁸ Source: www.doingbusiness.org.

3.2 Financial environment

A country's financing environment and sources of capital play a major role in creating a favourable or unfavourable environment for private equity. What types of investors in private equity funds does a country have? What is the level of interest rates, bank lending and the related availability of debt to finance buy-outs?

The majority of the survey participants consider these factors to be advantageous to Germany.

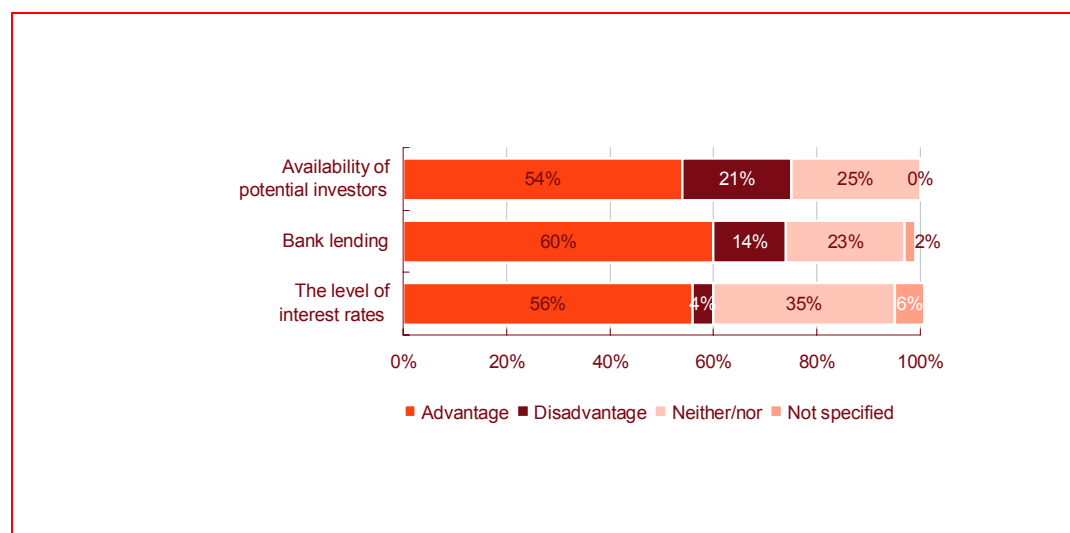


Fig. 9 Assessment of finance-related factors in Germany

Availability of potential investors in private equity

Across Europe, pension funds were the largest single source of capital in 2005. Other main sources include banks, funds of funds, insurance companies, government agencies, private individuals, academic institutions and corporate investors. In Germany, banks and government agencies are the largest sources of capital, altogether providing 44% of the total amount raised in 2005. Insurance companies and pension funds as important and long-term sources of capital only contribute 13% to the total amount raised. In the United Kingdom, by contrast, the contribution made by both types of investors amounts to 40%⁹.

The majority of the survey participants see a relative strength of Germany in the availability of potential investors, and only 21% consider the existing situation disadvantageous.

Insurance companies and pension funds as potential investors in private equity

In contrast to the United States Germany lacks well funded foundations and large pension funds that invest considerable sums of money in private equity. US pension funds, for example, invest on average 6% of their portfolio in private equity and British institutional investors approximately 2%¹⁰. German pension funds and insurance companies, by contrast, generally do not allocate more than of 1% to this asset class.

Bank lending, availability of debt and interest rates

The continued availability of debt to finance buy-outs in Germany and the current levels of interest rates are seen as a major advantage by 60 and 56% of the interviewees respectively. At the same time, the high levels of leverage in the market are increasingly regarded by commentators as a potential risk for the industry, especially the portfolio companies.

⁹ Source: EVCA Yearbook 2006.

¹⁰ Golding, J., "From Hunting Ground to Source of Capital - Germany's Evolving Private Equity Landscape", Financial Yearbook Germany 2007, p. 77.

3.3 Economic structure

Further factors impacting on a country's private equity market relate to the economic structure, such as labour and labour-related costs, the education and qualification of the workforce, the corporate structure and a country's innovation potential.

