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BUSINESS LIFE

EXPANSION STRATEGY

Silver Lake aims to make a splash

The US private equity fund has experienced meteoric growth in America. It is now turning to European technology groups, says Peter Smith

When Silver Lake launched in 1999, the US private equity fund's ability to win the support of Bill Gates, Michael Dell and Larry Ellison caused a ripple in Silicon Valley. A wave of envy followed when one of its earliest deals, the buy-out of US disc drive maker Seagate, converted the firm's \$382m (£219m) outlay into \$3bn.

Already gaining a reputation as a firm that punches above its weight, Silver Lake scored another coup this year when it orchestrated the second largest leveraged buy-out in history. It teamed up with six of the world's big private equity groups to buy SunGard, the US technology group, in an \$11.3bn deal.

The young firm now faces an altogether different test: to crack Europe, the world's richest hunting ground for private equity transactions.

Glenn Hutchins, in London with fellow co-founders David Roux and James Davidson to mark the opening this month of the group's Mayfair office, its third after Menlo Park, California, and New York, believes Silver Lake has at least two distinguishing characteristics that will help it replicate its US success in Europe.

First, it has specialist knowledge of the late-stage technology sector, an area typically avoided by most buy-out groups. Second, it has cultivated an



On the move: Silver Lake partners (l-r) Glenn Hutchins, Egon Durban, David Roux and James Davidson believe they have the experience and energy to thrive in Europe

Felix Clay

enviable network of industry contacts over many years.

"In technology, and for us that includes telecoms and media, we strive to be the partner of choice, both for companies we are looking to invest in and when we join up with other private equity groups," says Mr Hutchins. "We play well with others in the sand box."

Although Silver Lake already has two European investments under its belt – Business Objects, a business intelligence software company, and Thomson, which provides technology, systems and services for entertainment companies – the firm has recently begun to make more of a splash in the region.

In the summer it was part of an unsuccessful bid to buy Amena, the Spanish mobile phone group that eventually fell to France Telecom in a deal worth more than €10bn (£6.9bn). And it is currently part of a team attempting to buy TDC, the Denmark-listed telecoms group, for close to €12bn.

Views from outside the firm, though generally positive, can be mixed.

One executive from a European firm that has worked with Silver Lake has a good first impression. "Undoubtedly in technology they are plugged in. They know the suppliers to telecoms groups, they have cultivated a lot of very senior relationships in industry, which gives them great access. And they understand the evolution of technology.

'We are an unusual animal because we are in many ways a strategic player in our industry as well as a private equity group'

"They are very pragmatic and they go extremely deep in the way they approach businesses. There is no particular ego," he adds.

Another industry observer, however, notes that it is still early days for the firm. "Their numbers would look a lot less impressive without Seagate. How dependent are they on that one win?"

He adds that SunGard's ability to generate vast sums from licence fees was likely to protect investors from down-side risk but that the jury was still out on whether it would turn out to be a highly lucrative investment.

And an investor from a US endowment fund notes one of their best skills is self-promotion. "They are good but not as good as they tell you," he says.

Indeed, some of Silver Lake's early investments went sour, including a failed \$200m investment in Submit Order, a business that outsourced "e-fulfilment" tasks for e-commerce companies.

Even so, Silver Lake's maiden \$2.3bn fund performed better than most of its peer group in 1999 – a vintage year – generating annualised returns of more than 20 per cent. About half that gain is attributed to Seagate.

The Silver Lake fund made those returns despite weakness in the technology sector. The technology-rich Nasdaq index stood at about 3,400 when the firm started investing the fund. But when Silver Lake began divesting the fund, it had fallen to close to 2,000.

The movement underlines Silver Lake's ability to make profits on technology investments despite falling valuations for publicly-traded equivalents.

Mr Hutchins and Egon Durban, the partner leading Silver Lake's European charge, dismiss the idea that the firm is a late arrival to a market that has attracted more than a dozen US buyout groups in the past decade. "Our judgment is that now is the right time for private equity to be investing in European technology," Mr Hutchins says. He points to several trends underlying this judgment: a new generation of executives running technology companies; an increasingly activist shareholder movement; and growing acceptance of private equity as a source of capital.

Mr Durban believes there is an opportunity to spot European companies that are undervalued compared with their US counterparts, especially when those businesses become more global.

"There is a real opportunity to work with management teams and we are very good at that. We can bring US best practice to

European companies, some of which may not know what they don't know," he says, citing more efficient supply chain management and IT improvements.

When Silver Lake invests in companies it devises what it calls a "value creation plan".

"The deal team spends 100-plus days working with management on one-, three-and five-year business plans. From that, for example, we may start to extract working capital improvements," Mr Durban says.

Silver Lake claims to be agnostic in the way it puts its capital to work. Most private equity groups make control investments, owning more than half a portfolio company's equity. Silver Lake instead invests in different layers of a company's capital structure. It may invest in minority equity stakes, convertible preference shares and debt instruments.

"We focus on market leaders rather than lower growth companies with stable cash flows and we design a capital structure that helps them," Mr Hutchins says.

"Most technology businesses are growing faster than average gross domestic product. You want to under-lever the business to create opportunities and grow the business. We typically use less leverage than other buyout firms.

"Many private equity groups have eschewed technology be-

cause they worry that it is too volatile and requires too much research and development, and they rightfully worry about the need to have expertise," he says. "The classic disclaimer – 'amateurs shouldn't try this at home' – applies in technology investing."

But that dearth of capital has created opportunities and challenges in the sector. Because its first fund was relatively modest by large buy-out standards, Silver Lake had to go cap in hand to potential partners on the Seagate deal. At least five private equity groups refused to participate but with time running out Silver Lake secured the additional \$700m of equity capital required.

In the end, Seagate's investors also included Texas Pacific, one of the few large buy-out groups to invest in late-stage technology, as well as August Capital and the private equity wings of JP Morgan and Goldman Sachs.

Silver Lake's portfolio now employs more than 250,000 people and generates annual revenues of \$40bn. "That ranks us among the very largest technology companies in the world," Mr Hutchins says. "We are an unusual animal because we are in many ways a strategic player in our industry as well as a private equity group." That approach has helped deal flow.

Silver Lake says four out of five of its deals are proprietary.

"We don't like to line up in investment bank auctions," Mr Hutchins says. "We define ourselves by real specificity about the companies we like to invest in; our ability to help those companies; and our returns."

Silver Lake has 30 global investment professionals and hopes to have five or six in London by the year end. Apart from Mr Durban, most of the London-based staff will be European recruits.

As Mr Durban sees it, the opportunity to invest in European technology, media and telecommunications (TMT) is just beginning. "We are entering a golden age for private equity TMT."

AN EXCLUSIVE APPROACH TO INVESTING

- Silver Lake is a rarity in private equity because of its exclusive focus on late-stage technology. It does not make early-stage venture capital investments and will often invest hundreds of millions of dollars in individual companies.
- It targets large businesses which have the potential to become market leaders in their specialist technology field.
- Their underlying thesis is that technology industries are an under-exploited target for large-scale private equity investments.
- Most large buy-out groups seek "control equity". Silver Lake invests in many layers of a company's capital structure from full ownership to minority investments. These include leveraged buy-outs and going-private transactions; spin-offs and carve-outs from larger companies; restructurings and recapitalisations; structured minority investments and strategic stakes; and acquisition finance.
- Silver Lake is currently investing a \$3.6bn (£2bn) fund, the largest ever raised for investment in technology.