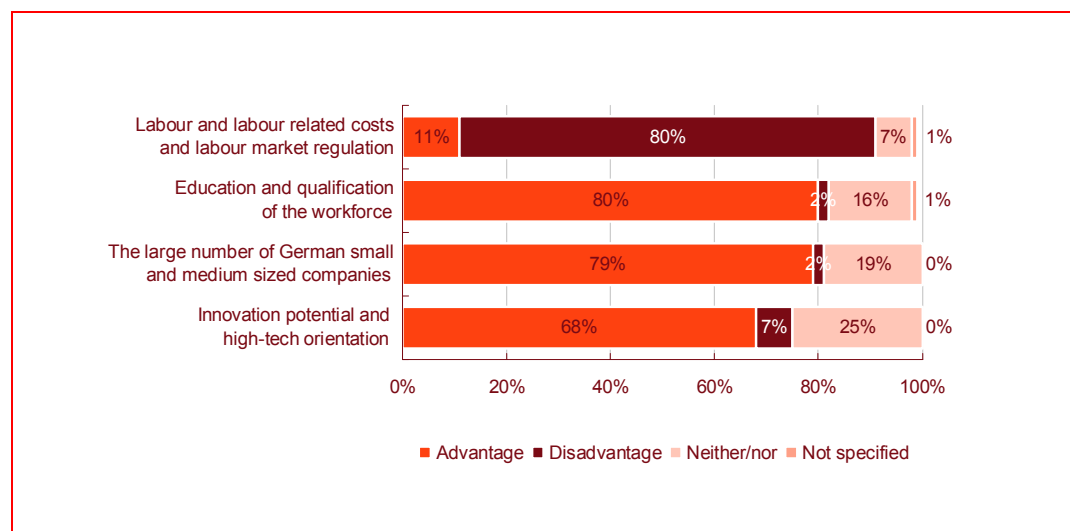


Fig. 10 Assessment of factors relating to the German economic structure

The German labour market

Labour and labour-related costs as well as labour market regulation are important location criteria. In the eyes of the survey participants, these factors are considered a clear disadvantage of Germany as a business location. A total of 80% of the respondents have expressed their dissatisfaction over this issue.

When asked to comment on Germany as a location for doing business, they identified inflexible labour laws as a key impediment to investment.

In the Global Competitiveness Report 2006-2007 by the World Economic Forum, the "most problematic factors for doing business" in Germany include the restrictive labour regulations.

Notable competitive disadvantages – Germany-include:	Rank / 125
Flexibility of wage determination	122
Hiring and firing practices	120

Tab. 1 Competitive disadvantages Germany¹¹

¹¹ Source: World Economic Forum: Global Competitiveness Report 2006-2007

Average labour costs per hour in the industrial and services sector (annual labour costs divided by the annual number of hours worked)	2005 in EUR
Belgium	30.73
Denmark	30.70 (2004)
Sweden	30.43 (2003)
France	29.29
Luxembourg	28.33 (2004)
The Netherlands	27.41
Germany	26.43
Finland	26.39
Austria	25.30 (2004)
United Kingdom	24.47
Italy	21.39 (2004)
EU-25	21.18
Spain	15.22
Greece	13.37 (2003)
Cyprus	11.10 (2004)
Slovenia	10.76
Portugal	10.60
Malta	8.35
Czech Republic	6.63
Hungary	6.14
Poland	5.55
Slovakia	4.80
Estonia	4.67
Lithuania	3.56
Latvia	2.77
Romania	2.33
Bulgaria	1.55

Tab. 2 Average labour costs per hour in the European Union¹²

With €26.43, German average labour costs per hour are above the EU-25 average, but are not the highest of all the member states. The discrepancies within the EU are high and range from €1.55 in Bulgaria to €30.73 in Belgium.

Education and qualification of the workforce

The education and qualification of the workforce are viewed very positively by the international respondents: A total of 80% consider them an advantage.

Corporate structure

Small and medium-sized companies in Germany with less than 250 employees make up approximately 98% of all companies and are therefore the backbone of the economy. As they often have limited access to capital, which has been reinforced by Basel II, private equity can function as an alternative source of financing.

The representatives of the international private equity houses show an appreciation for the existing structures in Germany: 79% consider the large number of small and medium-sized companies an advantage of Germany.

As the number of big-ticket deals is somewhat limited in Germany and private equity funds have raised large amounts of capital for their investments, mid-sized companies have become popular targets. A number of funds have been raised that are specifically aimed at investments in these companies.

¹² Source: Eurostat.

Innovation potential and high-tech orientation

When asked to assess the innovation potential and high-tech orientation of Germany, 68% of the respondents considered German companies to be innovative and high-tech oriented. However, some respondents also cited a lack of entrepreneurial approach.

Innovation is a prerequisite for a prospering economy and key to staying globally competitive. Research and development as well as sufficient financing lay the basis for innovations and growth. Industry sectors like communications, information technology, including computer and other electronics-related, biotechnology and medical are generally characterised as innovative. As private equity investors tend to focus on promising and future-oriented sectors and industries, they also contribute to a country's innovation potential. This is especially true for investments in the seed and start-up sector.

In Germany, the proportion of private equity investments in innovative industry sectors compared with other sectors has seen some variation between 1998 and 2005 (see figure 11). Private equity investments in Germany are still very much focused on "traditional" sectors like consumer or industrial products and services. The market is mostly dominated by buy-outs in these sectors rather than venture capital, which tends to focus on more innovative sectors.

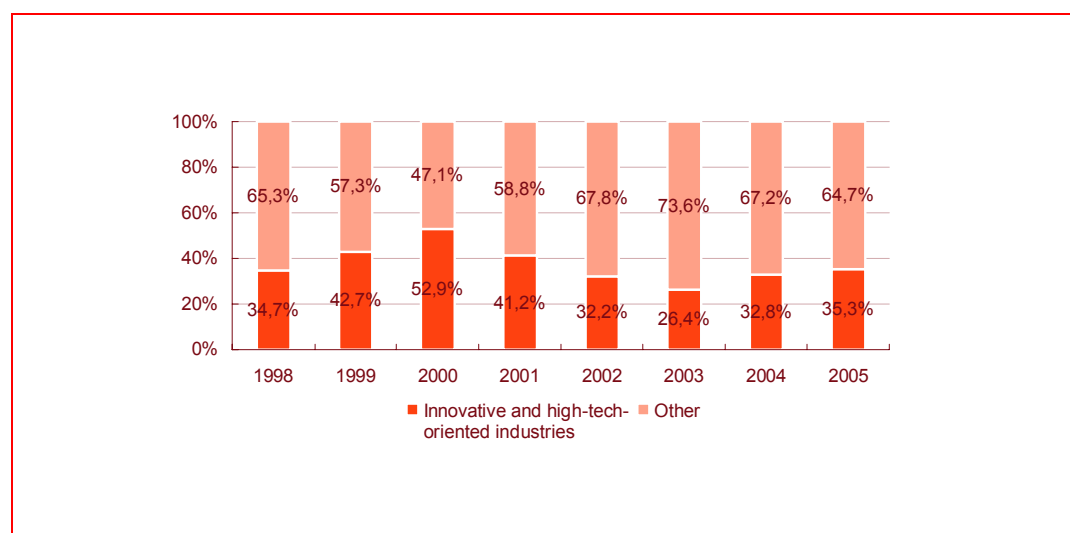


Fig. 11 Proportion of private equity investments in innovative and high-tech industries in relation to other industry sectors in Germany¹³

In the Global Competitiveness Report 2006-2007 by the World Economic Forum, Germany has achieved top scores for its capacity for innovation and company spending on R&D.

Notable competitive advantages – Germany – include:	Rank / 125
Capacity for innovation	1
Company spending on research and development	4

Tab. 3 Competitive advantages Germany¹⁴

Other advantages and disadvantages mentioned by the survey participants

The interviewees were asked to identify other factors they consider important in relation to Germany. Factors often mentioned to be an advantage were the open German business culture, the quality of management and the real estate market. Other disadvantages mentioned were the uncertainty about the private equity legislation under way, corporate legislation, labour unions and a perceived general opposition to private equity.

¹³ Source: EVCA

¹⁴ Source: World Economic Forum: Global Competitiveness Report 2006-2007

3.4 Summary

Despite the fact that Germany is one of Europe's largest economies, the country has a number of deficits as identified by the survey participants: German laws and regulations, labour costs and restrictive labour laws, taxation and red tape are key impediments to private equity investment.

On the other hand, Germany's trump cards in the opinion of the respondents are the highly skilled workforce, the number of small and mid-sized companies, sources of capital, public incentives for R&D and the country's innovation potential.

Germany therefore finds itself at a crossroads in terms of attractiveness for the private equity community. We believe that the current fragile balance between strengths and weaknesses could be strongly influenced in one direction or another by future regulation.

Quotes in relation to the regulatory framework in Germany:

“In comparison to other places, they still have a long way to go to improve the regulatory and tax environments and labour flexibility.”

(UK fund - €500 million to €1 billion capital under management)

“I think the restricted labour market is a problem for Germany.”

(Danish fund, < €500 million capital under management)

“We have confidence in the German economy. It is a large economy with a large supply of companies to buy, with relatively low levels of competition amongst private equity firms - we believe that Germany is an attractive place to invest.”

(UK fund, < €500 million capital under management)

“Germany needs new private equity laws and new tax laws.”

(Austrian fund, < €500 million capital under management)

“(Germany) is an attractive place, but we're concerned about labour costs and bureaucracy. There needs to be a change in the laws.”

(UK fund, < €500 million capital under management)

“We saw Germany as a good place to invest and we will continue to invest.”

(UK fund, > €1 billion capital under management)

“I think there is potential in Germany. It is a good population with well-educated people.”

(US fund, €500 million to €1 billion capital under management)



C International private equity investment trends

1 Overview

As a second part of the trend report, international investment patterns were analysed, and the interviewees were asked where they currently invested and where they planned to invest within the next five years.

A total of 94% of the respondents stated that they invested in Western Europe at the time of the survey. 21% of the interviewees invested in the United States, 18% in Central and Eastern Europe, and 13% were active in Asia. The relatively small proportion of current private equity funds investing in the United States is due to the fact that the vast majority of the survey participants are based in Continental Europe. "Other" countries include Australia, Canada, Mexico and South American countries.

The results reflect the subjective impression of the survey participants. While it may sometimes be difficult to state exactly in which country investments will be made, certain preferences and trends become clear. However, these may not necessarily reflect the actual size of the market nor the amount of investments made now and in future.

In relation to the interviewees' investment plans for the next five years, the dominance of Western Europe is set to continue but competition from other regions is clearly on the increase. 78% of the private equity funds have specific plans to invest in Western Europe in the future compared to 94% currently, but there is a shift towards Central and Eastern Europe where almost one quarter of the respondents plan to invest. Asia's role in their future investment plans is also slightly gaining in importance.

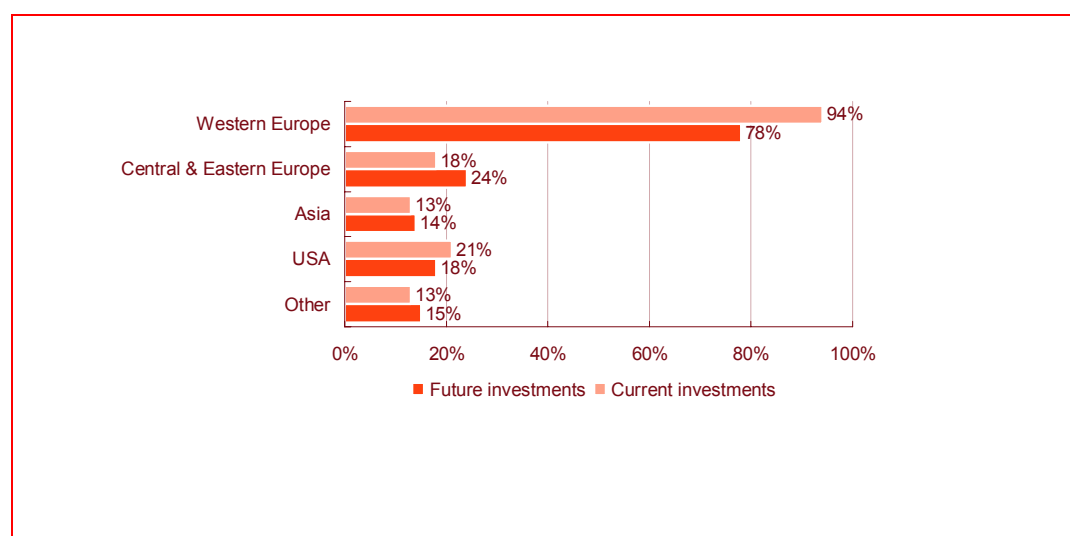


Fig. 12 Regions where the respondents currently invest and plan to invest in future (%)

2 Western Europe

When asked where they planned to invest in the future (within the next five years), between 38 and 39% of the respondents named Germany, the United Kingdom and France.

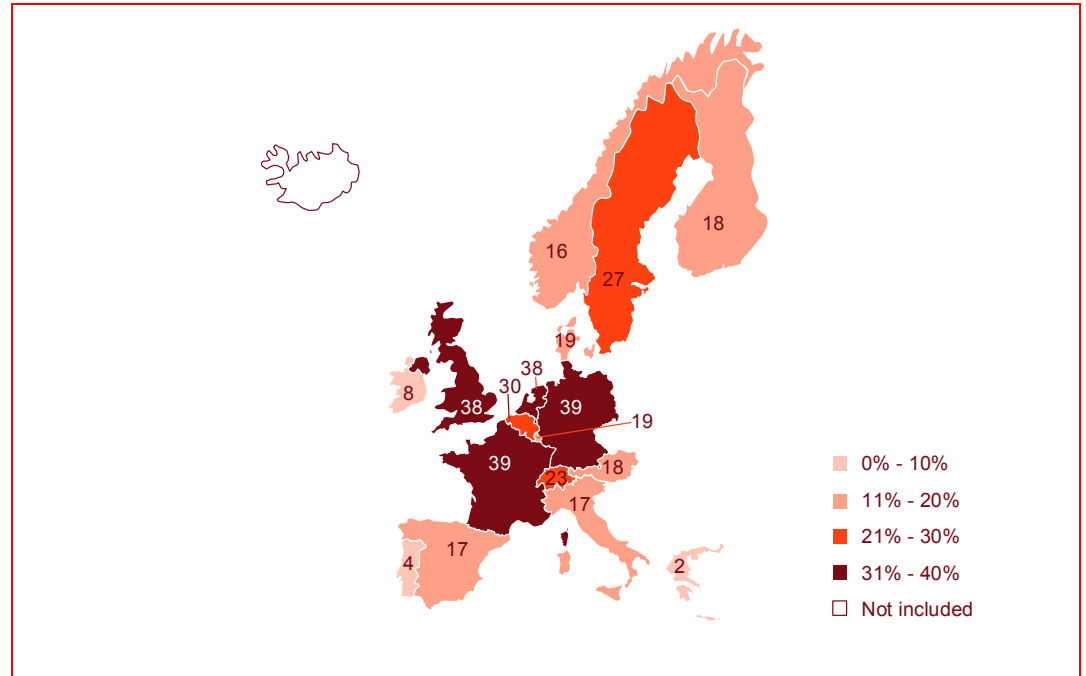


Fig. 13 Countries where the respondents plan to invest in future, Western Europe (%)

It should be noted that the survey participants' subjective impression does not reflect the relative size of the European private equity market and no conclusions can be drawn in respect of the likely value of investments in individual countries compared to prior years. As figure 14 shows, the UK has attracted by far the highest amount of investments between 1998 and 2005.

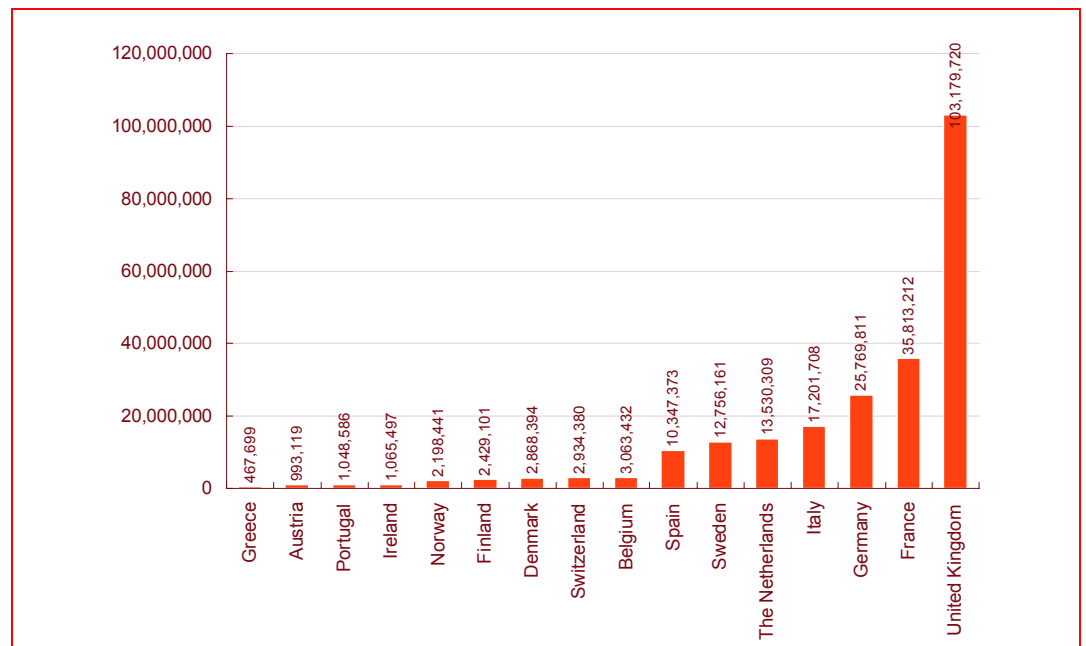


Fig. 14 Private equity investments Western Europe, 1998-2005 in € x 1,000¹⁵

¹⁵ Source: EVCA Yearbooks

The respondents were asked to give reasons for investing in Western European countries. Many of those who are based in Western Europe named geographic proximity and the related familiarity with these countries, their regulations, business culture and language as the main reasons for investing there. Other reasons include the number of medium-sized companies as potential targets in countries like Germany, Austria, France, Benelux, Ireland and the United Kingdom. Scandinavian countries, the UK, France and Germany were praised for their innovation potential and their highly educated workforce.

Countries described by the respondents as having a particularly favourable tax system for entrepreneurs include Belgium, France, Ireland, Luxembourg, The Netherlands, Switzerland and the United Kingdom.

Reasons given by the respondents for investing in a country or region:

“Proximity is convenient and we are very familiar with the regulations.”

(Benelux countries)

“We are very familiar with these countries.”

(Scandinavian countries)

“Good innovation potential and a highly-educated workforce.”

(Scandinavian countries, the UK, France and Germany)

“They are in our geographic reach. We understand their language and legal system.”

(Benelux countries, Switzerland, Germany, France and Scandinavia)

3 Central and Eastern Europe (CEE)

Central and Eastern Europe (including Russia) does not (yet) play a major role in the investment portfolios of the global private equity funds. However, 24% of all interviewees have plans to invest in the region within the next five years, an increase from 18% currently. The three most popular investment countries are Poland, Hungary and the Czech Republic. Between 11 and 13% of respondents expected to invest in each of these countries in the next five years.

The latest available EVCA figures for the CEE region from 2005 show that with €147 million, Hungary leads the ranking (a 21% increase over 2004), followed by the Czech Republic (€109 million) and Poland (€108 million). Romania ranks fourth in the EVCA statistics which state that over 85% of the region's investment activity in 2005 focused on these four countries.

Investments across the region totalled €508 million in 2005, some 7% below the level of 2004. As some countries show considerable fluctuation in investments, EVCA concludes that "private equity fund managers in CEE are looking across the region for attractive opportunities and invest where the most rewarding projects are available", which is also reflected in the comments made by the interviewees.

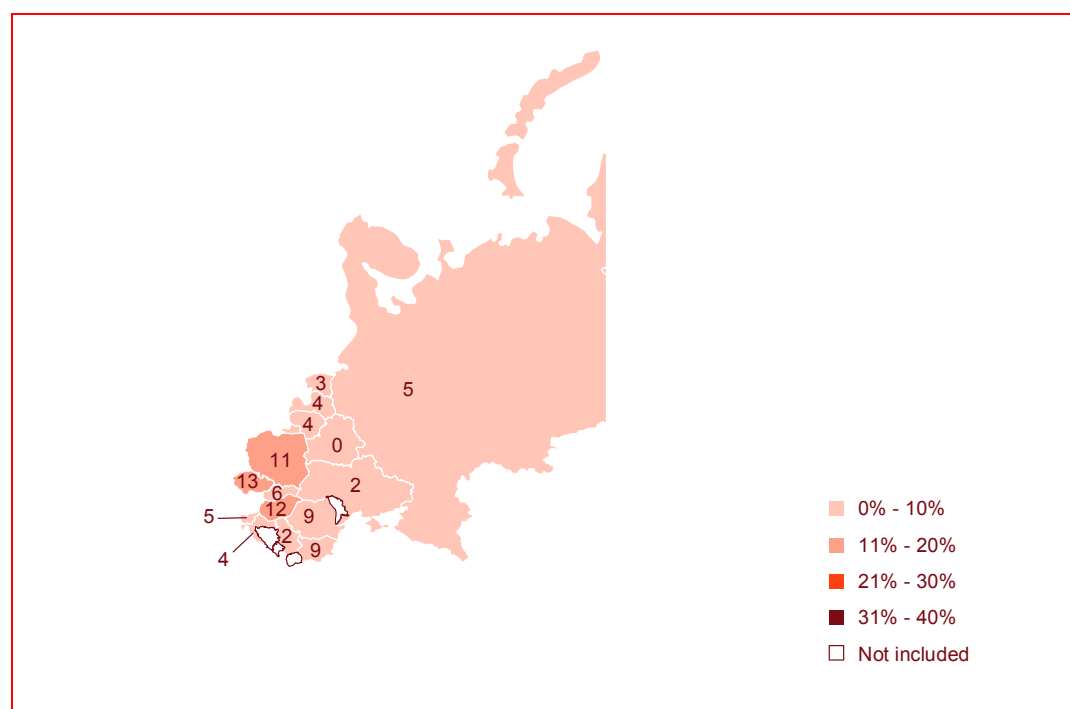


Fig. 15 Countries where the respondents plan to invest in future, CEE (%)

When asked to give reasons for investing in Central and Eastern Europe, the respondents stressed the region's fast economic growth, the development potential of target companies, a virtual lack of competitors, entrepreneurial spirit, low labour costs and a "satisfactory" regulatory environment.

Reasons given by the respondents for investing in the CEE region:

“High economic growth rates and relatively little competition.”

(CEE region)

“High growth rates.”

(CEE region)

“We think there are quite a few targets for us in these countries which have development potential.”

(Czech Republic, Poland)

“Growth potential and low labour costs together with a satisfactory regulatory environment.”

(Czech Republic, Hungary, Poland)

“They are highly entrepreneurial and benefit from low labour costs and fast-growth economies.”

(Czech Republic, Poland, Romania)

4 Asia

Asia currently plays a subordinate role in future portfolios of the private equity funds surveyed and this is expected to increase only marginally in the future. Only between 6 and 10% of the interviewees stated that they had plans to invest in China, India or Japan within the next five years.

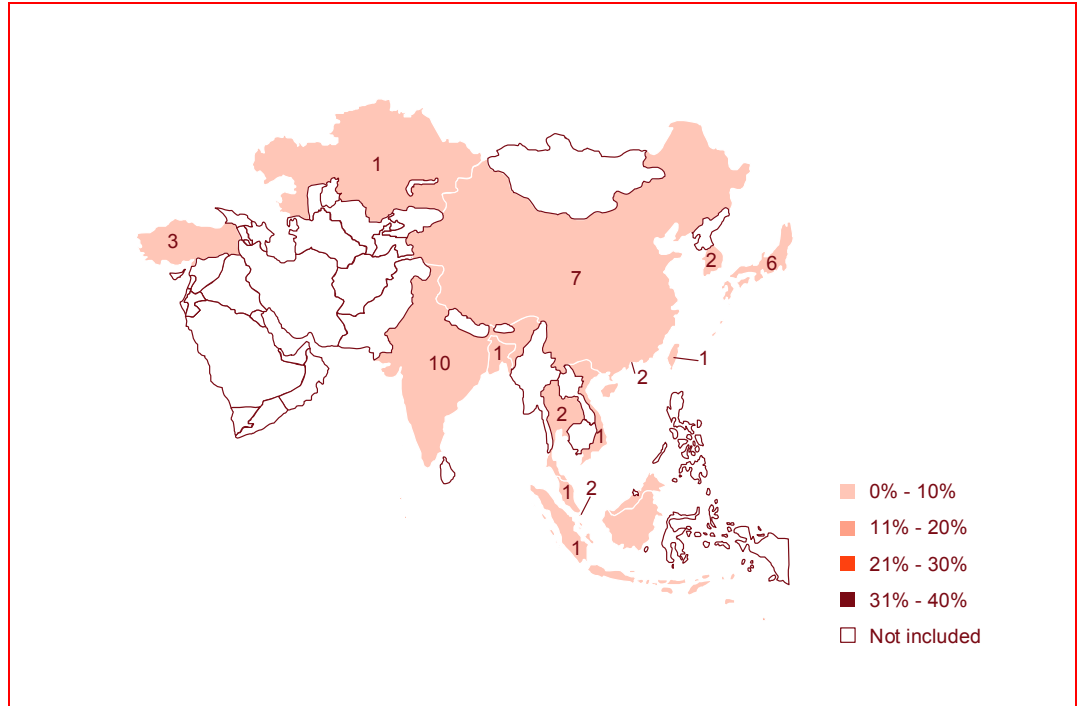


Fig. 16 Countries where the respondents plan to invest in future, Asia (%)

The reasons that the private equity funds gave for their Asian preference included the high growth and the size of the large developing private equity markets, especially India and China.

Reasons given by the respondents for investing in Asia

“The technology level is very high in these countries.”

(India, China)

“Growth.”

(India, China)

“It is a large and developing market for the private equity industry.”

(China, Japan, India, Thailand)

5 Investment criteria analysis

With a view to ascertaining the relative importance of certain location factors as a basis for international investment decisions, the interviewees were asked to assess the importance of a number of factors. The results are set out below. The majority of these factors have been discussed in detail in the section on Germany above.

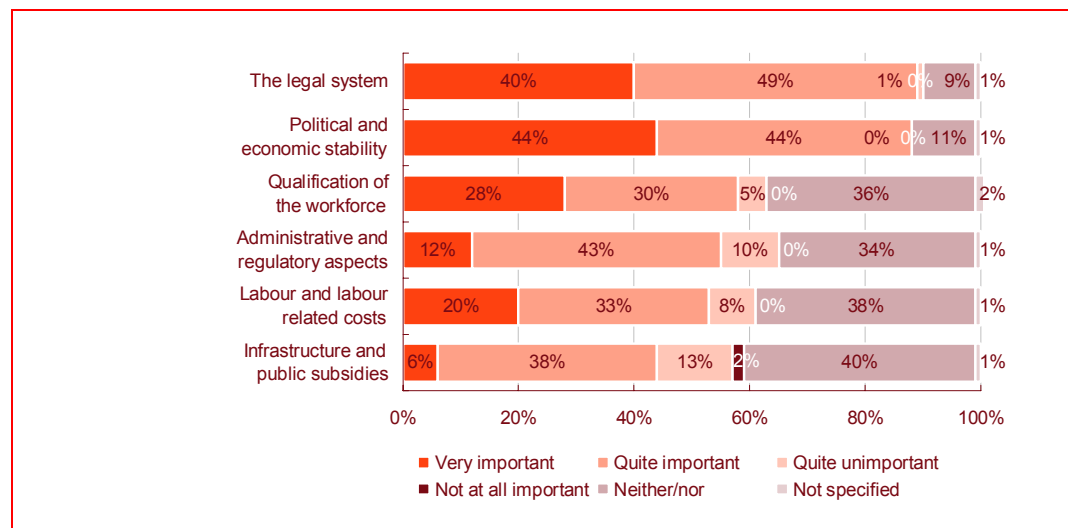


Fig. 17 Assessment of overall economic factors

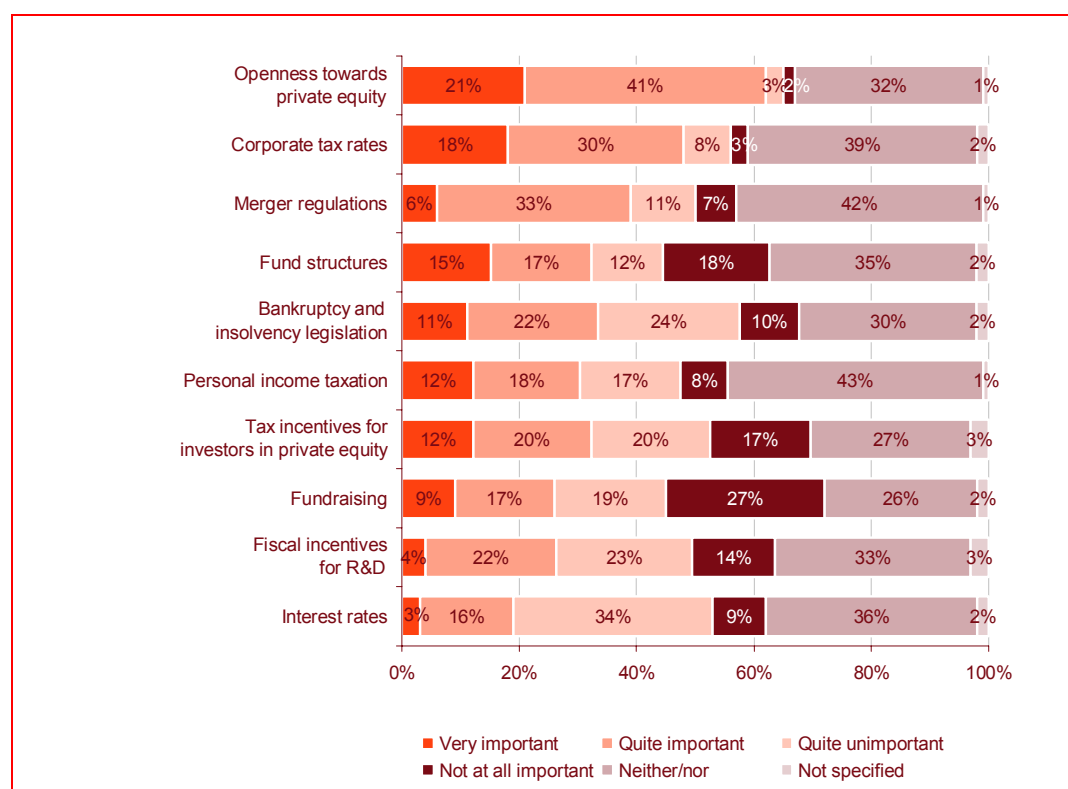
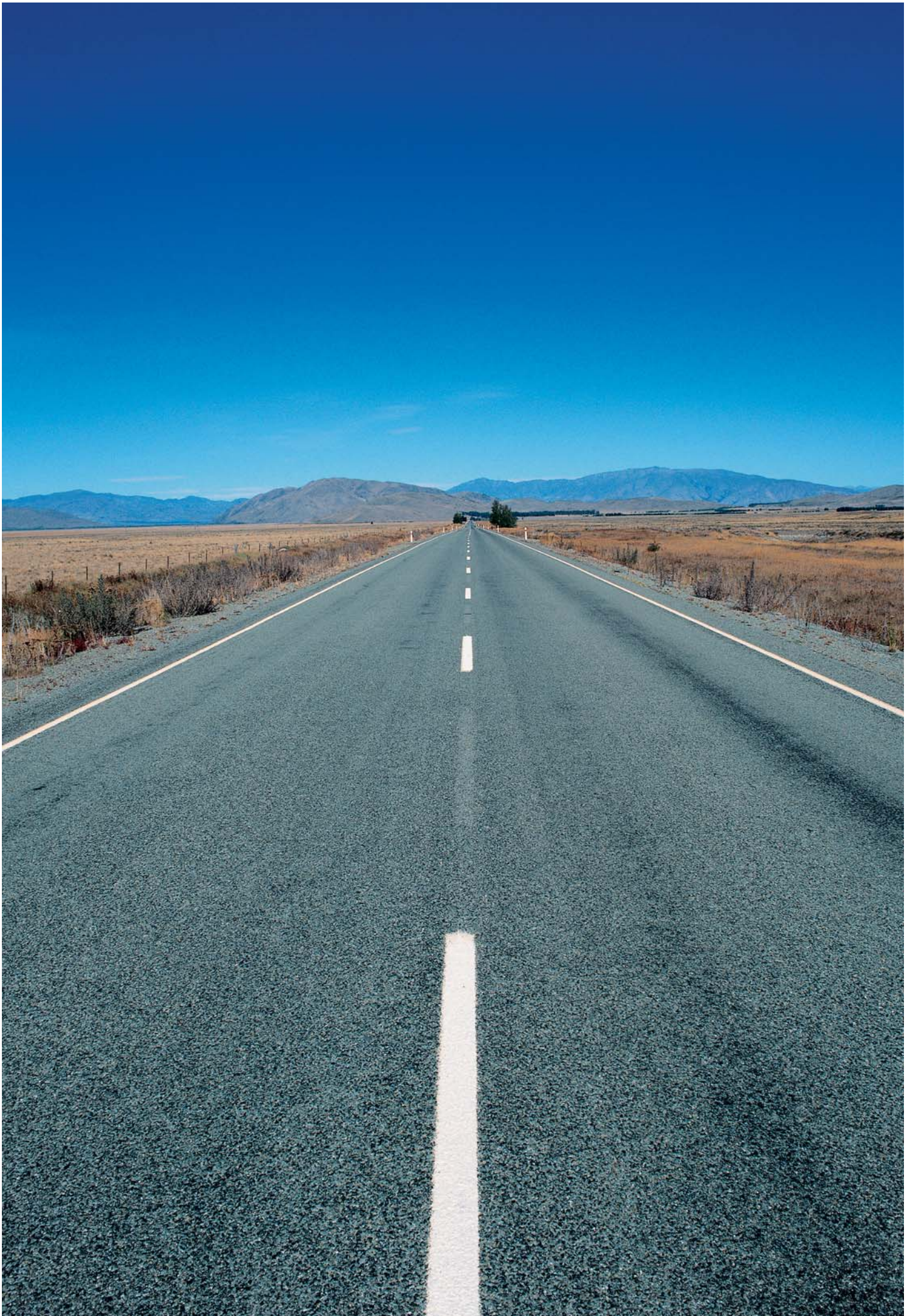


Fig. 18 Assessment of private equity-related factors

It is important to note that a large number of respondents are relatively indifferent to the private equity-related factors – very much in contrast to the above-mentioned overall economic factors pertaining to a specific country. The openness towards private equity enjoys great importance in the eyes of the respondents.



D Outlook

The survey has shown that Western Europe will remain a major focus for private equity in the medium term, but the competition for investment from Central and Eastern Europe and (to a lesser extent) Asia is increasing.

The main concerns expressed by many survey participants centred on legal and regulatory aspects which are recognized to be very important investment criteria for private equity funds. However, it has become clear that the wider economic environment also has a strong impact on the funds, such as labour market factors, red tape and the economic structure as a whole.

For Germany to stay competitive on a global scale and secure future investment activity, further incentives and improved structures in the regulatory and tax environment are necessary. The United Kingdom serves as an example where favourable regulations have attracted international private equity investors and contributed to the development of the national economy.

In this context, the lawmakers responsible for drafting and approving the proposed German private equity and tax law changes bear a large weight of responsibility for securing the country's future as an attractive location for private equity in the face of stronger international competition.

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